

# End of the Golden Age? The European Courts Move to Promote Greater Free Movement of Capital Within the EU by Attacking ‘Golden Shares’

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(Latham & Watkins)

A recent European Court of Justice (ECJ) ruling relating to ‘golden shares’ may further encourage the European Commission (Commission) to take a more aggressive stance against EU Member States pursuing protectionist policies towards cross-border mergers involving their former state utilities and strategically important companies.

### What is a ‘Golden Share’?

Golden shares are shareholdings which certain EU governments have retained in formerly state- owned companies following their privatisation, with special rights attached. Typically a government sells the majority of the shares in the company to the private sector, and keeps only a small minority shareholding. But that minority shareholding has rights attached to it which give the shareholder (that is, the government) influence over the company far in excess of the proportion of its stake in the company’s equity – hence the term golden share.

Rights typically attached to golden shares include powers to veto certain actions by the company in question; to limit the size of other shareholdings; to block foreign shareholdings; and to control the appointment of directors.

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## European Rulings Against Golden Shares

In recent years, the Commission and the ECJ have set about tackling golden shareholdings in former state utilities and strategic companies in France, Portugal, the UK and Spain. For instance, in 2003 the ECJ ruled that by maintaining a golden share in the privatised airport operator, BAA plc, the UK government had failed to fulfill its obligations under the EC principle of free movement of capital (Article 56 of the EC Treaty).

In the same year, the ECJ held that Spain's golden shares in the energy company, Repsol; the telecommunications company, Telefonica; the tobacco company, Tabacalera; the banking group Argentaria; and the electricity company, Endesa restricted the free movement of capital in the EU. As a consequence of the ECJ's judgments, the UK and Spain were forced to alter their relationships with the companies in which they held golden shares in order to allow for the free movement of capital in the EU, thus making it easier for third parties, foreign entities in particular, to invest in such companies.

In 2002, the only golden share arrangement that was not objected to by the ECJ was that held by the Belgian state in the energy distribution firm, Distrigaz. The ECJ did not object to this golden share on the basis that it was a legitimate measure designed to promote the general national interest in terms of the security of the national gas supply in times of emergency. This is essentially an exception to the principle of free movement of capital based on considerations of national security and the application of the principle of proportionality.

Most recently, on 28 September 2006, the ECJ ruled that the Netherlands had infringed the prohibition against restrictions on the free movement of capital contained in the EC Treaty by retaining golden shares in the privatised Dutch national postal and telecommunications companies, Koninklijke KPN NV (KPN) and TNT Post Groep NV (TNG) respectively.

The Dutch government retained a golden share in TNG upon privatisation in 1998. The Dutch government also retained a golden share in KPN, which was put in place at the time of KPN's privatisation (although the government has since relinquished its golden share in KPN).

The ECJ found that the golden shares retained in each of KPN and TNG reserved special rights to the Dutch government including prior approval of certain management decisions. The ECJ held that such rights were wholly out of proportion to those which an ordinary shareholding in the companies would normally allow it to obtain. As such, the ECJ held that the existence of golden shares in KPN and TNG would act as a deterrent to participation in those companies by investors from other Member States of the EU. The ECJ also dismissed the Dutch government's

argument that it had retained golden shares in the companies in order to guarantee a universal mail service in the Netherlands as the rights attached to those shares went beyond what was required to achieve that objective. Thus the ECJ held the golden shares to be an obstacle to the free movement of capital in the EU and consequently the Dutch government to be in breach of the EC Treaty. The Dutch government will now have to give up its remaining golden share in TNG.

## Comment

As a consequence of the ECJ's ruling in the KPN/TNG cases, the Commission is likely to be encouraged to take further steps against EU Member States still seeking to shield their privatised utilities and strategic companies from outside investment or takeover by means of the rights attached to their golden shares in those companies. In the UK alone there are more than 20 companies with golden shares which could fall within the Commission's sights. In particular, the Commission has recently placed great emphasis on the need to liberalise certain industrial sectors in the EU, including transport, energy, postal services and telecommunications. As such, these sectors may be the primary target of any Commission initiative against golden shares.

Perhaps as a sign of things to come, a few weeks after the ECJ's judgment in the KPN/TNG case, European Commissioner McCreevy's office (Internal Market) stated that "there is no place for golden shares in the EU's internal market". Indeed, in this respect the ECJ is expected soon to hear the Commission's case (which was initiated in 2004) against the German 'Volkswagen law', which ensures the German Bundesländer of Lower Saxony keeps a blocking minority vote in the European car manufacturing giant, Volkswagen. The Commission considers that these provisions may make it less attractive for EU investors to acquire shares in Volkswagen.

As such, companies with a golden share, particularly those operating in the sectors identified by the Commission as targets for liberalisation, should be aware of the potential for the Commission to instigate action against their golden share.

Certainly, potential acquirors of companies with golden shares should be aware of the complications attaching to such golden shares. More generally, companies and their advisers should note the trend against golden shares in European enforcement practice and the potential for greater liberalisation of markets currently protected by golden shares, increasing the scope for successful cross-border merger transactions involving former state utilities and national strategic companies.