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Free movement of capital and Golden Shares in Volkswagen: unexpected twist or foreseeable outcome?

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Pursuant to the so-called 'loyalty to the EU principle' enshrined in Article 10 EC, Member States are obliged to remove national barriers to free movement of capital (Article 63 TFEU). However there are certain national barriers which the Member States sought to retain in spite of the foresaid obligation. These barriers are the so-called 'golden shares'[i] which allow State to retain control over former SOE's. Typically, the special 'golden' share (hereafter: GS) aimed to remain property of State, granting it with special powers and allowing to exercise control over company's management which could only be exercised by a majority shareholder. In order to be acceptable under the then EC law GS had to be justified on grounds of exceptions laid down in the Treaty[ii], meet legal certainty and proportionality requirement – an imperative that could not be easily satisfied. The EU Commission has long acknowledged that there is no place for unjustified GS and sued erring Member States in the Court of Justice of European Union (CJEU). The CJEU has evaluated the legality of GS in fifteen cases and only in one instance their application has been justified.[iii] These condemning judgments are of declamatory character therefore it is up to the national Government to choose how to comply.

Compliance obligations stem from the CJEU's judgments – depending on the wording of the operative part and summary the State's Government could employ different compliance strategies. Firstly, the Member State could repeal GS, thus entirely eliminating the infringement of the Treaty. Compliance by repeal could

be seen as acting in line with the sincere co-operation principle as it eliminates the breach of the Treaty in its entirety and therefore effectively complies with the judgment. Secondly, the Member State could attempt to meet the justification criteria so that overruled GS could pass the justification test. Since passing the justifying GS is a challenging task, in practice the Commission was never satisfied with 'compliance by amendments'. Following such amendments GS retained their dissuasive powers for foreign investors and subsequently impeded capital movements. As a result, any justification attempts of overruled GS inevitably triggers further infringement proceedings on amended GS or even sparks further infringement procedure for non-compliance with the original judgment. Therefore, any 'compliance by amendment' could be seen as acting contrary to the sincere co-operation principle under Article 10 EC. The above finding has been tested by analysis of Italian cases[iv] which revealed that GS are of obstinate character and governments could be reluctant to repeal them while tampering with the justification test instead.

Generally GS judgments clearly established which provisions were illegal leaving the Member State with indication as to which GS have to be repealed or amended. However, as the following analysis will show, sometimes the Member States are left with a GS ruling with a seemingly dubious compliance obligations stemming from it. Such was the case with the CJEU's landmark ruling on C-112/05 *Commission v Germany*[v] which is one of the most famous and longest-running cases in Community history. In this case the Commission challenged one of the oldest instances of GS, the so-called 'Volkswagen Law' (the Law) implemented in 1960's exclusively for the automobile company Volkswagen. It must be stressed, that the Law differs considerably from other GS in other States in one respect: it did not reserve special powers for the sole benefit of the Member State *per se* but rather used provisions of national company law to treat State authorities as ordinary private shareholder.

The Law created a legal framework which indirectly benefited the State of Lower Saxony – major shareholder with 20% stake. The Law limited the voting rights for all shareholders to 20% of the total share capital, while at the same time increased the majority required for approval of resolutions by general shareholder meeting from 75% to 80%. The set percentage thresholds were by no means accidental, but rather aimed to correspond with Lower Saxony's stake in Volkswagen The combination of the ownership ceiling and increased majority

provision allowed for Lower Saxony to exercise control over Volkswagen that would normally be available only to a shareholder owning 25% of the shares. Additionally, the Law allowed for Lower Saxony to appoint two directors to the company's supervisory board for as long as it retains any shares in the company, thus explicably granting the authorities with special power to assign directors. However, neither increased majority, nor voting right ceiling referred to Lower Saxony as a sole beneficiary of the Law. In the strictest sense any other shareholder owning 20% of Volkswagen's shares could benefit from these provisions. However, it is clear that the Law was created for the sole benefit of Lower Saxony – the 20% minority stakeholder.

In spite of the fact that the Commission asserted that all three paragraphs of the Law infringe the Treaty individually, both Advocate General and the CJEU analysed the increased majority and the voting right ceiling together in order to assess their combined deterring effect on capital movements.[vi] At the joint examination of cumulative effects of the Law the Court went on to *link* the effects of the increased majority and the voting right ceiling, stating that provisions supplemented each other, creating *a legal framework* which enabled Lower Saxony to exercise considerable influence on the basis of its investment.[vii] The Court came to the conclusion that the *combination* of the foresaid provisions constitutes a restriction on the movement of capital.[viii] The Court ruled that by maintaining in force provision on directors' appointments, as well as voting right ceiling *in conjunction* with increased majority provision, Germany has failed to fulfil its obligations under Article 63 TFEU.

