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Privatisations and golden shares : bridging the gap between the State and the market in the area of free movement of capital in the EU

Antonaki, I.

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Privatisations and golden shares

Bridging the gap between the State and the market in the area of free movement of capital in the EU

PROEFSCHRIFT

ter verkrijging van
de graad van Doctor aan de Universiteit Leiden,
op gezag van Rector Magnificus prof. mr. C.J.J.M. Stolker,
volgens besluit van het College voor Promoties
te verdedigen op dinsdag 3 september 2019
klokke 16.15 uur

door

Ilektra Antonaki

geboren te Heraklion, Griekenland

in 1990

Promotor:	prof. dr. S.C.G. Van den Bogaert
Co-promotor:	dr. M. Jesse
Promotiecommissie:	prof. dr. R.C. Tobler prof. dr. S.M.M. Garben (College of Europe, Bruges, Belgium) prof. dr. H.E.G.S. Schneider (Maastricht University) prof. dr. P. van Cleynenbreugel (University of Liege, Belgium)

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Introduction

1 Setting the scene: The international debate about capital liberalisation

The role of the State in the functioning of the Market has played a crucial role in the development of the post-war politico-economic reality. It has been the premise upon which economic theories have been developed, Nobel prizes have been awarded (to both proponents and critics), political ideologies have been forged and national and international policies have been conceived and carried out. In our globalised world, the State-Market debate unfolds not only at the national level where the political dynamics are more clearly distinguishable and the stakes more easily defined, but also at the international level, which is characterised by a multilevel institutional framework that promotes *trade* and *capital liberalisation* as the two economic cornerstones intended to boost global economic growth. However, while most economists would agree that *trade liberalisation* contributes significantly to economic growth, the same cannot be argued (at least not with the same intensity) about *capital liberalisation*.[1] To be more precise, although capital liberalisation can contribute to economic efficiency by removing obstacles to international economic transactions and by promoting foreign investment, there is nevertheless a protracted controversy among economists regarding the extent to which capital movements should be liberalised. It is argued that an unfettered capital liberalisation bears significant risks for *financial stability* and *social equality*, which can in turn affect profoundly the economic and social fabric of societies.[2] These risks can be prevented by the implementation and enforcement of a transparent legal framework consisting of measures of prudential supervision and regulation aiming at restricting those capital movements which might threaten public interest objectives.

The relationship between *capital liberalisation* and *social inequality* has been at the heart of the economic and political debate over the role of the State in the

1 Joseph Stiglitz and others, *Stability with Growth: Macroeconomics, Liberalization and Development* (Oxford University Press 2006), pp. 167-168.

2 Andrew Charlton, 'Capital Market Liberalization and Poverty' in José Antonio Ocampo and Joseph Stiglitz (eds), *Capital Market Liberalization and Development* (Oxford University Press 2008), pp. 121-138.

organisation and functioning of the market. The historical origins of this debate are traced back to the Industrial Revolution and the emergence of the modern capitalist economy in the late 18th and early 19th century. In *Das Kapital*,[3] Karl Marx engaged in a critical analysis of the economic system of his time and concluded that the capitalist mode of production and accumulation is based on the annihilation of self-earned private property, in other words the expropriation of the labourer.

Almost a century later, Karl Polanyi laid the foundations of the concept of '*embedded liberalism*' arguing that the economy is not and cannot be autonomous and self-regulated; it is always 'embedded' (i.e. 'planted') in social relations.[4] Disembedding the market from the society cannot be successful because it leads to the commodification of human labour and the natural environment.[5] For Polanyi, *land*, *labour* and *money* are fictitious commodities in the sense that they are not originally produced to be sold on a market. Even if for real commodities the economy is supposed to be self-regulating, the State plays a crucial role in managing the markets of the three fictitious commodities. Especially in relation to the fictitious commodity of money, which is of interest for the purposes of the present thesis, Polanyi argues that the supply of money and credit in modern societies is necessarily shaped by governmental policies and that the State must intervene in adjusting the supply of money and credit to avoid the twin dangers of inflation and deflation.[6]

Although these theories played an instrumental role in the shaping of modern economics, today we have adopted a more balanced approach, one that recognises both the power and the limitations of the markets and accepts the necessity of some State regulatory interventions in the financial markets.[7] The main theoretical controversy now revolves around the *extent* and the *form* these regulatory interventions should take.

Zooming in on the specific question regarding the relationship between capital liberalisation and social inequality, Joseph Stiglitz argues that due to the high macroeconomic volatility of capital flows, capital liberalisation is associated with economic instability, increased likelihood of financial crises and rising levels of income inequality.[8] This is why government intervention in the form

3 Karl Marx, *Capital: A Critique of Political Economy* (Verlag von Otto Meisner 1867).
4 Karl Polanyi, *The Great Transformation* (Beacon Press 1944, 1957, 2001).
5 Ibid, p. xxv.
6 Ibid, p. xxvi.
7 Ibid, p. viii.
8 Jospeh Stiglitz, 'Capital Market Liberalization, Economic Growth and Instability' (2000) 28 *World Development* 1075, at p. 1076.

of certain capital restrictions can mitigate the negative effects that unfettered free movement of capital can have on the economy and the society.[9]

In a similar spirit, in 2014, Thomas Piketty collected and analysed extensive historical and comparative data covering three centuries and more than twenty countries from which he derived a grand theory of capital and inequality.[10] His main conclusion is that accumulated capital grows faster than economic output and wages.[11] This inequality threatens to generate arbitrary and unsustainable inequalities that stir discontent and undermine the meritocratic values upon which democratic societies are (or perhaps should be) based. In order to prevent this soaring inequality, he recommends the imposition of a global progressive annual tax on capital.[12] He concedes that the difficulty in this solution is that it requires a high level of international cooperation and regional political integration. However, he believes that only regional political integration – especially in the European Union – can lead to effective regulation of the globalised patrimonial capitalism of the twenty-first century.[13]

In 2016, eminent economists of the IMF published a revolutionary paper,[14] which, in a rather self-critical spirit, argues that the benefits of *capital account liberalisation* and *austerity* – two main aspects of 'neoliberalism' – such as foreign direct investment and reduction of public debt, have been somewhat overplayed, whereas the costs in terms of lower output, retrenched welfare, higher unemployment and increasing income inequality have been underplayed.[15] As it is aptly observed, 'the increase in inequality engendered by financial openness and austerity might itself undercut growth, the very thing that the neoliberal agenda is ostensibly intent on boosting'.[16]

In the light of the aforementioned recent developments in the field of economic theory, it can be argued that there is a contemporary economic school of thought which departs from an unconditional adherence to unfettered capital liberalisation and is advocating a more restrictive approach regarding international capital flows in order to prevent the risks of financial instability and social inequality. This economic thinking is to some extent embraced also by international economic organisations such as the IMF and the OECD, which,

9 Ibid.
10 Thomas Piketty, *Capital in the Twenty-First Century* (The Belknap Press of Harvard University Press 2014).
11 Ibid p. 571.
12 Ibid p. 515 et seq.
13 Ibid p. 573.
14 Jonathan Ostry, Prakash Loungani and Davide Furceri, 'Neoliberalism: Oversold?' (2016) 53 *Finance & Development* 38.
15 Ibid, p. 40.
16 Ibid, p. 40.

in view of the controversy surrounding the impact of free capital flows on social inequality as well as the inconclusive economic evidence regarding their contributory effect to economic growth, are of the opinion that capital liberalisation improves economic efficiency only if it is complemented by measures of prudential supervision and regulation, sound macroeconomic policies and transparency (see the analysis in Chapter 1).

2 Scope of the thesis: bridging the gap between the State and the market in the area of free movement of capital in the EU

This new economic thinking that advocates a more restrictive apporach to capital liberalisation has not been reflected at the EU level. In particular, despite the historical compromise between, on the one hand, *laissez-faire* policies and, on the other hand, strategic interventions from the State to protect social objectives upon which the project of European integration was originally constructed, in the post-Maastricht era it seems that economic integration through deregulation has led to the prevalence of the model of *liberal market economies* (as opposed to *coordinated market economies*, see Chapter 4) as the dominant political ideology and economic policy in Europe.[17]

Although in the early days of European integration capital movements were not liberalised completely as a result of the international scepticism regarding their possible contributory effect to financial crises and instability, with the entry into force of the Maastricht Treaty and the introduction of the Economic and Monetary Union, it was decided that the EU would follow the model of unrestricted capital liberalisation in order to facilitate the project of financial integration and the adoption of the euro. Furthermore, it was decided that in order to increase the credibility of the euro as a strong currency at the international level and in order to promote foreign direct investment, the free movement of capital would be applicable not only to Member States but also to third countries.

17 Fritz W. Scharpf, 'The Double Asymmetry of European Integration Or: Why the EU Cannot Be a Social Market Economy' (2010) 8 *Socio-Economic Review* 211, p. 211. In relation to this general debate, see more broadly: Philip Cerny, *Rethinking World Politics: A Theory of Transnational Neopluralism* (Oxford University Press 2010), p. 139; Kathleen McNamara, *The Currency of Ideas: Monetary Politics in the European Union* (Cornell University Press 1998); Bastiaan Van Apeldoorn, 'The Contradictions of 'Embedded Neoliberalism' and Europe's Multi-level Legitimacy Crisis: The European Project and its Limits' in Jan Drahokoupil, Bastiaan Van Apeldoorn and Laura Horn (eds), *Contradictions and Limits of Neoliberal European Governance: From Lisbon to Lisbon* (Palgrave 2009), p. 24. Drawing from Karl Polanyi, the neologism '*embedded neo-liberalism*' is often employed to describe the post-Maastricht economic system that combines on the one hand, strict budgetary discipline, freedom of capital and primacy of the markets and, on the other hand, some elements of neo-mercantilism and social market economy.

These developments led to the establishment of a rather sophisticated legal framework governing the free movement of capital in the EU, which is characterised to a large extent by a strong commitment to the principle of unrestricted capital flows as a vital feature of the project of economic integration. This is particularly evident in the case law regarding *privatisations* and *golden shares*, where the Court of Justice has adopted a broad interpretation of the notion of 'capital restrictions' under Article 63 TFEU and has treated forms of public ownership and special shareholding of public authorities in privatised undertakings as measures of *economic protectionism* inherently incompatible with the Internal Market.

It is true that Member States have used golden shares as a means of protecting national industries against hostile takeovers from foreign or even domestic competitors. For instance, in the famous *Volkswagen* case (analysed in Chapter 4), the special rights of the Federal State of Germany and the Land of Lower Saxony in Volkswagen effectively prevented the acquisition of total control of the company by the rival automobile industry Porsche.[18] However, the adoption of a very broad interpretation of the notion of 'capital restrictions' under Article 63 TFEU and the treatment of golden shares and forms of public ownership as inherently incompatible with the Internal Market raises significant concerns, firstly, regarding the division of competences between the EU and the Member States in the fields of corporate governance and property ownership systems, and secondly, regarding the protection of public interest objectives.

In relation to the first concern, the establishment of golden shares is a decision, which relates to the choice of the national corporate governance regime, which in turn remains a preserved competence of the Member States. Although such as decision might have an impact on the EU's shared competence on the Internal Market, it cannot be regarded as incompatible with the fundamental freedoms simply because it adheres to a specific model of corporate governance and market economy, especially in the absence of any harmonisation at the EU level. In the same vein, the decision to preserve public ownership in certain undertakings relates to the choice of the national property ownership system, which again remains a national competence and is, in fact, covered by the principle of neutrality enshrined in Article 345 TFEU (analysed in Chapter 3).

In relation to the second concern, it should be noted that golden shares and other types of public ownership sometimes pursue public interest objectives, which are vital for the society as a whole. To use again the *Volkswagen* case as an example, the special rights that the Federal State of Germany and the

18 Wolf-Georg Ringe, 'Case C-112/05, Commission v. Germany ("VW law"), Judgment of the Grand Chamber of 23 October 2007, nyr.' (2008) 45 *Common Market Law Review* 37.

Land of Lower Saxony retained in the privatised automobile industry were intended to pursue the legitimate objective of the protection of workers. Similarly, in strategic privatised undertakings active in the energy sector, the special shareholdings of national public authorities were intended to pursue the legitimate objective of safeguarding security of energy supplies (see the analysis in Chapter 4.).

In this context, this thesis examines, on a first level, the reach of the tentacles of EU Internal Market law and the implications of the golden shares and privatisations case law for the division of competences between the EU and the Member States and the protection of public interest objectives. On a second level, it attempts to address the risks of a very broad interpretation of 'capital restrictions' under Article 63 TFEU by identifying the legal tools under the existing legal framework and the possible modifications in the judicial interpretation of the free movement provisions that will ensure respect for the division of competences between the EU and the Member States in the fields of corporate governance and property ownership and will allow sufficient room for reconciling economic integration with societal values.

In this respect, the thesis puts forward two main suggestions: firstly, the rediscovery of the principle of neutrality under Article 345 TFEU as a legal provision which shields national decisions to maintain public ownership from Internal Market scrutiny and, secondly, the recalibration of the 'capital restrictions' test in the golden shares case law by reference to a *Keck*-inspired notion of 'investment arrangements'. The thesis argues that through this 'velvet revolution' in the context of negative integration, the interpretation of the free movement of capital in the EU can respect the delicate balance of competences between the EU and the Member States and can facilitate a reconciliation of the capital freedom with public interest objectives.

3 Research question and sub-questions

Drawing from the international controversy surrounding the costs and benefits of unfettered capital liberalisation, the thesis starts from the premise that a certain degree of regulation in the area of capital movements is necessary in order to prevent the risk of financial instability, reduce income inequality and protect legitimate social objectives. On the basis of this theoretical claim, it seeks to investigate the overall research question:

> *How can the EU free movement of capital provisions be interpreted so as to allow room for State participation in the market for the purposes of protecting public interest objectives in the context of privatisations and golden shares?*

In order to answer this overall research question, the thesis examines whether the broad interpretation of the free movement of capital by the Court of Justice favours a specific model of market economy and attempts to explore the extent to which the existing legal framework set out in the Treaties offers room for reconciling economic integration with societal values. For this purpose, it analyses the privatisations and golden shares case law as two case-studies and suggests certain adjudicative methods, which could allow Member States to determine their property ownership and corporate governance systems without imposing protectionist obstacles on foreign investment.

The selection of the two case-studies of privatisations and golden shares is based on the fact that they concern two national competences (the choice of *property ownership* and *corporate governance systems*) in the exercise of which the State can act not only as a *regulator* but also as a *market participant* operating under market conditions together with other private market participants. The degree of State participation in the market in those two competences affects profoundly the organisation of the national industrial policy and the identity of the national market economy system.

It should be clarified at the outset that golden shares presuppose the implementation of a privatisation scheme and as such the two case studies are inextricably linked. However, the distinction between privatisations and golden shares followed in this thesis is based on a *temporal* element which affects significantly the legal issues under consideration: the first case study focuses on the *pre*-privatisation phase and the role that EU law plays in the decision of a national government to privatise or nationalise an undertaking; the second case-study focuses on the *post*-privatisation phase and we examine the compatibility of golden shares (i.e. the special shareholding established *after* privatisation) with EU law. In the *pre*-privatisation phase, the decision to nationalise or privatise an undertaking touches upon the determination of the *national property ownership system*, whereas in the *post*-privatisation phase the decision to retain special rights in strategic privatised undertakings determines the shaping of the *national corporate governance system*.

However, both the *property ownership* and the *corporate governance* system constitute two sensitive national competences, which affect the industrial policies of the Member States and determine the degree of State intervention in the market. Ultimately, they both relate to the question whether the control of undertakings remains in public or private hands, which in turn represents the paradigm of the clash between the State and the market. Therefore, a legal study seeking to explore a possible reconciliation of capital liberalisation with State participation on the market in the EU must examine the case law on privatisations and golden shares in order to identify the legal parameters that

need to be changed in order to strike a fair balance between the free movement of capital and public interest objectives.

It should be noted that this thesis does not look at taxation. Although arguably taxation represents the lion's share of the case law on the free movement of capital, it nevertheless remains beyond the thematic scope of the present study, as when exercising its competence to impose taxation, the State acts as a regulator and not as a market participant. For this reason, taxation is excluded from the normative analysis of the thesis (Chapters 3 and 4). It is nevertheless included in the general descriptive analysis of the current legal framework governing the free movement of capital in the EU (Chapter 2), in order to demonstrate that although in principle the Court advocates the abolition of all capital restrictions in relation to taxation, it is nevertheless more willing to accept certain derogations in view of the principle of tax sovereignty and territoriality.

The thesis attempts to answer the overall research question gradually by addressing several sub-questions in each chapter:

Chapter 1
- How is capital liberalisation defined?
- Is there conclusive economic evidence that capital liberalisation contributes to economic growth?
- What is the legal framework governing capital liberalisation at the international level?

Chapter 2
- Why did the free movement of capital have a slower evolution compared to the other freedoms?
- What is the relationship between the free movement of capital and the other fundamental freedoms?
- What are the unique features of the free movement of capital?
- Is the strikingly broad interpretation of capital restrictions somehow counterbalanced by a more flexible justification/proportionality regime?

Chapter 3
- What is the EU legal framework regarding privatisations?
- How is Article 345 TFEU interpreted in the context of privatisations and golden shares?
- Should Article 345 TFEU be interpreted as an exemption from the scope of the free movement of capital or as a justification for capital restrictions?

Chapter 4

- What are golden shares?
- Why are golden shares so controversial?
- Is it possible and/or desirable to grant horizontal effect to Article 63 TFEU?
- Does the golden shares case law allow enough room for Member States to justify the restrictions imposed by the special holding they retain in privatised undertakings?
- What is the proportionality assessment adopted by the Court in the golden shares case law? Is it appropriate?
- Is there a need to delineate the scope of 'capital restrictions' in a more consistent way through the introduction of a *Keck*-inspired approach in the golden shares case law?

4 Academic relevance and method

Liberalising capital movements is of vital importance, not only for the achievement of the Internal Market, but also for the realisation of the Economic and Monetary Union.[19] Yet, in comparison with the other fundamental freedoms, the free movement of capital followed a slow historical development. The reason of this slow historical development was most probably the international post-war scepticism about free capital flows, which, due to their high volatility, were associated with increased risk of financial instability.

The adoption of the Maastricht Treaty, the introduction of the new Treaty provision on capital (Article 73b(1) EC, today Article 63 TFEU) and the recognition of its direct effect by the Court of Justice[20] accelerated the evolution of the capital freedom and provided a new impetus for legal scholarship, which for a long time had remained stagnant. The free movement of capital started attracting significant scholarly attention among European academics, practitioners and policy analysts and gradually developed into a fully-fledged freedom of the EU's Internal Market. In the last two decades, the case law of the Court on the free movement of capital has increased exponentially and has offered a great opportunity for the academic community to delve into sensitive legal issues touching upon core sovereign competences such as taxation, property ownership and corporate governance, which for a long time had remained beyond the reach of market integration.

19 Catherine Barnard, *The Substantive Law of the EU: The Four Freedoms* (Oxford University Press 2016), p. 518.

20 Joined cases C-163/94, C-165/94 and C-250/94 *Criminal proceedings against Lucas Emilio Sanz de Lera, Raimundo Díaz Jiménez and Figen Kapanoglu*, ECLI:EU:C:1995:451, para 41.

The by now profuse case law on the free movement of capital has the unique feature that it covers a wide range of financial instruments and transactions. This has led to the development of different lines of case law within the area of the free movement of capital relating to various topics, such as taxation, purchase of real estate, inheritances, charities and donations, foreign direct investment etc. Each of these categories can be regarded as *self-standing lines of case law*, in which the Court develops a distinct legal reasoning based on the intricacies and specificities of each category. The existence of multiple lines of case law should not be regarded as a fragmentation in the jurisprudential approach of the Court, but rather as a legally sound method of treating divergent thematic categories, which nevertheless fall within the broader scope of the free movement of capital.

The literature on the free movement of capital has followed to a great extent the categorisation of the case law. There is of course important input on the general legal issues arising from the free movement of capital (such as direct effect, scope, justifications, proportionality, significance of the capital freedom for the functioning of the Internal Market and the Economic and Monetary Union, relationship with the other freedoms, third-country dimension etc.).[21] But at the same time, there are scholarly contributions that focus exclusively on the interaction between free movement of capital and taxation,[22] academic

21 Jonh Usher, 'The Evolution of the Free Movement of Capital' (2007) 31 *Fordhman International Law Journal* 1533; Jukka Snell, 'Free movement of capital: Evolution as a non-linear process' in Paul Craig and Gráinne De Búrca (eds), *The Evolution of EU Law* (Oxford University Press 2011); Arie Landsmeer, 'Movement of Capital and Other Freedoms' (2001) 28 *Legal Issues of Economic Integration* 57; Steve Peers, 'Free Movement of Capital: Learning lessons or slipping on spilt milk?' in Catherine Barnard and Joanne Scott (eds), *The Law of the Single European Market: Unpacking the Premises* (Hart Publishing 2002); Leo Flynn, 'Free movement of capital' in Catherine Barnard and Steve Peers (eds), *European Union Law* (Oxford University Press 2017), p. 447; Leo Flynn, 'Freedom to Fund?: The Effects of the Internal Market Rules, With Particular Emphasis on Free Movement of Capital' in Ulla Neergaard, Erika Szyszczak, Johan Willem van de Gronden and Markus Krajewski (eds), *Social services of general interest in the EU* (Spinger 2013); Leo Flynn, 'Coming of Age: The Free Movement of Capital Case Law 1993-2002' (2002) 39 *Common Market Law Review* 773; Thomas Horsley, 'The Concept of an Obstacle to intra-EU Capital Movements in EU Law' in Niamh Nic Shuibhne and Laurence W. Gormley (eds), *From Single Market to Economic Union: Essays in Memory of John A Usher* (Oxford Univesrity Press 2012); Philippe Vigneron and others, *Libre circulation des personnes et des capitaux. Rapprochement des legislations* (Les éditions de l' Université de Bruxelles 2006), p. 167; Philippe Partsch, 'Articles 56-60 CE' in Isabelle Pingel (ed), *Rome à Lisbonne: Commentaire article par article des traités UE et CE* (Dalloz 2010), p. 492; Olivier Blin, 'Capitaux' in Denys Simon and Sylvaine Poillot Peruzzetto (eds), *Répertoire de Droit Européen* (Dalloz 2016).

22 Steffen Ganghof and Philipp Genschel, 'Taxation and Democracy in the EU' (2008) 15 *Journal of European Public Policy* 58; Steffen Ganghof, *The Politics of Income Taxation* (ECPR Press 2006); Martha O'Brien, 'Taxation and the Third Country Dimension of Free Movement of Capital in EU Law: The ECJ's Rulings and Unresolved Issues' (2008) 6 *British Tax Review* 628; Axel Cordewener, Georg W. Kofler and Clemens Philipp Schindler, 'Free Movement

papers analysing extensively the controversial golden shares case law[23] and

of Capital, Third Country Relationships and National Tax Law: An Emerging Issue before the ECJ' (2007) 47 *European Taxation* 107; Axel Cordewener, Georg W. Kofler and Clemens Philipp Schindler, 'Free Movement of Capital and Third Countries: Exploring the Outer Boundaries with Lasertec, A and B and Holböck' (2007) 47 *European Taxation* 371; Thomas Horsley, 'Death, Taxes, and (Targeted) Judicial Dynamism – The Free Movement of Capital in EU Law' in Antony Arnull and Damian Chalmers (eds), *The Oxford Handbook of European Union Law* (Oxford University Press 2015), pp. 784-808; Werner Haslehner, '"Consistency" and Fundamental Freesoms: The Case of Direct Taxation' (2013) 50 *Common Market Law Review* 737; Jukka Snell, 'Non-Discriminatory Tax Obstacles in Community Law' (2007) 56 *International and Comparative Law Quarterly* 339; Ryan Murphy, 'Why does tax have to be so taxing? The court revisits the Franked Investment Income litigation (Case Comment)' (2013) 38 *European Law Review* 695; Ryan Murphy, 'Why does tax have to be so taxing? The court revisits the Franked Investment Income litigation' (2013) 38 *European Law Review* 695; Brady Gordon, 'Tax competition and harmonisation under EU law: economic realities and legal rules' (2014) 39 *European Law Review* pp. 790; Axel Cordewener, Georg Kofler and Servaas Van Thiel, 'The Clash Between European Freedoms and National Direct Tax Law: Public Interest Defences Available to the Member States' (2009) 46 *Common Market Law Review* 1951

23 Carsten Gerner-Beuerle, 'Shareholders Between the Market and the State. The VW Law and other Interventions in the Market Economy' (2012) 49 *Common Market Law Review* 97; Stefan Grundmann and Florian Möslein, 'Golden Shares – State Control in Privatised Companies: Comparative Law, European Law and Policy Aspects' (2001-2002) 4 *EUREDIA* 623; Wolf-Georg Ringe, 'Case C-112/05, Commission v. Germany ("VW law"), Judgment of the Grand Chamber of 23 October 2007, nyr.' (2008) 45 Common Market Law Review 37; Wolf-Georg Ringe, 'Company Law and Free Movement of Capital' (2010) 69 *Cambridge Law Journal* 378; Wolf-Georg Ringe, 'Is Volkswagen the New Centros? Free movement of Capital's Impact on Company Law' in Dan Prentice and Arad Reisberg (eds), *Corporate Finance Law in the UK and EU* (Oxford University Press 2011); Peer Zumbansen and Daniel Saam, 'The ECJ, Volkswagen and European Corporate Law: Reshaping the European Varieties of Capitalism' (2007) 8 *German Law Journal;* Florian Sanders, 'Case C-112/05, European Commission v. Federal Rebublic of Germany: The Volkswagen Case and Art. 56 EC – A Proper Result, Yet Also a Missed Opportunity?' (2007-2008) 14 *Columbia Journal of European Law* 359; Gert-Jan Vossestein, 'Volkswagen: the State of Affairs of Golden Shares, General Company Law and European Free Movement of Capital – A discussion of Case C-112/05 Commission v Germany of 23.10.2007' (2008) 5 *European Company and Financial Law Review* 115; Jonathan Rickford, 'Free movement of capital and protectionism after Volkswagen and Viking Line' in Michel Tison and Eddy Wymeersch (eds), *Perspectives in Company Law and Financial Regulation – Essays in Honour of Eddy Wymeersch* (Cambridge University Press 2009); Jonathan Rickford, 'Protectionism, Capital Freedom and the Internal Market' in Ulf Bernitz and Wolf-Georg Ringe (eds), *Company Law and Economic Protectionism – New Challenges to European Integration* (Oxford University Press 2010); Florian Möslein, 'Compliance with ECJ judgments vs. compatibility with EU law – Free movement of capital issues unresolved after the second ruling on the Volkswagen law: Commission v. Germany' (2015) 52 *Common Market Law Review* 801; Jonathan Mukwiri, 'Free movement of capital and takeovers: a case-study of the tension between primary and secondary EU legislation' (2013) 38 *European Law Review* 829; Mads Andenas, Tilmann Gütt and Matthias Pannier, ''Free Movement of Capital and National Company Law' (2005) 16 *European Business Law Review* 757; Nadia Gaydarska and Stephan Rammeloo, 'The legality of the "golden share" under EC law' (2009) 5 *Maastricht Working Papers Faculty of Law;* Stephan Rammeloo, 'Past, Present (and Future?) of the German Volkswagengesetz under the EC Treaty' (2007) 4 *European Company Law* 118; Victoria Cherevach and Bas Megens, 'Commission of the

other works that explore the field of foreign direct investment (and portfolio investment) from the perspective of the free movement of capital in the EU comparing it often with the international trade and investment regime.[24]

However, despite the constantly growing literature on the free movement of capital, what is missing is a comprehensive account of the evolution of capital liberalisation at the European level in comparison with the relevant developments at the International level. The present thesis aspires to fill this gap and to provide a thorough analysis of the International and the European legal framework governing the free movement of capital.

At the same time, this thesis seeks to make a further contribution to the academic literature on the capital freedom by combining three distinct but inextricably linked legal methods in order to answer the research question. In particular, the thesis combines firstly, a *doctrinal legal analysis* of the legal framework on capital liberalisation at the International and the European level and the case law of the Court of Justice on privatisations and golden shares; secondly, a *law in context analysis*, aiming at illustrating the importance of relevant economic theories and concepts of political economy theory underpinning the ongoing debate regarding the economic and social asymmetry of European integration;[25] and thirdly a *normative legal analysis* suggesting changes in the

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European Communities v Federal Republic of Germany Case C-112/05 – The VW Law Case; Some Critical Comments' (2009) 16 *Maastricht Journal of European and Comparative Law* 370; Erika Szyszczak, 'Golden Shares and Market Governance' (2002) 29 *Legal Issues of Economic Integration* 255; Jaron Van Bekkum, 'Golden Shares: A New Approach' (2010) 7 *European Company Law* 13; Andrea Biondi, 'When the State is the Owner – Some Further Comments on the Court of Justice 'Golden Shares' Strategy' in Ulf Bernitz and Wolf-Georg Ringe (eds), *Company Law and Economic Protectionism: New Challenges to European Integration* (Oxford University Press 2010); Harm Schepel, 'Of Capitalist Nostalgia and Financialisation: Shareholder Primacy in the Court of Justice' in Christian Joerges and Carola Glinski (eds), *The European Crisis and the Transformation of Transnational Governance* (Hart Publishing 2014); Nicola Ruccia, 'The New and Shy Approach of the Court of Justice Concerning Golden Shares' (2013) 24 *European Business Law Review* 275;

24 Steffen Hindelang, *The Free Movement of Capital and Foreign Direct Investment: The Scope of Protection in EU Law* (Oxford University Press 2009); Frank G. Barry, *The internationalisation of production in Europe: case studies of foreign direct investment in old and new EU member states* (European Investment Bank 2004); Frank S. Benyon, *Direct Investment, National Champions and EU Treaty Freedoms From Maastricht to Lisbon* (Hart Publishing 2010); Angelos Dimopoulos, *EU Foreign Investment Law* (Oxford University Press 2011); Marc Bungenberg and Jo¨rn Griebel, *International investment law and EU law* (Springer 2011); Marise Cremona, 'The External Dimension of the Internal Market' in (eds), (Oxford:)' in Catherine Barnard and Joanne Scott (eds), *The Law of the Single European Market* (Hart Publishing 2002).

25 Fritz W. Scharpf, 'The Double Asymmetry of European Integration Or: Why the EU Cannot Be a Social Market Economy' (2010) 8 Socio-Economic Review 211; Fritz W. Scharpf, 'Legitimacy in the Multilevel European Polity' (2009) 1 *European Political Science Review* 173; Martin Höpner and Armin Schäfer, *A New Phase of European Integration: Organized Capitalisms in Post-Ricardian Europe* (Max Planck Institute for the Study of Societies, MPIfG

interpretation of the free movement of capital provisions that can create room for State participation in the market. In this way, the thesis aspires to contribute to the broader academic debate regarding the appropriate institutions and legal arrangements that are necessary in order to achieve economic growth and social justice in Europe.

5 Negative integration versus positive integration

It should be noted that this thesis focuses exclusively on negative integration, as both the legal analysis as well as the recommendations relate to the interpretation of the Treaty provisions on the free movement of capital by the European Court of Justice. To the contrary, the thesis does not examine any secondary legislation nor does it attempt to address the broader concerns about the division of competences and the protection of public interest objectives by means of positive integration. Therefore, it is to be distinguished from previous legal research on golden shares, which proposes the adoption of harmonising measures as a means of promoting the legitimate considerations pursued by golden shares, whilst ensuring compliance with the fundamental freedoms.[26]

In the field of positive integration, the European Commission has attempted to address some of the Member States concerns in relation to third-country investment by submitting a Proposal for a Regulation establishing a framework for screening of foreign direct investments into the European Union.[27] This

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Discussion Paper 07/04, 2007); Martin Höpner and Armin Schäfer, 'Embeddedness and Regional Integration. Waiting for Polanyi in a Hayekian Setting' (2012) 66 *International Organization* 429; Paulette Kurzer, *Markets and Moral Regulation: Cultural Changes in the European Union* (Cambridge University Press 2001); Roger Liddle, 'The European Social Model and the ECJ' (2008) 4 *Social Europe Journal* 27; Jonh Monks, 'European Court of Justice (ECJ) and Social Europe: A Divorce Based on Irreconcilable Differences?' (2008) 4 *Social Europe Journal* 22; James A. Caporaso and Sidney Tarrow, 'Polanyi in Brussels: Supranational Institutions and the Transnational Embedding of Markets' (2009) 63 *International Organization* 593; Martin Rhodes, 'Defending the Social Contract: The EU Between Global Constraints and Domestic Imperatives' in David Hine and Hussein Kassim (eds), *Beyond the Market: The EU and National Social Policy* (Routledge 1998), pp. 36-59; Thomas Faist, 'Social Citizenship in the European Union: Nested Membership' (2001) 39 *Journal of Common Market Studies* 37; Maurizio Ferrera, 'European Integration and National Social Citizenship: Changing Boundaries, New Structuring?' (2003) 36 *Comparative Political Studies* 611; Maurizio Ferrera, Anton Hemmerijck and Martin Rhodes, *The Future of Social Europe: Recasting Work and Welfare in the New Economy – Report prepared for the Portuguese Presidency of the EU* (Celta Editoria 2000).

26 Jérémie Houet, *Les Golden Shares en droit de l'Union Européenne* (Larcier 2015).

27 European Commission, *Proposal for a Regulation of the European Parliament and the Council establishing a framework for screening of foreign direct investments into the European Union* ({SWD(2017) 297 final}, 2017).

Proposal was the policy response to the public reaction that was triggered as a result of a series of takeovers of European companies active in sensitive technological sectors by third country investors with strong ties to their home governments. The objective of this Proposal is to establish a framework for the Member States, and in certain cases the European Commission (when a foreign direct investment may affect projects of Union interest, such as Galileo, Horizon 2020, Trans-European Transport Network or Trans-European Networks for Energy), to screen foreign direct investment on the grounds of security or public order. The scope of this proposed Regulation is limited to 'foreign direct investment', which means that it covers only investments from *third countries* seeking to establish or maintain *lasting and direct* links with undertakings carrying out an economic activity in the Member States (i.e. not portfolio investments). Additionally, the proposed Regulation operates on a voluntary basis in the sense that it does not impose an obligation on Member States to adopt or maintain a screening mechanism for foreign direct investment. Rather its objective is to create an enabling framework for Member States that already have or wish to adopt a screening mechanism and to ensure that any such mechanism meets some basic requirements such as the possibility of judicial redress of decisions, non-discrimination between different third countries and transparency.

Although this proposed Regulation raises controversial legal issues (such as the choice of Article 207 TFEU as the legal basis provision, the exclusion of portfolio investments, the definition of security and public order, possible overlapping with Article 21 of the EU Merger Regulation, the impact of the Opinion of the Court on the Singapore Agreement etc.), it nevertheless shows the Commission's acknowledgment that foreign direct investment can be detrimental for security and public order and the commitment of the Union to address Member States concerns regarding the protection of European undertakings from hostile takeovers from third-country investors. In this sense, this proposed Regulation could be regarded as a first step towards what Houet described as '*European economic patriotism*'.[28] Houet argues that the only possible avenue for Member States to protect their national industries is to regard them as European industries and to replace the concept of '*national economic patriotism*' with the concept of '*European economic patriotism*' based on a '*European citizenship conscience*', a common European defense policy and the pursuit of European large-scale cross-border projects.[29] He goes so far as to suggest that the '*European economic patriotism*' will form the normative basis for the creation of a '*golden share of the Union*' through the adoption of a Regulation which would establish a special mechanism under which an independent Committee would supervise third-country investments in Euro-

28 Jérémie Houet, *Les Golden Shares en droit de l'Union Européenne* (Larcier 2015), p. 297.
29 Ibid, p. 342.

pean companies and would prevent acquisitions in strategic sectors which could threaten public policy or public security.[30]

Houet's proposal is certainly novel and interesting, as it attempts to promote a supranational approach aiming at developing, on the one hand, a strong common commercial policy in order to attract foreign capital and, on the other hand, a legal framework that would protect public interest objectives against threats from third-country investors. This approach reflects to a large degree the rationale and the policy considerations of the aforementioned Proposal of the Commission.

