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Perspectives in Company Law and Financial Regulation

EDITED BY MICHEL TISON,
HANS DE WULF,
CHRISTOPH VAN DER ELST AND
REINHARD STEENNOT

CAMBRIDGE

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Free movement of capital and protectionism after *Volkswagen* and *Viking Line*

JONATHAN RICKFORD[1]

I. Introduction

It is a particular honour to provide an essay in tribute to Eddy Wymeersch. Just ten years ago I was appointed, after over fifteen years without involvement in company law matters, as project director of the UK Company Law Review.[2] Very shortly thereafter I received a generous invitation[3] from Eddy (whom I had never met) to attend a very high powered international corporate law conference convened by him in Siena. The contrast between the European approach of fifteen years before and those discussions was remarkable: the former mechanical, ideological harmonization *per se*, with the law of one Member State at its core; the new approach scientific and openly comparative, heavily law-and-economics in style, and purposive, concerned for efficiency and economic welfare. Soon afterwards I found this now generally characterized Commission and Brussels work. The responsibility for that change lay very much with Eddy and a group of colleagues[4] successfully dragging EU company law into enlightenment.[5]

[1] The paper develops thoughts offered at a conference marking the Finnish presidency of the EU in October 2006.

[2] Now largely embodied in the Companies Act 2006.

[3] The generosity extended to my wife also!

[4] Perhaps most notably, if another name is to be mentioned, Professor Klaus Hopt.

[5] The Siena papers were published as K. Hopt and E. Wymeersch (eds.), *Capital Markets and Company Law* (Oxford University Press, 2003). There is much more: perhaps most significantly K. Hopt, H. Kanda, M. Roe, E. Wymeersch (eds.), *Comparative Corporate Governance, the State of the Art and Emerging Research* (Oxford University Press, 1998); G. Ferrarini, K. Hopt, J. Winter and E. Wymeersch (eds.), *Reforming Company and Takeover Law in Europe* (Oxford University Press, 2004); K. Hopt, E. Wymeersch, H. Kanda and H. Baum (eds.), *Corporate Governance in Context* (Oxford University Press, 2005) and G. Ferrarini and E. Wymeersch (eds.), *Investor Protection in Europe, Corporate Law Making, the MiFID and Beyond* (Oxford University Press, 2006).

Two years later there emerged proposals at the highest political level, for opening up European law and related corporate service markets to free competition and restructuring.[6] The objective was an efficient structure and financial base for European business, exposed to open market forces, with a view to global competitiveness – the right objective for our law of business organization.

Ever since Siena I have derived enormous pleasure and satisfaction from cooperative work with Eddy, friends and colleagues met there, on occasions too numerous to enumerate. So I write in both admiration and gratitude.

However, while over the intervening decade enormous strides, both legislative[7] and jurisprudential,[8] have been made in developing EU law in that direction, recently problems have emerged at market, Member State and Community level. Member States pursued protectionist policies at community level in the Directive on Takeover Bids,[9] and implemented them with protectionist effects at market level. The Commission, too, seems to have lost confidence in new legislative projects addressing closed markets, notably on 'shareholder democracy', pre-bid takeover defences and proportionality.[10]

But the biggest concern is that the objectives of Member State governments have become more widely and overtly, and no doubt also covertly, protectionist – to achieve a 'national solution', 'economic patriotism', and

[6] Lisbon European Council Presidency Conclusions 23, 24 March 2000 EU see Press Release library at www.europa.eu.

[7] Including: Statute for a European Company: Directives on Employee Involvement; Cross Border Mergers and Takeover Bids; Regulation on International Accounting Standards; Directives on Company Accounts, on Audit and on Shareholder Rights; Corporate Governance Recommendations; and Financial Services Action Plan initiatives opening markets in financial services and capital.

[8] Cases C-212/97, *Centros,* [1999] ECR I-1459; C-208/00, *Ueberseering,* [2002] ECR I-9919; C-167/01, *Inspire Art,* [2003] ECR I-10155; C-411/03, *SEVIC,* [2005] ECR I-10805.

[9] Directive of the European Parliament and the Council 2004/25/EC [2004] OJ L142/12 – see article 12 (optionality for neutrality and pre bid defences).

[10] In October 2007 Commissioner McCreevy abandoned further action on 'shareholder democracy' (1 share:1 vote) and on the 14th Directive (corporate migration). In February 2008 he also abandoned work on capital maintenance (2nd Company Law Directive) reform. The original announcement relied on a false analogy between international best practice on binding balance sheet tests and EC law and a misrepresentation of the 'Rickford' Report on Reforming Capital, *European Business Law Review*, (2004), 919. The errors were corrected in March 2008, but the conclusion was maintained nevertheless.

so on.[11] This is particularly worrying, even distressing, for an observer from a Member State with open markets. One sees domestic businesses being acquired from foreign states (perfectly acceptably if the market so concludes) but then locked into closed corporate and national legal structures which lock out subsequent open restructuring – not so much the notorious 'unlevel playing field', of the football metaphor, as a kind of tilted billiard board where the balls are progressively sliding off the table and into pockets where they are destined to remain out of play. This irreversible progression of the market from open to closed represents not only a stifling but a reversal of the spirit of Lisbon.

In the face of this Member State hostility to basic principles of the European economic constitution, and the current unwillingness of the Commission to pursue its responsibilities, this paper considers the extent to which a reversal of these trends, and even progress, can be looked for from the Court of Justice, as champion by default of Community principles. The paper will focus on the impact on state interventions in the market for corporate control of the developing law on free movement of capital, mainly in the 'Golden Shares' cases and in particular the recent *Volkswagen*[12] decision, on the one hand, and the relevance in that context of the developing jurisprudence in the area of horizontal application of the fundamental freedoms,[13] on the other.

The paper thus falls into four parts:

- first, a selective survey of the free movement of capital as a constraint on state interference in the market for corporate control, based on the case law before *Volkswagen*;
- second, an examination of the implications of *Volkswagen*;
- third, examination of recent cases on the horizontal effect of fundamental freedoms and their implications for such state interference, beyond the traditional golden share public law mechanisms, and also for private law managerial entrenchments, which often complement state protectionism; and
- fourth, some conclusions and a proposed solution.

[11] Too frequently reported in the financial pages to require enumeration. Similarly K. Hopt, 'Concluding Remarks, ECFR Symposium on Cross-border Company Transactions', *European Company and Financial Law Review*, 4 (2007), 169.

[12] Case C-112/05, *EC* v. *Germany,* [2007] ECR, I-8995.

[13] *Viking Line* and *Laval* Cases (notes 88 and 89, below).

II. Free movement of capital

Free movement of capital ranks equally with the other three freedoms as a fundamental principle of Community[14] (soon to be EU)[15] law and as a component of the internal market which is the foundation of the Community. In many respects it corresponds in shape and effect to those freedoms (of goods, persons and services). But it presents special problems, because of the detail of the text and because capital transactions tend to be engaged in for ulterior or connected purposes (such as in pursuit of investment transactions – a service – or company control transactions – establishment), rather than in their own right.

As for the text, Article 56(1) EC simply states:

> Within the framework of the provisions set out in this chapter all restrictions on the movement of capital between Member States and third countries shall be prohibited.

Unlike freedoms of establishment or services,[16] for capital the beneficiary of the obligation need not be a community national. The transaction itself is required to be free regardless of the parties, as for free movement of goods.[17] But goods applies only to inter-State transactions: the territorial scope of the capital prohibition applies also to transactions between Member States and third countries. The capital freedom thus has a wider range than the others both as to beneficiaries and territorial scope.