Germany had to comply with the judgment by choosing its compliance strategy – to repeal or amend the Law. While choosing the strategy the Government referred to the judgment and proceeded with amending the Law by removing some overruled provisions.[ix] In the Government's view the judgment anticipated two necessary amendments: to the director's appointment right and the deterring *system*. The Government concluded that since the *interplay* or *interaction* between the two provisions of the Law infringes the Treaty, by removing only one component of the system the *interaction* between the two provisions will be eliminated effectively terminating GS so there would be no necessity to repeal the remaining provision. Therefore, the compliance strategy anticipated amendment to the Law by repealing the voting right ceiling (which was also contrary to German law on stock companies) and provision on director's appointments, yet

the increased majority provision remained in force. Subsequently, the Government choose to follow the wording of the ruling without going further than strictly necessary. Effectively, Germany has complied with the judgment while at the same time Lower Saxony's 20% stake allowed it to continue its influence over Volkswagen.

Commission was not satisfied with such compliance strategy and threatened to sue Germany for non-compliance with the original GS ruling under Article 260 TFEU. Germany defended its compliance strategy emphasising that it had no obligations to amend overruled Law beyond the requirements of the judgment. Germany insisted that the judgment required for abolition of the *legal framework* and subsequent amendment met that requirement. Commission pushed for removal of increased majority provision, but Germany resisted.

The ambiguity of compliance obligations stemming from *Commission v Germany* has been further deepened by judgment of District Court of Hannover[x]. The District Court assessed the wording of the CJEU's judgement and concluded that neither the increased majority provision nor the voting rights ceiling is contrary to the Treaty *per ce*.[xi] According to the District Court only the *joint effect* of the said provisions constitutes the breach of the Treaty.[xii] However, in spite of the District Court's finding, the EU Commission urged Germany to repeal the remaining provision of the Law in order to fully comply with ruling on C-112/05. Germany, on the other hand, sought to convince the Commission that such interpretation of compliance obligations stemming from the said judgement is erroneous. Germany insisted that repealing one of the two provisions of the Law is sufficient to facilitate full compliance. The government proposed to submit a joint application for interpretation of the CJEU's judgment in order to resolve the differing views on compliance obligations. Yet the Commission declined Germany's offer stating that there are "no doubts as to the meaning or scope of the 2007 Judgment".[xiii]

The above interpretative challenges led the Commission to refer the matter to the CJEU in 2012 under Article 260 TFEU suing Germany for non-compliance with judgment on C-112/05, stating that it is apparent that each of the three contested provisions of the Law infringed Article 63 TFEU individually. The resulting judgment on C-95/12 *Commission v Germany,* delivered on 22 October 2013 was the first of its kind in the existing body of GS case law since no other Member

State had to such great extent resisted the Commission's views on necessary compliance obligations. In C-95/12 the CJEU ruled that the Commission's complaints should be dismissed. Such an outcome of the judicial proceedings could be seen as a surprise for some, yet for others, it would appear to be anything but a surprise.

First, even though the judgment on C-112/05 could be seen as missing the opportunity to outlaw the increased majority provision of the Law, the judgment on C-95/12 merely concerns the alleged non-compliance with the GS ruling and not the potential illegality of the foresaid provision. In C-95/12 the Court has evaluated German compliance strategy and came to a conclusion that it has fully complied by removing one of the two provisions which constituted an illegal *system*. The outcome of C-95/12 also appears unsurprising once the ruling by the District Court of Hannover is taken into account. The District Court has rightfully observed that the CJEU has evaluated the two provisions of the Law *as two pieces of one whole* therefore removing one part of the system would result in its ineffectiveness. Lastly, the outcome of the case C-95/12 has been predicted by Advocate General when he concluded that the judgment on C-112/05 is not "particularly ambiguous" and it is "regrettable" that the parties had contrasting views on its interpretation and could not agree on the necessary compliance measures.[xiv] Advocate General's opinion has predicted doom for the Commission's claims, confirming that in order to determine the necessary compliance strategy Germany had to refer to the operative part of the judgment and not to the broad interpretation of assumed illegality of all three provisions of the Law as suggested by the Commission.[xv]

Even though the outcome of the judgment C-95/12 could have been predicted, it should be emphasised that the increased majority provision of the Law could once again become subject to further judicial review. The retained provision of the Law has the potential for being in breach of free movement of capital. However, the Commission would have to initiate a separate infringement procedure to prove that. The above analysis of German compliance strategy demonstrates the inherent obstinacy of GS. If, in line with the sincere co-operation principle, Germany would have opted to repeal all the contested provisions, there would not be any interpretational issues of the judgment and the increased majority provision would not retain the potential for being taken to the CJEU on separate proceedings in the future. This analysis once again demonstrates that when it

comes to compliance with GS judgments, the best possible compliance scenario would be repealing GS altogether rather than amending them. The controversy of the Court's judgment on C-112/05 is likely to re-appear in the future if the Commission would choose to refer the matter to the Court. The extent to which Germany's compliance with the ruling could be seen as acting in line with 'sincere co-operation' principle under Article 10 EC could also be questioned, especially if legality of the retained provision would be tested by the Court.

