

Rastislav Funta

Free Movement of Capital and VW Law: A Never Ending Story?

ABSTRACT

Among the most spectacular decisions in the field of European fundamental freedoms are the judgments of the Court of Justice of the European Union (CJEU) about the “golden shares”. It refers to special rights reserved by Member States concerning privately organised companies in order to have influence in key corporate policy decisions. Usually it is about formerly state-owned and now (partially) privatised companies as well as companies from certain key industries that strongly affect national interests. As an example of such special rights are veto rights on key business issues through which the public sector seeks to secure a special influence on the composition of the governing bodies of the concerned companies. In these situations, the CJEU sees regularly a restriction of the free movement of capital (Art. 63 (1) TFEU), since special state law discourage private investors and therefore is likely to deter investors from other Member States. The Volkswagen (VW) case touches upon a series of questions concerning the scope of the movement of capital in public-private entities. Therefore, it is worth having a closer look at it. The aim of the following considerations is, first, to examine the revised VW Law and then the new version of VW’s Articles of Association and their compatibility with the EU law.



Rastislav Funta

Swobodny przepływ kapitału i statut VW: niekończąca się opowieść?

STRESZCZENIE

Do najbardziej spektakularnych decyzji w dziedzinie europejskich podstawowych wolności należą wyroki Trybunału Sprawiedliwości Unii Europejskiej (CJEU) dotyczące „złoty akcji”. Chodzi tu o szczególne uprawnienia zastrzeżone dla Państw Członkowskich, dotyczące prywatnych spółek i umożliwiające wywieranie wpływu na podstawowe decyzje polityki korporacyjnej. Zwykle dotyczy to byłych spółek skarbu państwa, które obecnie są (częściowo) sprywatyzowane oraz spółek z określonych głównych branż przemysłu – mających istotne znaczenie dla interesów państwa. Przykładem takich szczególnych uprawnień jest np. prawo weta w kluczowych sprawach biznesowych, dzięki któremu sektor publiczny dąży do zachowania wpływu na skład organów danych spółek. W takich sprawach Trybunał widzi ograniczenie swobody przepływu kapitału (art. 63 (1) Traktatu o funkcjonowaniu Unii Europejskiej (TFEU)), ponieważ krajowe przepisy szczególne zniechęcają prywatnych inwestorów, a co za tym idzie – prawdopodobnie odstrasza ich z innych Państw Członkowskich. Sprawa Volkswagena (VW) stawia wiele pytań dotyczących zakresu przepływu kapitału w podmiotach publiczno-prywatnych, dlatego warta jest bliższego zainteresowania. Celem artykułu jest po pierwsze przeanalizowanie zmienionego prawa VW, po wtóre – nowej wersji statutu VW oraz jego zgodności z prawem UE.



1

INTRODUCTION

On the occasion of the privatization of Volkswagen in 1960, the VW law provided various shareholder provisions for Volkswagen AG, which should strengthen the influence of the public sector. Thus, the VW law granted the federal and state governments a right to appoint two seats to the supervisory board although holding only one share in Volkswagen AG (§ 4 (1) of the old version of the VW law). Thus, the German Lower House (Bundestag) has decided to amend the Volkswagen Law (§§ 2 and 4 (1) of the old version of the VW law, Restrictions on voting rights and rights of appointment have been repealed). Furthermore, the voting right of each shareholder (independent of the size of the shareholding) was limited to a maximum of 20% of the voting share capital (Voting cap, § 2 (2) of the old version of the VW law). Due to the participation of the Land of Lower Saxony in the amount of about 20% of the ordinary shares was secured that no single large shareholder could exercise greater influence than the Land of Lower Saxony. Equally tailored to the ownership interest of the Land of Lower Saxony was and still is a third rule (§ 4 (3) VW law). Base on this rule, to pass resolutions of the general assembly of shareholders there is a need to get 80% of the shares represented (although the Law on public limited companies speaks about a majority of 75%). This regulation ensures that the Land of Lower Saxony with a 20% participation on Volkswagen AG possess a lower blocking minority, which is (subject to any provisions deviating from the articles of association) achievable in corporate law only at 25% plus one share (§ 179 (2) sentence 1 of the Stock Corporation Act (AktG)). § 4 (1) and § 2 (1) „in connection with“ § 4 (3) of the VW law – according to the tenor of the judgment – violate the free movement of capital. The German Lower House (Bundestag) decided in late 2008 to amend the VW law. The three contested rules were not removed from the VW law (only the right of appointment and the restrictions on voting rights). The statutory reduction of the lower blocking minority (§ 4 (3) of the VW Law) was maintained. In December 2009, the General Meeting of Volkswagen AG decided, with votes of the Land of Lower Saxony and other shareholders – in particular Porsche SE holding, which has in the meanwhile become the majority shareholder and an affiliated company of the Emirate of Qatar – to change the Articles of Association. With this change, in the meantime deleted right of appointment