Second, there are also issues about the transactions which fall within the prohibition – what is a 'movement of capital'? In particular what is the distinction between such a movement (which, as we shall discover, includes an investment in a share and the exercise of the managerial rights attaching to a share) and an exercise of freedom of establishment, which includes 'the right to … set up and manage undertakings, in particular companies or firms'?[18]

[14] EC Treaty Articles 2, 3(1)(c) and 14 (abolition of obstacles to free movement of capital, one of the four freedoms characterizing the common market, as a means for achieving the Community task).

[15] The Reform Treaty, agreed in October 2007 but not yet ratified, renders the internal market an aim of the Union – Treaty on European Union, article 3(2) and defines it in article 22a, Treaty on Functioning of the European Union (which replaces the EC Treaty), substantially restating article 14, EC. Article 3(1)(c) EC is repealed. The ECJ's approach to the fundamental freedoms should be unaffected.

[16] Articles 43, 49 EC.

[17] Restrictions are prohibited 'between Member States' – articles 25 (customs duties) and 28 (quantitative restrictions and their equivalents).

[18] Article 43, 2nd paragraph EC.

Third, where a capital transaction is engaged in as an ancillary part of another transaction governed by a fundamental freedom, such as a movement of goods, the provision of a service, or an exercise of a right of establishment, to what extent is the right in question constrained by the limits which attach to those other rights?[19]

A fourth, perhaps most significant, area of difficulty is the need to characterize the kinds of Member State intervention in the markets for corporate control which are likely to fall foul of the prohibition on restricting capital movement.

All these issues are of concern for my purpose, which is to determine the extent to which Member States and others are and should be constrained by article 56 in their ability to engage in protectionist policies and operations.

A. *Beneficiaries and territorial scope*

Evidently on its face the capital freedom extends to non-Member State nationals and to transactions between third countries and Member States as well as to the normal scope of the EU freedoms (inter-state trade).[20] Also, since the beneficiary need not be a national, the qualifications (community incorporation, commercial character and perhaps additional requirements) for companies and firms as beneficiaries of freedoms of establishment and services[21] do not apply.[22] Such extended territorial, transactional and personal scope of the freedom would be significant for state protectionism – different considerations apply to protection against 3rd countries (as opposed to inter-State transactions and those done by Member State nationals). This might argue for a less extensive scope for the freedom in other respects. However it will be argued below that this is not justified.

[19] Further uncertainties arise as to the interference with the freedom prohibited in terms of the means used and the nature of the obligees, whether public, semi-public, private but performing some public law function, or private.

[20] Thus covering some ground normally within the common commercial policy – Article 113 EC.

[21] As explained in *Ueberseering* (note 8, above). *Quaere* also whether even a nationally incorporated firm must have a real economic link with a Member State economy – a concept originally developed in the General programme on Establishment and reserved in *Ueberseering* (note 8, above) at 74, 75.

[22] Thus a charitable body has the benefit of the freedom for an investment in land, Case C-386/04, *Centro di Musicologia* v. *Finanzamt Muenchen*, [2006] ECR I-8203 – article 48 applies only to ‘profit-making’ bodies.

B. Movement of capital

The treaty does not define 'movement of capital' but it has been established since 1999[23] that the nomenclature in Annex I (including important clarifications in its explanatory notes) to the Capital Directive of 1988[24] is 'indicative'. This, in brief, makes it clear that investments in companies whether direct (i.e. to establish or maintain lasting economic links) or portfolio (i.e. broadly speaking passive) investments are covered. Direct investment includes the power 'to participate effectively in the management of the company or its control'.[25]

C. Ancillary character of capital movements

It is clear, as already noted, from this definition that free movement of capital in some cases (but not all) covers transactions also subject to freedom of establishment: the right to 'set up and manage an undertaking', under article 43 EC, necessarily involves and coincides with, subscription for or purchase of shares.[26] So, so far as the definition of

[23] Case C-222/97, *Trummer and Mayer* [1999] ECR I-1661, para 20, 21. Repeated in all the Golden Share cases (see below) most recently in C-112/05 *Commission* v. *Germany ('Volkswagen')* [2007] ECR at para 18.

[24] Council Directive 88/361/EEC [1988] OJ L178/5, providing for direct implementation of the original capital provision, old article 67 EC, which was not directly effective in itself. Remarkably, old article 67 was materially different from article 56 EC enacted by the Treaty of Amsterdam; it applied only to 'movements of capital belonging to persons resident in Member States' – repeated in article 1 of the Directive.

[25] For a company share a rigid distinction between direct and portfolio investments is unsatisfactory since any share carries rights of control and influence and an investment which is intended to be passive may at any time become active, for example in a public offer – a good reason for rejecting (as the Court did) the arguments of Maduro AG in *EC* v. *UK ('BAA')* and *EC* v. *Spain*, (note 34, below), that direct investment issues should be resolved solely under the establishment chapter – but not of direct concern here, as in the context of state protectionism only direct investments are relevant.

[26] The Capital Directive Annex I nomenclature specifically includes in direct investment 'establishment of branches or new undertakings belonging solely to the person providing the capital and the acquisition in full of existing undertakings' as well as more limited participation – para I, 1 and 2. This is 'to be understood in its widest sense', explanatory note para 1. It has been suggested, relying on *Baars,* C-251/98 [2000] ECR I-2787 at para 21, 22, that acquisitions of shares providing a 'definite influence over a company' and allowing the shareholder to 'determine its activities' are a matter for freedom of establishment *and not for capital* – see C-208/00 *Ueberseering* v. *Nordic Construction* (note 8, above) at 77. But this now seems unsustainable. *Baars* decided that influence was required for establishment, not that it was a disqualifier for capital. The alternative question on capital in *Baars* was not reached.

movements of capital is concerned, the chapter would extend to the control transactions in companies which are of concern to protectionist Member States and would in that context extend the freedom to third country transactions and to non-nationals and companies and firms which do not qualify as nationals for establishment purposes.[27] However article 58(2) provides that the chapter is to be 'without prejudice to the applicability of restrictions on the right of establishment which are compatible with this Treaty'. Apparently[28] that exemption will allow Member States to deny a right of direct investment under the chapter to individuals and firms which could not take advantage of the chapter on establishment – a position confirmed by dicta in the *Volkswagen* case.[29]

It seems therefore that in spite of its wider territorial and personal extent the capital freedom does not extend, for transactions which involve establishment, to persons and territories beyond the establishment chapter. Therefore there is no need, in determining the appropriate scope of the capital freedom, to take account of the need of Member States in developing their mercantile policies to take special precautions against transactions involving third countries.[30]

As already noted, it is sometimes argued that where capital movements are ancillary to other transactions (e.g. investment services, such as life insurance, collective investment or brokerage, or lending, or establishment, as discussed above) it is appropriate to treat the capital right as no more extensive than the 'primary' right under consideration. It may be argued similarly that third country nationals who seek to make direct investments in a Member State are exercising their right of establishment as a primary matter and free movement of capital is really secondary in relation to that. This is an alternative route to the

[27] Article 48 EC – also article 55 for services.

[28] Unfortunately the argument is not completely free from doubt – article 57(1) provides that article 56 is without prejudice to certain restrictions which exist under national or community law on 31 December 1993 on capital movements to or from third countries involving direct investment, establishment, financial services and admission of securities to listing. But this specific transitional derogation must be without prejudice to the later general derogation for establishment restrictions in article 58(2).

[29] Case C-112/05, at para 17: 'article 56(1) generally prohibits restrictions on movements of capital between Member States', citing C-282/04, *EC* v. *Netherlands* (KPN) [2006] ECR I-9141 at para 18, which introduced this qualification.

