

## The Legality of Golden Shares under EC Law

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### Introduction

Golden shares (in German “goldene Aktien”, in French “actions spécifiques”) are special rights or powers vested in the State or in other public entities granting certain control in privatised companies. Golden shares have been a much debated issue since the year 2000 when the European Court of Justice (ECJ) delivered its first decision on golden shares.<sup>1</sup> This decision was followed by other rulings<sup>2</sup> where the Court found that Member States’ special rights violated EC law. However, in *Commission v Belgium* (C-503/99) the ECJ ruled that golden shares do not violate Articles 56 and 43 of the EC Treaty per se. The Court thus opened a door for Member States, who do not wish to waive their golden shares. To preserve special rights in privatised companies, Member States should consider that their golden shares must satisfy the criteria of legality established by the Court.

### 1. Golden Shares and Member States’ Obligations

#### 1.1. Characterisation of Golden Shares

Golden shares emerged in the beginning of 1980s in Great Britain and their function has not changed much since that time. The main objective of golden shares was and remains the protection of a State’s strategic interests by maintaining special rights in privatised companies.

There are many reasons why states created and continue to preserve golden shares. First, strategic privatised companies are important employers and tax-payers. Second, some companies have large financial power and influence on a State’s economy. Third, privatised companies have substantial effect on public policy and security. Golden shares help States to effectively safeguard these interests and protect companies against takeovers. Golden shares confer various special rights, which may be of various types and concern different subject matters, e.g.:

- (a) Rights to appoint company directors and members of the board<sup>3</sup>, rights to limit representation of foreign company directors;<sup>4</sup>

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<sup>1</sup> C-58/99 *Commission v Italy* [2000] ECR I-3811.

<sup>2</sup> C-367/98 *Commission v Portugal* [2002] ECR I-4731; C-483/99 *Commission v France* [2002] ECR I-4781; C-462/00 *Commission v Spain* [2003] ECR I-4581; C-98/01 *Commission v Great Britain* [2003] ECR I-4641.

<sup>3</sup> Pezard, A., ‘The Golden Share of Privatized Companies’ 21 *Brooklin Journal of International Law* (1995) 85, 92.

<sup>4</sup> Câmara, P., ‘The End of the “Golden” Age of Privatisations? – The Recent ECJ Decisions on Golden Shares’ 3 *EBOR* (2002) 503, 504.

- (b) Rights to veto and decision rights in the general meetings, 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;<sup>5</sup>
- (c) Obligation to obtain authorisation of the State before certain decisions or transactions;<sup>6</sup>
- (d) Rights to influence and restrict acquisition of shareholding of the company in question.<sup>7</sup>

The expression "golden shares" refers to the ownership of shares by the State or public body. However, golden shares 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.<sup>8</sup> Special rights and privileges attached to the golden shares, even where the right is vested in the golden share, may remain even when the State or public body sells its shares. Golden shares are therefore possible in fully privatised companies.<sup>9</sup>

Golden shares can be provided by law<sup>10</sup>, specific privatisation act<sup>11</sup> 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.<sup>12</sup> Rights deriving from golden shares may be temporary, but in some cases they can be exercised on a permanent basis.<sup>13</sup>

Since golden shares derogated from traditional company law,<sup>14</sup> they have raised tensions between protectionist interests of States, free movement of capital and freedom of establishment. Before the ECJ made its golden shares decisions there were attempts to dispute golden shares' provisions under national law.<sup>15</sup> When these attempts turned out to be unsuccessful, the legality of golden shares was disputed by the European Commission.

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<sup>5</sup> *Ibid.*

<sup>6</sup> *Ibid.*

<sup>7</sup> Grundmann, S. Möslin, F., 'Golden Shares – State Control in Privatised Companies: Comparative Law, European Law and Policy Aspects' Available: [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=410580](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=410580) (7.3.2005).

<sup>8</sup> *Ibid.*

<sup>9</sup> Câmara, note 4 above, 504.

<sup>10</sup> Grundmann, Möslin, note 7.

<sup>11</sup> *Ibid.*

<sup>12</sup> Pezard, note 3 above, 90; Câmara, note 4 above, 504.

<sup>13</sup> Câmara, note 4 above, 504.

<sup>14</sup> Kronenberger, V., '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' 4 EBOR (2003) 115, 123.