of the Land of Lower Saxony, has been introduced again the two seat principle to the supervisory board (§ 11 (1) of the VW Articles of Association) and the reduction of the lower blocking minority – in modified form – was reintroduced (§ 25 (2) of the VW Articles of Association). On the amendment of the VW law the European Commission responded with the introduction of an infringement proceedings, which led to a renewed hearing before the CJEU in the spring of 2012.

2

REVISED VERSION OF THE VW LAW

Whether the new VW law – precisely the maintenance of the lower blocking minority provision in § 4 (3) of the VW law – will stand an interpretation based on the law of the European Union, has been judged very differently in the case law and literature. In the discussion, however, this has been not always sufficiently clear, because there are two different approaches for possible violations from side of the Federal Republic. The first approach is concerning the alleged infringement of Art. 260 (1) TFEU (failure to comply with judgment of the CJEU)¹. The second approach is concerning the possible violation of the free movement of capital (Art. 63 (1) TFEU). The distinction between the two approaches is of considerable relevance, because only a violation of Art. 260 (1) TFEU may led to financial sanctions against the Federal Republic under Art. 260 (2) TFEU² (penalty payment and a lump sum penalty payment).

2.1. Was there a breach of the obligation to implement the VW judgment?

The European Commission and the Federal Republic have delivered different interpretations concerning the VW judgment of the CJEU. As a compromise between these two interpretations, there is a third version, namely, that the CJEU has decided neither positive nor negative on the admissibility of

¹ P. Varga, *Fundamentals of European Union Law*, Plzeň 2011.

² R. Funta, *Európske právo – otázky a odpovede*, Brno 2013.

an isolated blocking minority regulation. Studying the judgment in more detail, however, shows that only this third version convinces. At the beginning of the examination the CJEU found that the first two complaints (maximum voting rights and blocking minority) must be „in light of the arguments of the parties (...) and the cumulative effects of the two disputed provisions of the VW Law” considered together. Consequently the CJEU studied both provisions alongside „the requirement” (§ 43 of the CJEU judgment) and hold, that both provisions in their „combination” (§ 56 of the CJEU judgment) and „in conjunction with” each other (§ 82 of the CJEU judgment) restrict the free movement of capital. All this indicates that the CJEU has chosen the phrases in tenor wisely. To make an assessment of whether § 4 (3) of the VW law on its own infringe against the free movement of capital, the CJEU has apparently seen no reason since the old VW law went beyond an isolated blocking minority control. The CJEU hold that in the „light of all the foregoing, the complaints relied on by the European Commission alleging breach of Art. 56 (1) EC must be upheld”³. The grounds of the decision only allow the conclusion that the CJEU can not decide about the question whether the lower blocking minority violates the free movement of capital (neither in the positive nor in a negative sense). This approach of the CJEU has proved to be as not very fortunate. One may argue, with good reasons, that the CJEU would have to decide the said question in order to recognize the claim of the European Commission. Based on this, the Federal Republic has not failed, with the new version of the VW Law, to comply with its obligation to implement the CJEU judgment (Art. 260 (1) TFEU). The financial sanctions under Art. 260 (2) TFEU may not be imposed. A violation of Art. 260 (1) TFEU may be at best considered from another point, namely, that the VW law has been revised too late. Nevertheless, it took a good 13 months after the judgment was delivered to delete the right of appointment and the voting cap of the text of the VW law.

³ Case C-112/05, § 81.

3

A RENEWED VIOLATION OF THE FREE MOVEMENT OF CAPITAL?

In the infringement proceedings under Art. 258 TFEU⁴ remains to be clarified whether § 4 (3) of the VW law violates the movement of capital (Art. 63 (1) TFEU).