However, as appealing as this idea might seem, the concept of '*European economic patriotism*' fails to acknowledge the fierce competition that exists not only between 'European companies' and third-country companies, but also – and perhaps more importantly – among European companies themselves. The market for corporate control in Europe is still largely national and although in specific cases a European investor might be more welcome compared to a third country one (for instance, a Greek company might be more willing to give in to a German takeover than a Chinese one), the fact still remains that economic patriotism remains largely a national concept and Member States are very reluctant to surrender control of their 'national champions' to either European or third-country competitors. National governments will continue to protect their strategic sectors just like foreign investors will continue to strive to acquire control over the most profitable companies. The role of EU law is to ensure that foreign investment is not hindered whilst at the same time the right of the Member States to regulate their corporate governance systems and to protect their legitimate objectives is respected. It's a delicate balance, but the history of internal market adjudication has shown that it is not impossible to be achieved.

In this context, the thesis argues that this delicate balance can be better achieved by means of negative integration. There is no pressing need to adopt secondary legislation on this matter and there is certainly no need to adopt any formal amendment of the Treaties. In fact, it is argued that the two main concerns raised by the privatisations and golden shares case law, i.e. the respect of the division of competences between the EU and the Member States in the fields of corporate governance and property ownership system and the reconciliation of the capital freedom with social objectives can be addressed in a more effective way in the context of negative integration and, in particular, through the rediscovery of the principle of neutrality under Article 345 TFEU and the recalibration of the 'capital restrictions' test under Article 63 TFEU.

30 Ibid, p. 382.

6 Societal relevance

The protection of public interest objectives in the privatisations and golden shares case law relates to the broader discussion about the so-called 'social deficit' in Europe and the fundamental clash between economic freedoms and social values, which constitutes the overarching theme of this thesis. The discussion about the 'social deficit' of the EU has attracted anew significant scholarly attention in the aftermath of the eurocrisis.[31] Indeed, the debate regarding the strengthening of the social dimension of the European integration project has grown even more in scale as a result of the disrupting social and economic effects of the austerity policies that were adopted as a response to the financial crisis in Southern Europe. In particular, in the aftermath of the crisis, the need to protect public interest objectives against unfettered market forces has become pressing and has mobilised support for projects aiming at reinforcing the social component of the EU, such as the recent initiative of the Commission for a European Pillar of Social Rights.[32]

In this context, the overarching theme of the present thesis is the delicate balancing exercise between economic freedoms and social values, especially in times of ideological contestation over the social face of Europe. For this purpose, the thesis draws from the theoretical underpinning of 'social market economy' enshrined in Article 3 (3) TEU and attempts to provide a normative assessment of the clash between economic and social objectives in the field of free movement of capital.

It is true that originally the European Economic Community was founded as an international organisation aiming at establishing strong trade links between its Member States and creating a common market in which the four factors of production (goods, workers, services and capital) could circulate freely. At that time, little (if any) emphasis was given on social policies, which remained

31 Alicia Hinarejos, *The Euro Area Crisis in Constitutional Perspective* (Oxford University Press 2015); Claire Kilpatrick, 'Are the bailout measures immune to EU Social challenge because they are not EU Law?' (2014) 10 *European Constitutional Law Review* 393; Anastasia Poulou, 'Financial assistance conditionality and human rights protection: What is the role of the EU Charter of Fundamental Rights?' (2017) 54 *Common Market Law Review* 991; Bruno De Witte and Claire Kilpatrick, 'A comparative framing of fundamental rights challenges to social crisis measures in the Eurozone' (2014) 1 *European Journal of Social Law* 2; Alicia Hinarejos, 'Changes to Economic and Monetary Union and Their Effects on Social Policy' (2016) 32 *The International Journal of Comparative Labour Law and Industrial Relations* 231.

32 European Commission, *Recommendation on the European Pillar of Social Rights* (C(2017) 2600 final, 2017); European Commission, *Communication of 26 April 2017 establishing a European Pillar of Social Rights* (COM(2017) 250 final, 2017); Sacha Garben, 'The European Pillar of Social Rights: Effectively Addressing Displacement?' (2018) 14 *European Constitutional Law Review* 210

a competence of the Member States.[33] It was thought that social progress could be achieved through economic integration and the few social provisions of the Treaty of Rome 'merely served to "chaperon" the establishment of the common market'.[34] Today, six decades after the entry into force of the Treaty of Rome, the EU has arguably still limited competences in relation to social policies.

However, throughout these years, with every amendment of the Treaty new social objectives and competences were introduced,[35] the most prominent one being the inclusion of the objective of 'social market economy' in Article 3 (3) TEU with the Lisbon revision. The explicit reference to a 'highly competitive social market economy' constitutes a solemn proclamation and confirmation of a political pledge to strengthen the social dimension of the project of European integration.[36] It marks a new stage in the process of European economic integration and encapsulates the fundamental coexistence of a market economy with free competition and social justice. There are more and more judicial references and scholarly contributions regarding its content and its role in the formation of a new type of European economic model with a clear social dimension.[37] It is argued that the social market economy does not lie halfway between State and market, but represents a qualitatively different approach.[38] It is used to describe a market system organised by a comprehensive and well-structured regulatory framework, which clearly defines the boundaries of competition and actively promotes social justice through redistributive

33 Koen Lenaerts and Petra Foubert, 'Social Rights in the Case-Law of the European Court of Justice: The Impact of the Charter of Fundamental Rights of the European Union on Standing Case-Law' (2001) 28 *Legal Issues of Economic Integration* 267, p. 267.

34 Ibid.

35 Ibid.

36 Apart from Article 3 (3) TEU, the Treaty provisions shaping the frame of Social Europe include also amongst others the social clause contained in Article 9 TFEU, the environmental clause contained in Article 11 TFEU, the group of provisions forming the framework for the services of general economic interest (Article 14 TFEU, Article 106 (2) TFEU, Protocol 26 and Article 36 of the Charter), the Social Policy Title of the TFEU (Article 151-161 TFEU) as well as the Charter of Fundamental Rights.

37 Case C-201/15 *Anonymi Geniki Etairia Tsimenton Iraklis (AGET Iraklis) v Ypourgos Ergasias, Koinonikis Asfalisis kai Koinonikis Allilengyis,* ECLI:EU:C:2016:972, para 76; Case T-57/11 *Castelnou Energía v Commission,* ECLI:EU:T:2014:1021, para 211; Case T-565/08 *Corsica Ferries France v Commission,* ECLI:EU:T:2012:415, para 82; Loïc Azoulai, 'The Court of Justice and the social market economy: The emergence of an ideal and the conditions for its realization' (2008) 45 *Common Market Law Review* 1335; Dragana Damjanovic, 'The EU market rules as social market rules: Why the EU can be a social market economy' (2013) 50 *Common Market Law Review* 1685; Delia Ferri and Mel Marquis, 'Inroads to Social Inclusion in Europe's Social Market Economy: The Case of State Aid Supporting Employment of Workers with Disabilities' (2011) 4 *European Journal of Legal Studies* 38; Floris De Witte, 'The architecture of the EU's social market economy' in Panos Koutrakos and Jukka Snell (eds), *Research Handbook on the Law of the EU's Internal Market* (Edward Elgal Publishing 2017).

38 Joel Krieger (ed), *The Oxford Companion to Politics of the World* (Oxford University Press 2001).

policies.[39] It is 'a regulative policy which aims to combine, on the basis of a competitive economy, free initiative and social progress'.[40]

It is not only academic commentators who have analysed the meaning and the significance of the social provisions of the Treaties. These provisions were also recently referred to by the Court in the case *AGET Iraklis*,[41] in which the Court was asked to appraise the compatibility of the Greek legislation imposing a system of administrative authorisation in case of collective redundancies with Directive 98/29[42] and the freedom of establishment under Article 49 TFEU. The case concerned a dispute between AGET Iraklis, a limited liability company active in the manufacturing, distribution and marketing of cement, and the Minister of Employment, Social Security and Social Solidarity of Greece concerning the decision of the latter to reject a scheme of collective redundancies envisaged by the company as part of an organisational restructuring plan. In its judgment, the Court held that the Greek legislation imposed a restriction on the freedom of establishment, in so far as it reduced considerably, or even eliminated, the ability of economic operators to adjust their economic activity and effect collective dismissals.[43] However, it stressed that the objectives of the protection of workers and the encouragement of employment and recruitment constituted overriding reasons in the public interest capable of justifying restrictions on the fundamental freedoms.[44] The Court made further reference to the social provisions of the Treaties (Article 3 (3) TEU, Article 151 TFEU, Article 147 TFEU and Article 9 TFEU) in order to reinforce the view that the European Union has not only an economic but also a social purpose and that the economic freedoms must always be balanced against the objectives pursued by social policy.[45]

Similarly, in *Opinion 2/15 on the Free Trade Agreement between the EU and the Republic of Singapore*,[46] the Court made reference to Articles 9 and 11 TFEU

39 Ibid.

40 Alfred Müller-Armack, 'The Meaning of the Social Market Economy' in Alan T. Peacock and Hans Willgerodt (eds), *Germany's Social Market Economy: Origins and Evolution* (Macmillan 1989), p. 83.

41 Case C-201/15 *AGET Iraklis*.

42 'Council Directive 98/59/EC of 20 July 1998 on the approximation of the laws of the Member States relating to collective redundancies' (1998) *OJ L 225, 12.8.1998, p. 16-21.*

43 Case C-201/15 *AGET Iraklis*, paras 54-57.

44 Ibid, paras 73-74.

45 Ibid, paras 76-78. For the novel elements and the significance of this judgment, see the annotations: Ilektra Antonaki, 'Collective redundancies in Greece: AGET Iraklis' (2017) 54 *Common Market Law Review* 1513; Menelaos Markakis, 'Can Governments Control Mass Layoffs by Employers? Economic Freedoms vs Labour Rights in Case C-201/15 AGET Iraklis' (2017) 13 *European Constitutional Law Review* 724.

46 *Opinion 2/15 on the Free Trade Agreement between the European Union and the Republic of Singapore,* 16 May 2017.

in order to strengthen the novel argument that the objective of sustainable development forms an integral part of the common commercial policy, upon which the EU has exclusive competence under Article 3 (1) (e) TFEU.[47] The Court underlined the importance of the second sentence of Article 207 (1) TFEU, read in conjunction with Article 21 (3) TEU and Article 205 TFEU, that the common commercial policy shall be conducted in the context of the principles and objectives of the Union's external action.[48] Those principles and objectives are specified in Article 21 (1) and (2) TEU and, as stated in Article 21 (2) (f) TEU, relate *inter alia* to sustainable development linked to preservation and improvement of the quality of the environment and the sustainable management of global natural resources.[49] The Court clarified that the exclusive competence of the EU referred to in Article 3 (1) (e) TFEU could not be exercised in order to regulate the levels of social and environmental protection in the Parties' respective territory.[50] However, the envisaged agreement with Singapore was not intended to regulate the levels of social and environmental protection in the Parties' respective territory but to govern trade between the EU and the Republic of Singapore by making the liberalisation of that trade subject to the conditions that the Parties comply with their international obligations concerning social protection of workers and environmental protection.[51]

The increasing jurisprudential references to the objective of a 'social market economy' indicate an effort to strengthen the social dimension of the EU. In this context, this thesis draws from the theoretical underpinnings of 'social market economy' and attempts to explore the changes in the interpretation of Article 63 TFEU that can bridge the gap between the State and the market in order to allow Member States to participate in the market for the purposes of pursuing public interest objectives.

7 Structure of the thesis

The argumentation of the thesis develops in four different stages reflected in four distinct chapters. In a nutshell, the first two chapters establish the theoretical framework upon which the thesis is based and provide a detailed *descriptive* analysis of the International and the European regime on the free movement of capital (Part I). The other two chapters contain a *normative* analysis of the legal issues arising from privatisations and golden shares, the two case-studies

47 Ibid, paras 146-148.
48 Ibid, para 142.
49 Ibid, para 142.
50 Ibid, para 164
51 Ibid, para 166.

of this thesis, and suggest concrete changes in the existing legal framework in order to reconcile capital liberalisation with State participation in the market (Part II).

In more detail, Chapter 1 opens the scene with an introduction to the concept of capital liberalisation, a politically fraught issue, laden with ideological overtones, which has attracted significant scholarly attention from a wide spectrum of disciplines, varying from economists and political scientists to historians and lawyers. Particular emphasis is given on the protracted theoretical controversy surrounding the contribution of capital liberalisation to global economic growth. On the one hand, *neoclassical economic theory* suggests that the free movement of capital can contribute to economic efficiency, higher economic growth, better allocation of investment and rising living standards for many countries. On the other hand, the *Keynesian school* points to the lack of robust scientific evidence proving a correlation between capital liberalisation and economic growth. To the contrary, it claims that free capital flows have been associated with financial instability, increased likelihood of financial crises and rising levels of income inequality. The IMF and the OECD follow a midway path, according to which capital liberalisation improves economic efficiency and promotes global economic growth if it is complemented by measures of prudential supervision and regulation, sound macroeconomic policies and transparency.

After examining the ideological controversies surrounding the costs and benefits of capital liberalisation, Chapter 1 turns to the non-linear historical evolution of capital liberalisation at the international level, focusing particularly on the Gold Standard of the 'first age of globalization' and the Bretton Woods system. Subsequently, it examines the current legal framework regarding capital liberalisation, which is embedded in a regime of multilevel regulation based on the principle of State sovereignty in capital transfer matters. It is emphasised that apart from Article VI of the IMF Agreement, which allows national governments to adopt capital controls thus implicitly recognising that the free movement of capital remains a national competence, other attempts to promote and facilitate capital liberalisation have not yet found concrete reflection in general international law. Notable exceptions are found in Regional Free Trade Agreements and Bilateral Investment Treaties, which promote capital liberalisation through the expansion of foreign direct investment, as well as in the OECD Code of Liberalisation of Capital Movements.

In Chapter 2, the focus shifts to the free movement of capital in the EU. Contrary to the rather fragmented regime at the international level, at the European level there is a sophisticated legal framework on the free movement of capital, which is regarded as a necessary prerequisite not only for the completion of the Internal Market but also for the establishment and the proper functioning

of the Economic and Monetary Union. This legal framework is further developed and strengthened by the creation of the Capital Markets Union and the Banking Union, the two recent initiatives of the European Commission aiming at accelerating financial integration in the EU. However, despite its crucial role in the completion of financial integration in the EU, the free movement of capital has followed a slow historical development when compared to the other freedoms. Chapter 2 examines this historical development, focusing on the early refusal of the Court to recognise the direct effect of the Treaty provision on free movement of capital, the subsequent adoption of Directive 88/361 which brought about full liberalisation of capital movements, the advent of the Maastricht Treaty and the final recognition of the direct effect of the capital freedom in *Sanz de Lera*.

Turning to the current European legal framework, Chapter 2 carries out a doctrinal legal analysis of the main legal issues arising from the interpretation of the free movement of capital, i.e. the scope of the capital freedom, the relationship with the other freedoms, the direct effect of Article 63 TFEU, the restrictions prohibited under Article 63 TFEU, the Treaty-based and case law-made derogations and finally, the proportionality assessment conducted by the Court. In this context, particular emphasis is given on the *erga omnes effect* of Article 63 TFEU, i.e. the fact that it applies to not only to Member States but also to third countries. The expanded territorial scope is perhaps the most salient feature which distinguishes the free movement of capital from the other freedoms and elevates it to a whole different level, rendering it a potential gateway through which extra-EU investors can approach and ultimately access the EU's Internal Market. At the same time, Chapter 2 analyses extensively the strikingly broad interpretation of the scope of 'capital restrictions', which covers a wide variety of measures, such as golden shares, authorisation requirements, residence requirements for investments in real estate, foreign currency arrangements in mortgages or other financial credits, nationality requirements in relation to dividend or corporate taxation etc. However, it is emphasised that the strikingly broad interpretation of the scope of capital restrictions is somehow counterbalanced by the wide range of derogations that can be invoked by Member States in order to justify these restrictions. Finally, Chapter 2 explores the proportionality assessment, which in the capital case law is complemented by a requirement of compliance with the principle of legal certainty.

Chapter 3 turns to the case study of privatisations and attempts to explore the role that EU law has played on the advancement of privatisation as a national economic policy. In order to address this question, the Chapter first embarks upon a theoretical analysis of the economic, political and social debate about the costs and benefits of privatisation. Secondly, it seeks to investigate role that EU law plays in the decision of a national government to privatise

or nationalise an undertaking. This is a politically sensitive issue, which has become again topical because of the extensive privatisation schemes recently undertaken by the Member States affected by the eurocrisis in an effort to reduce the level of their public debt. In order to do so, firstly, it attempts to explore the ideological foundations of the European Economic Constitution, focusing particularly on German Ordoliberalism and the counter-movement of the French theory of *service public*. Secondly, it examines on the legal framework and in particular the different interpretations of the principle of neutrality enshrined in Article 345 TFEU and the significant role that this provision can play in safeguarding the discretion of the Member States to determine their property ownership systems.

The theoretical analysis of the free movement of capital in the EU culminates in Chapter 4, which addresses the controversial legal issues arising from the second case-study, i.e. the golden shares case law. The use of golden shares in strategically sensitive privatised undertakings (in the energy sector, telecommunications, postal services, airports, car industries etc.) is a widespread phenomenon in Europe, which has given rise to a long-running litigation between the Commission and the Member States before the Court of Justice. The establishment of special shareholding in national privatised champions is perceived as an expression of economic protectionism and as a threat or a hindrance to the emergence of a fully competitive market for corporate control. The Court has adopted a rigorous application of the free movement of capital, ruling in all but one case that golden shares constitute capital restrictions due to their *deterrent* effect on foreign investment.

Chapter 4 attempts to assess the far-reaching implications of the golden shares case law for the corporate governance systems of the Member States and the overall organisation and development of their industrial policies. In order to do so, it introduces the theoretical controversy surrounding the function of special rights as Control Enhancing Mechanisms derogating from the principle of proportionality between ownership and control and then focuses on the thorny legal issues arising from the golden shares case law of the Court of Justice. In particular, firstly, it investigates the possibility of granting horizontal direct effect to Article 63 TFEU; secondly, it provides an overview of the public interest objectives invoked (unsuccessfully) by the Member States in order to justify their golden shares as well as the 'procedural proportionality' assessment applied by the Court; and thirdly, it examines critically the strikingly broad interpretation of 'capital restrictions' and suggests a refined *Keck*-inspired test in order to delineate in a more consistent manner the scope of 'capital restrictions.

Finally, the Conclusion brings together the all the pieces of the thesis and summarises its main findings. It concludes that the judicial endorsement of

a very broad interpretation of 'capital restrictions' limits significantly the competence of the Member States to determine their corporate governace and property ownership systems and to protect public interest objectives. Therefore, it reiterates the two main modifications suggested by this thesis, i.e. the rediscovery of the principle of neutrality under Article 345 TFEU as a legal provision which shields national decisions to maintain public ownership in undertakings from Internal Market scrutiny; and the recalibration of the 'capital restrictions' test in the golden shares case law by reference to a Keck-inspired notion of 'investment arrangements'.

PART I

Regulatory framework governing capital liberalisation

1 Free Movement of capital at the international level

1 Introduction

This chapter introduces the theoretical discussion about capital liberalisation at the international level with the purpose of shedding light on some controversial aspects of the economic and political debate about the risks and benefits of free capital flows. It also provides an overview of the historical development and institutional embedment of financial integration in the modern international monetary order, focusing in particular on the birth of the Bretton Woods system in the aftermath of the Second World War, its demise in the late 1970s and the emergence of the neoclassical economic theory as the predominant ideology until today. This theoretical and historical context will enable us to grasp better the process of capital liberalisation in the European Union and its far-reaching implications for the property ownership and corporate governance systems of the Member States.

It should be clarified at the outset that this introductory chapter does not purport to contain a detailed analysis of the various *economic* aspects of the debate about capital account liberalisation. Neither does it claim to provide an extensive analysis of all the axioms underpinning the two opposing schools of thought, namely Keynesianism and neoclassical economics, or an evaluation of how each specific historical development in the post-war international financial system was influenced by adherence to either Keynesian or neoclassical tenets. This task has been successfully carried out by others, primarily economists and economic historians, who are evidently in a better position to delve into these questions compared to an EU lawyer. Besides, it would fall outside the scope of this thesis and it would substantially deviate from its ultimate objective, which is to explore whether the current EU legal framework allows capital liberalisation to be reconciled with State participation in the Market.

However, any effort to provide a thorough legal analysis of the free movement of capital as one of the fundamental freedoms of the EU's Internal Market presupposes a sufficient understanding of the economic debate about capital integration and how this has historically affected the view endorsed by international financial institutions. Therefore, this chapter has a two-fold objective: firstly, to present and explain the heated economic debate over the risks and

benefits of capital liberalisation and the on-going theoretical discussions as to whether liberalising the capital markets leads to higher economic growth (Chapter 1, Section 2); and secondly, to provide a brief historical overview of the evolution of capital liberalisation at the international level, from the 'Keynesian' Bretton Woods system and its collapse after the 'Nixon shock' to the rise of 'neoclassical economic theory' and the recent questioning of its intellectual foundations and its societal consequences by the IMF itself (Chapter 1, Section 3). On a more normative level, this theoretical exercise will hopefully help us understand how and why international financial institutions, such as the IMF and the OECD, have recently gone through a phase of self-criticism in relation to the uncritical acceptance of a completely unrestrained capital liberalisation, as the economic doctrine that had prevailed over the last three decades. This will inevitably make us wonder why the EU has not gone through the same process of self-criticism and is still in denial regarding the far-reaching implications of unfettered financial integration.

2 THE THEORETICAL CONTROVERSY SURROUNDING CAPITAL LIBERALISATION

2.1 Defining capital liberalisation

The term *capital liberalisation* is used to describe the removal of measures designed to limit capital flows, in other words the abolition of all restrictions on capital inflows and outflows.[1] Capital flows include several categories of financial transactions, such as foreign direct investment, portfolio investment (i.e. bond and equity flows), financial derivatives (i.e. financial contracts used to trade risks in financial markets), bank related flows and trade credit.[2] The concept of capital liberalisation covers both the underlying capital transaction and the related payment and 'it implies unrestricted convertibility of local currency in international financial transactions'.[3] It is also referred to as *capital flow liberalisation*, *capital account liberalisation*, *capital market liberalisation* or even *financial liberalisation*, *financial globalization*, *financial integration* or *financial openness*.[4] Strictly speaking, capital liberalisation is regarded as a prerequisite

1 IMF, *The Liberalization and Management of Capital Flows – An Institutional View* (Staff Paper of the IMF Executive Board, 2012), p. 10.

2 Ibid; Peter Chowla, *Time for a New Consensus: Regulating Financial Flows for Stability and Development* (London: Bretton Woods Project, 2011), p. 4.

3 IMF, *The Liberalization and Management of Capital Flows – An Institutional View* (2012), p. 10.

4 The IMF is using primarily the terms 'capital account liberalisation' and 'financial liberalisation'. See IMF, 'Capital Account Liberalization: Theoretical and Practical Aspects' (1998) . Financial globalisation and financial integration are two similar, though not identical, concepts. Financial globalisation is an aggregate concept that refers to increasing global linkages created through cross-border financial flows, whereas financial integration refers to an individual country's linkages to international capital markets. However, the two concepts are inextricably linked, since increasing financial globalisation leads inevitably

for the achievement of financial globalization,[5] as the latter 'requires that governments liberalise the domestic financial sector and the capital account'.[6] For the purposes of this thesis, the aforementioned terms are used interchangeably.

Capital movements are not a recent phenomenon.[7] They have existed for a long time and they have traditionally followed the movement of the other factors of production, i.e. goods, services and labour.[8] Zooming in on the most recent history, the process of liberalising capital flows that has occurred since the late 1970s – early 1980s,[9] culminated in mid-2007 when international capital flows reached historical highs. It is estimated that before the outbreak of the financial crisis, the size of annual gross cross-border flows increased considerably from about 5% of world GDP in the mid-1990s to approximately 20% in 2007.[10] The wave of financial globalization prior to the crisis was driven by financial innovation and development, the explosion of the banking sector, the abolition of capital controls, the globalization of trade with the ensuing creation of trade credits and export insurance, the increased attractiveness of emerging market economies, cyclical factors such as the prolonged period of low interest rates in advanced economies and the introduction of the euro in the Eurozone Member States.[11] Financial liberalisation was further accelerated by the revolutionary progress in information and communication technologies, which radically transformed the financial industry worldwide.[12] However, with the advent of the financial crisis, international capital mobility significantly decreased, albeit only for two years. Empirical evidence shows that since 2009 international capital flows have partially rebounded, though in a quite

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to increasing financial integration and thus the two terms can be used interchangeably. See Eswar Prasad and others, *Effects of Financial Globalization on Developing Countries: Some Empirical Evidence* (IMF, Occasional Paper 220, 2003).

5 Eswar Prasad, Kenneth Rogoff, Shang-Jin Wei and M. Ayhan Kose, *Effects of Financial Globalization on Developing Countries: Some Empirical Evidence* (2003), p. 6.

6 Sergio Schmukler, 'The Benefits and Risks of Financial Globalization' in José Antonio Ocampo and Joseph Stiglitz (eds), *Capital Market Liberalization and Development* (Oxford University Press 2008), p. 49.

7 Peter Chowla, *Time for a New Consensus: Regulating Financial Flows for Stability and Development* (2011). For a historical overview of general monetary law from the Middle Ages until the early 1970s, see David Fox and Wolfgang Ernst (eds), *Money in the Western Legal Tradition: Middle Ages to Bretton Woods* (Oxford University Press 2016).

8 Sergio Schmukler, 'The Benefits and Risks of Financial Globalization' in Ocampo and Stiglitz (eds), *Capital Market Liberalization and Development* (Oxford University Press 2008), p. 50.

9 Eswar Prasad, Kenneth Rogoff, Shang-Jin Wei and M. Ayhan Kose, *Effects of Financial Globalization on Developing Countries: Some Empirical Evidence* (2003), p. 1.

10 OECD, *Getting the most out of International Capital Flows* (OECD Economic Outlook, 2011), p. 290-291.

11 Ibid, p. 291-292.

12 Barry Eichengreen and others, *Liberalizing Capital Movements: Some Analytical Issues* (IMF Economic Issues No 17, 1999).

diversified manner, affecting heterogeneously various countries around the globe.[13]

In Europe, which was severely, though unevenly, hit by the recent global financial crisis, and whose periphery is still – despite the seemingly positive figures – suffering from an agonizing economic stagnation, the need for investment to promote growth is more imperative than ever.[14] The ambitious project recently launched by the European Commission to create a Capital Markets Union reveals the commitment of the European institutions to further integrate capital markets and to complete the process of financial integration that started in the 1980s.[15] Capital mobility is hoped to boost Europe's severely damaged economy, bring economic growth and combat the massive unemployment rates which are ravaging the Southern countries and are eroding the economic, political and social foundations of the European edifice.

However, the question whether international capital mobility is beneficial for the economy does not have a straightforward answer. Although neoclassical economic theory suggests that the free flow of capital across borders can increase economic efficiency, there is a protracted controversy among economists not only as to the actual benefits of capital liberalisation for economic growth but also as to its possible contributory effect to the worryingly rising levels of income inequality. The next section introduces the theoretical controversy surrounding capital liberalisation and attempts to explore the arguments in favour and against free capital flows. This theoretical analysis will allow us to contextualize the European debate about free movement of capital and to approach the research question of this thesis – i.e. whether capital liberalisation can be reconciled with State participation in the market in the EU – from a holistic angle that takes into account not only the particularities of the European integration project but also the conclusions that have been drawn from years of pre-existent capital liberalisation at the international level.

2.2 Neoclassical economic theory v Keynesianism

Capital account liberalisation is a highly controversial subject, which deeply divides the academic community and raises an animated controversy as to its actual contribution to global economic growth. The consensus in favour of capital liberalisation has always been less clear-cut than that in favour of

13 OECD, *Getting the most out of International Capital Flows* (2011), p. 290.
14 European Commission, *Green Paper: Building a Capital Markets Union* (COM(2015) 63 final, 2015).
15 European Commission, *Communication: Action Plan on Building a Capital Markets Union* (COM(2015) 468 final, 2015).

globalized trade. Indeed, although the majority of existing literature has found that trade globalization has a positive effect on economic growth,[16] the same cannot be said unconditionally about financial liberalisation.[17] The reasons for this scepticism towards international capital mobility relate primarily to the lack of scientific evidence proving a correlation between capital liberalisation and economic growth. Thus, over the years, two economic schools of thought have emerged representing two opposing views regarding capital account liberalisation: on the one hand, the *neoclassical economic theory* suggesting that capital liberalisation contributes to higher economic growth and, on the other hand, the *Keynesian school of thought* contesting the correlation between capital liberalisation and economic growth.

2.2.1 Arguments in favour of capital liberalisation

Neoclassical economic theory argues that in order to achieve higher levels of growth and economic efficiency, countries and international institutions should promote financial globalisation through the abolition of all measures designed to restrict capital movements.[18] Advocates of this theory, such as Peter Blair

16 Jefrey Sachs and Andrew Warner, 'Economic reform and the process of global integration' (1995) 1 *Brooking Papers on Economic Activity* pp. 1; Athanasios Vamvakidis, 'Regional Trade Agreements or Broad Liberalization: Which Path Leads to Faster Growth?' (1999) 46 *International Monetary Fund Staff Papers* 42; Romain Wacziarg, 'Measuring the dynamic gains from trade' (2011) 15 *The World Bank Economic Review* 393; Joseph Stiglitz, José Antonio Ocampo, Shari Spiegel, Ricardo Ffrench-Davis and Deepak Nayyar, *Stability with Growth: Macroeconomics, Liberalization and Development* (Oxford University Press 2006), p. 167-168. It should be noted that despite the growing consensus regarding the economic benefits of trade liberalisation, there is still part of the literature which questions its social consequences, see in particular Joseph Stiglitz, *Globalization and its Discontents* (W.W. Norton & Company 2002); Joseph Stiglitz, *The Roaring Nineties: A New History of the World's Most Prosperous Decade* (W.W. Norton & Company 2003); Jospeh Stiglitz, 'Whither Reform? Towards a New Agenda for Latin America' (2003) 80 *Revista de la CEPAL* 7; Francisco Rodri´guez and Dani Rodrik, 'Trade Policy and Economic Growth: A Skeptic's Guide to the Cross-National Evidence' in Ben Bernanke and Kenneth Rogoff (eds), *NBER Macroeconomics Annual 2000* (MIT Press 2001); José Antonio Ocampo, 'Latin America's Growth and Equity Frustrations During Structural Reforms' 18 *Journal of Economic Perspectives* 67.

17 Eswar Prasad, Kenneth Rogoff, Shang-Jin Wei and M. Ayhan Kose, *Effects of Financial Globalization on Developing Countries: Some Empirical Evidence* (2003), p. 3.

18 IMF, *The Liberalization and Management of Capital Flows – An Institutional View* (2012); Jonathan D. Ostry, Atish R. Ghosh and Anton Korinek, *Multilateral Aspects of Managing the Capital Account* (IMF Staff Discussion Note, 2012); OECD, 'International Capital Mobility: Structural Policies to Reduce Financial Fragility?' (2012) No. 13 *OECD Economics Department Policy Notes;* Joshua Aizenman and Vladyslav Sushko, *Capital Flows: Catalyst or Hindrance to Economic Takeoffs?* (National Bureau of Economic Research Working Paper No 17258, 2011); Janet L. Yellen, *Improving the International Monetary and Financial System* (Speech at the Banque de France International Symposium, Paris, 4 March 2011); Hongyi Chen, Lars Jonung and Olaf Unteroberdoerster, *Lessons for China from financial liberalization in Scandinavia* (European Commission, Economic and Financial Affairs, Economic Papers 383, 2009); M. Ayhan Kose and others, 'Financial Globalization: A Reappraisal' (2009) 56 *IMF Staff Papers;*

Henry,[19] Maurice Obstfeld[20] and Kenneth Rogoff,[21] espouse the view that international capital mobility provides significant economic benefits by contributing to economic efficiency, faster growth, better allocation of investment and rising living standards for many countries.[22] Drawing from the theory of trade liberalisation, proponents of capital liberalisation argue that governments should eliminate not only trade barriers but also all capital restrictions, as this will lead to higher growth and economic efficiency.[23] This theory is based on the ideological premise that free markets are inherently better than restricted markets (inspired by Adam Smith's 'invisible hand'). The liberalisation of capital markets is believed to allow countries with limited savings to attract foreign financing for productive domestic investment projects, to

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Frederic S. Mishkin, ''Why We Shouldn't Turn Our Backs on Financial Globalization' (2009) 56 *IMF Staff Papers* 139; Maurice Obstfeld, 'International Finance and Growth in Developing Countries: What Have We Learned?' (2009) 56 *IMF Staff Papers* 63; Joshua Aizenman and Reuven Glick, *Sterilization, monetary policy, and global financial integration* (National Bureau of Economic Research, Working Paper No 13902, 2008); Giovanni Dell'Ariccia and others, *Reaping the Benefits of Financial Globalization* (IMF Occasional Paper No 264, 2008); John Greenwood, 'The costs and implications of PBC sterilization' (2008) 28 *The Cato Journal* 205; M. Ayhan Kose, Eswar S. Prasad and Marco E. Terrones, *Does Openness to International Financial Flows Contribute to Productivity Growth?* (National Bureau of Economic Research, Working Paper No 14558, 2008); Eswar S. Prasad and Raghuram Rajan, *A Pragmatic Approach to Capital Account Liberalization* (National Bureau of Economic Research Working Paper No 14051, 2008); Kristin J. Forbes, 'The Microeconomic Evidence on Capital Controls: No Free Lunch' in Sebastian Edwards (ed), *Capital Controls and Capital Flows in Emerging Economies: Policies, Practices, and Consequences* (University of Chicago Press 2007); Kristin J. Forbes, 'One Cost of the Chilean Capital Controls: Increased Financial Constraints for Smaller Traded Firms' (2007) 71 *Journal of International Economics* 294; Sebastian Edwards, *Capital Controls, Sudden Stops and Current Account Reversals* (National Bureau of Economic Research, Working Paper No 11170, 2005); M. Ayhan Kose, Eswar S. Prasad and Marco E. Terrones, *How Do Trade and Financial Integration Affect the Relationship between Growth and Volatility?* (IMF Working Paper WP/05/19, 2005); Ross Levine, 'Finance and Growth: Theory and Evidence' in Philippe Aghion and Steven N. Durlauf (eds), *Handbook of Economic Growth* (Elsevier 2005); M. Ayhan Kose and Eswar Prasad, 'Liberalizing Capital Account Restrictions' (2004) 41 *IMF Finance and Development* 50; Stanley Fischer, 'Globalization and Its Challenges' (2003) 93 *American Economic Review* 1; Shogo Ishii and Karl Habermeier, *Capital Account Liberalization and Financial Sector Stability* (IMF Occasional Paper No 211, 2002).

19 Peter Blair Henry, 'Capital Account Liberalization: Theory, Evidence, and Speculation' (2007) XLV *Journal of Economic Literature* 887.

20 Maurice Obstfeld, 'The Global Capital Market: Benefactor or Menace?' (1998) 12 *Journal of Economic Perspectives* 9.

21 Kenneth Rogoff, 'International Institutions for Reducing Global Financial Instability' (1999) 13 *Journal of Economic Perspectives* 21;

22 Barry Eichengreen, Michael Mussa, Giovanni Dell'Ariccia, Enrica Detragiache, Gian Maria Milesi-Ferretti and Andrew Tweedie, *Liberalizing Capital Movements: Some Analytical Issues* (1999); Barry Eichengreen, *Toward a New International Financial Architecture: A Practical Post-Asia Agenda* (Peterson Institute for International Economics 1999); Christopher J. Neely, 'An Introduction to Capital Controls' (1999) 81 *Federal Reserve Bank of St Louis Review* 13, at p. 14.