<sup>15</sup> The French Constitutional Council ruled on legality of the Act of 10th July 1989 under which France exercised control over privatized companies. The French Conseil Constitutionnel decided that the Act did not violate the freedom of enterprise and legislator was entitled to apply restrictions that are justified on grounds of public interests. See Pezard, note 3 above, 94-96.

## 1.2. The Commission's 1997 Communication

In 1997 the European Commission adopted its Communication on Certain Legal Aspects Concerning Intra-EU Investment.<sup>16</sup> The aim of the 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.<sup>17</sup>

The European Commission emphasised that to determine the scope of application of Article 56 of the EC Treaty one may use Directive 88/361/EEC.<sup>18</sup> Annex 1 of the Directive contains types of transactions that constitute movement of capital in the meaning of Article 56. The list of transactions in Annex 1 contains, *inter alia*, acquisition of securities, which in the opinion of the Commission also means acquisition of shares and bonds. The European Commission supports the view that acquisition of shares of a company by investors from other Member States shall be regarded as movement of capital and falls under the scope of Article 56.<sup>19</sup>

The European Commission criticised several defensive measures existing in Member States, among them the authorisation procedures, a State's right to veto certain major decisions, and the right of nomination of directors of the company.<sup>20</sup> It therefore classified those measures in two categories: those with a discriminatory character and those with a non-discriminatory character.<sup>21</sup> While discriminatory measures, in the view of the Commission are contrary to Articles 56 and 43 of the EC Treaty, unless they are covered by the exceptions, measures belonging to the second category are not automatically contrary to EC law and are applicable without distinction to all investors.

By adopting the 1997 Communication the European Commission made it clear that it would not tolerate Member States' unjustified restrictions on free movement of capital and freedom of establishment in issues concerning cross-border investments.

## 2. Criteria of Legality of Golden Shares

The ECJ has formulated an important line between forbidden and permitted golden shares sending out a message to Member States in view of privatised companies. The message of the ECJ is that golden shares are permissible if they can be justified on specified grounds or

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<sup>16</sup> Communication of the Commission on Certain Legal Aspects Concerning Intra-EU Investment. – 1997 Official Journal C 220, 15-18.

<sup>17</sup> Putek, C., 'Limited but Not Lost: A Comment on the ECJ's Golden Share Decisions' 72 *Fordham Law Review* (2004) 2219, 2250.

<sup>18</sup> Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty. – *Official Journal L* 178, 5-18.

<sup>19</sup> Communication of the Commission on Certain Legal Aspects Concerning Intra-EU Investment. – 1997 Official Journal C 220, 4.

<sup>20</sup> *Ibid.*, 8.

<sup>21</sup> *Ibid.*, 6.

by overriding requirements of the general interest which are (a) non-discriminatory, (b) non-discretionary and (c) satisfy the principle of proportionality.

### 2.1. Non-Discriminatory Golden Shares

According to the ECJ, golden shares shall not discriminate on the basis of nationality. In case of discriminatory golden shares special rights are contrary to EC law, unless justified by express derogations of the EC Treaty. The Court approved the view of the Commission in the 1997 Communication. Point 9 of the Communication is worded as follows:

'The analysis undertaken above concerning measures having a restrictive character on intra-Community investment has concluded that discriminatory measures (i.e. those applied exclusively to investors from another EU Member State) would be considered as incompatible with Articles 73b and 52 of the Treaty governing the free movement of capital and the right of establishment, unless covered by one of the exceptions of the Treaty. As regards non-discriminatory measures (i.e. those applied to nationals and other EU investors alike), they are permitted in so far as they are based on a set of objective and stable criteria which have been made public and can be justified on imperative requirements in the general interest. In all cases, the principle of proportionality has to be respected.'

Article 58(1) (b) of the EC Treaty sets forth that Member States are entitled to take measures not in conformity with Article 56 which are justified on grounds of public policy or public security. ECJ has interpreted public policy and public security in *Church of Scientology*<sup>22</sup> where it found that Member States are free to determine the basis for public policy and public security in light of their national necessity. However, in the Court's view, these terms should be interpreted narrowly. This means that Member States may rely on the express derogations of Article 58 only when there is direct and serious threat to the protection of interest of the society.<sup>23</sup>

### 2.2. Non-Discretionary Golden Shares

Additionally the ECJ ruled that golden shares must not be discretionary.<sup>24</sup> Authorisation and opposition procedures can be held to be compatible with those freedoms only if they are covered by express exceptions provided in the EC Treaty. Otherwise, they should be justified by overriding requirements of the general interest and qualified by stable, objective criteria that were made public in order to restrict the discretionary power of the national authorities to a minimum.