[30] *Centro di Musicologia*, (note 22 above), which applies capital *ratione personae* beyond the beneficiaries of the establishment and services chapters, did not involve direct investment or establishment.

conclusion above. The Court has recently made such a finding for credit services provided in Germany from Switzerland.[31]

However that line seems precarious. It may (perhaps) be possible by the light of nature to conclude that in a credit transaction the receipt of the service by the borrower predominates in importance over the making of the investment by the lender. But how is it to be determined, in the case of the acquisition of a share conferring control powers, where the acquisition of the share and of the rights that go with it is both a capital right and an establishment right, which of the two predominates? Moreover the Golden Share cases, to which we now turn, are not consistent with this approach. They were generally decided on the basis that both establishment and capital were in issue, but determined in practice on the basis of capital, either because the Court regarded it as unnecessary also to decide on establishment, or because the Commission failed to press that charge.[32]

D. *Nature of the prohibited state interventions*

Having characterized a capital movement for Treaty purposes as including direct investment in companies, at first impression it seems easy enough to identify the obligation of Member States – surely any kind of state measure, legislative or administrative, which has the potential, object or effect of restricting the enjoyment of the freedom should be prohibited, on the analogy of the other freedoms?[33] Matters are however not so simple. The cases so far have focused on Member States' reservations of control powers over companies on privatization by means of so-called 'Golden Shares' powers.[34]

[31] Case 452/04, *Fidium Finanz,* [2006] ECR I-09521. The Court concluded that where one of the freedoms is 'entirely secondary in relation to the other and may be considered together with it' then the state measure will be considered in relation to that other freedom only (at 34); the effect on cross-border financial traffic was 'merely an unavoidable consequence of the restriction on the freedom to provide services' and 'the predominant consideration is freedom to provide services rather than the free movement of capital' (at 48, 49).

[32] As in *Volkswagen* C-112/05 (note 23, above) at para 14, 15.

[33] See the familiar jurisprudence on goods based on Case 8/74, *Dassonville,* [1974] ECR 837 at 5: 'all rules … which are capable of hindering, directly or indirectly, actually or potentially, intra community trade'.

[34] Key cases are: Cases C-367/98, *EC* v. *Portugal,* [2002] ECR I-04731 (privatization of a wide range of enterprises); C-483/99, *EC* v. *France* (Elf Aquitaine), [2002] I-4781; C-503/99, *EC* v. *Belgium* (Distrigas) [2002] ECR I-4809, ('1st generation cases'); similar is Case C-463/00, *EC* v. *Spain* (petroleum, telecommunications, banking, tobacco and

Typically such powers attach to special shares giving Member States rights enabling them to retain control over such enterprises in order to prevent their operation contrary to national interests and/or prevent undesirable persons obtaining control. Member States may accordingly take powers to veto certain strategic transactions, such as disposals of core assets, and certain acquisitions of shareholdings and/or of voting powers by persons, or groups of persons, above a percentage ceiling. In some cases they also take powers to nominate board members, so as to secure influence over ongoing operations, or at least to provide information.

Such powers may be acquired under public law provisions, or under public law provisions authorizing or requiring issue of shares to Member States conferring ostensibly private law powers to the same effect, or through issue of such shares under private law.

In 1997 the Commission, viewing such measures as liable to infringe Community law, issued a Communication to that effect[35] and took legal proceedings.

1. First generation Golden Share cases – powers under public law

The first three cases[36] all involved public law provision. The issue was made simpler because the powers in question were conceded to amount to restrictions on capital. France and Portugal did argue that the provisions were not discriminatory and did not involve any particularly restrictive treatment of nationals of other Member States; but the court ruled that they were 'liable to impede the acquisition of share in the enterprises concerned' and 'as a result to render free movement of capital illusory' thus restricting the right to make direct investments as defined by the capital directive.[37] The court thus, implicitly at least, refused to accept the argument that the provisions were not prohibited restrictions because they did not bear differentially on investors from outside the home Member State, i.e. inhibit 'access' to the state market.[38] So there were restrictions conflicting with the freedom.

electricity) [2003] ECR I-4581; C-98/01*EC* v. *UK (BAA)* [2003] ECR I-4641*;* C-463/00, and C-282/04 and -283/04, *EC* v. *Netherlands* (KPN/TPG), [2006] ECR I-9141 ('2nd generation').

[35] Communication of the Commission On Certain Legal Aspects Concerning Intra-EU Investment [2007] OJ C 220/15, 19.7.1997.

[36] I.e. the first generation cases cited at footnote 34 above.

[37] *EC* v. *Portugal* (note 34, above) at para 30 and 45–46; *EC* v. *France* (note 34, above) at para 37–42.

[38] See the discussion in P. Oliver and W. Roth, 'The Internal Market and the Four Freedoms', 41 (2004), *Common Market Law Review*, 407.

The issue then turned on whether these (to the extent they were not actually discriminatory)[39] were justifiable by reference to the 'rule of reason' or 'general interest/proportionality' tests familiar from the other freedoms.[40] The Court made three important rulings on what could be regarded as legitimate general interests and proportionate protection thereof: first, such interests would include protection of the national petroleum and gas supply or other vital public services such as telecommunications and electricity but did not include retention of state controls over other enterprises such as banking, or tobacco[41]; second, national economic policy could not be invoked as a general interest, so an attempt to uphold restrictions, as necessary to secure that national industry was restructured satisfactorily after the mass privatizations, could not be sustained[42]; and third, where the powers were discretionary, procedural safeguards were required to ensure transparency of the grounds on which the powers were exercised and recourse to legal challenge to secure this. This is an important point – even where such powers constraining or encumbering investment are exercisable on legitimate grounds they may in fact be abused. Transparent grounds and legal recourse must be available to meet this risk.

The effect of this first generation of cases was that where special powers to intervene in strategic decision making or to disallow acquisition of strategic stakes were conferred by or under public law on Member States, then if the effect was to render investment less attractive (inevitably so given the operational constraints and limits on realisation of investment, e.g. in takeovers), the provisions would be prohibited restrictions and not justifiable except in defence of such vital national interests as the protection of energy supply, and then only if the powers in question were transparent and subject to judicial scrutiny.

[39] As some of the restrictions in *EC* v. *Portugal* were.

[40] E.g. Case C-55/94 *Gebhard*, [1995] ECR I-4165 – restrictions to be justifiable must be imposed in order to serve a (*sc* legitimate) general interest, must be non-discriminatory, must be appropriate for the purpose, and must impose no greater restriction than is necessary to achieve the objective.

[41] *EC* v. *Spain* (note 34, above), at para 70; but in *Volkswagen* the Court seems to have accepted that the general interest could be served in the context of a particular manufacturing company – see below.

[42] *EC* v. *Portugal* (note 34, above) at para 52, 53. 'It is settled case law that economic grounds can never serve as justification for obstacles prohibited by the Treaty'. Portugal claimed the powers were necessary to enable it to ensure appropriate strategic partners, to strengthen the competitive market and to modernise and increase efficiency of production.

2. Second generation Golden Share cases – powers under private law

However the powers in these cases were conferred by or under public law provisions and created special exceptions to the normal company law provisions. In two later cases the powers were conferred by vesting the special share in a government official under private law, these powers were consistent with general company law and their legal source was the company's (private law) constitution.

The first of these was the *BAA* case, concerning a Golden Share in the company owning the major UK airports.[43] The UK government made two important arguments:

- First, that the constraints in question (which conferred a prior approval power on Government for disposals of major airports and for acquisitions of more than a 15% voting stakes) could not amount to restrictions because they bore equally on all shareholders and thus did not constrain access to the market.[44] The court responded, following the Commission, that the restrictions 'affected the position of a person acquiring a shareholding as such and are thus liable to deter investors from other Member States and, consequently, affect access to the market'. This amounts to an assertion that any deterrence of other Member States investors amounts to an effect on access regardless of whether it is greater than the effect on domestic investors; this is difficult to follow and open to challenge.[45] Any provision of a company's constitution, or indeed any provision of mandatory company law, may deter an investor – for example a limitation on the company's objects or a provision which restricts the extent to which the constitution can be changed or which enables directors to be removed. If the provision is there for private purposes then *ex hypothesi* there will be no general interest to be invoked by way of justification. If it is there for public purposes it will also

[43] Case C-98/01, *EC* v. *UK* (note 34, above). BAA is now wholly owned by the Spanish company Ferrovial SA.