3.1. Assessment based on the CJEU case law

There is an idea that the CJEU has in the VW law judgment significantly expanded the scope of its golden shares jurisprudence. Originally, the jurisprudence was directed only against special rights which confer the State a disproportionate influence. The CJEU has left this level in the VW judgment by seeing the restrictions on voting rights in combination with the reduction of the blocking minority as a violation of the free movement of capital. These two instruments create no special rights, but are equally applicable to all shareholders (no shareholder may exercise more than 20% of the voting rights and each shareholder with more than 20% enjoys the blocking minority). The two provisions were tailored particularly on the 20% participation of the state of Lower Saxony. The VW Law created a situation where the Federal as well as State authorities were able to procure for themselves, with a „lower level of investment than would be required under general company law”, allowing them to block important decisions⁵. Similarly, it was held that the framework, in itself, „enables the Federal and State authorities to exercise considerable influence over the decisions of the company on the basis of such a reduced investment”⁶. The central argument is clear: the restriction of the free movement of capital is not linked to the grounds of special state rights. Rather, a regulation applicable indiscriminately to all shareholders will be sufficient, provided that it will give the State voting rights to which it would not otherwise be entitled under company law. This requirement applies without restriction also to the new VW law: further,

⁴ V. Karas, A. Králik, *Právo Európskej únie*, Praha 2012.

⁵ *Ibidem* 4, § 50.

⁶ *Ibidem* 4, § 51.

§ 4 (3) of the new VW law is tailored to the interest of the State, and continues to allow this scheme to the involved State to secure a blocking minority with a lower investment as required normally under company law. As the CJEU has pointed out in its judgment on the combination of blocking minority and the limitation of voting rights, one might argue, that the daunting effect of a blocking minority regulation to potential investors becomes less significant. Based on this, one may build the argument that the daunting effect of a blocking minority regulation is in itself „too uncertain and indirect“ in order to justify a restriction of the free movement of capital. Equally less important, in line with the case law, is to see § 4 (3) of the VW law as a mere trade modality for capital within the meaning of the Keck⁷ jurisprudence and therefore excluded from the scope of the free movement of capital⁸. The CJEU has consistently pointed out that „golden shares“ are not covered by the Keck formula. More likely, it may be argued that the CJEU has in the VW judgment directed on the detriment of foreign direct investment. This type of investment is not to be taken into account (due to the altered shareholder structure of Volkswagen AG), because more than 87% of the ordinary shares are held by strategic investors (Porsche Holding SE, Qatar and the Land Lower Saxony). The CJEU has repeatedly pronounced that the power of the state to block important decisions of the company is likely to deter the so-called portfolio investments.

4

PARTIAL SUMMARY

Based on the reasoning above we can come to a conclusion that (in line with the existing CJEU case law) § 4 (3) of the VW law, in itself, is not restricting the freedom of capital movement. According to the findings of the CJEU in the VW judgment, this restriction can not be justified, as it does not constitute an overriding reason in the general interest for the reinforcement of state influence.

⁷ R. Funta, *Binnenmarktrecht (Grundlagen)*, Trnava 2007.

⁸ P. Svoboda, *Úvod do Evropského práva*, 3. vydání, Praha 2010.

REVISED VERSION OF VW'S ARTICLES OF ASSOCIATION

Should the CJEU pronounce illegality of the § 4 (3) of the VW Law with the EU Law, this would have no consequence for the corporate governance of the Volkswagen AG, if the provisions of the VW Articles of Association would remain unchanged. Although the European Commission directed its procedure alone against the VW Law, it makes sense to take into consideration the compatibility of the VW Articles of Association with the free movement of capital.

5.1. Content of the new VW Articles of Association

The VW Articles of Association saw since 1960, through the § 4 (3) of the VW law, a reduction of the blocking minority. Also in response to the VW judgment of the CJEU, the statutory provision in question was not deleted. On the contrary, the General Meeting of Volkswagen AG confirmed the reduction of the blocking minority in December 2009 in the redacted version and (at least in its wording) also in the extended version (§ 25 (2) of the VW Articles of Association). In the invitation to the General Meeting was expressly mentioned that this regulation should apply irrespective of the VW Law. The aim of the amendment to the Articles of Association was obviously to „save” the reduction of the blocking minority in case the § 4 (3) of the VW law will not withstand a new review by the CJEU.