The principle of proportionality is an important element of the non-discretionary requirement. The Court stated that 'since the structure of the system established does not include any precise, objective criteria, the legislation in issue goes beyond what is necessary in order to attain the objective indicated'.<sup>25</sup> Thus, in order to be non-discretionary, it is necessary for the measure to be proportionate.<sup>26</sup>

<sup>22</sup> C-54/99 *Association Église de Scientologie de Paris* [2000] ECR I-1335, p. 17.

<sup>23</sup> C-36/75 *Rutili* [1975] ECR I-1219, p. 28; C-348/96 *Calfa* [1999] ECR I-11, p. 21.

<sup>24</sup> C-483/99 *Commission v France* [2002] ECR I-4781, p. 51.

<sup>25</sup> C-483/99 *Commission v France* [2002] ECR I-4781, p. 53.

<sup>26</sup> Càmara, 509.

As noticed above, golden shares may provide for procedures of authorisation by making some decisions or certain transactions. In *Church of Scientology*, the Court established that the prior authorisation system for foreign investments violated Article 56(1) since it was not in conformity with the principle of legal certainty.<sup>27</sup> In that case the investors had no information about the circumstances in which prior authorisation was necessary. The authorisation system must provide investors with an objective basis of making administrative decisions to enable them to predict the outcome of the administrative decision. The ECJ found that the prior authorisation system violates principles of legal certainty and proportionality. The Court favours the *ex post facto* authorisation system instead.<sup>28</sup>

### 2.3. Principle of Proportionality

In the 1997 Communication the European Commission emphasised the necessity to respect the principle of proportionality when introducing special rights, *inter alia*, non-discriminatory measures.<sup>29</sup> The Court also found that golden shares must be subject to the principle of proportionality.<sup>30</sup> The proportionality test means that the restriction in question must be cumulatively necessary and proportionate to the objective pursued.<sup>31</sup>

In *Commission v Portugal* the Portuguese government claimed that the proportionality test was fulfilled 'inasmuch as an assessment of operations which alter the structure of the share ownership constitutes an appropriate means of attaining the objective pursued'.<sup>32</sup> The ECJ rejected this argument and pointed out that according to the Court's case law economic objectives can never constitute a valid justification for restrictions prohibited by the EC Treaty.

In *Commission v France* the French government argued that the measures taken in the context of the International Energy Agency were not sufficient to ensure supplies of petroleum products in the event of a serious crisis. Consequently, the Commission has failed to discharge its obligation to show that the measures in question do not comply with the principle of proportionality.<sup>33</sup> In its ruling the Court did not, however, address this issue directly.<sup>34</sup>

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<sup>27</sup> C-54/99 *Association Église de Scientologie de Paris* [2000] ECR I-1335, p. 22.

<sup>28</sup> Barnard, C., *The Substantive Law of the EU: The Four Freedoms*, 1 Ed., Oxford University Press, Oxford 2004, 478.

<sup>29</sup> Communication of the Commission on Certain Legal Aspects Concerning Intra-EU Investment. – 1997 Official Journal C 220, 5, 9.

<sup>30</sup> C-503/99 *Commission v Belgium* [2002] ECR I-4809, pp. 23, 45; C-483/99 *Commission v France* [2002] ECR I-4781, pp. 24, 45-46; C-462/00 *Commission v Spain* [2003] ECR I-4581, 34.

<sup>31</sup> Joined cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera* [1995] ECR I-4821, 23; C-54/99 *Association Église de Scientologie de Paris* [2000] ECR I-1335, 18.

<sup>32</sup> C-367/98 *Commission v Portugal* [2002] ECR I-4731, 33.

<sup>33</sup> C-483/99 *Commission v France* [2002] ECR I-4781, 33.

<sup>34</sup> *Ibid.*, 47-48.

In other disputes on golden shares the ECJ continued to consider proportionality. The Belgian Government claimed that its measures satisfied the tests of proportionality and legal certainty.<sup>35</sup> The Court held that the *ex post facto* opposition system implemented in Belgium is consonant with the principle of proportionality because it was based on objective, non-discriminatory criteria, which were known in advance to the undertakings concerned, and all persons affected by a restrictive measure of that type had a legal remedy available to them. The ECJ accepted the Belgian plea that for these reasons the principle of legal certainty was satisfied. By referring to previous jurisprudence,<sup>36</sup> the Court held that the Commission failed to produce evidence to prove the existence of alternative, less restrictive measures to attain the objective pursued.