[44] At 24–7, citing the well known cases on goods, Cases C-267 and 268/91 *Keck and Mithouard* [1993] ECR I-06097.

[45] In *EC* v. *Netherlands* (KPN Case) (note 34, above). Maduro AG at para 24 suggested that where any shares confer special rights they are likely to inhibit access because those rights are likely to be vested in nationals, thus deterring investment by non-nationals. This point clearly applies *a fortiori* to cases where the shares are vested in national governments. It suggests a way forward – see below.

require justification; but does all mandatory company law require justification?

- Second, the UK argued the powers were private-law powers, compatible with UK company law (albeit unusual) and thus not 'repugnant to company law'. The Commission responded that this made no difference because the powers were exercisable exclusively by the UK Government *qua* State. The Court rejected the UK argument on somewhat different grounds: that the articles 'do not arise as the result of the normal operation of company law' but had to be approved under the privatization Act; the UK thus acted 'in its capacity as a public authority'.[46]

The ruling on access was not a surprise.[47] Although the issue had been obscured in the previous cases by the concessions by the Member States the Court had found a restriction in each case in spite of equal applicability. This point apart, the decision turned on whether there was a state measure.[48] This was resolved on the basis of the statutory authorization. But that was essentially an accident: the same result could have been achieved by the UK as shareholder adopting the relevant articles before privatization, exercising normal shareholder powers. While the method of restriction would have been different, the effect would have been the same.

This issue presented itself in the second of the cases about the use of private law powers, *EC* v. *Netherlands*. Shortly before their privatization the Netherlands postal and telecommunications companies resolved[49] to issue to the Dutch government special shares which enabled it to require prior approval of a wide variety of transactions, including share issues and repurchases, distributions, mergers and demergers, and articles changes, but not acquisition of shares; the government also agreed that it would not use its powers to defeat a hostile takeover. It argued that these provisions did not result from exercise of public power but from

[46] *Ibid*. 47. The Commission itself suggested a 'derogation from company law' test in 1999 (note 35 above).

[47] Although Colomer AG protested, arguing that in the interests of uniformity of application of all the freedoms the Court 'should temper the rigour with which it applied its principles on restrictions applicable without distinction … as it did … in *Keck*', opinion at para 36 footnote 10.

[48] The restriction on acquisition of more than 15% of voting rights bore equally on all shareholders (except the Government which had powers to allow its removal) but nothing was made of this in the case. Compare the discussion of *Volkswagen* below.

[49] The resolution was carried by the Dutch government as shareholder – see the following footnote.

its powers as a shareholder, as a market operation, and did not therefore fall within article 56.[50] The court had no difficulty, following established jurisprudence, in finding that the provisions constituted restrictions on capital, as likely to deter investors. To the argument that they were not public measures, it responded that they were 'state measures', because they were 'the result of decisions taken by the Netherlands state in the course of the privatization of the two companies with a view to reserving a certain number of special rights under the companies' statutes'.[51] But, unlike the UK case, the Court found it necessary to go on to add two points: that the special shares conferred on the State important powers and a *disproportionate influence* – i.e. one 'not justified by the size of its investment and greater than that which an ordinary shareholding would normally allow it to obtain'[52] and thus 'limited the influence of other shareholders in relation to the size of their holding'; and that they created *a risk* that the Netherlands might pursue interests which did not coincide with the economic interests of the company, thus discouraging direct (and portfolio) investors.[53]

Thus the ruling turned on three points, apart from the familiar point that the powers attached to the shares deterred investors (albeit equally applicable as between those from the Netherlands and other Member States): i.e. that they:

- constituted a '*state measure*' because they were taken for privatization purposes,
- conferred *disproportionate powers* at the expense of other shareholders; and
- created *a risk* of state interference with operation of the company in its own best economic interests.

This deserves closer examination. The argument alleging existence of a state measure amounts to one that use by a Member State of private law powers may be regarded as a state measure where the purpose for their use is a public purpose of a certain kind – *in casu* a privatization policy. Such a 'public purpose' test will probably be satisfied whenever a state takes a shareholding with a view to exercising influence. Only where the state is investing as a portfolio investor is it likely that it is not exercising

[50] See speech of Maduro AG at para 19; cf. the ruling at para 16, characterizing the argument as that the powers were 'not State measures'.
[51] *EC* v. *Netherlands* (note 34, above), at para 22.
[52] *Ibid.* 24.
[53] *Ibid.* 28.

some industrial or other public policy objective. So the state measure requirement looks weak – it is likely always to be satisfied.

The nature of the disproportionality test is obscure. It may rely on some idealized vision of what level of shareholding entitles a company member to any particular level of influence. But, as the UK Government pointed out in *BAA*, national company law often allows shareholders autonomously to determine the allocation of powers between them, a freedom allowed by the Community legislators to continue in the context of the Takeover Bids Directive. A subsequent Commission study led in turn to the conclusion that departures from proportionality could not on the evidence be regarded as contrary to the general interest and that no further work should be done on the issue.[54] So the idealized view of proportionality is neither defined nor agreed.

An alternative view of proportionality, not open to these objections and conceivably what the Court had in mind, would be by reference to the default rules of the national company law applicable; a departure from these being not 'normal'.[55] It is true that default rules in all Member States seem to provide for a 'one share: one vote' rule and a standard level of minority blocking power in relation to decisions of major importance. However the decisions which require special majority approval (and thus confer a disproportionate blocking power on dissenters) are by no means uniform in their nature in all Member States, nor are the majorities required the same. Moreover ordinary default rules are by no means uniform. So reference to departure from such rules would produce different results in different Member States. Again, it by no means follows from the existence of a default rule that it is 'normally' followed – a conclusion which would require a statistical examination of national practice. So this 'non-idealized' version of the proportionality rule would have a subjective effect as between Member States, producing an absence of uniformity in the measures permitted to deter capital

[54] Commission announcement of October 2007 (note 10, above) referring to a Report by KPMG.

[55] *EC* v. *Netherlands* (note 34, above), at para 24. Compare the Commission assertion in its Communication of 1999 that even provisions of general application allowing state veto of certain operational decisions and state board nominations for that purpose are offensive as 'in derogation of company law'. This however seems to posit some single Platonic ideal, so to speak, of company law, rather than one that varies between Member States. Of course no such ideal model exists and special veto or nomination rights for particular shareholders or others are quite lawful under general law in many States.

movement as between different States.[56] It is not evident why company law rules should have this differential effect on the operation of a fundamental freedom, nor why national rules should determine whether capital movement is restricted.

The third test, relating to risk of abuse, is of course the heart of the matter. The concern is always the risk that powers may be exercised for purposes contrary to EU principles, particularly in pursuit of economic policies designed to achieve nationalist industrial policies and protectionism. The Court puts this argument in different terms however – i.e. of the risk that the State will depart from *the economic interests of the company* – following the Advocate General, who suggested that the principle should be that once the state places an enterprise in the market place it must live by the laws of the market place and in consequence must respect the company's economic autonomy, justifications by reference to security of public services apart.[57] But this is too wide – it is not in fact a universal principle of States' company laws that shareholders' powers must be exercised in the economic interest of the company (whatever that means) and even when such a principle operates it is no part of the competence of the Community to ensure that it is upheld. On the other hand, exercise of discretionary powers *to impede the common market* is of course highly offensive to Community principle and this is the risk of abuse which should be considered here.