23 IMF, *The Liberalization and Management of Capital Flows – An Institutional View* (2012), p. 10.

enable investors to diversify their portfolios and to spread investment risk more broadly.[24] The process of financial integration enables capital flows to be channelled from developed countries, where the abundance of capital usually implies lower profits for investors, to developing countries, where the scarcity of capital entails higher profits for investors.[25] In other words, the proponents of capital liberalisation believe that capital flows naturally towards where it is most needed, 'just like water naturally flows downhill'.[26]

The corollary of this theoretical assumption is that when a country faces an economic downturn, the devaluation of the labour cost and the price levels will attract foreign funds, which will subsequently stimulate the economy and put it back on growth track.[27] In fact, neoclassical theoretical models have identified a number of direct and indirect channels through which financial integration can promote growth in developing countries.[28] These channels include, *inter alia*, increased domestic savings, lower cost of capital through better global allocation of risk, transfer of technological and managerial know-how and promotion of specialization.[29]

Finally, it has been argued that capital market liberalisation can impose macroeconomic discipline, as countries failing to implement substantive reforms in their economy will not be able to attract foreign funds.[30]

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24 Barry Eichengreen, Michael Mussa, Giovanni Dell'Ariccia, Enrica Detragiache, Gian Maria Milesi-Ferretti and Andrew Tweedie, *Liberalizing Capital Movements: Some Analytical Issues* (1999); Maurice Obstfeld, 'The Global Capital Market: Benefactor or Menace?' (1998) 12 Journal of Economic Perspectives 9, who argues that financial openness allows developing countries to borrow money in order to finance investment, improve infrastructure and promote their economic growth, while at the same time he acknowledges that it poses some 'genuine hazards' and that the 'duality of benefits and risks is inescapable in the real world of asymmetric information and imperfect contract enforcement'. Nevertheless, he does not depart from conventional economic wisdom and he believes that 'the best was to maximise net benefits is to encourage economic integration'.

25 IMF, *The Liberalization and Management of Capital Flows – An Institutional View* (2012), pp. 10-11; Sergio Schmukler, 'The Benefits and Risks of Financial Globalization' in Ocampo and Stiglitz (eds), *Capital Market Liberalization and Development* (Oxford University Press 2008), at p. 57.

26 Joseph Stiglitz, José Antonio Ocampo, Shari Spiegel, Ricardo Ffrench-Davis and Deepak Nayyar, *Stability with Growth: Macroeconomics, Liberalization and Development* (Oxford University Press 2006), p. 169.

27 Ibid, p. 169.

28 Eswar Prasad, Kenneth Rogoff, Shang-Jin Wei and M. Ayhan Kose, *Effects of Financial Globalization on Developing Countries: Some Empirical Evidence* (2003), p. 13.

29 Ibid.

30 IMF, *The Liberalization and Management of Capital Flows – An Institutional View* (2012), p. 10.

2.2.2 *Arguments critical of capital liberalisation*

On the other hand, the second school of thought, which includes economists such as Joseph Stiglitz, José Antonio Ocampo and Dani Rodrik, contests the correlation between capital liberalisation and economic growth and even goes thus far as to suggest that in some circumstances free capital flows can be detrimental for national economies.[31] In particular, for the critics of neo-classical economics, the argument that the case for capital liberalisation is the same as the case for trade liberalisation is a fallacy.[32] Capital is fundamentally

31 Olivier Jeanne, Arvind Subramanian and John Williamson, *Who Needs to Open the Capital Account?* (Peterson Institute for International Economics 2012); Peter Chowla, *Time for a New Consensus: Regulating Financial Flows for Stability and Development* (2011); José Antonio Ocampo and Joseph E. Stiglitz, *Capital Market Liberalization and Development* (Oxford University Press 2008); Joseph Stiglitz, José Antonio Ocampo, Shari Spiegel, Ricardo Ffrench-Davis and Deepak Nayyar, *Stability with Growth: Macroeconomics, Liberalization and Development* (Oxford University Press 2006); Joseph Stiglitz, 'Capital-market Liberalization, Globalization, and the IMF' (2004) 20 *Oxford Review of Economic Policy* 57; Eswar Prasad, Kenneth Rogoff, Shang-Jin Wei and M. Ayhan Kose, *Effects of Financial Globalization on Developing Countries: Some Empirical Evidence* (2003); Ajit Singh, *Capital Account Liberalization, Free Long-term Capital Flows, Financial Crises and Economie Development* (University of Cambridge, ESRC Centre for Business Research–Working Papers, No 245, 2002); Jospeh Stiglitz, 'Financial Market Stability and Monetary Policy' (2002) 7 *Pacific Economic Review* 13; Jospeh Stiglitz, 'Capital Market Liberalization, Economic Growth and Instability' (2000) 28 World Development 1075; Dani Rodrik, 'Who Needs Capital-Account Convertibility?' in Stanley Fischer, Richard N. Cooper, Rudiger Dornbusch, Peter M. Garber, Carlos Massad, Jacques J. Polak, Dani Rodrik and Savak S. Tarapore (eds), *Should the IMF Pursue Capital-Account Convertibility? (Essays in International Finance No 207, May 1998)* (International Finance Section, Department of Economics, Princeton University 1998); Alberto Alesina, Vittorio Grilli and Gian Maria Milesi-Ferretti, 'The Political Economy of Capital Controls' in Leonardo Leiderman and Assaf Razin (eds), *Capital Mobility: The Impact on Consumption, Investment, and Growth* (Cambridge University Press 1994); Vittorio Grilli and Gian Maria Milesi-Ferretti, 'Economic Effects and Structural Determinants of Capital Controls' (1995) 42 *IMF Staff Papers* 517; Aart Kraay, *In Search of the Macroeconomic Effect of Capital Account Liberalization* (World Bank 1998); Areendam Chanda, 'The Influence of Capital Controls on Long Run Growth: Where and How Much?' (2005) 77 *Journal of Development Economics* 441; Carlos Arteta, Barry Eichengreen and Charles Wyplosz, *On the Growth Effects of Capital Account Liberalization* (University of California 2001); Sebastian Edwards, *Capital Mobility and Economic Performance: Are Emerging Economies Different?* (National Bureau of Economic Research, Working Paper No 8076, 2001); Helmut Reisen and Marcelo Soto, 'Which Types of Capital Inflows Foster Developing-Country Growth?' (2001) 4 *International Finance* 1; Hali Edison and others, *Capital Account Liberalization and Economic Performance: A Review of the Literature* (IMF Working Paper 02/120, 2002); Hali Edison and others, 'International Financial Integration and Economic Growth' (2002) 21 *Journal of International Money and Finance* 749; Carlos F. Di´az-Alejandro, 'Goodbye Financial Repression, Hello Financial Crash' (1985) 19 *Journal of Development Economics* 1.

32 Jospeh Stiglitz, 'Capital Market Liberalization, Economic Growth and Instability' (2000) 28 World Development 1075, p. 1079.

different from goods or services,[33] as contrary to the latter the primary function of capital is 'information-gathering' in the form of 'assessing which projects and firms are most likely to yield the highest returns'.[34] Despite the fact that there is evidence proving a correlation between *trade integration* and economic growth, there is no such evidence in relation to *financial integration*.[35] In the same vein, there is an interesting empirical literature examining the impact of trade and financial integration on a society's health status, which proves that despite the fact that trade integration is associated with faster increase in life expectancy and faster reduction in infant mortality in developing countries, such a relationship is not confirmed in relation to financial integration.[36]

Furthermore, adherents of this theory question the presumption upon which the neoclassical model is based, i.e. that capital markets are perfect, with perfect information, perfect competition, perfect employment and perfect rationality, and argue instead that, under the existing *imperfect* capitalism with *asymmetric* information, financial liberalisation may lead to economic instability.[37] Contrary to the claims made by neoclassical economists, empirical data accumulated over the past decades has not provided any consistent and persuasive evidence that capital liberalisation brings higher levels of growth.[38] It should be noted, however, that this finding holds true especially insofar as *short-term* capital flows are concerned, which are regarded by some economists as particularly destabilising.[39] By contrast, even opponents of capital liberalisation do acknowledge, though with certain caveats, that capital flows

33 Carlos F. Di´az-Alejandro, 'Goodbye Financial Repression, Hello Financial Crash' (1985) 19 Journal of Development Economics 1; Joseph Stiglitz, José Antonio Ocampo, Shari Spiegel, Ricardo Ffrench-Davis and Deepak Nayyar, *Stability with Growth: Macroeconomics, Liberalization and Development* (Oxford University Press 2006), p. 170.

34 Jospeh Stiglitz, 'Capital Market Liberalization, Economic Growth and Instability' (2000) 28 World Development 1075, p. 1079.

35 Ibid p. 1078.

36 Eswar Prasad, Kenneth Rogoff, Shang-Jin Wei and M. Ayhan Kose, *Effects of Financial Globalization on Developing Countries: Some Empirical Evidence* (2003), p. 19, citing S.J. Wei and Y. Wu, *The Life-and-Death Implications of Globalization* (National Bureau of Economic Research, Inter-American Seminar in Economics, 2002).

37 Joseph Stiglitz, 'Capital-market Liberalization, Globalization, and the IMF' (2004) 20 Oxford Review of Economic Policy 57, pp. 57-71.

38 Peter Chowla, *Time for a New Consensus: Regulating Financial Flows for Stability and Development* (2011); M. Ayhan Kose and others, *Financial Globalization: A Reappraisal* (IMF Staff Papers, Vol 56, No 1 2009); Alexander Cobham, *Capital Account Liberalisation and Poverty in Go with the flow? Capital account liberalisation and poverty* (Bretton Woods Project and Oxfam, 2001); Dani Rodrik, 'Who Needs Capital-Account Convertibility?' in Fischer and others (eds), *Should the IMF Pursue Capital-Account Convertibility? (Essays in International Finance No 207, May 1998)* (International Finance Section, Department of Economics, Princeton University 1998).

39 Joseph Stiglitz, 'Capital-market Liberalization, Globalization, and the IMF' (2004) 20 Oxford Review of Economic Policy 57, p. 60.

in the form of *foreign direct investment* appear to have a positive impact on economic growth.[40]

By the same token, critics of financial integration argue that due to the high macroeconomic volatility of capital flows, capital account liberalisation is associated with economic instability, increased likelihood of financial crises and a substantial hindrance of national governments' ability to respond to negative macroeconomic shocks.[41] Joseph Stiglitz goes thus far as to suggest that not only is there no case for capital liberalisation, but there is actually a compelling case against unfettered capital liberalisation, especially in developing countries.[42] He claims that the argument of neoclassical economists that capital liberalisation leads perforce to economic growth as it allows countries to attract more capital inflows is 'like assuming that an open birdcage will inevitably attract a bird'.[43] In addition, he refutes the claim made by advocates of the neoclassical theory that capital flows *into* a country when the economy is weak and *out* of the country when the economy is strong.[44] Quite the contrary, he says, capital flows are *pro-cyclical*, not counter-cyclical,[45] and as such

40 Ibid, pp. 60, 64. Stiglitz argues that although there is a broader sentiment in favour of FDI (as opposed to short-term capital flows), the actual benefits they bring to national economy depend on the type of FDI. For instance, privatisations do not always lead to economic efficiency and can significantly reduce a country's wealth. See William L. Megginson and Jeffry M. Netter, 'From State to Market: A Survey of Empirical Studies on Privatisation' (2001) 39 *Journal of Economic Literature* pp. 321; Simeon Djankov and Peter Murrell, 'Enterprise Restructuring: A Qualitative Survey' (2002) 40 *Journal of Economic Literature* 739. Furthermore, there is evidence that FDI in the field of natural resources development are often not associated with faster economic growth. See Jeffrey D. Sachs and Andrew M. Warner, 'The Curse of Natural Resources' (2001) 45 *European Economic Review* 827.

41 Joseph Stiglitz, 'Capital-market Liberalization, Globalization, and the IMF' (2004) 20 Oxford Review of Economic Policy 57, p. 59; Jospeh Stiglitz, 'Capital Market Liberalization, Economic Growth and Instability' (2000) 28 World Development 1075, p. 1079; William Easterly, Roumeen Islam and Joseph Stiglitz, 'Volatility and Macroeconomic Paradigms for Rich and Poor' in Jacques Drèze (ed), *Advances in Macroeconomic Theory* (Palgrave Macmillan UK 2001), pp. 352-372.

42 Jospeh Stiglitz, 'Capital Market Liberalization, Economic Growth and Instability' (2000) 28 World Development 1075, p. 1076.

43 Joseph Stiglitz, José Antonio Ocampo, Shari Spiegel, Ricardo Ffrench-Davis and Deepak Nayyar, *Stability with Growth: Macroeconomics, Liberalization and Development* (Oxford University Press 2006), p. 170.

44 Joseph Stiglitz, 'Capital-market Liberalization, Globalization, and the IMF' (2004) 20 Oxford Review of Economic Policy 57, p. 61.

45 Ibid, p. 61, citing an important study that was conducted by the World Bank, *Global Economic Prospects and the Developing Countries* (The World Bank 1998/1999), Chapter 3, pp. 121-157, at p. 146. When an economic quantity is procyclical it means that it is positively correlated to the state of the economy, i.e. it tends to increase in times of economic growth (boom) and tends to decrease in times of economic recession (bust). To the contrary, an economic quantity is countercyclical it means that it is negatively correlated to the state of the economy, i.e. it tends to increase in times of economic recession.

'they exacerbate both economic booms and recessions'.[46] Thus, capital liberalisation 'exposes a country to the irrationality of market sentiment based on the changing whims of short-term investors'.[47]

Furthermore, there is increasing evidence that capital liberalisation has a negative effect on poverty and income inequality, as (a) it weakens the bargaining position of labour; (b) it affects disproportionately the poor, who are particularly vulnerable to economic volatility and financial crises; and (c) it limits drastically the regulatory autonomy of national governments to implement redistributive and social policies, since any plan of tax increase is likely to lead to a capital flight, which depending on its scale, might lead to a considerable wealth loss and possibly to a severe financial instability.[48]

Finally, from a political economy perspective, the argument that financial integration acts as a disciplinarian, which rewards or punishes countries depending on the economic reforms they implement, is fiercely criticised by opponents of the neoclassical orthodoxy, who argue that market discipline is usually guided by myopic short-term investors and, most importantly, lacks democratic legitimacy and undermines the very foundations of a democratic society.[49]

2.2.3 Capital controls

Economists who support the view that financial markets are inherently unstable and can cause severe financial crises believe that the use of 'capital account regulations' should be regarded as an essential part of the macroeconomic policy toolkit and not as mere measures of last resort.[50] The term 'capital account regulations' is in effect a synonym of the much-stigmatised term

46 Joseph Stiglitz, José Antonio Ocampo, Shari Spiegel, Ricardo Ffrench-Davis and Deepak Nayyar, *Stability with Growth: Macroeconomics, Liberalization and Development* (Oxford University Press 2006), p. 170.

47 Ibid, p. 171.

48 Andrew Charlton, 'Capital Market Liberalization and Poverty' in Ocampo and Stiglitz (eds), *Capital Market Liberalization and Development* (Oxford University Press 2008), pp. 121-138; Joseph Stiglitz, José Antonio Ocampo, Shari Spiegel, Ricardo Ffrench-Davis and Deepak Nayyar, *Stability with Growth: Macroeconomics, Liberalization and Development* (Oxford University Press 2006), p. 185.

49 Joseph Stiglitz, José Antonio Ocampo, Shari Spiegel, Ricardo Ffrench-Davis and Deepak Nayyar, *Stability with Growth: Macroeconomics, Liberalization and Development* (Oxford University Press 2006), p. 188; Joseph Stiglitz, 'Capital-market Liberalization, Globalization, and the IMF' (2004) 20 Oxford Review of Economic Policy 57, p. 62.

50 Kevin P. Gallagher, Stephany Griffith-Jones and José Antonio Ocampo, *Capital Account Regulations for Stability and Development: A New Approach* (The Frederick S Pardee Center for the Study of the Longer-Range Future, No 22, 2011)

'capital controls'.[51] It is used by certain economists in order to highlight the fact that 'capital account regulations' belong to the broader family of 'financial regulations'.[52] Other economists use the term 'capital management techniques',[53] whereas the IMF prefers the term 'capital flow management measures'.[54] All these variations, as synonyms of 'capital controls', refer in reality to measures designed to limit capital movements. These measures can be imposed either on capital inflows or on capital outflows. Examples of regulations imposed on capital inflows may include unremunerated reserve requirements (i.e. the requirement that investors make a deposit in the central bank equivalent to a certain percentage of their investment, aiming essentially at discouraging short-term investors), taxes on foreign short-term debt instruments, mandatory approval for some capital transactions, minimum stay requirements, limitations on foreign borrowing, control on foreign ownership of companies and government approval for foreign investment in certain sectors (for instance, when there is a threat to national security).[55] Examples of regulations imposed on capital outflows may include taxes on capital outflows, mandatory approval for domestic agents to invest abroad or to hold bank accounts abroad, restrictions on the withdrawal of cash or on the transfer of capital to foreign bank accounts intended to prevent capital flight and limits on how much non-residents can borrow in the domestic market.[56] Another categorization of capital account regulations distinguishes between price-based measures, which alter the price of foreign capital (e.g. taxes on inflows or outflows) or quantity-based measures, which include prohibitions or caps on certain types of transactions (e.g. on foreign borrowing for purposes other than investment or international trade).[57] A third categorisation of measures restricting capital flows, followed by the IMF, distinguished between 'residence-based capital flow management measures' (i.e. measures that discriminate on the

51 Indeed, the use of the term 'capital controls' can bring stigma to some countries and can have a negative impact on the investment climate, as it can lead to downgrading by credit rating agencies. See Rawi Abdelal, *Capital Rules: The Construction of Global Finance* (Harvard University Press 2009).

52 Kevin P. Gallagher, Stephany Griffith-Jones and José Antonio Ocampo, *Capital Account Regulations for Stability and Development: A New Approach* (2011).

53 Gerald Epstein, Ilene Grabel and K.S. Jomo, *Capital Management Techniques in Developing Countries: An Assessment of Experiences from the 1990s and Lessons for the Future* (UN G-24 Discussion Paper Series, 2004); José Antonio Ocampo and Joseph E. Stiglitz, *Capital Market Liberalization and Development* (Oxford University Press 2008).

54 IMF, *The Liberalization and Management of Capital Flows – An Institutional View* (2012).

55 Kevin P. Gallagher, Stephany Griffith-Jones and José Antonio Ocampo, *Capital Account Regulations for Stability and Development: A New Approach* (2011), p. 3; Peter Chowla, *Time for a New Consensus: Regulating Financial Flows for Stability and Development* (2011), p. 2.

56 Kevin P. Gallagher, Stephany Griffith-Jones and José Antonio Ocampo, *Capital Account Regulations for Stability and Development: A New Approach* (2011), p. 3; Peter Chowla, *Time for a New Consensus: Regulating Financial Flows for Stability and Development* (2011), p. 2.

57 Kevin P. Gallagher, Stephany Griffith-Jones and José Antonio Ocampo, *Capital Account Regulations for Stability and Development: A New Approach* (2011), p. 3.

basis of residence, usually referred to as 'capital controls' in the IMF papers) and 'other capital flow management measures' (i.e. prudential policies that do not discriminate on the basis of residence).[58]

The scientific research that has been conducted so far is inconclusive about the effectiveness of capital controls.[59] This inconclusive research has given rise to three different schools of thought regarding the policy options that national governments can pursue in order to minimize the risks associated with capital liberalisation. The first school of thought opposes any type of government intervention. Economists belonging to this group argue that capital controls impose constraints on project financing by restricting the availability of foreign capital and by limiting investment possibilities.[60] Furthermore, they can reduce macroeconomic discipline, promote risk-seeking behaviour, moral hazard and corruption, repress the financial sector and distort the allocation of capital.[61] On the other end of the spectrum, the second school of thought supports the view that national governments should be able to deploy capital controls in order to prevent or mitigate the effects of financial crises caused by international capital flows.[62] Finally, the third school of thought acknowledges that capital movements can be risky, but it does not go so far as to suggest that governments should be able to impose capital controls. To the contrary, economists endorsing this theoretical framework emphasise the significance of risk management and argue that financial integration can be pursued insofar as it is combined with transparency and prudential supervision

58 IMF, *The Liberalization and Management of Capital Flows – An Institutional View* (2012).

59 Sergio Schmukler, 'The Benefits and Risks of Financial Globalization' in Ocampo and Stiglitz (eds), *Capital Market Liberalization and Development* (Oxford University Press 2008), p. 65.

60 IMF, *The Liberalization and Management of Capital Flows – An Institutional View* (2012), p. 10; Joshua Aizenman and Reuven Glick, 'Sterilization, monetary policy, and global financial integration' (2008) 17 *Review of International Economics* 777; Kristin J. Forbes, 'Capital controls: mud in the wheels of market efficiency' (2005) 25 *Cato Journal* 153; Kristin J. Forbes, 'The Microeconomic Evidence on Capital Controls: No Free Lunch' in Edwards (ed), *Capital Controls and Capital Flows in Emerging Economies: Policies, Practices, and Consequences* (University of Chicago Press 2007); Kristin J. Forbes, 'One Cost of the Chilean Capital Controls: Increased Financial Constraints for Smaller Traded Firms' (2007) 71 Journal of International Economics 294; John Greenwood, 'The costs and implications of PBC sterilization' (2008) 28 The Cato Journal 205.

61 IMF, *The Liberalization and Management of Capital Flows – An Institutional View* (2012), p. 10; Joshua Aizenman and Reuven Glick, *Sterilization, monetary policy, and global financial integration* (2008).

62 Kevin P. Gallagher, Stephany Griffith-Jones and José Antonio Ocampo, *Capital Account Regulations for Stability and Development: A New Approach* (2011); Paul Krugman, 'Saving Asia: It's Time to Get Radical' (1998) 138 *Fortune* 74; James Tobin, 'Financial Globalization' (2000) 28 *World Development* 1101; Jospeh Stiglitz, 'Capital Market Liberalization, Economic Growth and Instability' (2000) 28 World Development 1075; José Antonio Ocampo, 'Capital-Account and Counter-Cyclical Prudential Regulations in Developing Countries' in Ricardo Ffrench-Davis and Stephany Griffith-Jones (eds), *From Capital Surges to Drought: Seeking Stability for Emerging Economies* (Palgrave/MacMillan 2003).

to ensure the safety and soundness of the financial markets, without however distinguishing between foreign and domestic capital.[63]

3 The historical evolution of capital liberalisation

3.1 The Gold Standard

The 'first age of globalisation' (1870-1923) has been largely portrayed as the 'high noon' of capitalism.[64] The great expansion of trade and the accelerated growth of transnational investment that marked this period have been attributed to a harmonious combination of liberal and interventionist measures: a strong adherence to free market doctrines regarding fiscal policy (the balanced budget doctrine) and monetary policy (the Gold Standard) but also a significant participation of the State in the market with labour regulations, social welfare schemes, public investment in infrastructure and education.[65]

In relation to monetary policy, after the expansion of Europe's trade in the 1860s and despite the fact that there was no formal international agreement on a common standard for exchange-rate stability,[66] national governments (with Germany pioneering in 1871) started unilaterally pegging their currency to gold and thus, from 1880 until 1914, the Gold Standard prevailed as the normal state of affairs.[67] The monetary system of the Gold Standard was intended to foster monetary and price stability, as it linked the money supply to the quantity of gold reserves in a country.[68] In this way, the rates of exchange among the franc, the mark, the pound and the dollar were essentially fixed. Those fixed exchange rates were effectively expanded to other States as well, as they were linking their currencies to one of the key currencies and keeping their reserves either in gold or in one of those currencies.[69] However, sooner or later, the countries using the Gold Standard realised that they could not increase the money supply if they did not have enough reserves in gold

63 Sergio Schmukler, 'The Benefits and Risks of Financial Globalization' in Ocampo and Stiglitz (eds), *Capital Market Liberalization and Development* (Oxford University Press 2008), p. 66.
64 Ha-Joon Chang, *Economics:The User's Guide* (Penguin 2014), p. 65.
65 Ibid, p. 72.
66 In the international conference that was held in Paris in 1867 for the purpose of establishing a common standard, the bimetallic lobby remained powerful and was able to thwart all attempts to formally establish the gold standard as the international standard for stabilizing exchange rates. See Barry J. Eichengreen and Marc Flandreau (eds), *The Gold Standard in Theory and History* (Routledge 1997), p. 4.
67 Ibid, pp. 3-5. This unique volume brings together literature selections of economists, historians and political scientists and provides an important insight into the international gold standard.
68 Jonathan Law, *A Dictionary of Finance and Banking* (Oxford University Press 2014).
69 Andeas F. Lowenfeld, *International Economic Law* (Oxford University Press 2008), p. 598.

and therefore they could not devaluate their currency in order to increase the competitiveness of their exporting products.[70] Thus, as there was no international legal obligation for adherence to the Gold Standard,[71] with the advent of WWI all the major powers suspended their participation in the Gold Standard. Nevertheless, they tried to maintain fixed-exchange rates and imposed capital controls as a method of generating revenues for the governments and financing wartime expenditures.[72]

During the 1929 Great Depression it became clear that the Gold Standard deprived central banks of the possibility to increase the supply of money due to the fear of compromising the value of the currency.[73] This in turn meant that there was significantly restricted money supply, which led to credit scarcity and restricted private-sector activities.[74] The reduced demand was further exacerbated by the rigid doctrine of balanced budget, which imposed fiscal discipline and drastic cuts in spending.[75] The Great Depression forced many countries to depreciate their exchange rates in an attempt to foster trade and, by the mid-1930s, all countries had abandoned the Gold Standard. During the interwar period, the British pound and the French franc floated against the dollar. The United States abandoned the gold standard as one of the first acts of the Roosevelt presidency and rejected a proposed dollar-franc-pound stabilization proposal at the London International and Monetary Conference of 1933.[76] The monetary chaos caused a widespread political and economic turmoil. 'It was as if someone had picked up the world and shaken it into utter confusion' wrote the novelist Polish American Sholem Asch.[77] An example of the economic despair experienced worldwide was the 'pioneering' approach (as characterised by Mark Mazower) adopted by the Greek Government of bisecting all circulating banknotes, holding the one half as a loan certificate and returning the other half to their original owners![78]

As trade contracted sharply and unemployment increased worldwide, governments were employing manipulative devices, such as devaluations of domestic

70 Pavlos Masouros, *Corporate Law and Economic Stagnation: How Shareholder Value and Short-Termism Contribute to the Decline of the Western Economies* (Eleven International Publishing 2013), p. 45.
71 Stephen Zamora, 'Sir Jospeh Gold and the Development of International Monetary Law' (1989) 23 *The International Lawyer* 1009, at p. 1011.
72 Christopher J. Neely, 'An Introduction to Capital Controls' (1999) 81 Federal Reserve Bank of St Louis Review 13, p. 17.
73 Ha-Joon Chang, *Economics:The User's Guide* (Penguin 2014), p. 77.
74 Ibid.
75 Ibid.
76 Andeas F. Lowenfeld, *International Economic Law* (Oxford University Press 2008), p. 598.
77 Quoted in Mark Mazower, *Dark Continent, Europe's twentieth century* (USA: Vintage 2000), p. 104.
78 Ibid.

currencies, multiple exchange rates and protectionist trade restrictions in order to increase the competitiveness of the national exports and to divert economic distress abroad. In the 1930s, Nazi Germany was particularly adept at those manipulative devices, such as exchange controls, competitive currency depreciation and blocked balances, aiming at exploiting their creditors, their customers and their competitors in their international trade and financial relations.[79] In essence, using the words of US Secretary of the Treasury, Henry Morgenthau, 'these monetary devices were measures of international economic aggression and they were the logical concomitant of a policy directed toward war and conquest'.[80]

Instead of fostering growth, states were introducing exchange controls coupled with the erection of protectionist barriers to international trade, such as high tariffs and quotas aiming at reducing costly imports. This ultimately led to the phenomenon known as 'beggar thy neighbour', a dangerous economic strategy by virtue of which a country can remedy its economic hardship by harming its trading partners, which can ultimately lead to trade wars.[81] Countries were led to a race to the bottom with consecutive currency depreciations along the lines of a policy of 'each-country-for-itself-and-the-devil-take-the-weakest'.[82] The economic crisis and the contradictions of the capitalistic economic model of the inter-war period forged a new economic nationalism in Europe, which would ultimately shake the foundations of liberal democracies and would cause the outbreak of World War II (WWII).

79 Andeas F. Lowenfeld, *International Economic Law* (Oxford University Press 2008), p. 599.

80 Henry Morgenthau, 'Bretton Woods and International Cooperation' (1945) 23 *Foreign Affairs* 182, at p. 185.

81 Peter Moles and Nicholas Terry, *The Handbook of International Financial Terms*, (Oxford University Press 2005); Craig Calhoun (ed), *Dictionary of the Social Sciences* (Oxford University Press 2002). This strategy has been closely linked to two examples in game theory: the 'tragedy of the commons' and the 'prisoner's dilemma'. The 'tragedy of the commons' theory by Garrett Hardin explores problems of resource distribution and essentially argues that if each individual rationally pursues his or her own short-term interest while disregarding others similarly pursuing theirs, then the long-run consequence is that everyone loses their share in the collective resource. Similarly, the 'prisoner's dilemma' theory illustrates the divergence between individual and collective rationality, and the difficulty of maintaining cooperation in strategic situations. See Garrett Hardin, 'The Tragedy of the Commons' (1968) 162 *Science* 1243 and John Scott and Gordon Marshall, *Dictionary of Sociology*, (Oxford University Press 2009).

82 Pavlos Masouros, *Corporate Law and Economic Stagnation: How Shareholder Value and Short-Termism Contribute to the Decline of the Western Economies* (Eleven International Publishing 2013), pp. 45-46, citing J. Keith Horsefield (ed), *The International Monetary Fund, 1945-1965: Twenty Years of International Monetary Cooperation, Volume III: Documents* (IMF 1969), p. 40.

3.2 The Bretton Woods system

The period between the end of WWII (1945) and the first Oil Shock (1973) is usually referred to as the 'Golden Age of Capitalism', as it had the highest growth rate ever, unemployment was eliminated in the advanced capitalist countries and there was a high degree of financial stability (no banking crisis).[83] Among the factors that contributed to the Golden Age were first, the implementation of a well-designed policy of mixed economy (combining positive features of capitalism and socialism, i.e. free market with state-owned enterprises in key industries and welfare state facilitating social mobility and thus legitimizing the capitalist system) and secondly, the establishment of an ambitious and sophisticated global economic governance system consisting of three main institutions: the International Monetary Fund, the World Bank and the General Agreement on Trade and Tariffs, which later led to the creation of the World Trade Organisation .[84] It is the IMF to which we will now turn our attention.

In the aftermath of WWII, the speed and the zeal with which politicians and economists engaged in the effort to rebuild the global economy were truly remarkable.[85] The Bretton Woods Conference (named after the meeting of forty-four countries in Bretton Woods, New Hampshire which took place in July 1944) created two permanent financial organisations, which are still regarded as the two bastions of global capitalism: the International Monetary Fund and the International Bank for Reconstruction and Development (the original World Bank institution).

The principal protagonists of the creation of the Bretton Woods system were the United Kingdom, led by the eminent economist John Maynard Keynes,[86] and the United States, led by Harry Dexter White, assistant to the Secretary of the Treasury Henry Morgenthau and also fond of Keynesian economic theory. The main objective of this political effort was to create an international monetary system that would not repeat the mistakes of the past. In order to prevent an economic disaster from reoccuring, the architects of the Bretton

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83 Ha-Joon Chang, *Economics:The User's Guide* (Penguin 2014), p.79.

84 Ibid, pp. 80-82.

85 Lord Keynes wrote in 1942 that only a 'single act of creation, made possible by the unity of purpose and energy of hope for better things to come' brought about by the war could lead to a creation of an international monetary institution. See Roy F. Harrod, *The Life of John Maynard Keynes* (New York: Harcourt, Brace and Company 1951, repr. 1963, 1969), p. 551.

86 With his inspirational and revolutionary book John Maynard Keynes, *The General Theory of Employment, Interest and Money* (Palgrave Macmillan 1936), John Maynard Keynes laid down the theoretical foundations of the post-World War II economic boom, a period that is still regarded as the 'Golden Age of Capitalism'.

Woods system built the 'embedded liberalism' compromise[87] that allowed the coexistence of free markets and with a tissue of exceptions within the framework of multilateral free tade.[88] The outcome was the longest period of economic expansion in history.[89]

In particular, within the framework of the new monetary system, exchange rates would be reasonably stable and exchange controls on current transactions would be prohibited with the aim being 'equilibrium' in the balance of payments of the Member States.[90] The purpose was to create 'an orderly and agreed method of determining the relative exchange values of national currency units, so that unilateral action and competitive exchange depreciations [were] prevented'.[91]

In the field of monetary policy, the founders of the Bretton Woods system abandoned the Gold Standard, as they recognised that it made macroeconomic management too rigid.[92] In practice, however, they retained gold as the ultimate source of value, but the only currency directly tied to gold was the dollar. All the other currencies had fixed exchange rates with the dollar.[93]

87 The term 'embedded liberalism' was coined by John Ruggie in order to describe the post-war economic system in which multilateralism and domestic stability were linked to and conditioned by one another. According to Ruggie, the 'embedded liberalism' compromise operated on a double level: on the one hand, movement toward greater openness in the international economy was coupled with measures designed to cushion domestic economy from external disruptions and on the other hand, the latter were supposed to be proportionate to the degree of external disturbances and in line with the long-term expansion of international transactions. See John Ruggie, 'International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order' (1982) 36 *International Organizations* 379, at p. 405. The theoretical background upon which Ruggie based his analysis was Karl Polanyi's instrumental work The Great Transformation, in which he introduced the seminal distinction between 'embedded' and 'disembedded' economy. See Karl Polanyi, *The Great Transformation* (Beacon Press 1944, 1957, 2001), p. 60 et seq. 'According to Polanyi, embeddedness means the degree to which social relations are protected from and are sustainable independently of the markets. In contrast, disembedding the economy means commodifying the "very substance" of society, that is, land, money, and human beings'. See Martin Höpner and Armin Schäfer, 'Embeddedness and Regional Integration. Waiting for Polanyi in a Hayekian Setting' (2012) 66 International Organization 429, p. 433.

88 James A. Caporaso and Sidney Tarrow, 'Polanyi in Brussels: Supranational Institutions and the Transnational Embedding of Markets' (2009) 63 International Organization 593, p. 596.

89 Ibid.

90 Andreas Lowenfeld, *Bretton Woods Conference (1944)* (Oxford University Press 2013).

91 John Maynard Keynes, 'Proposals for an International Clearing Union' in J. Keith Horsefield (ed), *The International Monetary Fund, 1945-1965: Twenty Years of International Monetary Cooperation, Volume III: Documents* (IMF 1969), at p. 20.

92 Ha-Joon Chang, *Economics:The User's Guide* (Penguin 2014), p. 87.

93 Richard Baldwin and Charles Wyplosz, *The Economics of European Integration* (MacGraw-Hill Education 2006), p. 303.

This mechanism was created on the basis of the assumption that the dollar was 'as good as gold', given that at the time the American production counted for about half of the global output and the American dollar was admittedly the strongest and most wanted currency in the world.[94]

The Bretton Woods Agreement (IMF Agreement)[95] was formally adopted in July 1944 and entered into force in December 1945; it laid down the foundations of an international monetary and financial system based on two hallmarks: (1) a fixed exchange rate system; and (2) the possibility of imposing capital controls.

3.2.1 Fixed exchange rate

In relation to the fixed exchange rate system, a pegged currency system was established, under which all countries were supposed to peg their currencies to the US dollar, which in turn was tied to gold. This effectively meant that all currencies were tied to gold, though indirectly.[96] Legally speaking, the obligation under Article IV of the IMF Agreement was to actively ensure that the value of their currency would not fluctuate.[97] But it was not the purpose of the Bretton Woods Agreement to replicate the rigid gold standard regime of the pre-WWI period. Therefore, under the motto 'stability without rigidity', Article IV (5) IMF Agreement allowed States to adapt the value of their currency in case of imbalance of payments after consulting the IMF and obtaining its approval if the change of the value was more than 10%.[98]

The Bretton Woods system secured exchange rate stability based on an indirect recognition of the gold standard for 25 years. However, the 'Nixon shock' of the early 1970s marked its demise. In particular, in 1971, in the midst of economic uncertainty and political unrest, President Richard Nixon decided to suspend the convertibility of the dollar into gold in order to redress the balance of payments deficit that the US economy was running since the late 1960s and the erosion of confidence in the dollar, largely caused by the financing of the expensive and highly unpopular military operations in Vietnam.[99]

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94 Ha-Joon Chang, *Economics:The User's Guide* (Penguin 2014), p.88.