### 3. Golden Shares in Member States

#### 3.1. German Golden Shares in Volkswagen

German special rights in Volkswagen AG are a classic example of golden shares, which arose from the so-called Volkswagen Act<sup>37</sup> that existed in the form of the law for more than 45 years. The Volkswagen Act regulates the basis for the privatisation of the Volkswagen AG and provides for a 20 per cent voting cap and a 20 per cent blocking minority.

According to the Volkswagen Act, any shareholder who holds more than 20 per cent of voting shares in Volkswagen can exercise a maximum of 20 per cent of the votes in a shareholders' meeting (Article 2(1) of the Volkswagen Act). In addition, important company decisions should be adopted with approval of a majority of more than 80 per cent of shareholder votes at the general meeting of shareholders (Article 4(3) of the Volkswagen Act) and two thirds of votes of company directors (Article 4(2) of the Volkswagen Act). As long as the Federal Government and the Land of Lower Saxony have shareholding in Volkswagen they should each have two seats on the supervisory board (Article 4(1) of the Volkswagen Act). The Federal Government has already sold all its shares,<sup>38</sup> but the Land of Lower Saxony is still vested in the right to appoint two members to the supervisory board who can influence the adoption of the company's important decisions.

According to the procedure of Article 226 the European Commission sent Germany a formal notice to provide justifications of golden shares in Volkswagen.<sup>39</sup> The European Commission relied on the ECJ decision in *Commission v Italy* (C-58/99) where the Court

<sup>35</sup> C-503/99 *Commission v Belgium* [2002] ECR I-4809, 30.

<sup>36</sup> C-159/94 *Commission v France* [1997] ECR I-5815, 101-102.

<sup>37</sup> Act on the transfer of shares in Volkswagenwerk GmbH to private partnership, i.e. Gesetz über die Überführung der Anteilsrechte an der Volkswagenwerk Gesellschaft mit beschränkter Haftung in privater Hand, 21. Juli 1960 BGBl I 1960, 39, 585. As modified: Zweites Gesetz zur Änderung des Gesetzes über die Überführung der Anteilsrechte an der Volkswagenwerk Gesellschaft mit beschränkter Haftung in private Hand, 31. Juli 1970 BGBl I, 75, 1149.

<sup>38</sup> European Commission. IP/03/410. Free movement of capital: Commission asks Germany to justify its Volkswagen law. Available: <http://europa.eu.int/rapid/pressReleasesAction.do?&language=EN&reference=IP/03/410> (15.3.2005).

<sup>39</sup> *Ibid.*

established that the right to appoint members in the company's board of directors is liable to be contrary to the obligations of a Member State under Articles 43 and 56 of the Treaty. The Commission also referred to the Court's rulings of 4 June 2002 *Commission v France* (C-483/99), *Commission v Belgium* (C-503/99) and *Commission v Portugal* (C-367/98), according to which legislation that might dissuade investors from making investments is a restriction of free movement of capital and violates Article 56 of the EC Treaty.

Since the German response to the formal notice did not, in the Commission's view, justify golden shares in Volkswagen, the Commission sent a formal request, the second stage of infringement procedures under Article 226. Germany refused instead to provide justifications of the Volkswagen Act. In response the European Commission brought the matter before the Court.

The possible outcome of the dispute over golden shares in Volkswagen was widely discussed by academics.<sup>40</sup> According to a commonly accepted opinion the Volkswagen Act cannot be justified and violates Articles 56 and 43 of the EC Treaty. Necessity to preserve golden shares might be explained by the threat of hostile takeover and job losses. Such an argument may not however, similarly with Portuguese golden shares, justify German special rights in Volkswagen.<sup>41</sup> It is doubted that German golden shares might be justified in view of necessity for financial support to Stiftung Volkswagenwerk.<sup>42</sup>

### 3.2. Golden Share in Other Member States

The Netherlands holds a golden share in TNT Post Groep N.V. (TPG), a postal company and KPN N.V. (KPN), a formerly state-owned telecommunication giant. Despite the fact that the Commission initiated an infringement procedure under Article 226, the Netherlands has indicated no intention to relinquish its golden shares in these companies. As a result, the Commission has taken the Netherlands to the ECJ in two separate cases with respect to provisions of the Articles of Association of KPN and TPG that grant the Netherlands golden shares in the companies. In the Commission's view, these special rights could dissuade investors from other Member States from investing in the two firms and therefore are contrary to the Articles 56 and 43 of the EC Treaty.<sup>43</sup>