On the other hand, the right of appointment and the voting cap have been deleted in June 2009 from the Articles of Association. At the General Meeting in December 2009 was again decided about the incorporation of the right of appointment into the Articles of Association. The conditions for the right of appointment have been modified in two ways. According to § 4 (1) of the old version of the VW Law and the old version of the Articles of Association, both the state Lower Saxony and the Federal Republic were granted a right of appointment over two supervisory board memberships, if they were involved on the Volkswagen AG. Since 1988 the Federal Republic no longer belongs to the group of shareholders. The new version of the Articles of Association gives therefore only a reference to the two rights of appointment for the State of Lower Saxony. The second modification is that the new right of appointment may be exercised as long as the State of Lower

Saxony is involved with at least 15% of the ordinary shares on Volkswagen AG (§ 11 (1) of the VW Articles of Association).

Both decisions – the blocking minority as well as the right of appointment – were passed at the Annual General Meeting of Volkswagen AG, each with over 98% of the votes cast. The State of Lower Saxony has been involved in both polls.

6

CONCLUDING REMARKS: THE YEAR 2013 AND THE FINAL DECISION OF THE CJEU

Volkswagen AG was turned into a public limited company (PLC) in 1960 by a federal Volkswagen Law⁹. At the beginning, the Federal Republic of Germany as well as the Land of Lower Saxony were the two main shareholders (holding 20%) in Volkswagen AG. Today, the Federal Republic of Germany is no longer a shareholder in Volkswagen AG, while the Land of Lower Saxony still retains a shareholding of about 20%. The Volkswagen Law

- ☒ allowed the Federal Republic of Germany and the Land of Lower Saxony each to appoint two members to the supervisory board,
- ☒ capped the voting rights of each shareholder to a maximum of 20%,
- ☒ provided for a lower blocking minority, enabling a minority holding of only 20% of the share capital to oppose important resolutions, while the German Stock Corporation Act (AktG) requires 25%.

The European Commission saw a violation in the free movement of capital (an action against the Federal Republic of Germany was brought in 2005). Two years later the CJEU delivered a judgment¹⁰ according to which the Federal Republic of Germany has violated provisions of the EU free movement of capital. The Federal Republic of Germany repealed¹¹ the first

⁹ Gesetz über die Überführung der Anteilsrechte an der Volkswagenwerk Gesellschaft mit beschränkter Haftung in private Hand, 1960.

¹⁰ S. Mockenhaupt, *VW-Gesetz und Goldene Aktien, Zur Kapitalverkehrs- und Niederlassungsfreiheit nach dem VW-Urteil des EuGH*, Hamburg 2012.

¹¹ Gesetz zur Änderung des Gesetzes über die Überführung der Anteilsrechte an der Volkswagenwerk Gesellschaft mit beschränkter Haftung in private Hand, 2008.

two provisions. On the other side, it maintained the provision about the lower blocking minority. As the European Commission saw in this an infringement of the free movement of capital a new action before the CJEU was brought (requesting financial penalties to be imposed).

Based on the reasoning above, as well as the 2013 final decision of the CJEU we can come to a conclusion that § 4 (3) of the VW law, in itself, is not restricting the free movement of capital. According to the findings of the CJEU in the VW judgment, this restriction cannot be justified, as it does not constitute an overriding reason in the general interest for the reinforcement of state influence.

REFERENCES

- Commission of the European Communities v Federal Republic of Germany*, C-112/05, 2007, ECR I-8995.
- Czigler, B.M., *Die Rechtsprechung zu Golden Shares: Das VW-Gesetz und der EuGH*, Hamburg 2009.
- Funta, R., *Európske právo – otázky a odpovede*, Brno 2013.
- Funta, R., *Binnenmarktrecht (Grundlagen)*, Trnava 2007.
- Karas, V., Králik, A., *Právo Európskej únie*, Praha 2012.
- Mockenhaupt, S., *VW-Gesetz und Goldene Aktien, Zur Kapitalverkehrs- und Niederlassungsfreiheit nach dem VW-Urteil des EuGH*, Hamburg 2012.
- Svoboda, P. *Úvod do Evropského práva*, 3. vydání, Praha 2010.
- Varga, P., *Fundamentals of European Union Law*, Plzeň 2011.