Two further comments can be made about this risk test (whether or not the narrower scope for it argued for here is accepted):

- First, it will be satisfied in all cases where a Member State holds powers conferred by a company constitution or by public law to determine or influence a company's control, operations or strategy. Thus, while vital, it does not provide a useful criterion for determining which powers amount to a restriction – it suggests that all do.
- Second, the essence of the matter is the risk, or potential, for abuse. This suggests that, short of outlawing all such powers, the appropriate response is to outlaw those that conflict with community principles on the face of it and to ensure that the remainder are not abused in that way.

[56] The same can be said of reference to departures from mandatory, as opposed to default, company law rules, not in issue in the *BAA* or *KPN* cases, but which may be implicit in the first generation cases and as we shall see below were relevant in *Volkswagen*.

[57] ECJ at para 27–28, Maduro AG at para 27–30. Cf. D. Wyatt, A. Dashwood and others, *European Union Law*, 5th Edn. (London: Sweet and Maxwell, London, 2005) 860–1, suggesting that this is the meaning to be attached to the Commission's 'derogation from company law' test.

It was with this in mind that the High Level Group on Company Law and Corporate Governance ('Winter Group') in its first report, recommended that Golden Share powers should be subjected to public law due process principles – i.e. transparency and judicial review.[58] This calls to mind the approach to discretionary powers conferred by public law and the concern about the assertion of Member States' 'economic policy', considered by the Court at the level of justification in the first generation cases, discussed above. The Court there required that discretionary powers should be subject to due process and seems to have rejected economic policies contrary to the market.[59]

This is a key to the problem. But it is appropriate, before developing it, to complete the picture by considering the recent *Volkswagen case* and cases suggesting community freedoms apply to private law measures, whether or not states (or other bodies with public law functions) are involved.

A further question arises from the *Netherlands (KPN)* case. To what extent are the three grounds in the case independent? Would it have been decided the same way on the basis of any one or more, or are all three required, at least in cases where private law powers are in play? Is it enough that investment is deterred either by state measure, or by 'disproportionate' powers conferred on a state, or by powers which create a risk (whether to the company as the Court asserts or to the common market, as is argued here)? This question too is best examined after considering *Volkswagen*.

III. The effects of *Volkswagen*[60]

The notoriety of this case is such that it is likely to be much relied upon. But it does not give clear guidance to Member States and investors concerned with the liberty of investment across frontiers in the Community.

Volkswagen was founded in the 1930s to manufacture the people's car. It was largely controlled by government and trades unions and financed by deposits from prospective car purchasers. After World War II it fell to the German government to determine how the enterprise

[58] Report of the High Level Group of Company Law Experts, Report on Issues Related to Takeover Bids, Brussels 10 January 2002, 34.

[59] The scope of the ECJ's economic policy objection is vague. For a similar suggestion as to its scope see Wyatt and Dashwood, *European Union Law* (note 57, above). Compare Case C-174/04, *EC* v. *Italy* [2005] ECR I-04933 ('golden share' to achieve interstate competition policy).

[60] Case C-112/05, *EC* v. *Germany* ('Volkswagen'), [2007] ECR I-8995.

(now essentially *bona vacantia* but with various moral claims on its ownership) was to be owned and controlled. Under a historic compromise, after long debate between Federal Government, the Land of Lower Saxony (where the enterprise and its factory was based), the trades unions and other claimants, the matter was settled by federal legislation in 1960 privatizing Volkswagen. This Act incorporated the statutes of the new Volkwagen AG, and enabled 60% of the shares to be sold to the public while 20% each were retained by the Federal Government (sold at the time of the proceedings) and Lower Saxony.[61]

The legislation contained three provisions which the Commission argued were unlawful restrictions on free movement of capital and freedom of establishment:[62]

- a voting rights cap of 20% – i.e. provision that any holding in excess of 20% was disenfranchised to that extent;
- special board nomination powers – i.e. power for The Federal Government and the Land of Lower Saxony each to appoint two members of the supervisory board;
- a 20% enhanced blocking minority power – i.e. special company resolutions normally requiring a 75% majority were to require 80%.

Two general arguments were dealt with by the court for all three restrictions:

- First, Germany argued that this was not a state measure as required for liability by previous cases. The Court assumed that such a measure was needed but had no difficulty in concluding the restrictions, as imposed by legislation were 'a manifestation par excellence of State power'.[63]
- Second, the Court concluded that the provisions satisfied the requirement that they deterred investors from other Member States by restricting their ability to participate effectively in management. This conclusion was reached for the board appointment power independently;[64] for the enhanced minority and voting cap provisions it was taken in combination – i.e. that the two provisions taken together had this effect.[65]

[61] This settlement has been widely regarded in Germany as epitomizing the German post-war 'economic miracle' and its 'social market' model. For a fuller account see Colomer AG, footnote 47.

[62] The Commission failed to pursue the establishment charge which was on that ground dismissed by the Court, at paras 13–16.

[63] *Volkswagen* para 27.

[64] *Ibid.* para 66.

[65] *Ibid,* paras 51–5.

However apparently these two conclusions were not enough to settle the case.

On the board appointment provisions, the Court noted that these enabled the Land and Federal Government to appoint more members by such special powers than was permitted under general law (which limited such rights to one third of shareholders representatives)[66]. This was thus a specific right which derogated from general company law, enabling the two governments 'to participate in a more significant manner in the … supervisory board than their status of shareholders would normally allow'. This possibility would continue even if they held only one share each. So the provision gave these authorities 'the possibility of exercising influence which exceeds their levels of investment'.[67]

It is not clear whether the two points – that the appointment powers (i) were greater than normally allowed (i.e. conflicted with general mandatory company law) and (ii) 'exceeded the level of their investment' (i.e. were disproportionate to the potential level of shareholding which conferred them) – were separate points. If the Land had only been entitled to appoint one of the ten shareholder members would this have been disproportionate, albeit company law would have allowed it, or would the provision have needed to require that the Land should for this purpose retain 10% of the share capital (corresponding to 10% of the shareholder members) to satisfy the proportionality criterion? The decision indeed reads on first impression as if the Court regarded a level of representation corresponding to shareholding ('proportionate') as both necessary and sufficient,[68] but this is by no means a principle of the generality of community law. In many EU states, including the UK and Ireland (and I believe France and Belgium), directors can only be securely maintained

[66] Art. 101(2) AktG (which makes express exception for Volkswagen). German law sets the size of the supervisory board (which appoints and dismisses the management board and thus ultimately controls both strategy and operations) for companies of this size at twenty, with ten to be appointed by or on behalf of employees (art. 7 MitbestG). The maximum number of shareholder representatives allowed to be appointed by such special appointment powers was therefore three. The effect of the power even when exercised only by Lower Saxony was to confer a blocking majority on a combination of Lower Saxony and the employee representatives thus creating an effective veto on takeovers for Lower Saxony.

[67] *Volkswagen*, paras 61–4.

[68] A position adopted by Colomer AG at 72 'this exclusive power is totally detached from the importance of their respective shareholdings … and *ruptures the symmetry between the power of capital and the possibilities of management*' (author's translation, emphasis added).

in office by a simple majority.[69] It is also unclear whether if the power had been proportionate but had conflicted with mandatory company law it would have been acceptable. For example, suppose that the case had arisen in the UK, would it have been sufficient for the law to have allowed a power of appointment proportionate to the holding, even though this would have conflicted with the normal UK mandatory provision allowing a bare majority to dismiss *ad nutum*?

It may be argued that this ruling creates a Community proportionality principle, in the generally recognised sense, for shareholder powers exercisable by states by virtue of state measures.[70] This seems doubtful in view of the above points. Nor does the test seem apt to address the mischief in hand. The proportionality of the powers held by a state by reference to the size of its holding bears no relation to the risk that the powers held will (be used to) deter investors. The mere fact that a holding is proportional to the powers of a state can hardly be regarded as allowing those powers to be exercised in a discriminatory fashion. Why should such proportionality allow powers to be used to impede access by investors from other Member States? Yet if satisfaction of this test renders a power no longer a restriction its potential or actual use to hinder access to the State market is presumably not open to challenge.