95 Articles of Agreement of the International Monetary Fund (signed and entered into force 27 December 1945) 2 UNTS 39

96 Joseph Gold, 'The Legal Structure of the Par Value System' (1973) 5 *Law and Policy of International Business* 155, at p. 157.

97 Pavlos Masouros, *Corporate Law and Economic Stagnation: How Shareholder Value and Short-Termism Contribute to the Decline of the Western Economies* (Eleven International Publishing 2013), p. 47.

98 Ibid, p. 48.

99 Sabine Schlemmer-Schulte, *International Monetary Fund (IMF)*, (Max Planck Encyclopedia of Public international Law, Oxford University Press 2013); Richard Baldwin and Charles Wyplosz, *The Economics of European Integration* (MacGraw-Hill Education 2006), p. 303.

The suspension of the convertibility of the dollar into gold caused unprecedented waves of shock to the international monetary system and marked the *de facto* collapse of the Bretton Woods system.[100] Legally speaking, the Bretton Woods system did not cease to exist after the 'Nixon shock'. However, two important features of the Bretton Woods system, the dollar convertibility and the par value system, had ceased to exist. The violation by the US government of the obligation under the IMF Agreement to take all necessary measures to keep the dollar within the Bretton Woods margins in order to maintain the exchange rate stability[101]gave the right to (in effect legitimised) the non-observance of this obligation by the other members as well.[102] Therefore, after the subsequent reluctance of other members like Japan, Germany, France, Belgium, the Netherlands, the UK and Sweden to prevent their currencies from floating, the Bretton Woods system was *de facto* abandoned as the national economies moved from a fixed to a flexible/floating exchange rate system.[103] The *de jure* abolition of the fixed exchange rate regime came a few years later, in 1978, when the Second Amendment of the IMF Agreement came into force,

100 Pavlos Masouros, *Corporate Law and Economic Stagnation: How Shareholder Value and Short-Termism Contribute to the Decline of the Western Economies* (Eleven International Publishing 2013), pp. 56-57; Sabine Schlemmer-Schulte, *International Monetary Fund (IMF)*, (Max Planck Encyclopedia of Public international Law, Oxford University Press 2013).

101 It should be clarified that the violation of the IMF Agreement was not the suspension of the dollar convertibility into gold, but the announcement of the Secretary of the Treasury that the US government had no intention to keep the dollar within the Bretton Woods margins. See Pavlos Masouros, *Corporate Law and Economic Stagnation: How Shareholder Value and Short-Termism Contribute to the Decline of the Western Economies* (Eleven International Publishing 2013), p. 57. Moreover, it is important to note that the US was not the first country breaching the obligation under Article IV of the IMF Agreement. Mexico (1948), Canada (1950) and Germany (1971) had previously let their currencies float and, in fact, the decision of the German government to let the mark float aggravated the distress of the US economy. See Robert Leeson, *Ideology and the International Economy: The Decline and Fall of Bretton Woods* (Palgrave Macmillan UK 2003), pp. 66-71.

102 Joseph Gold, 'Unauthorized Changes of Par Value and Fluctuating Exchange Rates in the Bretton Woods System' (1971) 65 *American Journal of International Law* 113, at p. 124.

103 Pavlos Masouros, *Corporate Law and Economic Stagnation: How Shareholder Value and Short-Termism Contribute to the Decline of the Western Economies* (Eleven International Publishing 2013), p. 58. It is interesting to note that following those developments, the US proposed a fundamental reform of the international monetary law, which would pursue as a primary objective 'equilibrium' in the balance of payments. According to the US proposal (referred to as 'Outline of Reform'), neither surplus nor deficit could be accepted. Just as states in deficit were imposed strict conditionality by their creditors in order to reduce government spending, comparable remedies should be imposed to states in persistent surplus (like Germany or Japan) such as increased imports, a charge on excessive reserve accumulation or revaluation of their currency. However, this Outline of Reform was never legally adopted and it is still considered to be 'one of the great might-have-beens of history'. See Andeas F. Lowenfeld, *International Economic Law* (Oxford University Press 2008), p. 631.

which established the right of the members to adopt exchange rate arrangements of their choice.[104]

3.2.2 Restrictions on capital flows

In relation to capital controls, the solution that was adopted reflected the generalised reluctance to promote capital mobility that prevailed during the course of the 20th century, as international capital flows were widely held responsible for repeated balance-of-payment deficits and banking crises.[105] John Maynard Keynes was aware of the risks of free capital flows and sceptical about their benefits. He believed that capital mobility restrained a national government's ability to implement countercyclical macroeconomic policies in order to combat recessions and compromised national efforts to establish a strong welfare state and to pursue social policies of employment and growth, as anytime the government would plan to impose taxes on wealth, capital would flow out of the country.[106]

Thus, under his influence, the rules of the IMF provided Member States with the right to use capital controls and the IMF could even request governments

104 The amended version of Article IV of the IMF Agreement represents a complete departure from the Bretton Woods system, as it legalises a member's freedom to choose whatever exchange arrangement it wishes, including floating exchange rate regime. The introduction of flexible exchange rate system provided for under the amended Article IV brought significant changes to the discretion of the members to impose capital controls. In particular, the Fund adopted policies recognising that the right to regulate capital flows under Article VI was now qualified by members' newly established obligations under Article IV, Section 1 relating to the stability of the system of exchange rates. Thus, the 1977 Surveillance Decision recognised that members' use of capital controls could give rise to a breach of their obligations under Article IV, Section 1 (iii) to avoid manipulating exchange rates in order to prevent effective balance of payments adjustment or to gain an unfair comparative advantage. Other provisions of the Articles that further qualify members' right to regulate capital movements include Article VI, Section 1 and Article VIII, Section 2(a). See IMF, *The Liberalization and Management of Capital Flows – An Institutional View* (2012), p. 30; IMF, *Article IV of the Fund's Articles of Agreement: An Overview of the Legal Framework* (Prepared by the Legal Department, 2006).

105 Willem Molle, *The Economics of European Integration: Theory, Practice, Policy* (Ashgate 2006), pp. 122-123.

106 Pavlos Masouros, *Corporate Law and Economic Stagnation: How Shareholder Value and Short-Termism Contribute to the Decline of the Western Economies* (Eleven International Publishing 2013), pp. 50-51, citing John Maynard Keynes, *The Collected Writings of John Maynard Keynes, XXV: Activities 1940-1944 Shaping the Post-War World – The Clearing Union* (CUP 1980), p. 149. It is also worth mentioning that in this historical context, the UK feared that without some form of capital controls at the close of World War II, excessive sums would be transferred out of the country, see Andeas F. Lowenfeld, *International Economic Law* (Oxford University Press 2008), p. 608.

to use them as a condition for IMF financing.[107] It should be clarified at the outset that the fact that the Bretton Woods system allowed the introduction of capital controls in order to prevent balance of payment crises did not mean that it promoted 'isolationism as a recipe for the avoidance of contagious crises'.[108] Quite the contrary, the Bretton Woods system was very much in favour of trade liberalisation and, as such, the *current account convertibility* (i.e. the convertibility of currencies for the purpose of a transaction recorded on the *current* account)[109] was enshrined as a legal obligation in Article VIII (2) of the IMF Agreement. Under that provision, the parties to the Agreement undertook the obligation not to impose, without the approval of the Fund, restrictions on the making of payments and transfers for current international transactions. The distinction between *current transactions* and *capital transfers* is crucial for the understanding of the IMF regime, which is also reflected in the WTO rules. Under Article XXX (d) IMF Agreement, the term 'current transactions' means 'payments which are not for the purpose of transferring capital'. These include inter alia (1) payments due in connection with foreign trade or any current business including services, and normal short-term banking and credit facilities, (2) payments due as interest on loans and as net income from other investments, (3) moderate payments for amortization or depreciation of loans or of direct investments, and (4) moderate remittances for family living expenses. Article XXX (d) IMF Agreement further states that the IMF may, after consultation with the members concerned, determine whether certain specific transactions are to be considered *current transactions* or *capital transactions*.

107 Sacha Dierckx, 'After the Crisis and Beyond the New Constitutionalism? The Case of the Free Movement of Capital' (2013) 10 *Globalizations* 803, p. 807; John Ikenberry, 'The Political Origins of Brettion Woods' in Michael D. Bordo and Barry Eichengreen (eds), *A Retrospective on the Bretton Woods System: Lessons for International Monetary Reform* (University of Chicago Press 1993), p. 155-198.

108 Pavlos Masouros, *Corporate Law and Economic Stagnation: How Shareholder Value and Short-Termism Contribute to the Decline of the Western Economies* (Eleven International Publishing 2013), p. 51.

109 A countries balance of payments sheet, which records all transactions between the country and the rest of the world, consists of two separate parts: the 'current account' and the 'capital account'. On the one hand, the 'current account' records all receipts and payments due to imports and exports of goods and services. On the other hand, the 'capital account' records all transactions associated to international financial assets and liabilities, such as inward and outward foreign direct investment acquisitions of foreign securities by residents and of domestic securities by non-residents, lending to foreigners, borrowing from foreigners etc. 'A deficit in the current account is always accompanied by an equal surplus in the capital account and vice versa. This is because a country that imports more goods and services that it exports (i.e. current account deficit) must pay for those extra imports by selling assets or borrowing money (i.e. capital account surplus)', see ibid, p. 52. For an economic definition of the terms see also Jonathan Law, *A Dictionary of Finance and Banking* (Oxford University Press 2014); Peter Moles and Nicholas Terry, *The Handbook of International Financial Terms*, (Oxford University Press 2005).

Contrary to the obligation to liberalise *current transactions*, no such obligation was undertaken in relation to *capital transfers*, which remained within the sphere of State sovereignty. In particular, Article VI (3) IMF Agreement allowed IMF Members to exercise such controls as were necessary to regulate international capital movements. Furthermore, by virtue of Article VI (1) IMF Agreement, the IMF could even request governments to impose capital controls as a condition for IMF financing. In essence, the recognition of national discretion in relation to the imposition of capital controls was intended to provide States with the necessary macroeconomic leeway to prevent balance of payments crises and recessions.[110] In other words, State sovereignty in these matters was preserved for the sake of the protection of the balance of payments.[111] The IMF Executive Board in fact adopted a decision stating that the prohibition of discriminatory currency arrangements or multiple currency practices, which is enshrined in Article VIII (3) IMF Agreement, is inapplicable to capital controls.[112]

The economic explanation restricting capital flows by allowing States to introduce capital controls is found in the so-called 'irreconcilable trilemma/trinity' of the Mundell-Flemming model,[113] according to which it is impossible to have (1) free capital flows, (2) fixed exchange rates and (3) independent monetary policy at the same time. The trilemma is synopsized as follows: if a country wants to maintain an independent monetary policy and capital mobility, it can only do so under a floating/flexible exchange rate system; if a country wants to preserve exchange rate stability and capital mobility, this will inevitably curtail its monetary independence; if, finally, a country wishes to preserve both monetary independence and exchange rate stability, it will perforce have to impose restrictions on capital movements.[114] Necessarily one of the three has to be sacrificed. In the Bretton Woods system, it was the free movement of capital that was sacrificed.

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110 A country with a balance of payments deficit must finance it by borrowing from other countries or the IMF, or by using foreign currency reserves. Such deficits can cause a reduction in the reserves, which subsequently leads to economic pressure for devaluation in order to correct the imbalance. A country with a surplus is in a favourable position, but may come under international pressure to revalue its currency.

111 Matthias Ruffert, *Free Flow of Capital* (Max Planck Encyclopedia of Public International law, 2013).

112 Legal Department of the IMF, Decision No 8648-[87/104], Multiple Currency Practices Applicable Solely to Capital Transactions (1987).

113 Robert Mundell, 'Capital Mobility and Stabilization Policy Under Fixed and Flexible Exchange Rates' (1963) 29 *The Canadian Journal of Economics and Political Science* 475; Marcus Fleming, 'Domestic Financial Policies under Fixed and Floating Exchange Rate' (1962) 9 *IMF Staff Papers* 369. In 1999, Robert Mundell won the Nobel Prize in economics.

114 Pavlos Masouros, *Corporate Law and Economic Stagnation: How Shareholder Value and Short-Termism Contribute to the Decline of the Western Economies* (Eleven International Publishing 2013), p. 49.

3.3 The ambivalent standpoint of international institutions and the rediscovery of capital restrictions as a legitimate policy tool

In the 1990s, there was an important shift in the IMF policy towards capital account liberalisation.[115] The proponents of this shift tried to institutionalise capital liberalisation by proposing amendments to the IMF Agreement. In September 1997, the IMF formally proposed amending its charter to promote free capital flows, calling it 'an essential element of an efficient monetary system in this age of globalization'.[116] These amendments would include the promotion of the orderly liberalisation of capital accounts as one of the main objectives of the Fund and would give the Fund jurisdiction over the capital accounts of its members.[117] However, due to the Asian financial crisis and the subsequent resistance primarily from developing countries, the opinion among IMF Members shifted against free capital markets and the amendment proposal was never legally adopted.[118]

The absence of reliable scientific data led the IMF to openly question the neoclassical orthodoxy, which associates capital account liberalisation with higher levels of economic growth. In a paper published in 2003, the IMF's former chief economist and Professor of Public Policy and Economics at Harvard University, Kenneth Rogoff admits that the pertinent literature overwhelmingly finds no strong correlation between capital account liberalisation and growth, especially in emerging and developing countries.[119] After a critical analysis and collation of theoretical developments and empirical evidence on the effects of financial

115 Sacha Dierckx, 'After the Crisis and Beyond the New Constitutionalism? The Case of the Free Movement of Capital' (2013) 10 Globalizations 803, p. 807.

116 IMF, *Communiqué of the Interim Committee of the Board of Governors of the International Monetary Fund* (Press Release Number 97/44, 1997).

117 Sacha Dierckx, 'After the Crisis and Beyond the New Constitutionalism? The Case of the Free Movement of Capital' (2013) 10 Globalizations 803, p. 807. See also the cited Jeffrey Chwieroth, *Capital Ideas: The IMF and the Rise of Financial Liberalisation* (Princeton University Press 2010).

118 Peter Chowla, *Time for a New Consensus: Regulating Financial Flows for Stability and Development* (2011).

119 Kevin P. Gallagher and José Antonio Ocampo, 'IMF's New View on Capital Controls' (2013) XLVIII *Economy & Political Weekly* 10; Dani Rodrik, 'Who Needs Capital-Account Convertibility?' in Fischer and others (eds), *Should the IMF Pursue Capital-Account Convertibility? (Essays in International Finance No 207, May 1998)* (International Finance Section, Department of Economics, Princeton University 1998); José Antonio Ocampo, 'A Broad view of Macroeconomic Stability' in Narcis Serra and Joseph E. Stiglitz (eds), *The Washington Consensus Reconsidered* (Oxford University Press 2008), pp. 63-94; Anton Korinek, 'The New Economics of Prudential Capital Controls: A Research Agenda' (2011) 59 *IMF Economic Review* 523; Olivier Jeanne, Arvind Subramanian and John Williamson, *Who Needs to Open the Capital Account?* (Peterson Institute for International Economics 2012); Kevin P. Gallagher, Stephany Griffith Jones and José Antonio Ocampo, *Regulating Global Capital Flows for Long-Run Development* (Boston, Pardee Center for the Study of the Longer Range Future, 2012).

globalisation for developing economies, the paper concludes that notwithstanding the *prima facie* strong theoretical presumption, it is in fact difficult to detect a strong and robust correlation between financial integration and growth, especially in relation to developing countries.[120] Furthermore, the paper reports that there is some evidence suggesting that some countries may have experienced greater consumption volatility as a result of financial integration.[121] Due to the lack of sufficient and persuasive evidence of a correlation between financial globalisation and economic growth, developing countries should not be forced to fully open up their capital markets too quickly.[122] The paper underlines that countries can benefit from financial globalisation only if they have a robust legal and supervisory framework, low levels of corruption, a high degree of transparency and good corporate governance.[123]

This position was emphasised again in 2012 when the IMF adopted its institutional view regarding capital liberalisation. In particular, the IMF recognised – although in very careful wording – that full capital liberalisation might not be an appropriate goal for all countries and that under certain circumstances 'capital flow management measures' might be useful (or even necessary) in order to redress certain macroeconomic shortcomings. This carefully drafted institutional view is largely considered to have improved the public image of the IMF as a doctrinaire proponent of unfettered capital liberalisation.[124] The IMF supported the view that free capital mobility is advantageous to the global economy, while at the same time recognising that liberalised capital markets carry risks for economies which have not reached a certain level of financial and institutional development.[125]

Therefore, although this institutional view was largely regarded as embracing free capital flows, it also emphasised that there is no presumption that full liberalisation is an appropriate goal for all countries at all times.[126] With respect to the legal value of this institutional view, it should be noted that it did not change the rights and obligations that the Members have undertaken under the IMF Agreement, as legally this would require an official amendment of the Agreement.[127] Nevertheless, the Fund underlined that this view could

120 Eswar Prasad, Kenneth Rogoff, Shang-Jin Wei and M. Ayhan Kose, *Effects of Financial Globalization on Developing Countries: Some Empirical Evidence* (2003), p. 13.
121 Ibid, pp. 1-3.
122 Ibid, p. 1.
123 Ibid.
124 IMF, *The IMF's Approach to Capital Account Liberalization* (Independent Evaluation Office of the International Monetary Fund, 2015).
125 IMF, *The Liberalization and Management of Capital Flows – An Institutional View* (2012), pp. 10-12.
126 Ibid, p. 13.
127 Ibid, pp. 29-30.

be used as the basis for making recommendations, which the Members are encouraged to follow in the context of policy advice and bilateral or multilateral surveillance.[128] From a legal point of view, the decision of the IMF to slowly but steadily seize authority over capital movements – despite the lack of competence – was in line with the legal theory on the evolution of an international organisation's mandate. In particular, it was argued that, under the 'implied powers' doctrine, the evolution of the IMF's mandate to encompass capital movements into its monetary supervision powers in order to safeguard monetary stability (which can be impacted by unpredictable capital flows) was legally rational and justifiable.[129]

In 2016, eminent economists of the IMF published yet another paper which openly criticises 'neoliberalism', a term which – as the paper notes – is used more by its critics than by its architects.[130] Under the catchy title '*Neoliberalism: Oversold?*' the paper, in a rather self-critical spirit, tackles particularly two aspects of the neoliberal agenda, i.e. the *capital account liberalisation* and the *fiscal consolidation* (the so-called '*austerity*'). It argues that the benefits of those two policies, such as foreign direct investment and reduction of public debt, have been somewhat overplayed, whereas the costs in terms of lower output, retrenched welfare, higher unemployment and increasing income inequality have been underplayed.[131] As it is aptly observed, 'the increase in inequality engendered by financial openness and austerity might itself undercut growth, the very thing that the neoliberal agenda is intent on boosting'.[132] The authors of the paper bring back on stage the distinction between two types of capital flows: on the one hand, long-term capital flows, such as foreign direct investment, which usually entails technological transfer and labour mobility, seem to boost long-term growth; on the other hand, short-term capital flows, such as portfolio investments, banking and especially speculative debt inflows, not only do not seem to bring growth but they actually increase economic volatility and constitute one of the main risk factors liable to cause financial crises.[133]

128 Ibid, pp. 31-32.

129 Antoine Martin and Bryan Mercurio, 'The IMF and Its Shifting Mandate Towards Capital Movements and Capital Controls: A Legal Perspective' (2017) 44 *Legal Issues of Economic Integration* 211, p. 228.

130 Jonathan Ostry, Prakash Loungani and Davide Furceri, 'Neoliberalism: Oversold?' (2016) 53 Finance & Development 38.

131 Ibid, p. 40.

132 Ibid, p. 40.

133 Ibid, p. 39. This distinction has also informed the analysis of other research papers, such as Eswar Prasad, Kenneth Rogoff, Shang-Jin Wei and M. Ayhan Kose, *Effects of Financial Globalization on Developing Countries: Some Empirical Evidence* (2003) and Joseph Stiglitz, 'Capital-market Liberalization, Globalization, and the IMF' (2004) 20 Oxford Review of Economic Policy 57; Giovanni Dell'Ariccia, Julian di Giovanni, André Faria, Ayhan Kose, Martin Schindler and Marco Terrones, *Reaping the Benefits of Financial Globalization* (2008);

In fact, there is convincing evidence that surges in capital flows in emerging economies often end up in financial crises associated with large output decline.[134] Drawing from the past experience, the paper concludes that policy-makers and international financial institutions like the IMF 'must be guided not by faith but by evidence of what has worked'.[135] The search for scientifically sound evidence has therefore led economists of the IMF to reconsider their view on capital liberalisation and to acknowledge that in some cases capital controls are necessary in order to deal with the volatility of capital flows.[136]

In the same vein, the OECD shares the view of the IMF that there is no presumption that full liberalisation is an appropriate goal for all countries at all times.[137] The 'rich-country club', as it is commonly referred to, acknowledges that capital liberalisation bears significant risks and is often associated with costly financial and banking crises.[138] The risk of 'pervasively asymmetric information' that is inherent in liberalised financial markets can give rise to problems of 'adverse selection',[139] 'moral hazard'[140] and 'herding',[141] which

Jonathan Ostry, Alessandro Prati and Antonio Spilimbergo, *Structural Reforms and Economic Performance in Advanced and Developing Countries* (IMF Occasional Paper 268, 2009).

134 Jonathan Ostry, Prakash Loungani and Davide Furceri, 'Neoliberalism: Oversold?' (2016) 53 Finance & Development 38, p. 39 citing Atish Ghosh, Jonathan Ostry and Mahvash Qureshi, 'When Do Capital Inflow Surges End in Tears?' (2016) 106 *American Economic Review* 581and Dani Rodrik, 'Who Needs Capital-Account Convertibility?' in Fischer and others (eds), *Should the IMF Pursue Capital-Account Convertibility? (Essays in International Finance No 207, May 1998)* (International Finance Section, Department of Economics, Princeton University 1998).

135 Jonathan Ostry, Prakash Loungani and Davide Furceri, 'Neoliberalism: Oversold?' (2016) 53 Finance & Development 38, p. 41.

136 Ibid, p. 41.

137 OECD, *The OECD's Approach to Capital Flow Management Measures Used with a Macro-Prudential Intent* (Report to G20 Finance Ministers, 2015).

138 OECD, *Getting the most out of International Capital Flows* (2011).

139 The concept of 'adverse selection' refers to the tendency in the insurance sector for the most risky customers to be the most likely to demand products that exempt them from disclosing information on their risky status. For example, a person purchasing health insurance declines to reveal information on his/her serious health condition. To reduce their risk exposure, insurance companies often raise premiums generally or exclude high-risk customers. See Jonathan Law, *A Dictionary of Finance and Banking* (Oxford University Press 2014).

140 In economics, moral hazard results from asymmetric information and is a cause of market failure. Essentially it refers to a situation in which a person or an organisation has no incentive to act honestly or with due prudence, especially in the insurance sector where a typical example of a person exposed to moral hazard would be the owner of an insured car, who has little or no incentive to guard against theft. With the advent of the global financial crisis of 2007-2008 the term 'moral hazard' has also been used to describe the lack of transparency associated with complex structured finance products, which encouraged irresponsible risk taking. In relation to capital liberalisation, 'moral hazard' may also imply the risk that investors will expect governments to bail them out, an expectation created possibly by government guarantees in the absence of sufficient supervision and market disciple to police excessive risk taking. See Sergio Schmukler, 'The Benefits and Risks of Financial Globalization' in Ocampo and Stiglitz (eds), *Capital Market Liberalization and*

can subsequently lead to economic inefficiencies and financial crises harmful to the general welfare.[142] In light of these risks, the OECD supports the view that capital liberalisation improves economic efficiency on the condition that it is accompanied by measures of prudential supervision and regulation, sound macroeconomic policies and transparency.[143]

3.4 The current legal framework

After the collapse of the Bretton Woods system, the majority of national economies moved to a flexible exchange rate system, which meant that they no longer had to maintain capital controls. One after the other, most of the major economies (most notably the US, UK, Germany and France) started implementing 'policies of capital decontrol' and the global economy experienced an unprecedented wave of capital liberalisation and financial integration.[144] The election of Margaret Thatcher in the UK and Ronald Reagan in the US marked the beginning of the 'neoliberal' period which was characterised by reduced government spending (especially in education, housing and public transport), weakening of trade union power, widespread privatisation schemes in major State-owned enterprises (e.g. gas, electricity, water, airlines, automobile etc.), lower high-rate income taxes and abolition of capital controls.[145]

Regarding the abolition of capital controls, it is indeed true that the past three decades have been associated with greater openness in global financial markets and there has been a steady decline in the number of restrictions that countries impose on international capital flows.[146] Nevertheless, it should be noted that despite its unprecedented magnitude, the process of financial integration is not the result of a coordinated international effort, but rather the result of separate actions pursued by individual countries. Contrary to trade liberal-

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Development (Oxford University Press 2008), p. 60; Jospeh Stiglitz, 'Financial Market Stability and Monetary Policy' (2002) 7 Pacific Economic Review 13, pp. 25-26.

141 'Herding behaviour' (which literally illustrates a form of social organisation in mammals) has become a pejorative term in the financial jargon portraying investors and fund managers as herds that change into risky ventures without adequate information and appreciation of the risk-award trade-offs. See Bikhchandani Sushil and Sharma Sunil, *Herd Behavior in Financial Markets* (IMF Staff Papers Vol 47, No 3, 2001).

142 Barry Eichengreen, Michael Mussa, Giovanni Dell'Ariccia, Enrica Detragiache, Gian Maria Milesi-Ferretti and Andrew Tweedie, *Liberalizing Capital Movements: Some Analytical Issues* (1999).

143 OECD, *Getting the most out of International Capital Flows* (2011).

144 Pavlos Masouros, *Corporate Law and Economic Stagnation: How Shareholder Value and Short-Termism Contribute to the Decline of the Western Economies* (Eleven International Publishing 2013), pp. 62-72.

145 Ha-Joon Chang, *Economics:The User's Guide* (Penguin 2014), p. 90.

146 David Furceri and Prakash Loungani, *Capital Account Liberalization and Inequality*' (IMF Working Paper WP/15/243, 2015).

isation, capital liberalisation is not subject to an international legal regime. The free movement of capital is embedded in a regime of multilevel regulation, based on the principle of State sovereignty in capital transfer matters.[147] Tendencies to promote the capital liberalisation have not yet found any reflection in general international law.[148] In legal terms, this constitutes a major difference between trade and capital: while there is a strong multilateral legal framework for international trade in goods and services established by the World Trade Organisation, there is no such legal framework for international capital flows.[149] In other words, the free flow of capital is not regulated at the international level and remains largely a national competence.

As explained above, the IMF has limited competence in relation to the capital account policies of its Members. Despite the political upheaval and the internal debate that dominated IMF discussions in the 1990s, the proposal for a formal amendment of the Articles of the Agreement did not go through. As a consequence, Article VI of the IMF Agreement on capital controls (Chapter 1, Section 3.2.2) still remains untouched. In other words, Article VI of the IMF Agreement is still in force today and thus capital controls are still allowed within the IMF framework.

Other attempts to promote and facilitate capital liberalisation have not yet found concrete reflection in general international law.[150] Within the WTO framework, contrary to what one would assume considering its overall global trade policy, there is no strong tendency to liberalise capital movements.[151] The General Agreement on Trade in Services (GATS)[152] includes some elements of capital liberalisation, but only insofar as capital movements are needed for the effective delivery of a service.[153] Indeed Article XI (1) GATS provides that 'A Member State shall not apply restrictions on international transfers and payments for current transactions relating to its specific commitments'. Therefore, under the WTO regime, payments are liberalised only to the extent that

147 Matthias Ruffert, *Free Flow of Capital* (2013) referring to *Case Concerning the Payment of Various Serbian Loans Issued in France*, Ser A, No 20, 1929 (Permanent Court of International Justice).
148 Matthias Ruffert, *Free Flow of Capital* (2013).
149 Olivier Jeanne, Arvind Subramanian and John Williamson, *Who Needs to Open the Capital Account?* (Peterson Institute for International Economics 2012), p. 3.
150 Matthias Ruffert, *Free Flow of Capital* (2013).
151 Ibid.
152 General Agreement on Trade in Services (adopted 15 April 1994, entered into force 1 January 1995) 1869 UNTS 183.
153 OECD, *International capital flows: Structural reforms and experience with the OECD Code of Liberalisation of Capital Movements* (Report from the OECD to the G20 Sub-Group on Capital Flow Management, 2011).

they are necessary for 'current transactions', i.e. payments which are not for the purpose of transferring capital.[154]

International investment law, consisting of Regional Free Trade Agreements and Bilateral Investment Treaties, provides certainly a more coherent and concrete protection regime of capital movements, as it promotes capital liberalisation through the expansion of foreign direct investment (one of the main transactions falling within the scope of 'capital movements') and it guarantees the right of foreign investors to transfer the investment gains into the country where the investor resides ('repatriation').[155] For instance Article 7 of the US Model Bilateral Investment Treaty[156] provides that each Party shall permit all transfers relating to a covered investment to be made freely, without delay, into and out of its territory, in a freely usable currency at the market rate of exchange prevailing at the time of transfer. It further explains that such transfers include (a) contributions to capital, (b) profits, dividends, capital gains and proceeds from the investment, (c) interest, royalty payments, management fees and technical assistance, (d) payments made under a contract, (e) any payments that may arise as a result of a violation of the fair and equitable treatment principle or due to an illegal expropriation as well as (f) payments arising out of a dispute. Other examples of similar provisions can be found in Article 1109 of the North American Free Trade Agreement,[157] Article 14 Energy Charter Treaty[158] as well as Article 8.13 of the recently entered into force (provisionally) and heatedly debated Comprehensive and Economic Trade Agreement between Canada and the EU (CETA).

The OECD Code of Liberalisation of Capital Movements is the only international legally binding instrument regulating comprehensively and exclusively international capital movements (both inflows and outflows).[159] The Code stipulates progressive, non-discriminatory liberalisation of capital flows and the right of establishment.[160] By adhering to the Code, the OECD Members have undertaken the obligation to remove restrictions on specified lists of capital movements between residents of different Member countries. The OECD Code covers all capital movements, ranging from direct investment, operations in

154 Matthias Ruffert, *Free Flow of Capital* (2013). It should be noted, however, that international investment law promotes capital liberalisation by protecting inward international investment (without however covering capital outflows by residents), see OECD, *International capital flows: Structural reforms and experience with the OECD Code of Liberalisation of Capital Movements* (2011), p. 4.

155 Matthias Ruffert, *Free Flow of Capital* (2013).

156 2012 U.S. Model Bilateral Investment Treaty.

157 1994 North American Free Trade Agreement, 32 ILM 289, 605 (1993).

158 1998 Energy Charter Treaty, 34 ILM 360 (1995).

159 OECD, Code of Liberalisation of Capital Movements (12 December 1961) OECD/C(61)96.

160 OECD, 'Investment Policy' <http://www.oecd.org/daf/inv/investment-policy/codes.htm> accessed 31-01-2019.

real estate, operations in securities on capital markets, financial credits and loans, operations in foreign exchange, life assurance to personal capital movements (such as loans, gifts and endowments, inheritances and legacies) and physical movement of capital assets.[161] The OECD Code does not prohibit capital controls but neither does it encourage them. The Code allows for derogations from the obligation to liberalise capital movements, but only in so far as the economic and financial situation justifies such derogation and only for as long as it is deemed necessary. In this regard, a 'peer-review' system is established whereby countries introducing capital controls are examined by their peers in order to make sure that measures are implemented in a transparent and fair manner and are not maintained longer than necessary.

4 Conclusion of Chapter 1

This Chapter has introduced the theoretical debate about 'capital liberalisation' and has provided an analysis of the legal framework governing capital movements at the international level. Capital liberalisation is a highly controversial subject, which deeply divides the academic community and raises an animated controversy as to its actual contribution to global economic growth. On the one hand, *neoclassical economic theory* suggests that the free flow of capital across borders can contribute to economic efficiency, higher economic growth, better allocation of investment and rising living standards for many countries. On the other hand, the *Keynesian school of thought* contests the correlation between capital liberalisation and economic growth and expresses fears over its possible contributory effect to financial instability, increased likelihood of financial crises and rising levels of income inequality.

Proponents of the neoclassical economic theory oppose any type of capital controls and contend that restrictions on the free movement of capital impose constraints on investment projects, reduce macroeconomic discipline, promote risk-seeking behaviour, moral hazard and corruption, repress the financial sector and distort the allocation of capital. By contrast, advocates of Keynesianism argue that governments should in principle be able to impose capital controls as an essential part of their macroeconomic policy toolkit in order to prevent financial crises and to mitigate their negative effects on the economy and the society as a whole. Due to the inconclusive evidence regarding the effectiveness of capital controls, there is a third school of thought emphasising the significance of risk management and arguing that financial integration can be pursued only insofar as it is combined with transparency and prudential supervision in order to ensure the safety and soundness of financial markets.

161 OECD, Code of Liberalisation of Capital Movements (12 December 1961) OECD/C(61)96.

This conclusion is supported by the IMF and the OECD, which acknowledge the risks inherent in the unfettered free movement of capital and express the institutional view that capital liberalisation improves economic efficiency only if it is complemented by measures of prudential supervision and regulation, sound macroeconomic policies and transparency.

The above-mentioned ideological controversies surrounding the costs and benefits of capital liberalisation are reflected in its historical evolution, which has followed a non-linear course. The 'first age of globalisation' (1870-1923) was characterised by a great expansion of trade and transnational investment, attributed to a combination of free market doctrines (especially the balanced budget principle and the Gold Standard) and State interventionism. However, the Great Depression forced many States to abandon the Gold Standard in order to become more competitive. The global economy experienced a period of severe economic recession, trade contracted sharply and unemployment increased worldwide. In the aftermath of World War II, the global economy experienced a radical transformation. Growth reached its highest rate ever, unemployment was eliminated in the advanced capitalist countries and there was a high degree of financial stability. It is argued that this economic miracle was primarily due to the implementation of a well-designed policy of mixed economy and the establishment of an international institutional framework for monetary issues, the Bretton Woods system.

The Bretton Woods Agreement (IMF Agreement), which was deeply influenced by the eminent British economist John Maynard Keynes, laid down the foundations of an international monetary and financial system based on two cornerstones: (1) a *fixed exchange rate system*; and (2) the *possibility of imposing capital controls*. Regarding the *fixed exchange rate system*, the IMF Agreement introduced a pegged currency system under which all countries were supposed to peg their currencies to the US dollar, which in turn was tied to gold. The adherence to an indirect Gold Standard guaranteed exchange rate stability until the early 1970s, when the 'Nixon shock' led to the suspension of the convertibility of the dollar into gold and thus marked the *de facto* collapse of the Bretton Woods system. Regarding the *possibility of imposing capital controls*, Article VI of the IMF Agreement allowed IMF Members to exercise such controls as were necessary to regulate international capital movements. Despite the internal debate that dominated IMF discussions in the 1990s and the ideological shift towards capital liberalisation, the proposal for a formal amendment of this provision did not go through.

The current legal framework regarding capital liberalisation at the international level is embedded in a regime of multilevel regulation, based on the principle of State sovereignty in capital transfer matters. In legal terms, this constitutes a major difference between *trade* and *capital*: while there is a strong multilateral

legal framework for international trade in goods and services established by the World Trade Organisation, there is no such legal framework for international capital flows. In particular, apart from Article VI of the IMF Agreement, which allows national government to adopt capital controls thus implicitly recognising that the free movement of capital remains a national competence, other attempts to promote and facilitate capital liberalisation have not yet found concrete reflection in general international law. Within the WTO framework there is no strong tendency to liberalise capital movements. A more coherent protection regime of capital movements is provided by International Investment law, consisting of Regional Free Trade Agreements and Bilateral Investment Treaties, which promote capital liberalisation through the expansion of foreign direct investment. At the same time, the OECD Code of Liberalisation of Capital Movements constitutes a comprehensive international legal instrument regulating capital movements at the international level.