The United Kingdom still holds golden shares in a number of companies, including BAE Systems, British Energy and Rolls-Royce. The European Commission has sent a letter of formal notice to 'remind the United Kingdom of its obligation to comply with a Court of

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<sup>40</sup> Ruge, R., 'Goldene Aktien und EG-Recht' EuZW (2002) 421; Krause, R., 'Von „goldenen Aktien“, dem VW-Gesetz und der Übernahmerrichtlinie' NJW (2002) 2747; Spindler, G., 'Deutsches Gesellschaftsrecht in der Zange zwischen Inspire Art und Golden Shares' RIW (2003) 850; Bayer, W., 'Zulässige und unzulässige Einschränkungen der europäischen Grundfreiheiten im Gesellschaftsrecht' BB (2002) 2289; Kleinschmit, F., *Deutsches Volkswagengesetz und Europäische Kapitalverkehrsfreiheit*, Göttingen, 2004.

<sup>41</sup> Ambrüster, C., '„Golden Shares“ und die Grundfreiheiten des EG-Vertrags' JuS (2003) 225, 227; Wellige, K., 'Weg mit dem VW-Gesetz!' EuZW (2003) 427.

<sup>42</sup> Kilian, W., 'VW-Gesetz und Wissenschaftsförderung' NJW (2002) 3599, 3600.

<sup>43</sup> European Commission. IP/03/1753. Free movement of capital: Commission takes the Netherlands to Court of Justice on special powers in KPN and TNT. Available: <http://europa.eu.int/rapid/pressReleasesAction.do?&language=EN&reference=IP/03/1753> (15.3.2005).

Justice ruling of 13 May 2003', where the Court found that by maintaining their golden share in the British Airport Authority, the United Kingdom failed to comply with its obligations under Article 56 of EC Treaty.<sup>44</sup>

Italy is resisting pressure by the Commission to relinquish a golden share in Telecom Italia. Portugal among others does not comply with the Court's ruling.<sup>45</sup>

Hungary owns a golden share in MOL, an oil and gas company. MOL controls a large share of the fuel retail market and owns energy-related assets in Hungary. The government has expressed an intention to sell its shares within the next few years. Hungary may still preserve a golden share in MOL, following the scheme implemented by Belgium, which could hold up the Court's scrutiny.

After privatisation of AS Eesti Raudtee, an Estonian railway company that provides rail transport services for goods and related services, Estonia introduced the golden share arising from articles of association of the company. According to the articles of association of AS Eesti Raudtee, Estonia has special rights to veto strategic decisions of the general meeting of shareholders in all questions given to the competence of the general meeting of shareholders by law. Estonia has an exclusive right to appoint directors of the company and some other exclusive rights that derogate from Estonian company law. Articles of association do not provide for basis or criteria of using special powers of the Government and gives the State the right to intervene in the questions where it preserves golden shares at any time. It is not precluded that Estonian golden shares in AS Eesti Raudtee do not comply with the justification test formulated by the ECJ and the European Commission might feel particular interest about the special rights in AS Eesti Raudtee.

## Conclusion

Privatisation is still ongoing in the countries of Central and Eastern Europe. The Court's decisions have significant consequences for the ten new nations, which recently joined the EU. New Member States have better opportunities in comparison with old Member States to preserve and create golden shares and implement schemes to protect strategic industries. Using the Court's practice and the Belgian system as a framework, new Member States have a greater opportunity to amend their special rights and bring them in conformity with the Court's scrutiny. To do this, it should be kept in mind that in order to comply with the Court's criteria the national legislation that establishes golden shares must accord with the principle of proportionality, be based on non-discriminatory criteria, which are known in advance, and be non-discretionary.

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<sup>44</sup> European Commission. IP/04/17. Free movement of capital: Commission calls on United Kingdom to apply Court of Justice ruling. Available: <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/04/17&format=HTML&aged=1&language=EN&guiLanguage=et> (15.3.2005).

<sup>45</sup> European Commission. IP/03/692. Free movement of capital: Commission calls on Portugal to apply a ruling of the Court of Justice; proceedings against France are closed. Available: <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/03/692&format=HTML&aged=1&language=EN&guiLanguage=et> (15.3.2005).