The remaining two provisions in question, the voting cap and the enhanced minority provision, the Court considered together, as the Advocate General had done. Germany argued that these provisions could not amount to restrictions because, unlike all the earlier cases, they bore equally on all shareholders conferring burdens and (allegedly) benefits on all, rather than conferring special privileges on the two state authorities. While the voting cap was contrary to mandatory German law (which imposes a 'one share, one vote' rule for listed companies),[71] nothing in Community law prevented Germany from adapting this rule for particular companies. This was a formidable line of argument. If provisions which bear equally on all shareholders are objectionable, where is the limit to the powers exercisable by Member States as shareholders which are objectionable? Any normal company law power could be so.

The Advocate General considered the two provisions together, maintaining that it was their combined effect which was to be considered (without

[69] Companies Act 2006 sections 168, 169.

[70] As argued by J. van Bekkum, J. Kloosterman and J. Winter, 'Golden Shares and European Company Law – the Implications of Volkswagen', *European Law Review*, (2008) (forthcoming).

[71] Art 134(1) AktG.

explaining what special effect the combination achieved) and relied on two points (apart from the general deterrent effect of the provisions on investors seeking to exercise management control): that the provisions were imposed by a special law by the Government itself and that the special minority position entrenched the Land by virtue of its particular shareholding, which conferred the very blocking minority required to secure its use.

The Court accepted the German assertion that the cap provision was applicable without distinction to all shareholders and was a 'recognised instrument of company law',[72] but noted that it was an infringement of German mandatory company law. However, it clearly did not regard this as sufficient to outlaw it. So it turned, like the Advocate General, to consider the cap and the enhanced minority provisions together.

The relevant German special resolution provisions to which the special minority rule applied were those on various key strategic issues including amendment of the statutes and certain decisions relating to capital and financial structures.[73] While the 75% majority was the default rule nothing prevented companies from adopting articles with a higher requirement. However the Court noted that for Volkswagen the provision had been made mandatory by legislation and could not be revoked by the shareholders.[74] The provision was thus an exception to mandatory German company law in that sense; however the Court did not explicitly take that point.

But the critical aspect in this connection seems to have been that at the time of the enactment both state authorities, and still at the time of judgment the Land, held an approximately 20% holding – i.e. perfectly fitted to take advantage of the blocking minority provision – and were thus able to ensure, once the legislation was enacted, that no structural changes of the relevant kind could ever take place without the consent of each of them – a position which was bound to deter direct investors and particularly takeover bids.[75] This enabled the court to hold that the

[72] Case C-112/05, *EC* v. *Germany*, (note 60, above), paras 42, 38. German law allows voting caps for unlisted companies and they are common in certain other European states: see the Report of Institutional Shareholder Services on Proportionality between Ownership and Control in the EU, EC Brussels April 2007, 31. Note that the Court accepted this argument although the cap infringes any 'ideal' notion of proportionality of holding to voting power.

[73] This is all that is mentioned by the Court but a 75% majority is required for a number of other matters including mergers and voluntary dissolution.

[74] Case C-112/05, *EC* v. *Germany*, (note 60, above), para 45.

[75] The Court noted that takeover bids were in issue, though somewhat curiously, it mentions this in the context of the establishment issue, at paras 14, 15. For Porsche SE's current attempts to acquire control, see G.-J. Vossestein, 'Volkswagen, The State of Affairs of Golden Shares', 5:1 (2008), *European Company and Financial Law Review*, 132.

provision thus enabled the Federal and State authorities 'to procure for themselves a blocking minority on the basis of a lower level of investment than would be required under general company law'.[76] In other words *on the facts* the effect of the provision was to confer *a special right* on Lower Saxony (and allegedly on the Federal Government, which was true at the time of the legislation but was however no longer true). While the court did not say so, and perhaps implies otherwise,[77] a further shareholder could take a 20% holding (or a smaller one sufficient for the necessary blocking minority de facto) and would in so doing be able also to exercise the same right of veto; but in practice such a second right of veto would be of little value given the first mover advantage of the Land and would depress the value of the shares generally.

What of the voting cap? The Court held that 'by capping voting rights at the same level of 20% [the cap] supplements a legal framework which enables [these] authorities to exercise considerable influence on the basis of such a reduced investment (i.e. 20%)' and this situation (the combination of powers) was likely to deter investors.

This combined ruling is problematic. It clearly implies that each of the two powers would have been lawful without the other, and that there was some synergy between them which rendered them unlawful.

So apparently the Court did not believe that either provision, the cap or the enhanced blocking power, were sufficient in themselves to constitute a restriction. This was so although the former was contrary to German mandatory law (and clearly made the company a less attractive target for direct investors seeking to exercise control or influence) and the latter was contrary to default law (and excluded a mandatory consensual power, though it would have been lawful as a consensual provision), and also conferred on Lower Saxony de facto a special blocking power over constitutional change and other strategic decisions based on a lower than normal level of investment. The reason why the Court felt unable to find against the cap seems to have been that it conferred no special right on the authorities. The enhanced blocking power did do so de facto. Why did the Court not regard this as sufficient to find against this power in isolation? Perhaps the Court believed or assumed that a special *legal* power was needed to do so, but the factual result was to confer a special right which would be a wholly effective deterrent for strategic investors, as the Court clearly recognised. That is the concern of European law.

[76] Case C-112/05, *EC* v. *Germany*, (note 60, above), para 50.

[77] *Ibid.* 'enabling the authorities to procure for themselves'.

We need therefore in order to understand the Court's objection to the two powers in combination to understand the objectionable synergy between them. In what way was the operation of the two powers in combination offensive? Each provision deters direct investors, but separately – the cap, because it makes it difficult for them to exercise influence *outside* the field of the special minority decision – and the special minority provision, because it makes influence impossible (without state consent) *within* that field. The Court drew attention to the fact that the cap and the minority provision both applied at 20%[78] but that was incidental. There therefore seems to have been no legal synergy between the two provisions. One conferred a veto on certain strategic decisions; the other made investment less attractive in relation to the remaining, mainly operational, decisions because it made collective action more difficult – a difficulty increased by the Lower Saxony 20% holding, but there was no magic in that context in the 20%. If there was no legal synergy we are driven to consider synergy on the facts. The two provisions taken together did deter investors more than each provision separately. Perhaps this point about the degree of deterrence taken together founded the Court's conclusion.

But this rationale is unsatisfactory. If the fact that provisions confer no special powers on Member States excludes them, then how can two such provisions be objectionable taken together? If on the other hand the de facto special benefit of the enhanced minority provision rendered it objectionable (as is strongly arguable if we accept the general rationale, although an alternative approach will be suggested below) then why was that provision (which absolutely barred direct investors from power over the constitution, for example) not objectionable in isolation? Why was it necessary that there should have been a voting cap as well? Finally, if the objection to a power depends on the degree of deterrence de facto, then how is the objectionable degree to be calibrated?

The Court would apparently have had little difficulty in finding against the enhanced minority in isolation as a de facto special veto power conferred on the basis of a lower shareholding than normal. It clearly felt the need to find against the cap as well. But what was the real objection to the cap? Surely that, although it applied equally to all shareholders, in practice it made direct investment less attractive, thus enhancing the control powers of Lower Saxony.[79]

[78] *Ibid.* 'at the same level' paragraph 51 cited in full above.