2 Free movement of capital in the EU

1 INTRODUCTION

Contrary to the rather fragmented international legal regime regarding capital liberalisation, the European legal framework on capital movements is much more comprehensive and sophisticated. The free movement of capital under Article 63 TFEU constitutes one of the four fundamental freedoms of the EU's Internal Market. There is a complex grid of Treaty provisions and a series of judgments of the Court of Justice covering a wide range of both intra- and extra-EU capital movements and forming a highly advanced and thorough legal regime aiming at facilitating financial integration in the EU. This is perhaps explained by the fact that, when compared to the international community, the EU is a regional organisation consisting of Member States with relatively similar economic, political and social development.[1]

While known as one of the four fundamental freedoms of the EU's Internal Market, the free movement of capital is rather special. Liberalising capital movements is of vital importance, not only for the achievement of the Internal Market, but also for the realisation of the Economic and Monetary Union and the protection of monetary stability in Europe.[2] At the same time, the achievement of capital liberalisation is a *conditio sine qua non* for the successful completion of the Capital Markets Union and the Banking Union, the two recent

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* Certain sections of this Chapter are based on the following contribution: Stefaan Van den Bogaert, Armin Cuyvers and Ilektra Antonaki, 'Free movement of services, establishment and capital' in Pieter Jan Kuijper, Fabian Amtenbrink, Deirdre Curtin, Bruno De Witte, Alison McDonnell and Stefaan Van den Bogaert (eds), *The Law of the European Union, Fifth Edition* (Wolters Kluwer 2018).

1 Jérémie Houet, *Les Golden Shares en droit de l'Union Européenne* (Larcier 2015), p. 341 citing Maurice Allais, winner of the Nobel Prize in Economic Sciences, who wrote that: 'une libéralisation totale des échanges et des mouvements de capitaux n'est possible, et n'est souhaitable, que dans le cadre d'ensembles régionaux groupant des pays économiquement et politiquement associés, et de développement économique et social comparable', see Maurice Allais, *La crise mondiale d'aujourd'hui: Pour de profondes réformes des institutions financières et monétaires* (Clément Juglar 1999), p. 77.

2 Catherine Barnard, *The Substantive Law of the EU: The Four Freedoms* (Oxford University Press 2016), p. 518-519.

initiatives of the European Commission, which are expected to accelerate financial integration and boost economic growth in the EU.[3]

Chapter 2 constitutes the second descriptive component of the thesis, which completes the study of the theoretical background of capital liberalisation and lays the groundwork for the next two normative chapters focusing on privatisations and golden shares (Chapters 3 and 4). In particular, it provides a comprehensive legal analysis of the free movement of capital at the European level. In order to do so, firstly, it starts with a brief description of the rather slow historical evolution of the free movement of capital from the Treaty of Rome to the Treaty of Lisbon in order to demonstrate the unique features of the capital freedom and the differences from the other three fundamental freedoms (Chapter 2, Section 2). Secondly, it explores in a detailed manner the current legal regime on the free movement of capital through the exercise of a doctrinal legal analysis of the relevant Treaty provisions and the pertinent case law (Chapter 2, Section 3). This analysis focuses primarily on the main legal issues arising from the interpretation of the fundamental freedoms (i.e. scope, relationship with the other freedoms, direct effect, restrictions, derogations and proportionality).

2 A HISTORICAL OVERVIEW

Renumbering of Treaty articles on the free movement of capital

Treaty of Rome	Article 67 EEC on capital movements and Article 106 (1) EEC on current payments
Treaty of Maastricht Treaty	Article 73b(1) EC
Treaty of Amsterdam	Article 56 (1) EC
Treaty of Lisbon	Article 63 TFEU

3 European Commission, *Completing the Capital Markets Union by 2019 – time to accelerate delivery, Communication from the Commission* (COM(2018) 114 final, 2018). The bibliography on the Capital Markets Union and the Banking Union is already very rich. To name but a few, see in particular: Danny Busch and Guido Ferrarini (eds), *European Banking Union* (Oxford University Press 2015); Niamh Moloney, 'European Banking Union: assessing its risks and resilience' (2014) 51 *Common Market Law Review* 1609; Stefan Grundmann, 'The Banking Union Translated into (Private Law) Duties: Infrastructure and Rulebook' (2015) 16 *European Business Organization Law Review* 357; Niamh Moloney, 'Capital markets union: "ever closer union" for the EU financial system?' (2016) 41 *European Law Review* 307; Niamh Moloney, ' Institutional governance and capital markets union: incrementalism or a 'big bang'?' (2016) 13 *European Company and Financial Law Review* 376.

2.1 Treaty of Rome: the early tentative steps

In comparison with the other fundamental freedoms, the free movement of capital followed a slow historical development in the course of European integration. This slow historical development can be explained by the political and economic controversies of the time and the concomitant suspicion and hesitant attitude of the Member States as well as the European Institutions towards unrestricted capital flows. In the light of the politico-economic climate of the post-war period and the explicit choices of the international monetary system in favour of capital controls, it was only natural for the EU to follow the international trend towards restricting capital mobility. As a result, the capital freedom did not follow the same liberalisation process as the other freedoms. The 1956 Spaak Report, which laid down the foundations of the EU's Internal Market, made allusion to the gradual liberalisation of capital movements as the last component of the Internal Market and as a corollary to the free movement of labour.[4] Article 67 of the 1957 Treaty establishing the European Economic Community (Treaty of Rome/EEC Treaty) contained a qualified obligation: the abolition of capital restrictions between Member States was to be achieved only to the extent necessary to ensure the proper functioning of the common market. Furthermore, Member States were allowed to introduce safeguard measures and many financial operations were subject to prior authorisation requirements known as 'exchange controls'.

From the perspective of the theoretical accounts of European Integration, the free movement of capital displays features of *liberal intergovermentalism*, which is not the framework the four freedoms have traditionally been associated with.[5] Up until the beginning of the 1990s, the free movement of capital did not follow the same integration process as the other freedoms. The Commission and the Court were reluctant to proceed to full capital liberalisation and to deprive Member States of their sovereign right to impose capital restrictions. This was due to the general post-war climate and the suspicion towards unfettered capital liberalisation, which was viewed as a potential source of crises and a threat to monetary stability. The Commission was not a staunch supporter of the complete abolition of capital restrictions and the Court was reluctant to follow the integrationist approach it had developed in the frame-

4 Paul-Henri Spaak, *The Brussels Report on the General Common Market* (The European Community for Coal and Steel, 1956). The relevant passage reads as follows: 'As for free movement of capital, this was based on the liberalisation of capital transfers relating to commodity or service transactions or to free movement of labour. It also required recognition of the right of nationals of member countries to acquire capital from any of the six member countries and to transfer and use it within the common market'.

5 Jukka Snell, 'Free movement of capital: Evolution as a non-linear process' in Craig and De Búrca (eds), *The Evolution of EU Law* (Oxford University Press 2011).

work of the other freedoms.[6] By contrast, the liberalisation process was left to the Council, which through the adoption of secondary legislation would gradually open up the capital markets of the Member States.

Against this backdrop, the Court in *Casati* initially refused to recognise direct effect of the relevant provision (Article 67 (1) EEC Treaty), fearing that a complete freedom of capital could 'undermine the economic policy of the Member States or create an imbalance of payments, thereby impairing the proper functioning of the common market'.[7] The case concerned an Italian national residing in Germany who was charged with attempting to export from Italy the sum 24000 Deutsche Marks without the authorisation that was prescribed by the pertinent Italian legislation. He had previously imported that money into Italy without declaring it with a view to purchasing equipment for his business in Germany and he claimed that he was obliged to re-export the currency because the factory from which he intended to buy the equipment was closed for holidays.[8] The judgement of the Court was rather striking especially in the light of the seminal judgements in *Dassonville*[9] and *Cassis de Dijon*,[10] which had been delivered some years before. In essence, the Court refrained from applying the classic negative integration approach to the free movement of capital. To the contrary, it acknowledged that this was a rather special and sensitive case, which the Member States had decided to exclude from complete liberalisation. The Court first noted that the freedom to move certain types of capital was in practice a precondition for the effective exercise of the other freedoms guaranteed by the Treaty, and in particular the freedom of establishment.[11] Secondly, it underlined that 'capital movements are closely connected with the economic and monetary policy of the Member States' and that

> 'it cannot be denied that complete freedom of movement of capital may undermine the economic policy of one of the Member States or create an imbalance in its balance of payments, thereby impairing the proper functioning of the Common Market'.[12]

6 Catherine Barnard, *The Substantive Law of the EU: The Four Freedoms* (Oxford University Press 2016), p. 520.
7 Case 203/80 *Criminal Proceedings Against Guerrino Casati,* ECLI:EU:C:1981:261, para 9.
8 Ibid, para 2.
9 Case 8-74 *Procureur du Roi v Benoît and Gustave Dassonville,* ECLI:EU:C:1974:82.
10 Case 120/78 *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein (Cassis de Dijon),* ECLI:EU:C:1979:42.
11 Case 203/80 *Casati*, para 8.
12 Ibid, para 9.

Thirdly, it emphasised that

> 'Article 67 (1) differs from the provisions on the free movement of goods, persons and services in the sense that there is an obligation to liberalise capital movements only "to the extent necessary to ensure the proper functioning of the Common Market".'[13]

Contrary to the traditional integrationist approach, the Court refused to take on the role of the motor of integration it had assumed few years earlier in relation to the free movement of goods. Instead, it recognised that the liberalisation of capital movements '*was a matter for the Council*', which in accordance with Article 69 EEC Treaty was responsible for the adoption of secondary legislation for the progressive implementation of Article 67 EEC Treaty.[14] The Council had indeed adopted two directives, which, however, did not require the Member States to adopt any liberalising measures regarding the physical importation and exportation of financial assets (including bank notes).[15] The Court was, therefore, bound to respect the clear legislative choice of the Council according to which

> 'it [was] unecessary to liberalise the exportation of bank notes' and 'there [was] no reason to suppose that, by adopting that position, it [had] overstepped the limits of its discretionary power'.[16]

2.2 The Council Directives

Under Article 69 EEC, the Council was authorised to adopt directives concerning the progressive liberalisation of capital movements. The First Capital Directive was adopted in 1960[17] and the Second Capital Directive in 1963.[18] They essentially divided capital movements into four annexed lists (A, B, C and D), which would follow a different degree of liberalisation. The movements covered by lists A and B (such as direct investments, investments in real estate, personal capital movements, gifts and endowments, dowries, inheritances and various operations in securities) were subject to unconditional liberalisation;[19]

13 Ibid, para 10.
14 Ibid, para 11.
15 Ibid, para 11.
16 Ibid, para 12.
17 'First Council Directive for the implementation of Article 67 of the Treaty' (1960) *OJ 43, 12.7.1960, p. 921-932*.
18 'Second Council 63/21/EEC Directive of 18 December 1962 adding to and amending the First Directive for the implementation of Article 67 of the Treaty' (1963) *OJ 9, 22.1.1963, p. 62-74*.
19 Articles 1 and 2 of the 'First Council Directive for the implementation of Article 67 of the Treaty' (1960) *OJ 43, 12.7.1960, p. 921-932*.

for movements covered by list C (such as the issue and placing of securities of a domestic undertaking on a foreign capital market), Member States could maintain or reintroduce exchange restrictions if free movement of capital was capable of forming an obstacle to the achievement of its economic policy objectives.[20] Finally, with respect to the capital movements referred to in list D (such as loans, credits and the physical importation and exportation of financial assets), the directives did not require the Member States to adopt any liberalising measures.

Although the first two directives laid the groundwork for the progressive liberalisation of capital movements, the major breakthrough came with the Third Capital Directive, Directive 88/361,[21] which 'brought about the full liberalisation of capital movements'[22] and gave the single market its full financial dimension. This Directive was adopted on the basis of Articles 69 and 70 (1) of the Treaty of Rome, the two old legal basis provisions which allowed the Council to adopt unanimously secondary measures in the field of the free movement of capital.[23]

The adoption of secondary legislation was not a self-evident decision. The Council was well aware of the risks and potential drawbacks of capital liberalisation and this was imprinted in the Preamble to Directive 88/361. In particular, the Preamble warned that free capital movements could seriously disturb the monetary or financial situation of Member States or cause serious stresses on the exchange markets.[24] It even stated that capital liberalisation might prove harmful for the cohesion of the European Monetary System, the smooth operation of the Internal Market and the progressive achievement of

20 Ibid, Article 3.

21 'Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty' (1988) *OJ L 178, 8.7.1988, p. 5-18*.

22 Joined cases C-358/93 and C-416/93 *Criminal proceedings against Aldo Bordessa and Vicente Marí Mellado and Concepción Barbero Maestre,* ECLI:EU:C:1995:54, para 17.

23 It should be noted that today these two provisions do not exist. Under the current legal regime there is no specific legal basis provision regarding free movement of capital between Member States (intra-EU capital movements). Article 64 (2) and (3) TFEU do provide the legal basis for the adoption of secondary legislation, but only in relation to capital movements to/from third countries (extra-EU capital movements). In particular, Article 64 (2) TFEU provides that the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall adopt the measures on the movement of capital to or from third countries involving direct investment (including investment in real estate) establishment, the provision of financial services or the admission of securities to capital markets. Article 64 (3) TFEU, on the other hand, provides that the Council, acting in accordance with a special legislative procedure, may unanimously, and after consulting the European Parliament, adopt measures, which constitute a step backwards in Union law as regards the liberalisation of the movement of capital to or from third countries.

24 Preamble to 'Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty' (1988) *OJ L 178, 8.7.1988, p. 5-18*.

the Economic and Monetary Union.[25] It therefore expressed the view that Member States should, if necessary, be able to take measures to restrict temporarily capital movements, which were liable to seriously disrupt the conduct of their monetary and exchange rate policies.[26] It drew special attention to the serious implications that capital liberalisation could have for the market of secondary residences in Member States located in border areas as well as to the risks of tax evasion and tax avoidance resulting from the divergent national systems of taxation.[27] Furthermore, it recognised that capital liberalisation would be particularly detrimental for the Hellenic Republic and Ireland, which were faced, albeit to differing degrees, with difficult balance-of-payments situations and high levels of external indebtedness.[28] It therefore granted to those two Member States further time to comply with the obligations arising from the Directive.[29]

Despite the initial hesitation and the possible risks associated with capital liberalisation, Article 1 of Directive 88/361 required Member States to abolish all restrictions on movements of capital taking place between persons resident in Member States. Shortly after the adoption of the Directive, the Court, in *Bordessa*, ruled that this prohibition on capital restrictions laid down in Article 1 thereof was directly effective and thus could be relied upon before national courts by individuals.[30] The case concerned two sets of criminal proceedings initiated against an individual due to the fact that he had exported a certain amount of money from Spain without possessing the requisite authorisation from the competent Spanish authorities. The Court was therefore asked to appraise the compatibility of the Spanish requirement of prior authorisation for the export of money with the Treaty provisions. In its assessment, the Court first noted that rules making the export of coins, banknotes or bearer cheques conditional upon a prior declaration or administrative authorisation did not fall within the scope of Articles 30 and 59 of the Treaty (today Article 34 and 56 TFEU), but rather within the scope of Article 67 of the Treaty (today Article 63 TFEU) and the scope of Directive 88/361.[31]

Next, in relation to its conformity with the provisions of Directive 88/361, the Court first emphasised that

25 Ibid.
26 Ibid.
27 Ibid.
28 With the benefit of hindsight, it is fair to say that this estimation was more than accurate.
29 Preamble to 'Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty' (1988) *OJ L 178, 8.7.1988, p. 5-18*.
30 Joined cases C-358/93 and C-416/93 *Bordessa*, paras 33-35.
31 Ibid, paras 11- 15, citing the Case 7/78 *Regina v Ernest George Thompson, Brian Albert Johnson and Colin Alex Norman Woodiwiss*, ECLI:EU:C:1978:209, para 25, in which the Court had ruled that means of payments were not to be regarded as goods.

> 'the Directive brought about the full liberalisation of capital movements, for which purpose Article 1 required Member States to abolish restrictions on movements of capital taking place between persons resident in Member States'.[32]

However, under Article 4 of the Directive, Member States were allowed to:

> 'take all requisite measures to prevent infringements of their laws and regulations, inter alia in the field of taxation and prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information'.[33]

The use of '*inter alia*' allowed the Court to expand the scope of possible justifications and to accept that

> 'other measures are also permitted in so far as they are designed to prevent illegal activities of comparable seriousness, such as money laundering, drug trafficking or terrorism'.[34]

However, in the proportionalisty assessment, the Court found that the requirement of prior authorisation is disproportionate as:

> 'it has the effect of suspending currency exports and makes them conditional in each case upon the consent of the administrative authorities, which must be sought by means of a special application. A requirement of that nature would cause the exercise of the free movement of capital to be subject to the discretion of the administrative authorities and thus be such as to render that freedom illusory'.[35]

The government could have adopted a less restrictive measure such as a system of declaration, as

> 'unlike prior authorisation, it does not entail suspension of the transaction in question but does still allow the national authorities to exercise effective supervision in order to prevent infringements of their laws and regulations'.[36]

The ruling in *Bordessa* was one of the first rulings in which the Court developed the distinction between *authorisation* and *declaration*: a system of declaration allows the national authorities to exercise effective supervision in order to prevent infringements of their laws and regulations without entailing the suspension of the transaction in question; by contrast, a system of prior authorisation suspends the transaction in question and creates an unreasonable

32 Joined cases C-358/93 and C-416/93 *Bordessa*, para 17.
33 Ibid, para 18. Today, this derogation is found in Article 65 (1) (a) TFEU.
34 Ibid, para 21.
35 Ibid, paras 24-25.
36 Ibid, para 27.

burden on the individual applying for it. Thus, a system of prior authorisation will most likely fail to meet the requirements of the principle of proportionality, if a system of declaration could have been adopted instead. The distinction between prior authorisation and declaration is a recurrent theme in the capital case law, which illustrates the preference of the Court for administrative procedures which do not impose unreasonable burden on the economic operators and do not hinder their economic activity, whilst at the same time allowing the public authorities to exercise the necessary regulatory supervision over the economic activities that take place within the territory of the Member State concerned.

Another important feature of Directive 88/361 is the non-exhaustive nomenclature of capital movements contained in Annex I, which includes a wide variety of financial transactions such as direct investments, investments in real estate, operations in securities (e.g. shares and bonds), operations in units of collective investment undertakings, operations in securities and other instruments normally dealt in on the capital market, operations in current and deposit accounts with financial institutions, credits related to commercial transactions, financial loans and credits, sureties, other guarantees and rights of pledge, transfers in performance of insurance contracts, personal capital movements (e.g. gifts and endowments, dowries, inheritances and legacies), physical import and export of financial assets and other capital payments. The Court has ruled that:

> 'even though Directive 88/361 was adopted on the basis of Articles 69 and 70(1) of the EEC Treaty, which was later replaced by Article 73b et seq. of the EC Treaty, the nomenclature in respect of movements of capital still has the same indicative value, for the purposes of defining the notion of capital movements, as it did before the entry into force of Article 73b et seq'.[37]

Therefore, in the absence of a definition of the concept of 'movement of capital' within the meaning of Article 63 (1) TFEU, the Court still uses the non-exhaustive list of capital movements annexed to Directive 88/361 when determining whether a specific transaction qualifies as 'capital movement'.

2.3 The Maastricht Treaty

The free movement of capital developed into a fully-fledged freedom of the EU's Internal Market in 1993 with the entry into force of the Maastricht Treaty

37 Case C-222/97 *Manfred Trummer and Peter Mayer,* ECLI:EU:C:1999:143, para 21; Joined cases C-105/12 to C-107/12 *Staat der Nederlanden v Essent NV, Essent Nederland BV, Eneco Holding NV and Delta NV,* ECLI:EU:C:2013:677, para 40.

and the establishment of the Economic and Monetary Union,[38] which is arguably one of the most significant developments in the history of European Integration. After a long period of economic turmoil and persistent political controversies, the entry into force of the Maastricht Treaty marked the transition to the fourth stage of economic integration, which enabled European economies to not only benefit from an Internal Market with free circulation of goods, persons, services and capital, but also to converge on a macro-economic level, to develop common economic and monetary policies and eventually to adopt a common currency.[39] In order to achieve this transition, it was

38 For an overview of the historical evolution, the institutional foundations and economic, political and legal implications of the functioning of the EMU, see in particular: Mads Andenas and others, *European Economic and Monetary Union: The Institutional Framework* (Kluwer Law International 1997); Jean-Victor Louis, 'The New Monetary Law of the European Union and its Scope of Application' in Mario Giovanoli (ed), *International Monetary Law: Issues for the New Millennium* (Oxford University Press 2000), pp. 137-59; Kenneth Dyson, *European States and the Euro: Europeanization, Variation, and Convergence* (Oxford University Press 2002); Kenneth Dyson and Kevin Featherstone, *The Road To Maastricht: Negotiating Economic and Monetary Union* (Oxford University Press 1999); Dermot Hodson, *Governing the Euro Area in Good Times and Bad* (Oxford University Press 2011); Tommaso Padoa-Schioppa, *The Road to Monetary Union in Europe: The Emperor, the Kings, and the Genies* (Oxford University Press 2000); Kenneth Dyson, 'Economic and Monetary Union' in Erik Jones, Anand Menon and Stephen Weatherill (eds), *The Oxford Handbook of the European Union* (Oxford Univrsity Press 2012); Peter Kenen, *Economic and Monetary Union in Europe: Moving beyond Maastricht* (Cambridge University Press 1995); Mark Hallerberg, Rolf Rainer Strauch and Jürgen von Hagen, *Fiscal Governance in Europe* (Cambridge University Press 2009); Paul Masson and Mark Taylor, *Policy Issues in the Operation of Currency Unions* (Cambridge University Press 1993); Otmar Issing, *The Birth of the Euro* (Cambridge University Press 2001).

39 According to one of the leading post-war trade economist, the Hungarian Béla Balassa, economic integration as a process refers to measures designed to abolish discrimination between economic units belonging to different national states and as a state of affairs it is the absence of discrimination between national economies. Béla Balassa distinguished five stages of economic integration: (1) Free trade areas, where tariffs are eliminated between member countries, which means that there is free movement of goods within this area; (2) Customs Union, where in addition to the abolition of tariffs, member states establish a common customs rules regarding imported goods from third countries; (3) Common Market, which combines a customs union with free movement not only of goods but also of the other factors of production, i.e. free movement of persons, services and capital; (4) Economic Union, where in addition to the four freedoms, member states undertake some degree of harmonisation of national economic policies; and (5) Complete Economic Integration, which entails 'the unification of monetary, fiscal, social and countercyclical policies' and 'the setting up of a supra-national authority whose decisions are binding for the member states'. See Bela Balassa, *The Theory of Economic Integration* (Irwin Homewood 2011); André Sapir, 'European Integration at the Crossroads: A Review Essay on the 50th Anniversary of Bela Balassa's Theory of Economic Integration' (2011) 49 *Journal of Economic Literature* 1200. For more literature on economic integration see Richard Baldwin and Anthony Venables, 'Regional economic integration' in Gene Grossman and Kenneth Rogoff (eds), *Handbook of International Economics* (Elsevier 1995), pp. 1597-1644; Richard Baldwin and Charles Wyplosz, *The Economics of European Integration* (McGraw-Hill 2012); Richard Baldwin and others, *Market Integration, Regionalism and the Global Economy* (Cambridge University

decided that capital movements had to be liberalised not only within the EU but also in relation to third countries. The entry into force of the Maastricht Treaty was therefore a turning point in the history of European financial integration, as it signified the fundamental deviation from the post-war international scepticism regarding unfettered capital flows and the adoption of a much more liberal approach at the European level.

3 THE CURRENT LEGAL FRAMEWORK

This part of the thesis addresses the main legal questions arising from the interpretation of the free movement of capital as one of the four fundamental freedoms of the EU's Internatl Market, i.e. the material and territorial scope of Article 63 TFEU (section 3.1); the relationship with the other freedoms (section 3.2); the direct effect of Article 63 TFEU (section 3.3); the definition of restrictions on capital movements (section 3.4); the derogations from the free movement of capital (section 3.5) and the proportionality assessment applied by the Court of Justice (section 3.6).

3.1 The scope of Article 63 TFEU

3.1.1 Difference between 'capital movements' and 'payments'

As is evidenced by its wording, Article 63 (1) TFEU prohibits all restrictions on capital movements, while Article 63 (2) TFEU prohibits all restrictions on payments. In the past, the abolition of restrictions on 'payments' was provided for under Article 106 EEC, which stipulated that payments relating to the provision of services had to be liberalised to the extent to which the movement of services itself was liberalised, which in turn, by virtue of Article 59 of the Treaty, had to be achieved by the end of the transitional period. Today, Article 106 EEC Treaty has been repealed and restrictions on both capital movements and payments are prohibited under Article 63 TFEU.

The distinction between 'capital movements' and 'payments' was first recognised by the Court in *Luisi and Carbone*.[40] The case concerned two Italian residents who were fined for the Treasury for purchasing various currencies for tourism and medical treatment abroad which exceeded the maximum amount permitted by Italian law. The plaintiffs claimed that the restrictions on the export of means of payment in foreign currency for the purpose of

Press 1999).

40 Joined cases 286/82 and 26/83 *Graziana Luisi and Giuseppe Carbone v Ministero del Tesoro* ECLI:EU:C:1984:35.

tourism or medical treatment were contrary to the provisions of the EEC Treaty relating to current payments and the movement of capital. The Court clarified that:

> 'current payments are transfers of foreign exchange which constitute the consideration within the context of an underlying transaction, whilst movements of capital are financial operations essentially concerned with the investment of the funds in question rather than remuneration for a service'.[41]

Therefore, the physical transfer of bank notes as a means of payment for a transaction involving the movement of goods or services (such as tourism, medical treatment, education or business) was classified as 'current payment' and not as 'capital movement'.[42] These restrictions on current payments relating to the provision of services had to be abolished by the end of the transitional period.[43]

The distinction between 'capital movements' and 'current payments' was reiterated in the *Lambert* judgment.[44] The case concerned Mr Lambert, a Luxembourg cattle dealer, who accepted payment in banknotes, both in foreign currency (German marks and Dutch guilders) and in Belgian and Luxembourg francs for the sales of cattle in Germany and the Netherlands. The Luxembourg legislation applicable at that time required exporters to have foreign currency payable in respect of their sales paid through a bank and to exchange such currency on the regulated foreign exchange market. Essentially, it prohibited exporters from obtaining payment in banknotes. Mr Lambert challenged this legislation, arguing that the requirement to sell foreign currency to approved banks (i.e. the controlled exchange market) had the effect of reducing the value of the money ultimately received by the exporter by 5% to 10% compared to what could have been obtained on the free market. The Court referred to *Luisi and Carbone* and clarified once again the difference between 'current payments' and 'capital movements'.[45] *In casu*, the Court found that the transaction which Mr Lambert carried out 'did not constitute a capital movement but was a transfer of foreign currency connected with a movement of goods'.[46] The logic behind the requirement for exporters to have foreign currency payable through a bank was

41 Ibid, para 21.
42 Ibid, paras 22-23.
43 Ibid, para 24.
44 Case 308/86 *Criminal proceedings against R. Lambert,* ECLI:EU:C:1988:405.
45 Joined cases 286/82 and 26/83 *Luisi and Carbone*, para 10.
46 Case 308/86 *Lambert*, para 14.

> 'to ensure that current payments are made exclusively on the regulated foreign exchange market and that the free market is reserved for capital movements. It is therefore intended to ensure the separation of the two markets'.[47]

Such a requirement was compatible with the Article 5 (1) of the First Capital Directive, which allowed Member States to

> 'maintain a two-tier foreign exchange market to adopt themeasures necessary to ensure that current payments are made exclusively on the regulated market and that the free market is reserved for capital movements'.[48]

It was also compatible with Article 106 EEC Treaty since it dealt 'solely with the way in which the exporter must receive payment, regardless of whether that payment is expressed in foreign or national currency'.[49] Furthermore, the Court emphasised that:

> 'the prohibition of exporters obtaining payment in banknotes, which is the corollary of the abovementioned requirement, is also not contrary to Article 106 of the Treaty the aim of which is […] to ensure that the necessary monetary transfers may be made for the free movement of goods. […] [T]ransfers of banknotes cannot be regarded as necessary for the free movement of goods since it is a method of payment which is not in conformity with standard practice'.[50]

Accordingly, the Court concluded that, as Community law stood at the time:

> 'rules which require exporters to have foreign currency payable in respect of their sales paid through a bank and to exchange such currency on the regulated foreign exchange market and which prohibit them as a result from taking payment in banknotes, are not a barrier to the liberalisation of payments connected with the movement of goods which is incompatible with Article 106 of the Treaty'.[51]

3.1.2 Territorial scope

Perhaps the most salient feature distinguishing the free movement of capital from the other freedoms is the fact that it applies to not only to Member States but also to third countries (*erga omnes* effect).[52] The extra-EU territorial di-

47 Ibid, para 12.
48 Ibid, para 15.
49 Ibid, para 16.
50 Ibid, para 17.
51 Ibid, para 18.
52 The third-country-dimension of the free movement of capital has attracted a remarkable scholarly attention. See, for instance, Michael Lang and Pasquale Pistone (eds), *The EU and Third Countries: Direct Taxation* (Kluwer Law International 2008); Alexandre Maitrot de la Motte, 'Les spécificités de la libre circulation des capitaux: l'exemple de la contestation des entraves fiscales' in Édouard Dubout and Alexandre Maitrot de la Motte (eds), *L'unité des*

mension of the free movement of capital was recognised by the Court in *Sandoz*, where it was emphasised that Article 73b (I) of the Treaty (today Article 63 TFEU) covered all restrictions on movement of capital between Member States and between Member States and third countries.[53] This unique feature elevates the free movement of capital to a whole different level, rendering it a potential gateway through which extra-EU investors can approach and ultimately access the EU's Internal Market.

Even though the Treaty does not state the reasons why the scope *ratione loci* of the free movement was extended so as to cover also capital movements to/from third counties, it is commonly accepted that this extension was impelled by the EU's monetary policy.[54] Indeed, the external dimension of the free movement of capital may pursue objectives other than that of establishing the internal market, such as, in particular, that of ensuring the credibility of the single currency on the international financial markets and creating and maintaining financial centres with a world-wide dimension within the Member States.[55]

The external dimension of the free movement of capital has been used in order to bring into the scope of the EU's Internal Market investments and financial transactions to and from third countries, which otherwise would be excluded from the benefits of the single market. In particular, the *erga omnes* effect of the free movement of capital has been interpreted so as to cover restrictions on capital movements involving the provision of financial services between Member States and third countries,[56] national measures which restrict pay-

libertés de circulation – In varietate concordia (Bruylant 2013), pp. 289-329; Axel Cordewener, Georg W. Kofler and Clemens Philipp Schindler, 'Free Movement of Capital and Third Countries: Exploring the Outer Boundaries with Lasertec, A and B and Holbo¨ck' (2007) 47 European Taxation 371; Axel Cordewener, Georg W. Kofler and Clemens Philipp Schindler, 'Free Movement of Capital, Third Country Relationships and National Tax Law: An Emerging Issue before the ECJ' (2007) 47 European Taxation 107; Martha O'Brien, 'Taxation and the Third Country Dimension of Free Movement of Capital in EU Law: The ECJ's Rulings and Unresolved Issues' (2008) 6 British Tax Review 628; Philippe Vigneron, 'L'effet erga omnes de la libre circulation des capitaux dans la Constitution européenne: un retour en arrière?' (2004) 23 *Euredia* 369; Christiana Hjipanayi, 'The Fundamental Freedoms and Third Countries: Recent Perspectives' (2008) 48 *European Taxation* 571; Cees Peters and Jan Gooijer, 'The free movement of capital and third countries' (2005) 45 *European Taxation* 475; Joanna Mitroyanni, 'Exploring the Scope of the Free Movement of Capital in Direct Taxation' (2005) 8 *EC Tax Journal* 1; Louis Vogel, *Traité de droit économique, Tome 4: Droit européen des affaires* (Bruylant 2015), pp. 300-302.

53 Case C-439/97 *Sandoz GmbH v Finanzlandesdirektion für Wien,* ECLI:EU:C:1999:499, para 18.

54 *Opinion of Advocate General Bot in Case C-101/05 Skatteverket v A,* ECLI:EU:C:2007:493, paras 75-77.

55 Case C-101/05 *Skatteverket v A,* ECLI:EU:C:2007:804, para 31.

56 Case C-560/13 *Finanzamt Ulm v Ingeborg Wagner-Raith,* ECLI:EU:C:2015:347, para 37.

ments of dividends deriving from investments to or from third countries[57] and national tax legislation under which the dividends paid by companies established in a Member State to an investment fund established in a non-Member State are not the subject of a tax exemption, while investment funds established in that Member State receive such an exemption.[58]

However, this expansion of the territorial boundaries of the Internal Market carries an element of risk, especially in cases of abuse where third-country investors attempt to extend the scope of other freedoms through the backdoor of the free movement of capital. This is the reason why the delineation of the border between the freedom of establishment or services (which apply only to intra-EU transactions) and the free movement of capital (which applies to extra-EU transactions as well) is of paramount importance (Chapter 2, Sections 3.2.2 and 3.2.3). It should be noted, however, that the extended territorial scope of the free movement of capital is counterbalanced by additional justification grounds available to Member States in order to protect sensitive national interests when these are threatened by capital flows to/from third countries (Chapter 2, Section 3.5.1.2). Therefore, while it is true that non-EU investors can in principle rely on Article 63 TFEU, the Member States nevertheless enjoy a wider discretion regarding the imposition of restrictions on capital movements to/from third countries.

3.1.3 Material Scope

Contrary to the freedom to provide services,[59] the Treaty provisions on the free movement of capital do not define the concept of 'capital movements'. In the absence of any definition of capital movements in the Treaty, the Court has held that the non-exhaustive nomenclature in Annex I of Directive 88/361 has indicative value for the purposes of defining capital movements. This list includes a wide variety of capital movements, such as the physical import and export of financial assets and other capital payments,[60] direct invest-

57 Case C-446/04 *Test Claimants in the FII Group Litigation,* ECLI:EU:C:2006:774, para 183.

58 Case C-190/12 *Emerging Markets Series of DFA Investment Trust Company,* ECLI:EU:C:2014:249, para 35.

59 Article 57 TFEU provides a broad definition of 'services' within the meaning of the Treaty, stating that they are normally provided for remuneration on a temporary basis and they particularly include activities of an industrial or commercial character, activities of craftsmen and various professions.

60 Joined cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera*, paras 17-18; Joined cases C-358/93 and C-416/93 *Bordessa*, paras 13-15; Case C-190/17 *Lu Zheng v Ministerio de Economía y Competitividad,* ECLI:EU:C:2018:357.

ments,[61] investments in real estate,[62] operations in securities (e.g. resale of shares,[63] bonds,[64] receipt of dividends[65]), financial loans and credits,[66] mortgages and other guarantees,[67] gifts and endowments[68] and inheritances.[69] The most important categories are examined in more detail in the sections that follow.

3.1.3.1 Investments in real estate

In *Konle*, the Court held that investments in real estate on the territory of a Member State by non-residents are covered by Annex I of Directive 88/361 and thus constitute capital movements for the purposes of Article 63 TFEU.[70] The case concerned a German national who, in the context of a procedure for compulsory sale by auction, acquired a plot of land in Austria on the condition that he obtain the administrative authorisation required under the Austrian legislation at that time. In order to obtain such an authorisation, the acquirer

61 Joined cases C-282/04 and C-283/04 *Commission v The Netherlands (golden shares),* ECLI:EU:C:2006:608, para 19; Case C-309/99 *J. C. J. Wouters, J. W. Savelbergh en Price Waterhouse Belastingadviseurs BV tegen Algemene Raad van de Nederlandse Orde van Advocaten, in tegenwoordigheid van: Raad van de Balies van de Europese Gemeenschap,* ECLI:EU:C:2002:98, para 38; Case C-174/04 *Commission v Italy (golden shares),* ECLI:EU:C:2005:350, para 12; Case C-39/11 *VBV – Vorsorgekasse AG v Finanzmarktaufsichtsbehörde (FMA),* ECLI:EU:C:2012:327, para 21; Case C-483/99 *Commission v France (golden shares – Sociéte Nationale Elf-Aquitaine),* ECLI:EU:C:2002:327, para 37; Case C-503/99 *Commission v Belgium (golden shares),* ECLI:EU:C:2002:328, para 38.

