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EU Corporate Law Developments NEWSLETTER

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EUROPEAN COURT OF JUSTICE ISSUES JUDGMENTS ON "GOLDEN SHARES"

The European Court of Justice issued three decisions on the validity of "golden share" restrictions in Portuguese, French and Belgian companies on 4 June 2002. The decisions mark a milestone in the future development of the internal market of the European Union. Governmental protection by Member States of their privatised companies will no longer be possible except under very limited circumstances. Furthermore, the decisions will likely influence the ongoing effort to establish a Community directive on takeovers and other initiatives to further incentivise cross-border takeovers.

I. The "Golden Share" Schemes Reviewed

There were significant differences among the three schemes.

- Under the Portuguese plan, the "golden share" restrictions applied to a framework law on privatisations and a number of related decrees. These laws gave the Portuguese government the right of prior approval of any investment of over 10% of the voting capital in a reprivatised entity, and set an overall maximum participation of 25% for foreign entities in such reprivatised Portuguese entities. The Court found this system to be illegal under the EC Treaty.

- Under the French plan, the government held a "golden share" in Société Nationale Elf-Aquitane that carried the right to prior approval of (i) any shareholder who exceeded the threshold of one-tenth, one-fifth, or one-third of the voting rights; and (ii) the transfer or pledge of the majority of the assets in four subsidiaries of Elf-Aquitane. The Court found this system to be illegal under the EC Treaty.

- Under the Belgian plan, the government held "golden shares" in Société Nationale de Transport par Canalisations and Distrigaz. The system did not give the government the right to oppose an investment in the companies or the transfer of their shares. Rather, the "golden shares" gave the government the right to (i) advance notice and the right to oppose any transfer, pledge or change in the strategic energy distribution infrastructure owned by the two companies; and (ii) appoint two representatives to the board, who under tight time limits may propose the annulment of any measures taken by the company that they regard as contrary to national energy policy. The scheme was subject to judicial review. The Court upheld this system as compatible with the EC Treaty.

II. Law Applicable to the Free Movement of Capital

A. *A Fundamental Freedom*

The Court began its analysis with the observation that Article 56 (ex Article 73b) of the EC Treaty prohibits "all restrictions on the movement of capital between Member States and between Member States and third countries." The Court had little difficulty establishing that a direct participation in the form of a shareholding constitutes a capital movement within the terms of the EC Treaty. Further, the Court reasoned that the prohibition applies to all restrictions, not just those that might discriminate against non-nationals. The key inquiry is whether such provisions "impede the acquisition of shares in the undertakings concerned," which in the opinion of the Court they plainly did because they "dissuade[d] investors in other Member States from investing in the capital of those undertakings." The effect was to render the free movement of capital "illusory."

B. *Potential Justifications*

The Court then turned to potential justifications for the "golden share" measures. Since the free movement of capital is a fundamental EC Treaty principle, only two limited exceptions are permissible. Firstly, Article 58(1)(b) (ex Article 73d) EC permits Member States to pass measures concerned with preventing infringements of national law (applicable in particular to taxation and supervision of financial institutions), administrative convenience or statistical collection, or "measures which are justified on grounds of public policy or public security." Secondly, and as an additional potential justification, the Court referred to "overriding requirements of the general interest … which are applicable to all persons and undertakings pursuing an activity in the territory of the host Member State." Lastly, whatever scheme is devised must accord with the principle of proportionality by not exceeding what is strictly necessary to achieve the objectives sought.

III. Analysis of the Three Cases

A. *The Portuguese "Golden Share"*

In applying these legal principles to the facts before it, the Court readily concluded that the discriminatory portion of the Portuguese scheme (setting forth foreign ownership restrictions) violated Article 58 and must be struck down. As to the prior authorisation process for acquisition of shares in re-privatised companies, the Court considered that the economic and financial arguments offered by Portugal were insufficient to justify restrictions on a fundamental freedom. Without going into detail, the Court noted disapprovingly that the kind of prior authorisation procedure envisaged in the Portuguese scheme must be applied under objective criteria and be demonstrably the least restrictive means available to achieve the intended goals, as compared to the preferred *ex post facto* review procedure. A legal remedy was also necessary for aggrieved parties. The Portuguese scheme was insufficient on all of these counts.

B. *Energy and Public Security*

The French and Belgian schemes both concerned the energy sector, which the Court observed was solidly within the acknowledged scope of the "public security" justification for capital movement restrictions set forth in Article 58(1)(b). The outcome of the decisions, however, was quite different in the two cases.

i. *The French "Golden Share"* - The Court considered the French scheme was fatally lacking in objective criteria and transparency. The Court seemed generally hostile to the idea of prior authorisation procedures, and was especially critical of the fact that there was no way to determine, based on the sketchy reference to "protection of the national interest," whether an investment would be authorised or denied. The broad discretion afforded to the French government thus violated the principal of legal certainty as to potential investors in the company. The system of controls on transfers of assets similarly lacked appropriate limitations on the discretion of the French government. Therefore, even though it was an opposition procedure *ex post* which the Court prefers, the Court found it went beyond what was necessary to safeguard the French petroleum supply, as the right of opposition was again not qualified by objective criteria. It is important to emphasize the Court did not dismiss the right or necessity of a Member State to safeguard its energy supply; it merely rejected the manner in which the French plan pursued this objective.

ii. *The Belgian "Golden Share"* - The Belgian plan differed from both the Portuguese and the French plans in that there were no restrictions placed on the ownership or participation in the company. The free movement of capital, including from other Member States or outside the Community, was preserved to the maximum extent possible. It seems reasonable to surmise that this aspect animated the Court's analysis at least to some degree. The Court did not articulate this distinction with the other plans, however, noting rather that even the limitations on transfers of assets in the plan constituted restrictions on the free movement of capital in the sense of Article 56 EC.

From the language of the decision, it appears that the Court upheld the Belgian plan on the strength of its procedural safeguards and its narrow focus on strategic energy assets. In particular, there were objective criteria by which the actions of the government could be measured and subjected to judicial review if it chose to challenge a particular company decision. The Court noted approvingly that the opposition procedure allowed the companies maximum autonomy, and that government intervention required a formal statement of reasons. The express limitation to matters affecting national energy policy was also positively noted, as were the strict time limits applicable throughout to governmental action.

IV. Outlook

Pending cases against the United Kingdom and Spain for their "golden share" schemes will give additional guidance as to what constitutes a permissible "golden share" restriction. Plainly, as a result of these decisions, the EU Commission now has precedent to initiate proceedings against Member States using "golden shares" on the basis that such schemes violate the principle of the free movement of capital. It can be expected that other schemes that are not on their face "golden shares" (such as broad voting restrictions) may come under scrutiny and could be challenged as presenting an obstacle to the free movement of capital.

It is also expected that these decisions may give renewed impetus to the Commission's efforts to pass a Community directive on takeover law. As a consequence of these decisions, the complex regulation of governmental rights and privileges — one of the principal sources of political conflict in past attempts to pass a takeover directive — may no longer be necessary. The decisions may thus help pave the way for political agreement on a takeover directive.

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