[79] The enhanced majority looks objectionable per se. It is reported at the time of writing that the German government proposes relying on the combined nature of the ruling to

The case thus leaves us with the conclusion that for powers over company control and operations to be objectionable they must be:

i. likely to deter investors (perhaps particularly investors from other Member States);
ii. be exerciseable by states; and
iii. be operable in pursuance of a state measure[80] or state power[81] (though how significant this is, is debatable).[82]

Further factors regarded by the Court as relevant are whether the measure:

iv. creates a special power for the state authority;
v. infringes mandatory state law,
vi. departs from default state law; or
vii. infringes proportionality principles (which may be by reference to state law or to some abstract ideal of proportionality).[83]

More sense needs urgently to be made of this catalogue. Items (i) to (iii) seem to be necessary in all cases on the basis of the cases. But the extent to which (iv) to (vii) are needed and in what combination is far from clear. But before considering this task we need to examine the recent jurisprudence on horizontal effect, which brings into question the extent to which (i) to (iii) are required.

IV. Horizontal effects

There is no doubt that the obligation not to obstruct movement of capital, like the other freedoms, binds Member States and other state bodies. It has for many years been debated whether these obligations also bind private persons exercising autonomous private law powers.

Extension of the freedoms to bind private bodies exercising autonomous powers under private law would, if it applies to capital, exclude *a fortiori* any requirement that Member States exercising such powers

leave this in place while repealing the cap and the appointment power, blocking Porsche control. See *Financial Times* 26 January 2008, 19, and 15 March 2008, 21.

[80] *KPN* (note 34, above), at para 22.

[81] *Volkswagen* (note 60, above), at para 27.

[82] See the discussion of the *KPN* case (note 34, above).

[83] There is also an important (but beyond our purpose) ruling in Volkswagen that the restrictions were not justified by protection of employees from strategic or control changes, *Volkswagen* (note 60, above) at para 74.

must do so under a state measure or must be in some sense exercising sovereign power.

A series of cases on free movement of workers and services have imposed the obligation on bodies exercising rule-making functions under private-law powers, including bodies making rules about sports[84] and this case law has been applied to professional services and establishment[85]. In one case (*Angonese*)[86] freedom of movement of workers has been held to bind a private employer, even though not exercising any rule-making function,[87] but only in respect of discriminatory practices.

This case law has been extended by two recent cases: *Laval*[88] and *Viking Line*[89]. Both involved trade union industrial action under private law powers. In *Laval* Swedish trades unions sought, by 'blockading' Laval work sites in Sweden staffed by Laval, a Latvian company providing workers in Sweden to work on building sites operated by a subsidiary of Laval, to force Laval to sign the Swedish building sector collective agreement, and to pay a certain hourly wage. Laval claimed this was an unlawful restriction of its freedom to provide services in Sweden and sought a declaration and damages.[90] The Court held compliance with article 49 EC, on freedom of services 'is also required in the case of rules which are not public in nature but which are designed to regulate collectively provision of services' and applies to 'exercise of their legal autonomy by associations or organizations not governed by public law';[91] so

[84] Case 36/74, *Walrave* v. *Union Cycliste Internationale,* [1974] ECR 1405 (discriminatory rules governing cycle racing – affecting workers and services); Case 13–76, *Dona* v. *Mantero,* [1976] ECR 1333 (discriminatory rules of a football association affecting workers and services); C-415/93, *Union Royale Belge des Societes de Football Association* v. *Bosman,* [1995] ECR I-4921 (Belgian National football association imposing transfer fees on cross-border transfers and discriminating on eligibility to play for other nation clubs – affecting workers and services); C-51/96 C-191/97, *Christelle Deliège* v. *Ligue francophone de Judo et al,* [2000] ECR I-02549 – to similar effect.

[85] C-309/99, *Wouters* v. *Algemene Raad van Nederlands Orde van Advocaten,* [2002] ECR I-1577 (professional rules on cross-professional partnerships for advocates – affecting services and establishment).

[86] C-281/98, *Roman Angonese* v. *Cassa di Risparmio di Bolzano,* [2000] ECR I-4139.

[87] The practice was permitted but not required by a collective agreement so the decision to apply it was that of the individual defendant employer, *ibid.* at para 11, 36, 37.

[88] C-341/05, *Laval un Partneri Ltd* v. *Svensaka Byggnadsarbefoerbundets et al,* [2007] ECR I – not yet reported.

[89] C-438/05, *International Transport Workers Union and Finnish Seamens' Union* v. *Viking Line ABP,* [2007] ECR I – not yet reported.

[90] The terms sought by the union went beyond those the host state was entitled to impose on services operators under the relevant Community Directive.

[91] *Laval* (note 88, above), at para 98.

that article precluded the union from forcing Laval to enter negotiations on rates of pay and to sign the agreement.

In *Viking Line* Viking proposed to re-register in Estonia a ship registered in Finland, and thus crewed at Finnish rates of pay, in order to subject it to the lower Estonian rates. The unions sought by collective action to prevent this. Viking claimed a declaration that this interfered with its freedom of establishment, and injunctive relief. The referring court asked the European Court if 'article 43 has horizontal direct effect so as to confer rights on private undertakings which may be relied on against another private party and, in particular a trade union in respect of collective action'. The Court ruled that it was clear from the case law that 'abolition of obstacles to free movement of persons and services would be compromised if the abolition of state barriers could be neutralized by obstacles resulting from the exercise by associations or organizations not governed by public law of their legal autonomy [citing the cases mentioned above[92]]'.[93] It added that 'it does not follow [from that case law] that that interpretation applies only to quasi public organizations or to associations exercising a regulatory task and having quasi legislative powers. There is no indication in that case law that could validly support the view that it applies only to [such organizations and associations]'; but the court then added 'furthermore it must be pointed out that in exercising their autonomous power pursuant to their trade union rights … trade unions participate in the drawing up of agreements seeking to regulate paid work collectively'.[94]

Three questions are prompted by this body of case law in the present context:

- Does the case law apply to freedom of capital?
- What are the implications for the restriction applied in the Golden Share cases that, for the obligation to apply, the state must pursue a 'national measure' or exercise 'state power'?
- What are the implications for private persons in the company law context with powers which enable them to impede free movement of capital?

There can be no doubt that this case law applies to free movement of capital. It applies to establishment and the two freedoms are consistently

[92] *Walrave*, *Bosman*, *Deliege*, *Angonese* (note 84, above).
[93] *Viking Line* (note 89, above), at para 57.
[94] *Ibid*. at para 33 'articles 39, 43 and 49 [freedom of workers establishment and services] do not apply only to the actions of public authorities but extend also to rules of any nature aimed at regulating in a collective manner gainful employment, self-employment and the provision of services'.

treated in the Golden share cases as subject to the same rules. Moreover, since the cases of concern also involve establishment this case law will apply by that route anyway.

On the second question, it seems strongly arguable that since the case law applies to private persons exercising private powers it follows *a fortiori* that it does to public persons exercising private powers. This is wholly in conformity with community principles. As the Advocate General pointed out in the *KPN* case, Member States are bound by the treaties *qua* signatories and not *qua* state authorities.[95] Moreover, Member States are obliged by article 10 EC to ensure fulfilment of the obligations arising out of the Treaty, to facilitate the achievement of the Community's tasks and to abstain from any measure which could jeopardize the attainment of the objectives of the Treaty. Where a State can exercise a power in a way which has the object or effect of restricting a fundamental freedom it is bound to comply with the treaty, whatever the legal basis of that power. If a state may exercise powers by virtue of a shareholding in a company then it must not do so in a manner which discriminates, nor in a manner which restricts the fundamental freedoms of others, however that share was acquired. Similarly if a share is acquired with the object of restricting such freedoms or its acquisition would tend to have that effect, that is a breach of the Treaty by that State.