62 Case C-370/05 *Criminal proceedings against Uwe Kay Festersen,* ECLI:EU:C:2007:59, para 23; Case C-452/01 *Margarethe Ospelt and Schlössle Weissenberg Familienstiftung,* ECLI:EU:C:2003:493, para 7; Joined cases C-515/99, C-519/99 to C-524/99 and C-526/99 to C-540/99 *Hans Reisch and Others,* ECLI:EU:C:2002:135, para 29; Case C-446/04 *Test Claimants in the FII Group Litigation*, paras 23-24.

63 Richard Baldwin and Charles Wyplosz, *The Economics of European Integration* (MacGraw-Hill Education 2006), para 29.

64 Case C-329/03 *Trapeza tis Ellados AE v Banque Artesia,* ECLI:EU:C:2005:645, para 34.

65 Case C-35/98 *Staatssecretaris van Financiën v B.G.M. Verkooijen,* ECLI:EU:C:2000:294, paras 28-30.

66 Case C-452/04 *Fidium Finanz AG v Bundesanstalt für Finanzdienstleistungsaufsicht,* ECLI:EU:C:2006:631, para 42; Case C-282/12 *Itelcar – Automóveis de Aluguer Lda v Fazenda Pública,* ECLI:EU:C:2013:629, para 14; Case C-39/11 *VBV – Vorsorgekasse*, para 36; Case C-478/98 *Commission v Belgium (Eurobond),* ECLI:EU:C:2000:497, para 17.

67 Case C-222/97 *Trummer and Mayer*, paras 24, 34; Case C-279/00 *Commission v Italy,* ECLI:EU:C:2002:89, para 37.

68 Case C-318/07 *Hein Persche v Finanzamt Lüdenscheid,* ECLI:EU:C:2009:33, paras 24,25.

69 Case C-256/06 *Theodor Jäger v Finanzamt Kusel-Landstuhl*, ECLI:EU:C:2008:20, para 25; Case C-513/03 *Heirs of M. E. A. van Hilten-van der Heijden,* ECLI:EU:C:2006:131, para 42; Case C-364/01 *The heirs of H. Barbier v Inspecteur van de Belastingdienst Particulieren/Ondernemingen buitenland te Heerlen,* ECLI:EU:C:2003:665, para 58.

70 Case C-302/97 *Klaus Konle v Republik Österreich,* ECLI:EU:C:1999:271, para 22. See also the case comment Alina Lengauer, 'Case C-302/97, Klaus Konle v. Republic of Austria, Judgment of the Full Court of 1 June 1999' (2000) 37 *Common Market Law Review* 177.

had to prove that the planned acquisition would not be used to establish a secondary residence. However, such a requirement of proof was not applicable to Austrian nationals, for whom a mere declaration was sufficient in order to obtain the authorisation. When the Austrian authorities rejected his application, he challenged the compatibility of the national legislation with EU law. The questions referred to the Court concerned both the discriminatory treatment of foreign nationals (TGVG 1993) and the system of authorisation as such which was applicable to both Austrian and foreign nationals (TGVG 1996). With respect to the first issue, the Court acknowledged that it was a discriminatory restriction against nationals of other Member States in respect of capital movements between Member States,[71] which was however covered by Article 70 of the Act of Accession allowing Austria to maintain different schemes for the acquisition of land depending on the nationality of the acquirer as laid down in the TGVG 1993. In relation to the general scheme of authorisation laid down in TGVG 1996, this was not covered by the Act of Accession and therefore it entailed a restriction on the free movement of capital.[72]

3.1.3.2 Direct and portfolio investments

Direct and portfolio investments are another important category of capital movements that has given rise to a wide range of cases, most notably the line of case law relating to golden shares, which is extensively discussed in Chapter 4. The Court has ruled on numerous occasions that the nomenclature contained in Directive 88/361 includes both 'direct' investments, i.e. participation in an undertaking through the holding of shares which confers the possibility of effectively participating in its management and control, and 'portfolio' investments, i.e. the acquisition of shares on the capital market solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking as capital movements for the purposes of Article 63 TFEU.[73]

71 Case C-302/97 *Konle*, para 23.

72 Ibid, para 39.

73 Case C-222/97 *Trummer and Mayer*, para 21; Case C-483/99 *Commission v France (golden shares – Sociéte Nationale Elf-Aquitaine)*, paras 36-37; Case C-98/01 *Commission v UK (golden shares)*, ECLI:EU:C:2003:273, para 40.

3.1.3.3 Loans, mortgages and commercial credits

Loans,[74] mortgages[75] and commercial credits[76] are also included in the concept of capital movements. In that respect, in *Fidium Finanz*, the Court held that loans and credits granted by non-residents to residents feature under Heading VIII of Annex I to Directive 88/361, entitled 'Financial loans and credits' and thus constitute capital movements for the purposes of Article 63 TFEU. It also noted that, according to the explanatory notes of Annex I, this category includes also consumer credit.[77] Furthermore, it has also been found that the cross-border lending of a vehicle free of charge constitutes a capital movement within the meaning of Article 63 TFEU.[78]

3.1.3.4 Receipt of dividends

The receipt of dividends, although not expressly mentioned in the nomenclature annexed to Directive 88/361, necessarily presupposes participation in undertakings referred to in Heading I (2) of the nomenclature and is therefore inextricably linked to 'capital movements' according to the judgment in *Verkooijen*.[79] Dividends from a company established in another Member State and quoted on the stock exchange can even qualify as 'acquisition by residents of foreign securities dealt in on a stock exchange' as referred to in Heading III A (2) of Annex I to Directive 88/361.[80]

3.1.3.5 Resale of shares

Furthermore, the resale of shares to the issuing company has also been recognised as 'capital movement' within the meaning of Article 63 TFEU in *Bouanich v Skatteverket*,[81] which concerned the refusal of the Swedish Local Tax Board to refund to Ms Bouanich, a French national and shareholder in a Swedish public limited company, the amount of the tax charged on the repurchase of her shares by the company in connection with a reduction in its share capital. The Court found that that the national legislation at issue constitutes arbitrary discrimination against non-resident shareholders in so

74 Case C-478/98 *Commission v Belgium*.
75 Case C-222/97 *Trummer and Mayer*.
76 Case C-452/04 *Fidium Finanz*, paras 42-43.
77 Ibid.
78 Case C-39/11 *VBV – Vorsorgekasse*, para 36.
79 Case C-35/98 *Verkooijen*, para 28.
80 Ibid, paras 29-30.
81 Richard Baldwin and Charles Wyplosz, *The Economics of European Integration* (MacGraw-Hill Education 2006), para 29.

far as it taxes them more onerously than resident shareholders in an objectively comparable situation.[82]

3.1.3.6 Inheritances

Inheritances involving a transfer to one or more persons of assets left by the deceased fall within Heading XI entitled 'Personal capital movements' of Annex I to Directive 88/361 and therefore are considered to be 'capital movements' for the purposes of Article 63 TFEU, except in cases where their constituent elements are confined within a single Member State, as it was established in *Jäger*.[83]

3.1.3.7 Gifts and endowments

Finally, gifts and endowments are also listed in Annex I to Directive 88/361 and are thus capital movements for the purposes of Article 63 TFEU. In *Persche*, the Court held that the qualification of gifts as capital movements is irrespective of whether those gifts are in money or in kind.[84] The case concerned a German resident who claimed a tax deduction for his donation of bed linen and towels to a retirement and children's home situated in Portugal. The German legislation applicable at that time allowed the deduction for tax purposes only of gifts made to charitable institutions located in Germany. The Court found that those national rules contravened Article 63 TFEU.

3.2 Relationship with the other freedoms

Although, in principle, the aforementioned types of transactions qualify as capital movements, it is sometimes difficult to determine which fundamental freedom is applicable. The following three sections focus on the relationship between the free movement of capital and the other fundamental freedoms and seek to shed light on the somewhat confusing case law of the Court.

3.2.1 Capital v goods

The delineation of the material scope of the free movement of goods and the free movement of capital is a rather easy exercise, which does not give rise to any particular difficulty. Thus, the Court as early as in 1978 clarified that

82 Ibid, para 41.

83 Case C-256/06 *Jäger*, para 25; Case C-513/03 *van Hilten-van der Heijden*, para 42; Case C-364/01 *Barbier*, para 58; Case C-11/07 *Hans Eckelkamp and Others v Belgische Staat*, ECLI:EU:C:2008:489, para 39.

84 Case C-318/07 *Persche*, paras 24-25.

'means of payment' are not to be regarded as goods.[85] In particular, in *Regina v Thomson*, it was held that silver alloy coins which constituted legal tender in a Member State were, by their very nature, to be regarded as 'means of payment' and therefore not falling within the scope of the free movement of goods.[86] The same was true for South African Krugerrands, which, although not means of legal payments, were treated in some Member States as coins equivalent to currency.[87]

3.2.2 Capital v Establishment

3.2.2.1 The theory of parallelism

Contrary to the distinction between capital and goods, the distinction between capital and establishment is a rather difficult exercise. As early as in 1981, the Court underlined the special character of the free movement of capital by explaining that although it constitutes one of the fundamental freedoms, it is also quite often a precondition for the effective exercise of other freedoms guaranteed by the Treaty, in particular the right of establishment.[88] The need to insert reciprocal reservations in the Treaty reveals how closely intertwined and inextricably linked these two freedoms are. In particular, Article 49 (2) TFEU provides that the freedom of establishment covers the right to take up and pursue activities as a self-employed person and the right to set up and manage undertakings, subject to the provisions of the Chapter relating to capital. At the same time, under Article 65 (2) TFEU, the provisions of the Chapter on capital shall be without prejudice to the applicability of restrictions on the right of establishment which are compatible with the Treaties.

One could probably argue that, at first glance, the existence of these two reservations implies that capital and establishment are mutually exclusive (theory of *exclusivity*).[89] However, the Court's reasoning has been consistently based on the premise that fundamental freedoms can apply in parallel (theory

85 Case 7/78 *Regina v Thompson and Others*, para 25.
86 Ibid, para 26.
87 Ibid, para 27.
88 Case 203/80 *Casati*, para 8.
89 This was in fact the argument of the Dutch Government in the *Baars* case. See Case C-251/98 *C. Baars v Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem,* ECLI:EU:C:2000: 205, para 18. See also *Opinion of Advocate General Alber in Case C-251/98 Baars,* ECLI:EU:C: 1999:502, para 24, where he expressed the view that the second paragraph of Article 49 TFEU must mean that a restriction on capital movements is not *per se* an infringement of the freedom of establishment. Conversely, Article 65 (2) TFEU should be interpreted as meaning that when a measure directly restricts establishment, it should be examined only from the angle of establishment.

of *parallelism*).[90] Indeed, Article 49 (2) TFEU and Article 65 (2) TFEU are based on the principle that the freedom of establishment and the free movement of capital can apply simultaneously. Otherwise there would be no need to insert two reservations clarifying that the application of the one freedom shall be without prejudice to the application of the other. In other words, the two reservation clauses would be superfluous if a certain factual situation could *a priori* be captured only by one freedom.[91] Furthermore, the parallel application of the two freedoms is also supported by the fact that when the free movement of capital developed into a fully-fledged freedom of the EU's Internal Market with the advent of the Maastricht Treaty, 'the intention was to add a further fundamental freedom to those already in existence, and extend the range of protected cross-frontier economic activities'.[92] The endorsement of the theory of *parallelism* is thus based not only on the grammatical reading of the Treaties, but also on a teleological interpretation of the fundamental freedoms and a historical perception of the evolution of the Internal Market.

3.2.2.2 The exercise of definite influence as the test to determine which freedom has priority

The next question is to determine which of the two has *priority*. In other words, in a situation where the contested national legislation is captured by both the freedom of establishment and the free movement of capital, the question arises which of the two is going to take precedence over the other. As a general rule, according to well-established case law, the *purpose* of the national legislation at issue is the main factor determining which fundamental freedom is applic-

90 Case C-204/90 *Hanns-Martin Bachmann v Belgian State,* ECLI:EU:C:1992:35, para 34, where the Court held that rules on capital movements do not cover restrictions which flow indirectly from the restriction of other fundamental freedoms; Case C-484/93 *Peter Svensson and Lena Gustavsson v Ministre du Logement et de l'Urbanisme,* ECLI:EU:C:1995:379, paras 8-11, where the Court found that a provision which makes lending by banks more difficult might constitute an infringement of bot Article 56 TFEU and Article 63 TFEU; Case C-222/95 *Société civile immobilière Parodi v Banque H. Albert de Bary et Cie,* ECLI:EU:C:1997:345, para 10, where the Court stated that the freedom to provide services would only cease to apply where there is a restriction on the free movement of capital which is compatible with Community law; Case C-410/96 *Criminal proceedings against André Ambry,* ECLI:EU:C:1998: 578, para 40, where the Court applied the freedom to provide services to national rules barring non-resident credit institutions from lodging certain securities, leaving open the question whether such rules might also infringe Article 63 TFEU; Case C-302/97 *Konle*, para 22, where the Court, while stating that both capital and establishment were applicable to an Austrian legislation rendering more difficult the acquisition of land by foreigners, in the end it limited its analysis only to Article 63 TFEU. All these cases show that regardless of the actual application, the Court starts from the premise that the parallel application of capital with either establishment or services is *in principle* possible.

91 Wolfgang Schön, 'Free Movement of Capital and Freedom of Establishment' (2016) 17 *European Business Organization Law Review* 229.

92 *Opinion of Advocate General Alber in Case C-251/98 Baars*, para 23.

able.[93] However, where a national measure relates to several fundamental freedoms at the same time, the Court will in principle examine the measure in relation to only one of those freedoms if it appears that the other freedoms are entirely secondary.[94] In that respect, Advocate General Alber in *Baars* formulated a three-step test for the determination of the applicable freedom: (1) If the contested national measure restricts directly the free movement of capital and only indirectly the freedom of establishment, only the rules on capital apply; (2) If the measure restricts directly the freedom of establishment and only indirectly the free movement of capital, only the rules on establishment apply; (3) if the measure restricts both capital and establishment, both freedoms should apply simultaneously.[95]

However, despite its appeal, this test could not always capture all the intricacies and the different characteristics of the national measures under scrutiny. Thus, although certainly informed by the contribution of the Advocate General, the Court gradually developed a more elaborate test allowing for a more clear delimitation of the fundamental freedoms. The golden shares case law can help us understand the methodological approach the Court has followed in order to determine the applicable freedom. Golden shares are primarily examined from the perspective of the free movement of capital and secondarily from the perspective of the freedom of establishment.[96] The criterion applied by the Court in order to distinguish between freedom of establishment and free movement of capital is the exercise of *definite influence* over the management of the company. On the one hand, provisions of national law which apply to the possession, by nationals of a Member State, of holdings in the capital of a company established in another Member State allowing them to exert a definite influence on the company's decisions and to determine its

93 Case C-157/05 *Winfried L. Holböck v Finanzamt Salzburg-Land,* ECLI:EU:C:2007:297, para 22; Case C-196/04 *Cadbury Schweppes plc,* ECLI:EU:C:2006:544, paras 31-33; Case C-452/04 *Fidium Finanz*, paras 34, 44-49; Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation,* ECLI:EU:C:2006:773, paras 37 and 38; Case C-446/04 *Test Claimants in the FII Group Litigation*, para 36; Case C-524/04 *Test Claimants in the Thin Cap Group Litigation,* ECLI:EU:C:2007:161, paras 26-34.

94 Case C-233/09 *Gerhard Dijkman and Maria Dijkman-Lavaleije v Belgische Staat,* ECLI:EU:C:2010:397, para 33; Case C-42/07 *Liga Portuguesa,* ECLI:EU:C:2009:519, para 47; Case C-452/04 *Fidium Finanz*, para 34.

95 *Opinion of Advocate General Alber in Case C-251/98 Baars*, para 26 and 30.

96 For instance, in the Case C-244/11 *Commission v Greece (golden shares),* ECLI:EU:C:2012:694, para 23, the Court preferred to apply the freedom of establishment instead of the free movement of capital on the ground that the Greek prior authorisation scheme covered only the acquisition of more than 20% of the capital shareholding and was thus intended to cover investments aiming at exerting a definite influence over the managements and control of the undertaking concerned. See Jérémie Houet, *Les Golden Shares en droit de l'Union Européenne* (Larcier 2015), p. 144.

activities, fall within the ambit *ratione materiae* of Article 49 TFEU.[97] On the other hand, 'direct investments', i.e. investments of any kind made by natural or legal persons which serve to establish or maintain lasting and direct links between the persons providing the capital and the company to which that capital is made available in order to carry out an economic activity, fall within the scope of Article 63 TFEU.[98] National legislation which is not limited to those shareholdings which enable the holder to have a definite influence on a company's decisions and to determine its activities but which applies irrespective of the size of the holding which the shareholder has in a company may fall within the ambit of both Articles 49 and 63 TFEU.[99]

97 Case C-244/11 *Commission v Greece (golden shares)*, para 21; Case C-212/09 *Commission v Portugal (golden shares – GALP Energia SGPS SA),* ECLI:EU:C:2011:717, paCase C-196/04 *Cadbury Schweppes*ra 42; Case C-326/07 *Commission v Italy (golden shares),* ECLI:EU:C:2009:193, para 34; Case C-543/08 *Commission v Portugal (golden shares – EDP),* ECLI:EU:C:2010:669, para 41; Case C-251/98 *Baars*, para 22; Case C-436/00 *X and Y,* ECLI:EU:C:2002:704, paras 37, 66-68. Case C-446/04 *Test Claimants in the FII Group Litigation*, para 37; Case C81/09 *Idryma Typou AE v Ypourgos Typou kai Meson Mazikis Enimerosis,* ECLI:EU:C:2010:622, para 47; Case C-310/09 *Ministre du Budget, des Comptes publics et de la Fonction publique v Accor SA,* ECLI:EU:C:2011:581, para 32; Case C31/11 *Marianne Scheunemann v Finanzamt Bremerhaven,* ECLI:EU:C:2012:481, para 23; and Case C-35/11 *Test Claimants in the FII Group Litigation,* ECLI:EU:C:2012:707, para 91; Case C-196/04 *Cadbury Schweppes*, para 31. As it was acknowledged by Advocate General Kokott, 'the Court has not established a holding threshold of general application which must be reached in order for a determining influence to be presumed' (see *Opinion of Advocate General Kokott in Case C-311/08 Société de Gestion Industrielle,* ECLI:EU:C:2009:545, para 29). However, it is clear that sole ownership or majority ownership (51% or more) leads to definite influence over the management of the company and thus falls within the ambit of Article 49 TFEU (see in particular Case C31/11 *Marianne Scheunemann*, para 19). In a reasoned order given under Article 104 (3) of the Rules of Procedure of the Court, it found that a participation amounting to 25 % of voting rights conferred a dominant influence over the company and thus was regarded as falling within the material scope solely of the freedom of establishment, see Case C-492/04 *Lasertec Gesellschaft für Stanzformen mbH v Finanzamt Emmendingen,* ECLI:EU:C:2007:273, paras 21-24. Similarly, in Case C31/11 *Marianne Scheunemann*, paras 25-30, the Court found that a direct holding of more than one quarter of the capital of the company affected primarily the freedom of establishment. Moreover, it has also been established that national legislation concerning relationships within a group of companies falls primarily within the scope of the freedom of establihsment (in that respect see Case C-196/04 *Cadbury Schweppes*, para 32; Case C-231/05 *Oy AA,* ECLI:EU:C:2007:439, para 23; Case C-524/04 *Test Claimants in the Thin Cap Group Litigation*, para 33).

98 Case C-212/09 *Commission v Portugal (golden shares – GALP Energia SGPS SA)*, para 43; Case C-112/05 *Commission v Germany (golden shares – Volkswagen I),* ECLI:EU:C:2007:623, para 18; Case C-326/07 *Commission v Italy (golden shares)*, para 35; Case C-543/08 *Commission v Portugal (golden shares – EDP)*, para 42; Case C-446/04 *Test Claimants in the FII Group Litigation*, paras 36-38; Case C-157/05 *Holböck*, paras 23-25.

99 Case C81/09 *Idryma Typou*, para 49; Case C-326/07 *Commission v Italy (golden shares)*, para 36.

3.2.2.3 The distinction between direct and portfolio investments

In more recent case law, the Court introduced a further distinction between 'direct' and 'portfolio' investments: on the one hand, 'direct investments' are investments in the form of participation in an undertaking through the holding of shares, which confers the possibility of effectively participating in its management and control; on the other hand, 'portfolio' investments are investments in the form of the acquisition of shares on the capital market solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking.[100] At first sight one could argue that 'direct investments' fall within the ambit of establishment and 'portfolio investments' fall within the ambit of capital. Nevertheless, this is not case. Both direct and portfolio investments are referred to in Annex I of Directive 88/361 and thus fall within the scope of Article 63 TFEU.[101] This approach arguably blurs the distinction between establishment and capital as articulated by the Court through the use of the *definite influence* criterion.

In particular, in the case of 'portfolio investments', the aim of the investor is driven essentially by the desire to make a financial profit either in the long or in the short term without having any intention of effectively participating in the management of the company or influencing somehow the decision-making process within the organs of the company.[102] It is thus only logical that 'portfolio investments', which most of the time take the form of minority shareholdings,[103] would fall only within the scope of the free movement of capital.[104]

However, the problem arises in relation to 'direct investments'. The determination of the applicable freedom in the case of 'direct investments' is a much more complex question. In its 1997 Communication the Commission expressed

100 Joined cases C-105/12 to C-107/12 *Essent NV*, para 40; Case C-182/08 *Glaxo Wellcome GmbH & Co. KG v Finanzamt München II,* ECLI:EU:C:2009:559, para 40; Case C81/09 *Idryma Typou*, para 48; *Opinion of Advocate General Wahl in Case C-201/15 AGET Iraklis,* ECLI:EU:C:2016:429, para 36. See also European Commission, *Case Law Guide of the European Court of Justice on articles 63 et seq. TFEU, Free Movement of Capital* (DG FISMA, 2015), p. 54 et seq.

101 Joined cases C-105/12 to C-107/12 *Essent NV*, para 40; Case C-182/08 *Glaxo Wellcome*, para 40; Case C81/09 *Idryma Typou*, para 48; *Opinion of Advocate General Wahl in Case C-201/15 AGET Iraklis*, para 36.

102 Jérémie Houet, *Les Golden Shares en droit de l'Union Européenne* (Larcier 2015), p. 130.

103 It seems that minority shareholdings below 10% are regarded as 'portfolio investments' and thus fall within the scope of free movement of capital. See in particular Case C-168/11 *Manfred Beker and Christa Beker v Finanzamt Heilbronn,* ECLI:EU:C:2013:117, para 29; Case C-377/07 *Finanzamt Speyer-Germersheim v STEKO Industriemontage GmbH,* ECLI:EU:C:2009:29, para 56; Joined cases C-436/08 and C-437/08 *Haribo Lakritzen Hans Riegel BetriebsgmbH and Österreichische Salinen AG v Finanzamt Linz,* ECLI:EU:C:2011:61, para 36.

104 Jérémie Houet, *Les Golden Shares en droit de l'Union Européenne* (Larcier 2015), p. 130.

the view that the acquisition of controlling stakes is covered by both the free movement of capital and the freedom of establishment. This is because Article 49 (2) TFEU includes the right of EU investors to set up and manage undertakings in a Member State under the same conditions as the ones applicable for domestic investors.[105] Therefore, it seems that that 'direct investments', i.e. controlling stakes, are to be distinguished from stakes which enable the holder to have a *definite influence* on the company. The former can fall within the scope of both establishment and capital, whereas the latter will necessarily fall only within the scope of establishment pursuant to the aforementioned case law of the Court.[106]

Taking everything into account, the approach that has been so far followed by the Court (and the Commission) can be summarised as follows: Firstly, when the shareholding in question enables the investor to exercise *definite influence* over the company, then it falls within the scope of establishment. Secondly, if the shareholding in question does not meet the threshold of *definite influence*, but nevertheless is a *direct investment* which allows the exercise of control over the company, then both establishment and capital are applicable. Finally, if the shareholding at issue is a *portfolio investment* which is intended merely to make a financial profit, then it is the free movement of capital which applies.

3.2.2.4 The distinction between capital and establishment in legal literature

The distinction between capital and establishment has attracted significant scholarly attention. Jérémie Houet, in his doctoral dissertation on golden shares, made an interesting synthesis of the existing case law and distinguished three types of 'direct investment' in the golden shares case law.[107] Firstly, when the Court is faced with a situation concerning a direct investment which confers a certain and definite influence over the company, it should examine it from the perspective of the freedom of establishment. Secondly, when the direct investment at issue is intended to maintain direct and long-lasting relations with the company, we have to look at the contested golden shares: if the special rights introduced with the golden shares at issue concern the management of the company, then they fall within the scope of the freedom of establishment, as a matter of priority; when, on the other hand, the special rights at issue concern the structure of the capital shareholding of the company,

105 European Commission, *Communication of the Commission on Certain Legal Aspects concerning Intra-EU Investment* (Official Journal C 220, 1997), p. 16.

106 Case C-244/11 *Commission v Greece (golden shares)*, para 21; Case C-212/09 *Commission v Portugal (golden shares – GALP Energia SGPS SA)*, para 42; Case C-326/07 *Commission v Italy (golden shares)*, para 34;Case C-543/08 *Commission v Portugal (golden shares – EDP)*, para 41; Case C-251/98 *Baars*, para 22; Case C-436/00 *X and Y*, paras 37, 66-68.

107 Jérémie Houet, *Les Golden Shares en droit de l'Union Européenne* (Larcier 2015), p. 137.

they should be examined from the perspective of the free movement of capital.[108]

Wolfgang Schön, on the other hand, argues that the use of the definite influence criterion and the subsequent quantification of shareholdings for the purposes of determining the applicable freedom has not produced any clear results, which leads us to the conclusion that 'the solution is being sought in the wrong place'.[109] For him, the starting point for the determination of the applicable freedom is the acceptance that establishment captures activity-related measures, whereas capital concerns investment-related measures. If the objective of the measure in question is to regulate an economic activity or the business behaviour of the operators then it is captured by Article 49 TFEU. If on the other hand its objective is the relocation or acquisition of assets, it falls within the scope of Article 63 TFEU.[110]

The distinction between capital and establishment should not be regarded as a legal formalism, but rather as an important factor, which can determine the outcome of the case. This is due to the different justification grounds and the different territorial scope of the two freedoms. As regards the justification grounds, it is true that Article 52 TFEU and Article 65 TFEU do not refer to the same public interest considerations.[111] In particular, Article 52 TFEU provides that restrictions on the freedom of establishment can be justified on three general justification grounds of the Internal Market, i.e. of public policy, public security or public health. By contrast, Article 65 TFEU lays down justification grounds, which reflect the distinct and sensitive nature of the restrictions imposed on capital movements. Nevertheless, despite these differences, the case law of the Court has to a great extent aligned the analysis of justifications in the context of the two freedoms.[112] It has, therefore, reduced the practical importance of the distinction between establishment and capital and has implicitly endorsed the theory of *convergence* of the fundamental freedoms, at least in relation to the interpretation of restrictions and justifications.[113]

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108 Ibid, p. 137.

109 Wolfgang Schön, 'Free Movement of Capital and Freedom of Establishment' (2016) 17 European Business Organization Law Review 229, p. 13.

110 Ibid, pp. 9-10, 13-14.

111 Ibid, p. 5.

112 Ibid, p. 5.

113 Ibid, p. 1. For a more general but very thorough and insightful analysis of the trends of convergence or divergence of the fundamental freedoms see Niamh Nic Shuibhne, *Coherence of EU Free Movement Law: Constitutional Responsibility and the Court of Justice* (Oxford University Press 2013); *Opinion of Advocate General Maduro in Joined Cases C-158 & 159/04 Alfa Vita Vassilopoulos AE,* ECLI:EU:C:2006:212; Eleanor Spaventa, 'From Gebhard to Carpenter: Towards a (non-)economic European constitution' (2004) 41 *Common Market Law Review* 743; Peter Oliver and Wulf-Henning Roth, 'The internal market and the four freedoms' (2004) 41 *Common Market Law Review* 407; Jukka Snell, 'And then there were two: Products

However, the distinction remains still relevant as regards the territorial scope of the freedoms. Indeed, it has already been stated, the free movement of capital is unique in that it applies not only to capital movements between Member States, but also capital movements to/from third countries. This distinctive feature has a significant bearing on the determination of the applicable freedom. Firstly, it confronts the Court with a much wider range of rules than the ones that are being challenged in the framework of the other freedoms. Due to the external dimension of the free movement of capital, the Court might have to deal not only with national rules but also with rules of an international nature, such as international conventions regulating explicitly or implicitly international capital flows.[114] Secondly, Article 63 TFEU can be used as an instrument of policy-making with respect to foreign investments, allowing the Court to disapply national provisions which restrict intra-EU capital flows and threaten the process of economic integration within the EU, while at the same time safeguarding that European undertakings are not surrendered to foreign control. Thus, when the Court wants to limit the territorial scope of its rulings to investors coming from Member States and to exclude third country investors, it upholds the application of the freedom of establishment, which applies only to nationals of Member States. This is what happened with the Greek golden shares case.[115] The contested Greek legislation introduced a prior authorisation scheme for shareholdings above the threshold of representing 20%, targeting essentially the shareholders who were able to exert a definite influence over the management and control of the companies concerned. Thus, the Court used the 'definite influence' criterion and applied the freedom of establishment.[116]

For Jérémie Houet this decision falls within his scheme: prior authorisation and arrangements of *ex post* control restrict the possibility of investors to attain the level required to exercise control over the management of the company.

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and Citizens in Community Law' in Takis Tridimas and Paolisa Nebbia (eds), *European Union Law for the Twenty-First Century* (Hart Publishing 2005); Henri de Waele and Jochen Meulman, 'A Retreat from Säger? Servicing or Fine-Tuning the Application of Article 49 EC' (2006) 33 *Legal Issues of Economic Integration* 207; Jesper Lau Hansen, 'Full Circle: Is there a Difference Between the Freedom of Establishment and the Freedom to Provide Services?' in Mads Andenas and Wulf-Henning Roth (eds), *Services and Free Movement in EU Law* (Oxford University Press 2002), p. 197; Miguel Poiares Maduro, 'Harmony and Dissonance in Free Movement' (2001) 4 *Cambridge Yearbook of European Legal Studies* 315; David O Kee?e and Antonio Bavasso, 'Four freedoms, one market and national competence: In search of a dividing line' in David O Keeffe (ed), *Judicial Review in European Union Law: Essays in Honour of Lord Slynn* (Springer Netherlands 2000).

114 Arie Landsmeer, 'Movement of Capital and Other Freedoms' (2001) 28 Legal Issues of Economic Integration 57, p. 68.

115 Case C-244/11 *Commission v Greece (golden shares)*.

116 Ibid, para 23.

Thus, the freedom of establishment should apply.[117] Although this explanation is absolutely correct, one could also argue that the prior authorisation scheme was a measure affecting the structure of the shareholding and not the management of the company, and therefore the free movement of capital should also apply. This is why we have reasons to believe that another factor was also crucial for the determination of the applicable freedom: the argument of the Greek government that the legislation was intended primarily to control speculative hostile acquisitions by sovereign wealth funds established in non-member countries.[118] Aware of the serious repercussions of its judgment and cautious about opening Pandora's box in the field of extra-EU investments, the Court preferred to limit the territorial scope of its ruling to EU nationals by ruling that the freedom of establishment was applicable.[119]

3.2.2.5 The distinction between capital and establishment in tax law

As a final remark it should be noted that in its tax law, the Court follows a different methodological approach regarding the distinction between establishment and capital.[120] The differentiation that is observed in the field of taxation might be due to the fact that the objective of taxation is to provide the State with the necessary revenue to fulfil its social and other missions and as such it lacks the 'tendency to regulate professional behaviour'.[121] The evolution of the case law in the field of taxation reveals a preference for capital as opposed to establishment, without however setting clear and consistent criteria for the determination of the applicable freedom.[122] The approach that has been recently adopted is the following: although according to settled case law it is the *purpose* of the legislation concerned that determines which freedom

117 Jérémie Houet, *Les Golden Shares en droit de l'Union Européenne* (Larcier 2015), p. 144.
118 Case C-244/11 *Commission v Greece (golden shares)*, para 26.
119 Ibid, para 25.
120 Tax lawyers have extensively commented on the distinct approach that is being followed in the field of taxation. See, for instance, Mattias Dahlberg, *Direct Taxation in Relation to the Freedom of Establishment and the Free Movement of Capital* (Kluwer Law International 2005); Steven Den Boer, 'Freedom of Establishment versus Free Movement of Capital: Ongoing Confusion at the ECJ and in the National Courts?' (2010) 50 *European Taxation* 250; Daniel Smit, 'The relationship between the free movement of capital and the other EC Treaty freedoms in third country relationships in the field of direct taxation: a question of exclusivity, parallelism or causality?' (2007) 16 *EC Tax Review* 252.
121 Wolfgang Schön, 'Free Movement of Capital and Freedom of Establishment' (2016) 17 European Business Organization Law Review 229, p. 24.
122 The legal uncertainty created by the case law regarding the distinction between establishment and capital in the field of taxation has been criticised by Sigrid Hemels and others, 'Freedom of establishment or free movement of capital: Is there an order of priority? Conflicting visions of national courts and the ECJ' (2010) 19 *EC Tax Review* 19.

is applicable,[123] when the contested measure is generally applicable with no principal purpose related to a particular freedom, capital and establishment apply simultaneously. This means that if the dispute concerns a third country company, the free movement of capital may be relied on regardless of the holdings at issue, except in cases of abuse, the reason being the purely intra-Community nature of the freedom of establishment.[124]

More precisely, in *Kronos*,[125] the Court distinguished between three possible situations: (1) if the national legislation at issue is intended to apply solely to shareholdings which enable the holder to exercise *definite influence* over the company, then it has to be examined in the light of freedom of establishment;[126] (2) if the national legislation applies to shareholdings acquired solely with the intention of making a *financial investment* without any intention to influence the management and control of the undertaking, then it falls within the scope of the free movement of capital;[127] (3) if, however, the national legislation at issue is intended to apply both to *definite influence* holdings and to *investment* holdings, we should distinguish between dividends originating in a Member State (intra-EU) and dividends originating in a third country (extra-EU). With regard to *intra-EU dividends*, account should be taken of the facts of the case in point in order to determine the applicable freedom.[128] It should be noted, however, that in the light of Article 54 TFEU, the freedom of establishment applies only on the condition that the company in question has been incorporated in accordance with the law of a Member State.[129] With regard to *extra-EU dividends*, however, the free movement of capital may be relied on regardless of the holdings at issue, except in cases of abuse,[130] the reason being the purely intra-Community nature of the freedom of establishment.[131] In the case at hand, Kronos International Inc., a holding company incorporated under the laws of the State of Delaware (USA), whose management seat was located in Germany, was permitted to rely on Article 63 TFEU

123 Case C-196/04 *Cadbury Schweppes*, paras 31-33; Case C-452/04 *Fidium Finanz*, paras 34, 44-49; Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation*, paras 37-38; Case C-446/04 *Test Claimants in the FII Group Litigation*, para 36; Case C-524/04 *Test Claimants in the Thin Cap Group Litigation*, paras 26-34.

124 See indicatively the recent Case C-157/05 *Holböck*, paras 22-24; Case C-47/12 *Kronos International Inc. v Finanzamt Leverkusen,* ECLI:EU:C:2014:2200.

125 Case C-47/12 *Kronos International*.

126 Ibid, para 31.

127 Ibid, para 32.

128 Ibid, para 37.

129 Ibid, paras 45-46.

130 The Court is aware of the risk of abuse and has therefore clarified that the free movement of capital cannot be used in order to circumvent the territorial limitation of the freedom of establishment, see ibid, para 53 and Case C-35/11 *Test Claimants in the FII Group Litigation*, para 100.