Key terms: Golden Shares, Compliance, Free Movement of Capital

Legislation:

Law governing the transfer of share rights of Volkswagenwerk GmbH to private parties *(Gesetz über die Überführung der Anteilsrechte an der Volkswagenwerk Gesellschaft mit beschränkter Haftung in private Hand)* of 21 July, 1960, *BGBI.* I 1960, at 585 and *BGBI.* III at 641, amended 6 September 1965, *BGBI.* I at 461 and 31 July 1970, *BGBI.* I at 1149.

Draft law Amending the Law governing the transfer of share rights of Volkswagenwerk GmbH to private parties (*Gesetzentwurf der Bundesregierung, Entwurf eines Gesetzes zur Änderung des Gesetzes über die Überführung der Anteilsrechte an der Volkswagenwerk Gesellschaft mit beschränkter Haftung in private Hand)*

Cases:

C-112/05 *Commission v Germany;*

C-95/12 *Commission v Germany;*

Judgment of the first Commercial Chamber of the District Court of Hannover of 27.11.2008 – 21 O 52/08, Judgment of the first Commercial Chamber of the District Court of Hannover of 27.11.2008 – 21 O 61/08.

[i] On the subject see Jelena Ganza for KSLR European Law Blog: 'A Continuing analysis of the Never-Ending Story: Golden Shares after Italian elections', (10 June 2013) and 'Italian Golden Shares – a Never-Ending Story?', (January 2013).

[ii] public health, policy and security, see Article 55 EC, Article 56 EC, Article 223 (b) EC, Article 65(1)(b) TFEU

[iii] *Commission v. Italy,* C-58/99, judgment of the CJEU of 23 May 2000; *Commission v. France*, C-483/99, 4 June 2002; *Commission v. Belgium,* C-503/99, 4 June 2002 (justified); *Commission v. Portugal,* C-367/98, 4 June 2002; *Commission v. United Kingdom*, C-98/01, 13 May 2003; *Commission v. Spain,* C-463/00, 13 May 2003; *Commission v. Italy* C-174/04, 02 June 2005; Joined cases C-282/04 and C-283/04, *Commission v. Netherlands*, 28 September 2006; *Federconsumatori v. Commune di Milano*, C-463/04 and C-464/04, referred to the Court for preliminary ruling, 6 December 2007; *Commission v. Germany,* C-112/05, 23 October 2007; *Commission v. Spain,* C-274/06, 14 February 2008; *Commission v. Spain*, C-207/07, 17 July 2008; *Commission v. Italy*, C-326/07, 26 March 2009; *Commission v. Portugal* , C-171/06, 8 July 2010; *Commission v. Portugal*, C-543/08, 11 November 2010

[iv] *ibid* n (i)

[v] *Commission v. Germany* note iii above

[vi] Opinion of Advocate General Ruiz-Jarabo Colomer, delivered on 13 February 2007 in Case C-112/05 *Commission v Germany* [76]-[81]

[vii] *Commission v. Germany* [51].

[viii] *Commission v. Germany* [56].

[ix] See Deutscher Bundestag (25 September 2008), Gesetz zur Änderung des Gesetzes über die Überführung der Anteilsrechte an der Volkswagenwerk Gesellschaft mit beschränkter Haftung in private Hand (Law amending the Law governing the transfer of share rights of Volkswagenwerk GmbH to private parties), *BGBl.* 2008 I No 56, p. 2369

[x] Judgment of the first Commercial Chamber of the District Court of Hannover of 27.11.2008 – 21 O 52/08, Judgment of the first Commercial Chamber of the District Court of Hannover of 27.11.2008 – 21 O 61/08.

[xi] Judgment 21 O 61/08 (n x) at Reasons I 2 (k)

[xii] Judgment 21 O 61/08 (n x) at Reasons I 2 (k)

[xiii] Advocate General (2013), Opinion of Advocate General Wahl, delivered on 29 May 2013, Case C 95/12, European Commission v Federal Republic of Germany, [12].

[xiv] Advocate General (2013) [24]-[25].

[xv] Advocate General (2013) [26].