It may be argued that this reasoning neglects the point that the cases apply the law to private persons exercising quasi-regulatory functions. Very considerable doubt at the least is cast on this by the ruling in *Viking* quoted above (although it does then emphasize that the union in question had powers to seek to draw up agreements that regulate work collectively). But in any case this restriction is clearly intended to limit the nature of the private bodies who are to be subject to the case law; it is very doubtful that the court would apply it to a public body.[96]

On the third question, how far can *private persons* engaging in protectionist activity intended to inhibit free movement of capital be bound by the horizontal effect of the freedom? This is more speculative. It is doubtful whether where a private party engages for private purposes

[95] 'Treaty provisions on free movement of persons services and capital impose obligations on national authorities regardless of whether these authorities act as public powers or private law entities': Maduro AG in *EC* v. *Netherlands* (note 89, above), at para 22 (author's translation) and again in cases C-463 and 464/04 *Federconsumatori et al* v. *Comune di Milano* [2007] ECR I – not yet reported, at para 22.

[96] Perhaps company constitutions, given the breadth of their effect, do regulate a matter collectively.

in conduct which falls short of discrimination (which is probably outlawed by *Angonese*)[97] the freedoms can be invoked. But there is room for development of a principle, and some authority, that where such a party engages in such conduct for public purposes, then on the analogy of a trade union which is entrusted by private law with the function of negotiating collective agreements with general effect, that party should be subject to the obligation not to obstruct the operation of the freedoms except in conditions permitted by community law. Where a private party is entrusted with public functions under private law the treaty freedoms apply to that party because he acts as a surrogate for the state.[98]

Two examples of the application of this principle in the context of private persons exercising company powers impeding freedom of capital come to mind:

- First, in the case of some companies a special shareholding is vested in a private body entrusted with functions for the general good. A UK example is the Reuters Trust which has the responsibility of ensuring through a private law Golden Share that control changes in Reuters plc do not endanger editorial independence. Similar is the position of certain foundations in Nordic countries which hold voting shares, often with enhanced powers, exercisable for the benefit of the company in the widest sense, including its continuity, the interests of the employees and the community in which it operates.
- Second, the company laws of some States confer public functions on company boards in the sense that their fidelity obligation requires that they serve not only interests of shareholders but also a wider range of constituencies and the public interest. Such boards are similarly acting as surrogates for the state. A particular context is where boards exercise powers to frustrate the success of takeover bids under authority allowed them under the Takeover Bids Directive[99] and in particular the so-called 'reciprocity' power to block a bid from a company with a less open structure than their own.[100] It is clear from the legislative

[97] Note 86, above.

[98] Cases 266 and 267/87, *The Queen* v. *Royal Pharmaceutical Society,* [1989] ECR I-1295; Case C-16/94, *Édouard Dubois et Fils SA and Général Cargo Services SA* v. *Garonor Exploitation SA,* [1995] ECR I-2421.

[99] Directive 2004/25/EC, article 12.

[100] The legality of the Directive is beyond the scope of this paper – see J. Rickford, 'The Emerging European Takeover Law from a British Perspective', *European Business Law Review,* (2004), 1379, 1402 ('contrary to well recognized Treaty principles'), developed in 'Takeovers in Europe: a UK Perspective', in T. Baums and A. Cahn (eds.), *Die*

history that this has a public purpose – to level the regulatory playing field. Boards exercising such powers should be subject to Treaty freedoms.

V. Conclusion – proposed way forward

How are the uncertainties attaching to Golden Share cases and horizontal-effects cases to be resolved? As in every game it is important to keep our eye on the ball. As Eddy Wymeersch has himself pointed out more than once,[101] it is not the concern of the Court of Justice or European lawyer to create company law. Nor is it therefore to impose some idealized version of company law on Member States, nor their own company law default rules, nor even their mandatory rules – it is to ensure that States do not adopt powers or actions which conflict with Treaty principles – i.e., here, which have the object or effect of deterrence of inter-State investment.

We must address realities: it is notorious that Member States, in taking powers over companies, whether by public law or private law and whether by special provision or by acquisition of shares in the market place, often (perhaps always) intend to use those powers in pursuit of their industrial policies, frequently for protectionist or other purposes conflicting with Treaty principles. The issue is not the legal means by which those powers are obtained, nor the nature of legal provisions under which they are exercisable, but the actual or potential effect of their existence and actual or potential use. It follows from this reasoning, and, as we have seen, from the implications of the *Netherlands (KPN)* case and the authorities on the horizontal effects of the freedoms, that insistence that States are only subject to Treaty principles if they are acting under State measures is unsustainable. It is sufficient if they are pursuing political objectives. Or to put it another way, the 'state measure' requirement in *KPN* is met wherever states have or may have an industrial policy objective – privatization is merely an example. Similarly insistence on qualifications by reference to actual

Umsetzung der Uebernahmerichtlinie in Europa (Berlin: De Gruyter, 2006) 88, 89; cf. Wyatt, Dashwood and others, *European Union Law* (note 57, above), Chapter 20.

[101] 'Cross-Border Transfer of the Seat of a Company', Chapter 6 in J. Rickford (ed.), *The European Company* (Antwerp: Intersentia, 2003) 83, 84; and again, E. Wymeersch, 'The Transfer of a Company Seat in European Company Law', 40 (2003) *Common Market Law Review*, 661, 674.

or ideal company law provisions would only be justifiable if compliance with such provisions were an indicator of absence of the mischievous effect (or even conceivably an indicator that it would be less likely). As a matter of common experience, that is not so – whatever the character of a State's control power it has the potential for protectionist abuse; in some states such abuse is very likely, not disguised and even publicly paraded to deter unwelcome investors. Moreover what applies to States also applies to bodies acting as surrogates of States, such as nationalized industries and state investment banks.[102]

All this is wholly consistent with the general principles of the European economic constitution and far from original. More difficult is how to carry it through in terms of legal consequences in this sensitive context. Clearly where States *exercise* such powers in ways which are discriminatory or deter cross-border investment such exercises are open to challenge. But, as the Court recognizes, the problem lies deeper. The very *existence* of the powers carries the risk of abuse. Such powers are objectionable as such unless they are subject to a transparent and enforceable regime at domestic level which ensures that they are only used for legitimate purposes. If such a regime is in place then investment will not be unlawfully deterred because there is an assurance of the absence of abuse. The burden is on Member States to show that such regimes are effective as the Court itself ruled in the *France* and *Belgium* cases. In the absence of such regimes the powers exercisable by States should be void as contrary to Community law; if they are attached to shares, the shares should remain valid, but be shorn of control rights.

There will be strong political opposition to this proposal and the Commission may well be unable to summon the necessary internal conviction to pursue it before the Court. But fortunately that is not necessary. Any shareholder in a company subject to such powers may pursue it. A suitable test case might be brought by such a shareholder wishing to pursue or facilitate a takeover bid. A shareholders' association has already successfully challenged a Golden Share in this way.[103] Damages will be available, as well as enforcement orders.[104]

[102] Such as the Caisse des Depots et Consignations in France.

[103] Cases C-463 and 464/04 *Federconsumatori et al* v. *Comune di Milano* (disproportionate, but lawful, control power reserved by local authority in articles under private law powers).

[104] As in the *Laval* and *Viking* cases (notes 88 and 89, above). Cases C-46 and 48/93, *Brasserie du Pecheur/Factortame III* [1996] ECR I-1029.

Similar conclusions can be applied to company organs exercising public law powers. It is often argued that private persons are subject to Treaty principles even when exercising private powers. This seems a step too far[105] and one the Court deliberately did not take in *Volkswagen, Laval* and *Viking*. It is not necessary for the purposes examined here. And it is sufficient to leave the discipline of true market players to the market, to autonomous regulation and to competition law.

[105] See van Bekkum, Kloosterman and Winter, 'Golden Shares and European Company Law – the Implications of Volkswagen', (note 70, above). Many *contra,* e.g. Wyatt, Dashwood et al., *European Union Law* (note 57, above), 861–863; M. Andenas, T. Guett and M. Pannier, 'Free Movement of Capital and National Company Law', *European Business Law Review*, 16 (2005) 757, 775.