131 Case C-47/12 *Kronos International*, paras 38-39.

in order to challenge the discriminatory taxation of its foreign-sourced dividends.

In view of the possible far-reaching implications of the possibility of third country investors to invoke the free movement of capital, scholars have argued that the Court should be very vigilant against abusive attempts to rely on the free movement of capital in order to circumvent the limitation of the territorial scope of the freedom of establishment and extend its reach through the back door.[132] The Court itself is also aware of this risk and has emphasized that the interpretation of Article 63 TFEU should not enable economic operators who do not fall within the territorial scope of the freedom of establishments to profit from that freedom.[133] However, both in *Kronos* and in *SECIL*, it has found that there is no such risk when the tax treatment of dividends is at issue, since this does not concern the conditions of access in a Member State by a company from a third country.[134]

3.2.3 Capital v Services

The distinction between capital and services is less problematic, though not entirely clear. In *Fidium Finanz*, the Court had the opportunity to clarify the demarcation between services and capital and the starting point of its reasoning was that 'where a national measure relates to the freedom to provide services and the free movement of capital at the same time, it is necessary to consider to what extent the exercise of those fundamental liberties is affected and whether, in the circumstances of the main proceedings, one of those prevails over the other'.[135] The reasoning of the Court starts again from the premise that both freedoms can in principle apply in parallel (*theory of parallelism*). This general rule means that in case one freedom is entirely secondary to the other, then the Court should apply only the one which is directly relevant for the case at hand.[136] The case concerned the authorisation requirement under

132 Wolfgang Schön, 'Free Movement of Capital and Freedom of Establishment' (2016) 17 European Business Organization Law Review 229, p. 23.

133 Case C-47/12 *Kronos International*, para 53; Joseph Stiglitz, *The Euro: How a Common Currency Threatens the Future of Europe* (W. W. Norton Company 2016), para 42.

134 Case C-47/12 *Kronos International*, para 54; Joseph Stiglitz, *The Euro: How a Common Currency Threatens the Future of Europe* (W. W. Norton Company 2016), para 43.

135 Case C-452/04 *Fidium Finanz*, para 34; Case C-71/02 *Herbert Karner Industrie-Auktionen GmbH v Troostwijk GmbH,* ECLI:EU:C:2004:181, para 47; Case C-36/02 *Omega Spielhallen- und Automatenaufstellungs-GmbH v Oberbürgermeisterin der Bundesstadt Bonn,* ECLI:EU:C:2004:614, para 27; Case E-1/00 *State Debt Management Agency,* (EFTA Court), para 32.

136 Case C-452/04 *Fidium Finanz*, para 34; Case C-275/92 *Her Majesty's Customs and Excise tegen Gerhart Schindler en Jörg Schindler,* ECLI:EU:C:1994:119, para 22; Case C-390/99 *Canal Satélite Digital,* ECLI:EU:C:2002:34, para 31; Case C-71/02 *Karner*, para 46; Case C-36/02 *Omega*, para 26; Case C-20/03 *Criminal proceedings against Marcel Burmanjer, René Alexander Van*

German legislation for the operation of lending activities in Germany by the Swiss undertaking Fidium. The Court first examined whether the activity of granting credit on a commercial basis was a service or a capital movement. In that regard, it noted that according to settled case law, that the business of a credit institution consisting of granting credit constitutes a service within the meaning of Article 56 TFEU.[137] This conclusion was reinforced by reference to Directive 2000/12/EC relating to the taking up and pursuit of the business of credit institutions, which sought to regulate the activity of granting loans, *inter alia*, from the point of view of both the freedom of establishment and the freedom to provide financial services. At the same time, the Court acknowledged that loans and credits granted by non-residents to residents feature under Heading VIII of Annex I to Directive 88/361. Thus, the granting of credit on a commercial basis was activity falling within the scope of both Article 56 and 63 TFEU.[138]

Nevertheless, the 'predominant consideration' was the freedom to provide services, as the rules impeding access to the German financial market for companies established in non-member countries affected primarily their freedom to provide financial services.[139] The effect of reducing cross-border financial traffic relating to credit services was merely an *unavoidable consequence* of the restriction on the freedom to provide services.[140] Consequently, the Court held that national rules whereby a Member State makes the granting of commercial credit by a non-EU company subject to prior authorisation, and which provide that such authorisation must be refused if that company does not have its central administration or a branch in that territory, affect primarily the exercise of the freedom to provide services.[141] However, the freedom to provide services does not cover the economic activities of third-country companies. Its territorial scope is limited to intra-EU provision of services. Therefore, the Court concluded that the Treaty provisions on services could not be relied on by an undertaking established in a third country and there were no grounds for examining the compatibility of the national rules with the free movement of capital.[142] This case is another example of the efforts of the Court to prevent the circumvention of the territorial boundaries of the Internal Market by the invocation of the external dimension of the free movement of capital. The 'predominant consideration' criterion was employed by

Der Linden and Anthony De Jong, ECLI:EU:C:2005:307, para 35; Case C-42/07 *Liga Portuguesa*, para 47; Case C-233/09 *Dijkman*, para 33; Case C-182/08 *Glaxo Wellcome*, para 37.

137 Case C-452/04 *Fidium Finanz*, para 39. See also the case law cited: Case C-484/93 *Svensson*, para 11; Case C-222/95 *Parodi*, para 17.

138 Case C-452/04 *Fidium Finanz*, para 43.

139 Ibid, para 49.

140 Ibid.

141 Ibid, paras 47-49.

142 Ibid, paras 47, 51.

the Court in order to restrict the ambit and the implications of the *erga omnes* effect of Article 63 TFEU and prevent abusive behaviour from non-EU companies.[143]

By the same token, the Court applied the freedom to provide services in the *Van der Weegen* case,[144] which concerned the refusal of the Belgian tax authorities to grant a tax exemption for interest payments received from savings accounts held in banks established in other Member States. In a previous case against Belgium, the Court had already found that by introducing and maintaining a system of discriminatory taxation of interest payments made by non-resident banks, resulting from the application of a tax exemption reserved solely to interest payments made by resident banks, Belgium had failed to fulfil its obligations under Article 56 TFEU and Article 36 of the EEA Agreement.[145] In that case, the Court justified its choice to examine the national legislation in question from the perspective of the freedom to provide services under Article 56 TFEU on the basis of the fact that 'the provision of banking services constitutes a service within the meaning of Article 57 TFEU'.[146] It then found that there was no need for a separate examination of that legislation

143 Martha O'Brien, 'Case C-452/04, Fidium Finanz AG v. Bundesanstalt für Finanzdienstleistungsaufsicht, judgment of the Court of Justice (Grand Chamber) of 3 October 2006' (2007) 44 *Common Market Law Review* 1483, at p. 1495. The case has been extensively discussed by scholars and has provoked a heated debate among taxation experts. The relevant academic literature include, among others, the following journal articles: Daniel Smit, 'The relationship between the free movement of capital and the other EC Treaty freedoms in third country relationships in the field of direct taxation: a question of exclusivity, parallelism or causality?' (2007) 16 EC Tax Review 252; Pasquale Pistone, 'Kirchberg 3 October 2006: Three Decisions that Did ... Not Change the Future of European Taxes' (2006) 34 *Intertax* 582; Tatiana Falcao, 'Third-Country Relations with the European Community: A Growing Snowball' (2009) 37 *Intertax* 307; Sergey Bezborodov, 'Freedom of Establishment in the EC Economic Partnership Agreements: in Search of its Direct Effect on Direct Taxation' (2007) 35 *Intertax* 658; Christiana HJI Panayi, 'Thin Capitalization Glo et al. – A Thinly Concealed Agenda?' (2007) 35 *Intertax* 298; Vassilis Hatzopoulos, 'The Court's approach to services (2006-2012): From case law to case load?' (2013) 50 *Common Market Law Review* 459; Sigrid Hemels and others, 'Freedom of establishment or free movement of capital: Is there an order of priority? Conflicting visions of national courts and the ECJ' (2010) 19 EC Tax Review 19; Mathieu Isenbaert, 'The Contemporary Meaning of 'Sovereignty' in the Supranational Context of the EC as Applied to the Income Tax Case Law of the ECJ' (2009) 18 *EC Tax Review* 264; Ryan Murphy, 'Why does tax have to be so taxing? The court revisits the Franked Investment Income litigation (Case Comment)' (2013) 38 European Law Review 695; Stefan Enchelmaier, 'Always at your service (within limits): the ECJ's case law on article 56 TFEU (2006-11)' (2011) 36 *European Law Review* 615.

144 Case C-580/15 *Maria Eugenia Van der Weegen and Others v Belgische Staat,* ECLI:EU:C:2017:429.

145 Case C-383/10 *Commission v Belgium,* ECLI:EU:C:2013:364. The relevance of the EEA Agreement is not explained in the judgment, but it seems to be related to the situation of Belgian savers who are customers of the Luxembourg subsidiary of an Icelandic bank referred to in paragraph 18 of the judgment.

146 Ibid, para 41.

in the light of Article 63 TFEU.[147] In the same vein, in *Van der Weegen*, which concerned an amended version of the aforementioned Belgian legislation abolishing the discriminatory element, but still maintaining certain restrictive conditions which were *de facto* specific to the national market,[148] the Court again chose to apply only the freedom to provide services under Article 56 TFEU. It explained that:

> 'although such national legislation was capable of coming within the scope of the two fundamental freedoms alluded to by the referring court, the fact remains that any restrictive effects which that legislation might have on the free movement of capital would be no more than the inevitable consequence of any restrictions on the freedom to provide services'.[149]

In other words, despite the fact that operations in current accounts or deposit accounts effected by residents with foreign financial institutions are set out in point VI.B of the nomenclature annexed to Directive 88/361,[150] the Court found that the free movement of capital was entirely *secondary* in relation to the freedom to provide services. This confirms the *Fidium Finanz* approach that when banking services are concerned and when the Court wants to restrict the territorial application of its judgment only to Member States (to the exclusion of third countries), it applies the freedom to provide services and not the free movement of capital.

3.2.4 Capital v Workers

The distinction between capital and workers is straightforward and does not raise any difficulties. Nevertheless, in the recent *Jahin* case,[151] the free movement of capital was invoked by an EU national in an effort to circumvent the territorial scope of the free movement of workers, which applies only to EU nationals who have made use of their free movement rights within the territory of the EU. In particular, the case concerned a French national, Mr Jahin, who was living in China and was affiliated to a private social security scheme there. Mr Jahin was asked to pay some levies on income from real estate and on a capital gain realised on the transfer of immovable property. Those levies were linked to the French social security. Under Regulation 883/2004, the legislation of a single Member State only is to apply in matters of social security, which in practice means that a person insured under a social security scheme of a Member State other than that of his nationality is exempted from the obligation

147 Ibid, para 74.
148 Case C-580/15 *Maria Eugenia Van der Weegen*, para 29.
149 Ibid, para 25.
150 Case C-383/10 *Commission v Belgium*, para 20.
151 Case C-45/17 *Frédéric Jahin v Ministre de l'Économie et des Finances and Ministre des Affaires sociales et de la Santé*, ECLI:EU:C:2018:18.

to pay social security contributions in his home State. Mr Jahin contested the unequal treatment between French persons insured under a social security scheme of a Member State and French persons insured under a social security scheme of a third country, arguing that such difference in treatment amounted to a violation of the free movement of capital under Article 63 TFEU.

The Court started by clarifying that Article 63 TFEU was indeed applicable in the case at hand, as the levies related to investments in real estate, which under settled case law, constitute capital movements.[152] It then found that such a difference in treatment was in principle prohibited under Article 63 TFEU, as it was liable to dissuade natural persons affiliated to a social security scheme of a third country from making investments in immovable property in the Member State whose nationality they hold and was therefore liable to hinder the movement of capital from such third countries to that Member State.[153] However, this difference in treatment was justified since the situation of a French national residing in China is not objectively comparable to the situation of a French national residing in a Member State, insofar as the latter alone can benefit from the provisions of Regulation 883/2004, by reason of his movement within the EU.[154] By contrast, a French person residing in China or a French person residing in France cannot benefit form the provisions of Regulation 883/2004, since they have not made use of their free movement rights in the EU.[155] This conclusion can also be drawn from the personal scope of application of Regulation 883/2004, which covers only nationals of a Member State who are subject to the social security legislation of another Member State.[156] The Court finally underlined that the external dimension of Article 63 TFEU cannot be used in order to enable persons who do not come within the territorial scope of the free movement of workers to profit from that freedom.[157] In other words, just like with establishment and services, the Court in *Jahin* prevented to use the free movement of capital as a means to expand the territorial scope of the free movement of workers.

152 Ibid, para 23.
153 Ibid, para 28.
154 Ibid, para 42.
155 Ibid, para 43.
156 Ibid, para 45.
157 Ibid, para 46.

3.3 Direct effect of Article 63 TFEU

3.3.1 Vertical Direct effect

One of the most important factors why the free movement of capital followed a slow historical development compared to the other freedoms was the fact that up until 1995 the Court had not recognised the direct effect of Article 67 EEC Treaty, thus depriving the individuals of the possibility to rely on it. As a result of the absence of direct effect, very few cases were reaching the Court of Justice in relation to that provision. It was only with the Maastricht Treaty and the advent of the EMU that the Court realised that the time was ripe for the free movement of capital to become directly effective. The recognition of direct effect of the current Article 63 TFEU, first in *Sanz de Lera*[158] and then in *Skatteverket v. A*,[159] accelerated the evolution of the case law and provided a new impetus for legal scholarship.[160]

The joined cases *Sanz de Lera* concerned two Spanish and one Turkish national who were arrested for transferring a certain amount of banknotes exceeding the maximum amount permitted under Spanish legislation to a third country (Switzerland and Turkey) without having sought prior authorisation from the Spanish authorities.[161] The latter initiated criminal proceedings against those persons and the national court decided to stay the proceedings and ask the Court of Justice through a preliminary ruling procedure whether the requirement of prior authorisation was compatible with the free movement of capital.

Firstly, the Court clarified that even though the facts of the case occurred before the entry into force of the Maastricht Treaty (1 November 1993), nevertheless the relevant provisions of the Maastricht Treaty were applicable, on the ground that the principle, recognised in Spanish law, of the retroactive effect of the more favourable criminal provision would render inoperative national provisions under which allegedly criminal offences were committed if such provisions were found to be incompatible with the free movement of capital provisions as amended with the Maastricht Treaty (Articles 73b to

158 Joined cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera*, para 41.

159 Case C-101/05 *Skatteverket v A*, para 21.

160 Jukka Snell, 'Free movement of capital: Evolution as a non-linear process' in Craig and De Búrca (eds), *The Evolution of EU Law* (Oxford University Press 2011); Jonh Usher, 'The Evolution of the Free Movement of Capital' (2007) 31 Fordhman International Law Journal 1533; Steve Peers, 'Free Movement of Capital: Learning lessons or slipping on spilt milk?' in Barnard and Scott (eds), *The Law of the Single European Market: Unpacking the Premises* (Hart Publishing 2002); Leo Flynn, 'Free movement of capital' in Barnard and Peers (eds), *European Union Law* (Oxford University Press 2017); Arie Landsmeer, 'Movement of Capital and Other Freedoms' (2001) 28 Legal Issues of Economic Integration 57.

161 Joined cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera*, paras 2-4.

73d).[162] These new articles brought about full capital liberalisation not only between Member States but also between Member States and third countries.[163] Under this new regime introduced by the Maastricht Treaty, Article 106 EEC on 'current payments' was repealed; thus, both capital movements and payments were covered by the first and the second paragraph of Article 73b of the Treaty respectively. The Court explained that the export of banknotes at issue did not represent payments for trade in goods or services within the meaning of Article 73b (2) of the Treaty, but capital movements within the meaning of Article 73b (1) of the Treaty.[164]

Secondly, the Court for the first time ruled that Article 73b (1) of the Treaty was directly effective, as 'it [laid] down a clear and unconditional prohibition for which no implementing measure [was] needed'.[165] With the advent of the Maastricht Treaty, this provision had developed into a fully-fledged freedom and '[conferred] rights on individuals which they may rely on before the courts and which the national courts must uphold'.[166] The Court explained that the exception contained in the *grandfather* clause,[167] according to which Member States were allowed to retain existing restrictions on capital movements to/from third countries, was not sufficient to deprive Article 73b (1) of its direct effect.[168] Neither was the legislative power granted to the Council by virtue of Article 73c (2) of the Treaty,[169] as the measures that it could adopt related only to the categories of capital movements to/from third countries and were not a prerequisite for the implementation of the general prohibition of capital restrictions.[170] Therefore, the Court held that 'Article 73b(1) […] may be relied on before national courts and may render inapplicable national rules inconsistent therewith'.[171]

3.3.2 Horizontal direct effect

So far, the case law of the Court has acknowledged that Article 63 TFEU is vertically directly effective. In other words, it has recognised that Article 63 TFEU can be relied on by individuals before their national courts against the State. However, the question of the horizontal applicability of Article 63 TFEU,

162 Ibid, para 14.
163 Ibid, para 19.
164 Ibid, paras 17-18.
165 Ibid, para 41.
166 Ibid, para 43.
167 At the time Article 73c (1) of the Treaty and today Article 64 (1) TFEU.
168 Joined cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera*, para 44.
169 Today this power is conferred on the Council together with the Parliament under Article 64 (2) TFEU.
170 Joined cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera*, paras 45-46.
171 Ibid, para 48.

i.e. the invocation of this provision by an individual against another individual, has not been explicitly dealt with by the Court of Justice. Catherine Barnard argues that this may be explained by the fact that a substantial part of the case law raising questions on the interpretation of the free movement of capital concerns taxation, 'a quintessentially vertical subject matter'.[172] In the golden shares case law, the Court was faced with the question of a possible horizontal application of the free movement of capital, but it chose to evade it by qualifying the measures at issue as 'State measures'. Nevertheless, in view of the multidimensional nature of the various corporate governance arrangements that exist in the Member States (which can be contained not only in national legislation, but also in private agreements, Articles of Association of companies etc.), it is very likely that sooner or later the Court will have to deal with the question of horizontality of Article 63 TFEU. The relevant case law and the intricate legal issues arising from the question of the horizontal effect of the free movement of capital are extensively analysed in Chapter 4, Section 3.1.

3.4 Restrictions

The long-standing debate on the distinction between non-discrimination and market access does not resonate – at least not to the same extent – in the field of the free movement of capital.[173] The wording of Article 63 TFEU goes beyond the mere elimination of unequal treatment on grounds of nationality and prohibits all restrictions on the movement of capital between Member States and between Member States and third countries.[174]

3.4.1 Discriminatory measures

3.4.1.1 Direct discrimination

Although rare, cases of direct discrimination do exist in the capital case law and they are treated as manifest infringements of Article 63 TFEU. Thus, the Court has disapplied a Portuguese provision which precluded investors from other Member States from acquiring more than a given number of shares in certain Portuguese undertakings,[175] an Austrian provision which exempted only Austrian nationals from having to obtain authorisation before acquiring

172 Catherine Barnard, *The Substantive Law of the EU: The Four Freedoms* (Oxford University Press 2016), p. 526.

173 Leo Flynn, 'Freedom to Fund?: The Effects of the Internal Market Rules, With Particular Emphasis on Free Movement of Capital' in Neergaard and others (eds), *Social services of general interest in the EU* (Spinger 2013), p. 188.

174 Case C-98/01 *Commission v UK (golden shares)*

175 Case C-367/98 *Commission v Portugal (golden shares),* ECLI:EU:C:2002:326 para 40.

a plot of land[176] and an Italian provision exempting only Italian nationals from the requirement of obtaining an authorisation to buy a property in certain parts of the national territory.[177]

3.4.1.2 Indirect discrimination

In relation to indirect discrimination, the Court has found that the Danish legislation on agriculture imposing a residence requirement, which could be waived only with the authorisation of the minister responsible for agriculture, restricted the free movement of capital.[178] Furthermore, the Belgian rules which resulted in an inheritance consisting of immovable property situated in Belgium being subject to transfer duties that were higher than the inheritance duties payable if the person whose estate was being administered had, at the time of death, been residing in that Member State – were found to have the effect of restricting the movement of capital.[179] Similarly, the Court held that a Portuguese provision under which the amount of capital gains realised by residents when transferring immovable property was to be taken into account as to only 50% of its amount, whereas for non-residents the full amount of capital gains was subject to tax, constituted a capital restriction.[180] Very recently, in *SERGO*, the Court explicitly used the term 'indirect discrimination' when scrutinising the Hungarian legislation under which usufruct rights which had previously been created over agricultural land and the holders of which did not have the status of close relation of the owner of that land were extinguished by operation of law and were, consequently, deleted from the property registers.[181] The Court found that the contested legislation was operating to the disadvantage of nationals of other Member States more than Hungarian nationals and was therefore liable to conceal *indirect discrimination* based on the usufructuary's nationality or the origin of the capital.[182]

176 Case C-302/97 *Konle*, para 23.
177 Case C-423/98 *Alfredo Albore,* ECLI:EU:C:2000:401, para 16.
178 Case C-370/05 *Festersen*, para 25.
179 Case C-11/07 *Eckelkamp*, paras 45-46.
180 Case C-443/06 *Erika Waltraud Ilse Hollmann v Fazenda Pública,* ECLI:EU:C:2007:600, paras 36, 40.
181 Joined cases C-52/16 and C-113/16 *'SEGRO' Kft. v Vas Megyei Kormányhivatal Sárvári Járási Földhivatala and Günther Horváth v Vas Megyei Kormányhivatal,* ECLI:EU:C:2018:157.
182 Ibid, para 74.

3.4.2 Non-discriminatory measures

3.4.2.1 Direct investments

3.4.2.1.1 Golden shares

The broad interpretation of capital restrictions can be evidenced especially – but not exclusively – in the golden shares case law.[183] The Court has consistently ruled that the special rights retained by the State in privatised undertakings restrict capital movements, as they are liable to *deter/discourage* foreign investors form investing in the undertakings at issue. This rigorous application of the free movement of capital has far-reaching implications for national corporate governance systems. This is why the Member States tried to argue that, under certain conditions, golden shares should be placed beyond the reach of free movement rules through the application of a *Keck*-inspired approach. However, so far the Court has not accepted this argument, without however dismissing it in principle (Chapter 4, Section 3.2).[184]

3.4.2.1.2 Authorisation requirement

Another important restriction on capital movements is the authorisation requirement which is usually imposed by national legislation for certain types of investments. According to settled case law, a requirement of prior authorisation is considered to be a disproportionate restriction on capital movements, as it causes the exercise of the free movement of capital to be subject to the discretion of the administrative authorities and thus renders that freedom

183 Case C-58/99 *Commission v Italy (golden shares – ENI/Telecom Italia),* ECLI:EU:C:2000:280; Case C-309/99 *Wouters and others*; Case C-483/99 *Commission v France (golden shares – Société Nationale Elf-Aquitaine)*; Case C-503/99 *Commission v Belgium (golden shares)*; Case C-463/00 *Commission v Spain (golden shares),* ECLI:EU:C:2003:272; Case C-98/01 *Commission v UK (golden shares)*; Case C-174/04 *Commission v Italy (golden shares)*; Joined cases C-282/04 and C-283/04 *Commission v The Netherlands (golden shares)*; Case C-112/05 *Commission v Germany (golden shares – Volkswagen I)*; Joined cases C-463/04 and C-464/04 *Federconsumatori and Others and Associazione Azionariato Diffuso dell'AEM SpA and Others v Comune di Milano (AEM/Edison),* ECLI:EU:C:2007:752; Case C-274/06 *Commission v Spain (golden shares),* ECLI:EU:C:2008:86; Case C-207/07 *Commission v Spain (golden shares in the energy sector),* ECLI:EU:C:2008:428; Case C-326/07 *Commission v Italy (golden shares)*; Case C-543/08 *Commission v Portugal (golden shares – EDP)*; Case C-171/08 *Commission v Portugal (golden shares – Portugal Telecom SGPS SA),* ECLI:EU:C:2010:412; Case C-212/09 *Commission v Portugal (golden shares – GALP Energia SGPS SA)*; Case C-244/11 *Commission v Greece (golden shares)*; Case C-95/12 *Commission v Germany (golden shares – Volkswagen II),* ECLI:EU:C:2013:676.

184 Case C-463/00 *Commission v Spain (golden shares)*; Case C-98/01 *Commission v UK (golden shares)*; Case C-171/08 *Commission v Portugal (golden shares – Portugal Telecom SGPS SA)*; Case C-543/08 *Commission v Portugal (golden shares – EDP)*; Case C-212/09 *Commission v Portugal (golden shares – GALP Energia SGPS SA).*

illusory.[185] Instead of prior authorisation, the national authorities can adopt less restrictive measures, such as a system of *declaration*.[186] It should be noted, however, that in *Église de Scientologie*, the Court clarified that 'it has not held that a system of prior authorisation can never be justified, particularly where such authorisation is in fact necessary for the protection of public policy or public security'.[187]

3.4.2.1.3 Qualification requirement

Qualification requirements can also restrict capital movements. For instance, the Court has ruled that national legislation providing that the members of companies and firms operating pharmacies can only be pharmacists prevents investors from other Member States who are not pharmacists from acquiring stakes in companies and firms of that kind and, consequently, imposes restrictions on the freedom of establishment and the free movement of capital.[188]

3.4.2.2 Investments in real estate

With respect to investments in real estate, the Court has qualified as capital restrictions primarily authorisation and residence requirements. Thus, it has ruled that a prior authorisation procedure is likely to discourage non-residents from making investments in immovable property and therefore such an obligation constitutes a restriction on the free movement of capital under Article 63 TFEU.[189] Furthermore, the Court has held that Article 63 TFEU precludes national legislation which lays down as a condition for acquiring an agricultural property the requirement that the acquirer take up fixed residence on that property.[190]

185 Joined cases C-358/93 and C-416/93 *Bordessa*, para 25; Joined cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera*, para 141; Case C-54/99 *Association Eglise de scientologie de Paris,* ECLI:EU:C:2000:124, para 14; Case C-302/97 *Konle*, para 39; Joined cases C-515/99, C-519/99 to C-524/99 and C-526/99 to C-540/99 *Reisch*, para 32; Case C-567/07 *Minister voor Wonen, Wijken en Integratie v Woningstichting Sint Servatius,* ECLI:EU:C:2009:593, para 22; Case C-197/11 *Eric Libert and Others v Gouvernement flamand and All Projects & Developments NV and Others v Vlaamse Regering,* ECLI:EU:C:2013:288, paras 46-47; Case C-39/11 *VBV – Vorsorgekasse*, paras 22, 27.

186 Joined cases C-358/93 and C-416/93 *Bordessa*, paras 26-27.

187 Case C-54/99 *Association Eglise de scientologie de Paris*, para 19.

188 Case C-531/06 *Commission v Italy (pharmacies),* ECLI:EU:C:2009:315, paras 47-48.

189 Case C-302/97 *Konle*, para 39; Case C-567/07 *Sint Servatius*, para 39; Case C-197/11 *Libert and Others*, paras 46-47; Case C-452/01 *Margarethe Ospelt*, para 34.

190 Case C-370/05 *Festersen*, paras 25, 48; Case C-302/97 *Konle*, para 40; Joined cases C-515/99, C-519/99 to C-524/99 and C-526/99 to C-540/99 *Reisch*, para 33; Case C-452/01 *Margarethe Ospelt,* para 34.

3.4.2.3 Mortgages

With respect to mortgages the Court has found that the prohibition on the creation of a mortgage in a foreign currency constitutes a restriction on capital movements, as it deprives the private parties concerned of a component element of the free movement of capital and payments.[191] The effect of such a prohibition is to weaken the link between the debt to be secured, payable in the currency of another Member State, and the mortgage, whose value may, as a result of subsequent currency exchange fluctuations, come to be lower than that of the debt to be secured. This can only reduce the effectiveness of such a security, and thus its attractiveness.[192]

3.4.2.4 Financial loans and credits

The Court has also found that provisions implying that a bank must be established in a Member State in order for recipients of loans residing in its territory to obtain an interest rate subsidy from the State out of public funds are liable to dissuade those concerned from approaching banks established in another Member State and therefore constitute an obstacle to movements of capital such as bank loans.[193] Furthermore, national legislation which discriminates according to the place where the loan is contracted is likely to deter residents from contracting loans with persons established in other Member States and therefore constitutes a restriction on the movement of capital.[194] Finally, national legislation which prohibits the acquisition by persons resident in a Member State of securities of a loan issued abroad constitutes a restriction within the meaning of Article 63 TFEU.[195]

3.4.2.5 Taxation

The case law on taxation is very rich and covers different types of measures and economic transactions. Given its distinct and technical nature, it has attracted significant scholarly attention as a separate field of law.[196] For the purposes of the present thesis, this section presents some examples of taxation rules that have been scrutinised by the Court of Justice under the free movement of capital.

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191 Case C-222/97 *Trummer and Mayer*, paras 26-28.
192 Ibid.
193 Case C-484/93 *Svensson*, para 10.
194 Case C-439/97 *Sandoz*, para 31.
195 Case C-503/99 *Commission v Belgium (golden shares)*, paras 15, 19.
196 Sjoerd Douma, *Optimization of Tax Sovereignty and Free Movement* (IBFD 2011); Paul Farmer and Richard Lyal, *EC Tax Law* (Oxford University Press 1995); Laurence Gormley, *EU Taxation Law* (2005).

3.4.2.5.1 Taxation of profits from the sale of shares

In relation to the sale of shares, the Court has ruled that national legislation under which the profits from sales of shares in foreign limited companies are taxable as soon as the shareholding amounted to 1%, whereas the profits from sales of shares in limited companies governed by national law were taxable only when that shareholding amounted to 10% introduces a difference in treatment on the basis of the place of investment of the capital and has the effect of discouraging a shareholder from investing his capital in a company established in another State.[197]

3.4.2.5.2 Taxation of dividends

The Court has also ruled that Article 63 TFEU precludes national legislation on dividends taxation which makes the granting of a tax advantage (e.g. tax exemption or reduced tax rate) subject to the condition that the dividends are paid by companies established within national territory.[198]

3.4.2.5.3 Corporate tax

In corporate taxation, a taxpayer's right to deduct from his taxable profits the losses relating to the partial reduction in value of the shares held in the company, where the reduction in value of the shares results from the distribution of the profits, undeniably constitutes a tax advantage.[199] The Court has ruled that the grant of that advantage to a resident taxpayer only where he acquires shares in a resident company from a resident shareholder makes shares held by non-residents less attractive and is, therefore, likely to dissuade the resident taxpayer from acquiring them. In addition, such a difference in treatment is also likely to dissuade non-resident investors from acquiring shares in the resident company and therefore to represent an obstacle to that company's accumulation of capital from other Member States. Thus, it constitutes a restriction on the free movement of capital.[200] In addition, national legislation under which a resident company cannot deduct from its taxable revenue reductions in profit resulting from the partial write-down of holdings in non-resident companies, whereas it can do so in relation to holdings in resident companies has a restrictive effect on capital movements.[201]

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197 Case C-436/06 *Per Grønfeldt and Tatiana Grønfeldt v Finanzamt Hamburg-Am Tierpark,* ECLI:EU:C:2007:820, paras 13-14; Case C-446/04 *Test Claimants in the FII Group Litigation*, para 166.

198 Case C-35/98 *Verkooijen*, paras 34-36; Case C-194/06 *Staatssecretaris van Financiën v Orange European Smallcap Fund NV,* ECLI:EU:C:2008:289, para 65; Case C-513/04 *Mark Kerckhaert and Bernadette Morres v Belgische Staat,* ECLI:EU:C:2006:713, para 24; Case C-379/05 *Amurta SGPS v Inspecteur van de Belastingdienst/Amsterdam,* ECLI:EU:C:2007:655, paras 15, 25-28; Case C-101/05 *Skatteverket v A*, paras 41-43; Case C-446/04 *Test Claimants in the FII Group Litigation*, para 74.

199 Case C-182/08 *Glaxo Wellcome*, paras 53-59.

200 Ibid, paras 53-59.

201 Case C-377/07 *STEKO*, paras 25-27.

3.4.2.5.4 Taxation of gains from movable and immovable property

In relation to income from capital and movable property, the Court found that the Belgian tax legislation which established less favourable tax treatment of income from capital and movable property received by non-resident investment companies with no permanent establishment in Belgium in comparison with income earned by resident investment companies or non-resident companies with a permanent establishment in Belgium constituted a capital restriction.[202] In the same vein, regarding immovable property, the Court recently found that the Belgian legislation regarding the calculation of income tax from immovable property, according to which if the immovable property was situated on national territory the tax base was calculated on the basis of the *cadastral* value, whereas if the immovable property was located outside Belgium the tax base was calculated on the *actual* rental value, constituted a restriction on the free movement of capital under Article 63 TFEU.[203] Similarly, the Portuguese provision laying down a basis of assessment of 50% applicable only to capital gains realised by taxable persons residing in Portugal and not to those realised by non-resident taxable persons was found to be a restriction on the movement of capital.[204]

3.4.2.5.5 Inheritance tax

The Court has developed a profuse case law on inheritance taxation which in essence prohibits national provisions whose effect is to reduce the value of the inheritance of a resident of a State other than the Member State in which the assets concerned are situated and which taxes the inheritance of those assets.[205] In particular, in *Barbier*, the Court found that the Dutch legislation under which in order to assess the property's value, the fact that the person holding legal title was under an unconditional obligation to transfer it to another person who has financial ownership of that property may be taken into account if, at the time of his death, the former resided in that Member State, but may not be taken into account if he resided in another Member State.[206] Furthermore, in *Olivier Halley*, the Court ruled that the Belgian legislation which resulted in a distinction being made in relation to the limitation period for the valuation of registered shares for the purposes of inheritance tax according to the location of the issuing company's centre of effective

202 Case C-387/11 *Commission v Belgium (tax on income from capital and movable property)*, ECLI:EU:C:2012:670, paras 38-40.

203 Case C-110/17 *Commission v Belgium (tax on income from immovable property)*, ECLI:EU:C:2018:250.

204 Case C-443/06 *Hollmann*, paras 35-36, 39.

205 Case C-484/93 *Svensson*, para 10; Case C-222/97 *Trummer and Mayer*, para 26; Case C-439/97 *Sandoz*, para 19; Case C-364/01 *Barbier*, para 62; Case C-513/03 *van Hilten-van der Heijden*, para 44; Case C-194/06 *Orange European Smallcap Fund*, para 37; Case C-11/07 *Eckelkamp*, para 44; Case C-256/06 *Jäger*, para 30.

206 Case C-364/01 *Barbier*, para 62.

management constituted a restriction on the free movement of capital for the purposes of Article 63 TFEU.[207]

3.5 Derogations

As with the other fundamental freedoms, restrictions on the free movement of capital can be justified either by express derogations set out in the Treaty provisions or by case law made derogations ('mandatory requirements', 'overriding reasons in the public interest', 'imperative requirements of general interest' or the so-called 'rule of reason' doctrine). According to the classic doctrinal approach which is followed in Internal Market law, discriminatory measures (i.e. distincly applicable) can only be justified by the expressly provided Treaty exceptions, whereas non-discriminatory restrictions (i.e. indistinctly applicable) can be justified not only by the expressly provided Treaty exceptions but also by the open-ended list of case law-made overriding reasons in the public interest.[208] Regarding indirectly discriminatory measures (which are indistinclty applicable in law but distinctly applicable in fact), despite the initial uncertainty, it has now been established that they can be upheld not only by the express Treaty derogations but also by the case law made objective justifications.[209]

3.5.1 Express derogations

The express derogations laid down in the Treaty provisions are divided between, on the one hand, those that apply to capital movements to/from both Member States and third countries laid down in Article 65 TFEU and, on the other hand, those that apply exclusively to capital movements to/from third countries.

3.5.1.1 Derogations for capital movements between Member States and between Member States and third countries

Article 65 TFEU (the exception clause) contains two express derogations, one specific in Article 65 (1) (a) TFEU and one general in Article 65 (1) (b) TFEU.

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207 Case C-132/10 *Olivier Halley, Julie Halley and Marie Halley v Belgische Staat,* ECLI:EU:C:2011:586, paras 23-25.

208 Stefaan Van den Bogaert, *Practical Regulation of the Mobility of Sportsmen in the EU Post Bosman* (Kluwer Law International 2005), p. 150 et seq.

209 Case C-237/94 *John O'Flynn tegen Adjudication Officer,* ECLI:EU:C:1996:206, paras 19-20; Case C-29/95 *Pastoors and Trans-Cap v Belgian State,* ECLI:EU:C:1997:28, para 19; Case C-57/96 *Meints v Minister van Landbouw, Natuurbeheer en Visserij,* ECLI:EU:C:1997:564, para 45; Case C-187/96 *Commission v Greece,* ECLI:EU:C:1998:101, para 19.

3.5.1.1.1 Article 65 (1) (a) TFEU (specific derogation – tax differentiation)
Article 65 (1) (a) TFEU contains a rather special derogation that allows Member States to apply national legislation which distinguishes between *resident* and *non-residents* taxpayers in relation to matters of taxation. In the absence of fiscal harmonisation at EU level, Member States felt the need to insert into the Maastricht Treaty (then Article 73d (1) (a) of the Treaty) a derogation that would allow for a certain degree of fiscal differentiation of taxpayers according to their place of residence (fiscal non-residents benefit from tax exemptions in most Member States) or the place where the capital is invested (usually, foreign investments will be discriminated against through less favourable tax treatment).[210] Even before the entry into force of the Maastricht Treaty, national tax legislation differentiating between resident and non-resident taxpayers was justified on the condition that it applied to situations which were not objectively comparable or could be justified by overriding reasons in the general interest, in particular in relation to the cohesion of the tax system.[211] This rule was essentially the codification of the *Schumacker* and *Bachmann* case law.[212]

The underlying rationale of this permitted discrimination lies in the sensitive notion of fiscal sovereignty and the principle of territoriality. The principle of territoriality is a principle enshrined in international tax law and recognised by EU law, according to which each Member State is entitled to tax profits generated in its territory.[213] Independent tax systems coexist without hierarchy between them and in the EU context this entails the need to ensure a balanced allocation of the Member States' powers to impose taxes.[214]

The tax differentiation set out in Article 65 (1) (a) TFEU is a unique provision since it allows economic considerations relating to taxation to be regarded as justification grounds for capital restrictions.[215] However, this provision, insofar as it derogates from the fundamental principle of the free movement

210 European Commission, *European Economy* (Directorate-General for Economic and Financial Affairs, No 6/2003), p. 321.
211 Case C-35/98 *Verkooijen*, para 43.
212 Case C-279/93 *Finanzamt Köln-Altstadt v Roland Schumacker,* ECLI:EU:C:1995:31; Case C-204/90 *Bachmann*; Case C-300/90 *Commission v Belgium,* ECLI:EU:C:1992:37.
213 Case C-250/08 *Commission v Belgium (purchase of immovable property),* ECLI:EU:C:2011:793, para 48; Case C-231/05 *Oy AA*, para 47; Case C-35/08 *Grundstücksgemeinschaft Busley and Cibrian Fernandez v Finanzamt Stuttgart-Körperschaften,* ECLI:EU:C:2009:625, paras 29-30.
214 Case C-250/95 *Futura Participations SA and Singer v Administration des contributions,* ECLI:EU:C:1997:239, para 22; Case C-132/10 *Olivier Halley*, para 75; Case C-479/14 *Sabine Hünnebeck v Finanzamt Krefeld,* ECLI:EU:C:2016:412, paras 49, 65; Case C-342/10 *Commission v Finland,* ECLI:EU:C:2012:688, para 45; Case C-471/04 *Finanzamt Offenbach am Main-Land v Keller Holding GmbH,* ECLI:EU:C:2006:143, para 44.
215 Case C-309/99 *Wouters and others*, para 52.

of capital, must be interpreted narrowly.[216] The Court has ruled that the principle of territoriality must be exercised in accordance with the principles of EU law.[217] Acceptance of the view that a Member State may freely apply a different treatment solely on the basis of the location of the residence would deprive the rules relating to the free movement of capital of all meaning.[218] In *Lenz*,[219] which concerned the Austrian legislation providing for half-rate taxation only in relation to revenue from capital of Austrian origin, the Court highlighted that Article 65 (1) (a) TFEU must be interpreted strictly and does not render automatically any tax legislation making a distinction between taxpayers by reference to the place of residence or place where they invest their capital compatible with the Treaty.[220] The Court added that this derogation should be read in conjunction with Article 65 (3) TFEU (universality clause), according to which the national legislation shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital.[221] In other words, the derogation provided for in Article 65 (1) TFEU is itself limited by Article 65(3) TFEU.[222] Therefore, an unequal treatment permitted under Article 65 (1) (a) TFEU must clearly be distinguished from an arbitrary discrimination or a disguised restriction prohibited under Article 65 (3) TFEU.

The Court has consistently held that an unequal treatment of taxpayers on the basis of their residence is compatible with the free movement of capital only insofar as it relates to situations which are not objectively comparable or must be justified by an overriding reason in the public interest, such as the need to safeguard the coherence of the tax system.[223] The assessment of the comparability of the situations is based on the premise that in relation to direct taxation the situations of a resident and a non-resident taxpayer are *in principle* not comparable.[224] A lack of comparability implies that a possible unequal treatment would be justified. Nevertheless, most of the times the Court departs from this principle, as the actual situation of a non-resident taxpayer is *in fact* comparable to that of a resident taxpayer.

216 Case C-256/06 *Jäger*, para 40.
217 Case C-250/08 *Commission v Belgium (purchase of immovable property)*, para 48.
218 Ibid, para 50.
219 Case C-315/02 *Anneliese Lenz v Finanzlandesdirektion für Tirol,* ECLI:EU:C:2004:446.
220 Ibid, para 26.
221 Ibid.
222 Case C-45/17 *Frédéric Jahin*, para 33; Case C-322/11 *K,* ECLI:EU:C:2013:716, para 34; Case C-181/12 *Yvon Welte v Finanzamt Velbert,* ECLI:EU:C:2013:662, para 43.
223 Case C-450/09 *Ulrich Schröder v Finanzamt Hameln,* ECLI:EU:C:2011:198, para 35; Case C-318/07 *Persche*, para 41; Case C-510/08 *Vera Mattner v Finanzamt Velbert,* ECLI:EU:C:2010:216, para 34; Case C-35/98 *Verkooijen*, para 43.
224 Case C-279/93 *Schumacker*, para 31.

Thus, in *Grünewald*,[225] the Court found that due to the comparability of the situations the unequal treatment of taxpayers introduced by the German legislation at issue was not permitted under Article 65 (1) (a) TFEU. The case concerned the deductibility by a German national non-resident in Germany of the support payments he made to his parents in consideration of some shares he received as a gift by way of anticipated succession. The Court cited *Schröder*[226] and explained that, in relation to direct taxes, the situations of residents and of non-residents are generally not comparable, first because non-residents in most cases only receive part of their total income in the Member State in question, and secondly because it is easier to assess their ability to pay tax at the place of their residence.[227]

However, the situations are comparable where the non-resident receives no significant income in the State of his residence and obtains the greater part of his taxable income from an activity performed in the other Member State concerned.[228] Furthermore, with respect to expenses directly linked to an activity that has generated taxable income in a Member State, residents of that State and non-residents are in a comparable situation.[229] The Court found that in the case at hand the situations were comparable and thus the difference in treatment was not justified by Article 65 (1) (a) TFEU.

Similarly, in *Lenz*, in relation to a tax rule designed to attenuate the effects of double taxation of the profits distributed by the company in which the investment was made, shareholders who were fully taxable in Austria and received revenue from capital from a company established in another Member State were therefore in a situation comparable with that of shareholders who were likewise fully taxable in Austria but received revenue from capital from a company established in Austria.[230] Thus, the national legislation at issue could not be justified by the derogation in Article 65 (1) (a) TFEU.

Furthermore, in *Manninen*, the Court held that the principle of territoriality cannot justify different treatment of dividends distributed by companies established in Finland and those paid by companies established in other Member States, if those dividends share the same objective situation.[231]

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225 Case C-559/13 *Finanzamt Dortmund-Unna v Josef Grünewald,* ECLI:EU:C:2015:109.
226 Case C-450/09 *Schröder*, para 37.
227 Case C-559/13 *Josef Grünewald*, para 25; see also Case C-376/03 *D. v Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen,* ECLI:EU:C:2005:424, para 38.
228 Case C-376/03 *D. v Inspecteur van de Belastingdienst*, para 27.
229 Ibid, para 29.
230 Ibid, para 32.
231 Case C-319/02 *Petri Manninen,* ECLI:EU:C:2004:484, para 39.

Finally, Article 65 (1) (a) TFEU has found application also in the sensitive sector of social security, where the Court usually takes a more prudent approach recognising the competence of the Member States to organise their own social security systems. Thus, in *Blanckaert*, the Court held that it is for the Member States to determine the range of insured persons and the level of their contributions to the social security system.[232] This entails also the competence to allow entitlement to reduction in contributions only to persons insured under that system.[233] Consequently, the Dutch legislation at issue was justified in the light of Article 65 (1) (a) TFEU, by the objective difference between the situation of a person who is insured under the Netherlands social security system and that of a person who is not so insured.[234]

3.5.1.1.2 Article 65 (1) (b) TFEU (general derogation)

Article 65 (1) (b) TFEU is the general derogation clause in the field of free movement of capital, similar to the ones contained in Articles 36, 45 (3) and 52 TFEU concerning the other freedoms. This general derogation recognises three legitimate objectives that Member States can invoke in order to justify the imposition of a restriction on capital movements. First, they are allowed to adopt restrictive measures in order to prevent infringements of national law and regulations, in particular in the field of taxation and prudential supervision of financial institutions. Secondly, the Treaty permits procedures for declarations of capital movements for purposes of administrative or statistical information. Those two derogations were also found in Article 4 of the Directive 88/361. Finally, as with the other freedoms, reasons related to public policy or public security can provide a safety net for national regulatory measures.

3.5.1.1.2.1 Prevention of infringements of national law and regulations in particular in the field of taxation and the prudential supervision of financial institutions

Under Article 65 (1) (b) TFEU, Member States are allowed to adopt restrictive measures in order to prevent infringements of national law and regulations, in particular in the field of taxation and prudential supervision of financial institutions. As evidenced by the words *in particular*, the list of grounds on which Member States are allowed to take restrictive measures in order to prevent infringements of national law and regulations is non-exhaustive. The reference to taxation and prudential supervision of financial institutions sets out the prime objectives of this provision, without however excluding others.

232 Case C-512/03 *J.E.J. Blanckaert v Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen,* ECLI:EU:C:2005:516, para 49-50.

233 Ibid, para 49.

234 Ibid, para 50.

This was underlined in *Sanz de Lera*[235] and *Bordessa*,[236] where the Court said that other measures are also permitted, as long as they are designed to prevent 'illegal activities of comparable seriousness, such as tax evasion money laundering, drug trafficking or terrorism'. This interpretation is reinforced by the fact that public policy or public security are in any case justification grounds under Article 65 (1) (b) TFEU.[237]

The derogation of Article 65 (1) (b) TFEU was successfully invoked in the *Sandoz* case,[238] which concerned the compatibility with EU law of an Austrian rule under which the tax authorities could levy a stamp duty of 0.8 % on the value of loans contracted by residents borrowers with non-resident lenders. The Court, following the Opinion of Advocate General Léger, ruled that the Austrian legislation deprived residents of a Member State of the possibility of benefiting from the absence of taxation, which may be associated with loans obtained outside the national territory.[239] Therefore, this measure was likely to deter such residents from obtaining loans from persons established in other Member States and as such it constituted an obstacle to the free movement of capital.[240] Nevertheless, the duty was regarded as a requisite measure justified on the grounds of Article 73d (1) (b) of the Treaty (now Article 65 (1) (b) TFEU). In particular, the Court accepted the arguments brought forward by the Austrian Government that first, due to the partial harmonisation of tax law, the imposition of an indirect tax was within the competence of the Member States and second, the contested tax was justified by the need to observe the principle that residents should be treated equally for tax purposes.[241] The purpose of the legislation was to prevent taxable persons from evading the requirements of domestic tax legislation through the exercise of freedom of movement of capital.

The Court also found that the requirements laid down in Article 65 (3) TFEU were fulfilled, as the measure applied to all borrowers resident in Austria without distinction on grounds of nationality or the place where the loan was contracted and thus, it was not a means of arbitrary discrimination.[242] Thus, the measure was considered to be essential in order to prevent infringements of national tax law, as provided for in Article 65 (1) (b) TFEU. It has been suggested that this case should be treated with considerable caution, as the Court appears to be very generous with respect to indistinctly applicable

235 Joined cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera*, para 22.
236 Joined cases C-358/93 and C-416/93 *Bordessa*, para 21.
237 Ibid, para 22.
238 Case C-439/97 *Sandoz*.
239 Ibid, para 19.
240 Ibid, para 20.
241 Ibid, para 23.
242 Ibid, paras 25-26.

national tax rules which are intended to ensure effective fiscal supervision and to combat illegal activities such as tax evasion.[243]

However, the relative clemency with such national rules are treated does not reflect a general trait of this case law, but rather it should be judged on a case-by-case basis. Thus, in *Commission v Belgium*, the Court held that a general presumption of tax evasion or tax fraud cannot justify a fiscal measure which compromises the objectives of the fundamental freedoms, especially when the contested measure consists in an outright prohibition on the exercise of the free movement of capital.[244] The Belgian legislation in question prohibited the acquisition by persons resident in Belgium of securities of a loan issued abroad. This measure was regarded as a manifestly disproportionate measure which could not by justified under Article 65 (1) (5) TFEU.[245]

3.5.1.1.2.2 Procedures for the declaration of capital movements for purposes of administrative or statistical information

So far there has been no case law in relation to this derogation.[246] However, it is interesting to note that the Commission considers that the national tax authorities are entitled, within reasonable limits, to require taxpayers to declare money transfers abroad for administrative or statistical purposes.[247] The Commission further clarifies that it considers reasonable that an EU taxpayer may be required to file a declaration not only when she/he transfers or sells assets to another country but also every year in order to confirm the bank and other details in relation to the assets that she/he holds.[248] This has become relevant in the light of the liquidity crisis that some Member States – particularly Greece – have been experiencing as a result of the massive capital outflows caused by fear of a possible credit event and exit from the Eurozone.

3.5.1.1.2.3 Public policy or public security

Public policy and public security are two traditional derogation grounds applicable to all four freedoms. In relation to the free movement of capital, the Court has explained in *Église de Scientologie* that:

243 Jukka Snell, 'Free movement of capital: Evolution as a non-linear process' in Craig and De Búrca (eds), *The Evolution of EU Law* (Oxford University Press 2011), p. 557.

244 Case C-478/98 *Commission v Belgium*, para 45, citing Case C-28/95 *Leur-Bloem v Inspecteur der Belastingsdienst/Ondernemingen Amsterdam 2*, ECLI:EU:C:1997:369, para 44.

245 Case C-478/98 *Commission v Belgium*, para 47

246 Catherine Barnard, *The Substantive Law of the EU: The Four Freedoms* (Oxford University Press 2016), p. 550.

247 European Commission, 'Legal framework of the free movement of capital in the EU' <https://ec.europa.eu/info/files/document-legal-framework-free-movement-capital-eu_en> accessed 31-01-2019

248 Ibid.

> 'while Member States are free to determine the requirements of public policy and public security in the light of their national needs', they must nonetheless be interpreted strictly as derogations from the fundamental freedoms and 'their scope cannot be determined unilaterally by each Member State without any control of the Union institutions'.[249]

It subsequently held that public policy and public security might be relied on 'only if there is a genuine and sufficiently serious threat to a fundamental interest of society'.[250] It further stressed that those derogations must not be misapplied so as to serve purely economic ends and that any person affected have access to legal redress.[251]

The Court has accepted, for instance, that safeguarding supplies of petroleum products in the event of a crisis is a matter of public security capable of justifying restrictions on free movement.[252] Furthermore, in *Kadi I*, it established that the concept of public security covers both the State's internal and external security[253] and that therefore the Member States were entitled under Article 65 (1) (b) TFEU to adopt a Regulation imposing the freezing of individuals funds in connection with the fight against international terrorism.[254]

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249 Case C-54/99 *Association Eglise de scientologie de Paris*, para 17.

250 Ibid.

251 Ibid.

252 Case C-483/99 *Commission v France (golden shares – Sociéte Nationale Elf-Aquitaine)*, para 28; Case 72/83 *Campus Oil Limited and others v Minister for Industry and Energy and others*, ECLI:EU:C:1984:256, paras 34-35.

253 This was already held in relation to the free movement of goods in Case C-367/89 *Aimé Richardt and Les Accessoires Scientifiques SNC*, ECLI:EU:C:1991:376, para 22.

254 Case T-315/01 *Yassin Abdullah Kadi v Council and Commission*, ECLI:EU:T:2005:332, para 110. The Kadi litigation includes also the following cases: Joined cases C-402/05 P and C-415/05 P *Yassin Abdullah Kadi and Al Barakaat International Foundation v Council and Commission*, ECLI:EU:C:2008:461; Case T-85/09 *Yassin Abdullah Kadi v Commission*, ECLI:EU:T:2010:418; Joined cases C-584/10 P, C-593/10 P and C-595/10 P *Commission and Others v Yassin Abdullah Kadi*, ECLI:EU:C:2013:518. There is abundant literature on the Kadi saga: N. Türküler Isiksel, 'Fundamental rights in the EU after Kadi and Al Barakaat' (2010) 16 *European Law Journal* 551; Samantha Besson, 'European Legal Pluralism after Kadi' (2009) 5 *European Constitutional Law Review* 237; Conor Gearty, 'In Praise of Awkwardness: Kadi in the CJEU' (2014) 10 *European Constitutional Law Review* 15; Angus Johnston, 'Frozen in Time? The ECJ Finally Rules on the Kadi Appeal' (2009) 68 *The Cambridge Law Journal* 1; Armin Cuyvers, 'The Kadi II Judgment of the General Court: The ECJ's Predicament and the Consequences for Member States' (2011) 7 *European Constitutional Law Review* 481; Takis Tridimas, 'Economic Sanctions, Procedural Rights and Judicial Scrutiny: Post-Kadi Developments' (2009-2010) 12 *Cambridge Yearbook of European Legal Studies* 455; Joris Larik, 'The Kadi Saga as a Tale of 'Strict Observance' of International Law: Obligations Under the UN Charter, Targeted Sanctions and Judicial Review in the European Union' (2014) 61 *Netherlands International Law Review* 23; Mielle Bulterman, 'Fundamental Rights and the United Nations Financial Sanction Regime: The Kadi and Yusuf Judgments of the Court of First Instance of the European Communities' (2006) 19 *Leiden Journal of International Law* 753; Larissa Van den Herik, 'The Security Council's Targeted Sanctions Regimes: In Need of

The external dimension of public security has been examined also in the context of national legislation regarding the purchase of real property. In particular, in *Albore*, the Italian rules at issue required an administrative authorisation for any purchase of real property by non-nationals in Barano d'Ischia, an area of the country designated as being of military importance.[255] The Court found that a mere reference to the requirements of defence of the national territory cannot suffice to justify discrimination on grounds of nationality against other EU national regarding access to immovable property.[256] Nevertheless, the Court left a window open for possible justification of discriminatory measures on grounds of public security. It held that if a Member State can demonstrate, for each area to which the restriction applies, that non-discriminatory treatment of EU nationals would expose the military interests of the Member State concerned to real, specific and serious risks, then the restrictive measure could be justified.[257]

3.5.1.2 Derogations applicable only to capital movements to/from third countries

Capital movements to/from third countries are subject to further four derogations. Those derogations clearly create a less liberalised framework for extra-EU capital flows.

3.5.1.2.1 Article 64 (1) TFEU ('grandfather clause')

The grandfather clause contained in Article 64 (1) TFEU allows Member States to maintain restrictions that existed on 31 December 1993 under national or Union law on capital movements to or from third countries involving direct investment – including in real estate – establishment, the provision of financial services or the admission of securities to capital markets.[258] According to the same article, in respect of restrictions existing under national law in Bulgaria, Estonia and Hungary, the relevant date shall be 31 December 1999. The Court has emphasised that the list of capital movements in Article 65 (1) TFEU is restrictive and therefore it does not cover capital movements which are not

Better Protection of the Individual' (2007) 20 *Leiden Journal of International Law* 797; Martin Scheinin, 'Is the ECJ Ruling in Kadi Incompatible with International Law?' (2009) 28 *Yearbook of European Law* 637; Nikolaos Lavranos, 'The Impact of the Kadi Judgment on the International Obligations of the EC Member States and the EC' (2009) 28 *Yearbook of European Law* 616; Marise Cremona, 'EC Competence, 'Smart Sanctions', and the Kadi Case' (2009) 28 *Yearbook of European Law* 559; Armin Cuyvers, '"Give me one good reason": The unified standard of review for sanctions after Kadi II' (2014) 51 *Common Market Law Review* 1759.

255 Case C-423/98 *Alfredo Albore*, para 12.

256 Ibid, para 21.

257 Ibid, para 22.

258 Alexandre Maitrot de la Motte, 'Les exceptions a' la liberté européenne de circulation des capitaux: réflexions sur le champ d'application de l'article 64 TFUE' (2011) 24 *Revue de Droit Fiscal* 26.

mentioned there, such as inheritances.[259] At the same time, however, the Court has found that the grandfather clause extends not only to measures which restrict investment or establishment, but also measures which restrict payments of dividends deriving from them.[260] Furthermore, the Court has held that the applicability of Article 64 (1) TFEU depends, not on the purpose of the national legislation containing such restrictions, but on its effect on capital movements.[261] This means that Article 64 (1) TFEU applies even where the restriction imposed by the national legislation can also be applied to situations, which have nothing to do with direct investment, establishment, the provision of financial services or the admission of securities to capital markets.[262] In relation to the acquisition of immovable property, Article 64 (1) TFEU has been accepted as a justification ground for the Austrian legislation requiring foreign nationals (including nationals of Switzerland) when acquiring immovable property situated in the province of Vienna to obtain prior authorisation.[263]

In *SECIL*, the Court, however, clarified that a Member State waives the power provided for in Article 64 (1) TFEU where, even without formally repealing or amending the existing rules, it concludes an international agreement, such as an association agreement, which provides, in a provision with direct effect, for a liberalisation of a category of capital referred to in Article 64 (1) TFEU.[264] That change in the legal framework must therefore be deemed to amount, in its effects on the possibility of invoking Article 64 (1) TFEU, to the introduction of new legislation, since it is based on a logic different from that of the existing legislation. Otherwise, a liberalisation of the movement of capital provided for by an international agreement would be devoid of any useful effect.[265]

3.5.1.2.2 Article 64 (2) and (3) TFEU and Article 65 (4) TFEU

Article 64 (2) and (3) and Article 65 (4) TFEU grant legislative powers to the Council to adopt secondary measures regarding capital movements with third countries. In more detail, Article 64 (2) TFEU is a legal basis provision which allows the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, to adopt measures regarding the same types

259 Case C-181/12 *Welte*, paras 28-29.
260 Case C-446/04 *Test Claimants in the FII Group Litigation*, paras 171 and 183.
261 Case C-317/15 *X v Staatssecretaris van Financiën,* ECLI:EU:C:2017:119, para 21.
262 Ibid, para 25.
263 Case C-541/08 *Fokus Invest AG v Finanzierungsberatung-Immobilientreuhand und Anlageberatung GmbH (FIAG),* ECLI:EU:C:2010:74, para 49.
264 Joseph Stiglitz, *The Euro: How a Common Currency Threatens the Future of Europe* (W. W. Norton Company 2016), para 89.
265 Ibid, para 90. See also the annotation Martha O'Brien, 'Free movement of capital between EU Member States and third countries and the Euro-Mediterranean Agreements: SECIL' (2018) 55 *Common Market Law Review* 243.

of capital movements to and from third countries as the ones referred to in Article 64 (1) TFEU. Furthermore, Article 64 (3) TFEU allows the Council, acting in accordance with a special legislative procedure, to unanimously, and after consulting the European Parliament, adopt measures which constitute a step backwards in Union law as regards the liberalisation of the movement of capital to or from third countries.

Article 65 (4) TFEU is a new and special provision, as it allows the Council to pronounce on the legality of restrictive tax measures adopted by Member States concerning third countries. It specifically provides that in the absence of measures pursuant to Article 64 (3) TFEU, the Commission or, 'in the absence of a Commission decision within three months from the request of the Member State concerned, the Council, may adopt a decision stating that restrictive tax measures adopted by a Member State concerning one or more third countries are to be considered compatible with the Treaties in so far as they are justified by one of the objectives of the Union and compatible with the proper functioning of the internal market. The Council shall act unanimously on application by a Member State'.

It has been observed that Article 65 (4) TFEU bears a certain resemblance to Article 108 (2) (3) TFEU, which provides that on application of a Member State, the Council may, acting unanimously, declare certain state aids compatible with the internal market if such decision is justified by exceptional circumstances.[266] This provision constitutes an exception from the rule that the Commission has the exclusive competence in ruling on the compatibility of a state aid with the internal market.[267] Article 65 (4) TFEU goes even further as it grants to the Council the competence to rule on the legality of national measures, something that is normally reserved for the Court.[268]

This new clause was inserted originally in the Constitutional Treaty in 2004 (which never entered into force) and later in the Lisbon Treaty by the Member States in an effort to restrain the expansionist and intrusive negative integration pursued by the Court. As aptly noted, the inclusion of this provision in the Lisbon Treaty demonstrates a distrust of the Court on the part of the Member

266 Jukka Snell, 'Free movement of capital: Evolution as a non-linear process' in Craig and De Búrca (eds), *The Evolution of EU Law* (Oxford University Press 2011), p. 553.

267 European Commission, *Commission notice on the enforcement of State aid law by national courts* (OJ C 85, p 1–22, 2009); Case C-284/12 *Deutsche Lufthansa AG v Flughafen Frankfurt-Hahn GmbH,* ECLI:EU:C:2013:755, para 28; Joined cases C-261/01 and C-262/01 *Belgische Staat v Eugène van Calster and Others,* ECLI:EU:C:2003:571, para 75; Case C-368/04 *Transalpine Ölleitung in Österreich GmbH,* ECLI:EU:C:2006:644, para 38.

268 Jukka Snell, 'Free movement of capital: Evolution as a non-linear process' in Craig and De Búrca (eds), *The Evolution of EU Law* (Oxford University Press 2011).

States when it comes to capital movements with third countries.[269] It has been regarded as a rebuff to the Court that its excessively broad interpretation of the concept of 'restrictions' has crossed the boundaries set by the Treaties.[270]

3.5.1.2.3 Article 66 TFEU (safeguard measures)
Article 66 TFEU allows the Council, on a proposal from the Commission and after consulting the European Central Bank, to take safeguard measures where, in exceptional circumstances, movements of capital to or from third countries cause, or threaten to cause, serious difficulties for the operation of Economic and Monetary Union.[271] However, the safeguard measures must be strictly necessary and temporary, i.e. for a period not exceeding six months.

3.5.1.2.4 Article 75 TFEU (freezing of funds to prevent and combat terrorism)
Article 75 TFEU is a politically sensitive provision authorising the freezing of funds, financial assets or economic gains belonging to, or owned or held by, natural or legal persons, groups or non-State entities in order to prevent and combat terrorism. This provision constitutes the legal basis for financial sanctions directed against individuals or non-State actors, not towards States.[272] As it currently stands, Article 75 TFEU allows the European Parliament and the Council, acting by means of regulations in accordance with the ordinary legislative procedure, to define a framework for administrative measures with regard to capital movements and payments, such as the freezing of funds, financial assets or economic gains belonging to, or owned or held by, natural or legal persons, groups or non-State entities in order to prevent and combat terrorism and related activities. Those measures shall include necessary provisions on legal safeguards, which are intended to ensure that the right to an effective judicial protection of the individuals concerned is respected.

Article 75 TFEU was moved to Title V on the area of freedom, security and justice with the Lisbon revision. Before Lisbon, Article 60 EC authorised the Council to take the necessary urgent measures as regards *third countries* when this was deemed necessary in light of a decision adopted under Article 301 EC (today Article 215 TFEU). The latter provided that within the framework of the common foreign and security policy (CFSP) Member States could decide

269 Ibid, p. 554.
270 Catherine Barnard, *The Substantive Law of the EU: The Four Freedoms* (Oxford University Press 2016), p. 525.
271 Case C-101/05 *Skatteverket v A*, para 33.
272 Bart Van Vooren and Ramses A. Wessel, *EU External Relations Law: Text, Cases and Materials* (Cambridge University Press 2014), p. 396.

to interrupt or to reduce economic relations with one or more third countries.[273]

The relationship between these provisions (Article 60 EC, Article 301 EC, Article 75 TFEU and Article 215 TFEU) was analysed in the annulment action that the Parliament brought against Council challenging the legal basis of Regulation 1286/2009[274] on restrictive measures against persons associated with Usama bin Laden, the Al-Qaeda network and the Taliban which the Community had adopted in order to implement the United Nations Security Council Resolution 1390 (2002).[275] The Court explained that after the Lisbon revision, the content of Article 60 EC and 301 EC is mirrored in Article 215, which is found in Part Five of the TFEU on the Union's External Action.[276] Article 301 EC and 215 (1) TFEU are worded in the same way. Furthermore, Article 215 (1) TFEU contains a reference to financial relations to cover the areas previously within the ambit of Article 60 EC.[277] In addition, Article 215 (2) TFEU allows the Council to adopt restrictive measures against natural or legal persons and groups or non-State entities, which before the Lisbon Treaty required also the use of Article 308 EC as an additional legal basis provision.[278] As regards Article 75 TFEU, the Court underlined that its context and its tenor differ from those of Article 60 EC and 301 EC as it does not concern economic relations with third countries, but it is incorporated into Part Three on Internal Actions and in particular in Title V on the Area of freedom, security and justice.[279]

Under the current legal framework, the difference between Article 215 (2) TFEU and Article 75 TFEU is that the latter is the legal basis for the adoption of administrative measures with regard to capital movements and payments necessary to achieve the objectives set out in Article 67 TFEU and refers specifically to the objective of preventing and combating terrorism. By contrast, Article 215 (2) TFEU can be used only after a CFSP decision has been adopted author-

273 Today Article 215 TFEU provides a legal basis for the interruption or reduction, in part or completely, of the Union's economic and financial relations with one or more third countries, where such restrictive measures are necessary to achieve the objectives of the Common Foreign and Security Policy (CFSP). The procedure that needs to be followed is that the Council, acting by a qualified majority on a joint proposal from the High Representative of the Union for Foreign Affairs and Security Policy and the Commission, shall adopt the necessary measures and it shall inform the European Parliament thereof.

274 'Council Regulation (EU) No 1286/2009 of 22 December 2009 amending Regulation (EC) No 881/2002 imposing certain specific restrictive measures directed against certain persons and entities associated with Usama bin Laden, the Al-Qaeda network and the Taliban' (2009) *OJ L 346, 23.12.2009, p. 42-46*.

275 Case C-130/10 *Parliament v Council,* ECLI:EU:C:2012:472

276 Ibid, para 51.

277 Ibid, para 52.

278 Ibid, para 53.

279 Ibid, para 54.

ising the adoption of restrictive measures against natural or legal persons, groups or non-State entities. Moreover, it does not specifically refer to the combating of terrorism and it does not limit the scope of the possible measures to the ones relating to capital movements and payments.[280]

In *Parliament v Council*, the Court ruled:

> 'while admittedly the combating of terrorism and its financing may well be among the objectives of the area of freedom, security and justice, as they appear in Article 3(2) TEU, the objective of combating international terrorism and its financing in order to preserve international peace and security corresponds, nevertheless, to the objectives of the Treaty provisions on external action by the Union'.[281]

Thus:

> 'Article 215(2) TFEU constitutes the appropriate legal basis for measures, such as those at issue in the present case, directed to addressees implicated in acts of terrorism who, having regard to their activities globally and to the international dimension of the threat they pose, affect fundamentally the Union's external activity'.[282]

The negative consequences for the Parliament's prerogatives – Articles 75 TFEU provides for recourse to the ordinary legislative procedure whereas, under Article 215 TFEU the Parliament is merely informed – could not affect the choice of the legal basis.[283]

Regarding the interplay of Article 75 and 215 TFEU with the other provisions stipulating possible legitimate derogations from the free movement of capital, the case law on Article 60 EC might give us some useful insights. In particular, the Court explained that the restrictions which the Member States and the Community could impose under Article 57 (1) EC (today Article 64 (1) TFEU) on the movement of capital to or from third countries were, in addition, not only to those provided for in Articles 59 EC (Article 66 TFEU) and 60 EC (Article 75 TFEU) but also to those restrictions resulting from measures adopted by the Member States in accordance with Article 58(1)(a) and (b) EC (Article 65 (1) (a) and (b) TFEU) or which were otherwise justified by an overriding requirement of general interest.[284] This was because the movement of capital to or

280 Ibid, paras 57-58.
281 Ibid, para 61.
282 Ibid, para 78.
283 Ibid, para 79.
284 Case C-101/05 *Skatteverket v A*, para 35.

from third countries takes place in a different legal context from that which occurs within the Community.[285]

Regarding, finally, the judicial review of the acts adopted under Article 60 EC, the Court had ruled that the Council enjoyed wide discretion when adopting economic and financial sanctions on the basis of Article 60 EC and 301 EC, as these decisions were adopted on the basis of the CFSP. Decisions adopted under CFSP are subject to a limited judicial review under Article 24 (1) TEU and Article 275 TFEU.[286] Therefore, the Court could only review whether the rules of procedure and the statement of reasons had been complied with, whether the facts were materially accurate and whether there had been no manifest error of assessment of the facts or misuse of power.[287] Nevertheless, in order to ensure that the right to an effective judicial protection is respected, the parties concerned should be allowed to bring an action before the Court against the decision freezing their assets.[288] The right to an effective judicial protection can be sufficiently safeguarded if the judicial review of the lawfulness of the decision extends to the assessment of the facts and evidence,[289] the right to a fair hearing is observed, the requirement of a statement of reasons is satisfied and the overriding considerations of the Council are well-substantiated.[290] This case law is still valid for the restrictive measures adopted under Article 215 TFEU, which presuppose a decision adopted under CFSP. However, it is doubtful whether it is still relevant for Article 75 TFEU, insofar as the restrictive measures adopted on the basis of the latter are legislative acts adopted in accordance with the ordinary legislative procedure and therefore they are subject to a thorough judicial review.

285 Ibid, para 36.

286 The limited judicial review was one of the reasons why the Court considered that the Draft Agreement on the Accession of the EU to the ECHR was not compatible with EU law. See *Opinion 2/13 Accession of the European Union to the European Convention for the Protection of Human Rights and Fundamental Freedoms,* ECLI:EU:C:2014:2454, paras 249-257.

287 European Commission, *Commission notice on the enforcement of State aid law by national courts* (2009), para 45; Case T-228/02 *Organisation des Modjahedines du peuple d'Iran v Council,* ECLI:EU:T:2006:384, para 159.

288 Case T-228/02 *Organisation des Modjahedines du peuple d'Iran v Council*, paras 152; Judgment of 30 June 2005, *Bosphorus v Ireland,* No 45036/98 (ECtHR), para 165; Judgment of 23 May 2002, *Segi and Others and Gestoras pro Amnisti´a v The 15 Member States of the European Union,* Nos 6422/02 and 9916/02 (ECtHR).

289 Case T-306/01 *Yusuf and Al Barakaat International Foundation v Council and Commission,* ECLI:EU:T:2005:331, para 225.

290 Case T-228/02 *Organisation des Modjahedines du peuple d'Iran v Council*, paras 152-154.

3.5.2 Case law-made derogations (overriding reasons in the public interest/ emergency break)

Apart from the exhaustive list of express derogations provided for in the Treaties, the Court has created a number of public interest requirements or overriding reasons in the public interest that justify restrictions on capital movements.[291] The definition of the overriding reasons in the public interest lies in principle with the Member States, which can indeed decide on the degree or protection which they whish to afford to such legitimate interests and on the way which that protection is to be achieved within the limits prescribed by the principle of proportionality.[292] Thus, in relation to taxation, the Court has recognised as legitimate objectives the need to maintain a balanced allocation of the power to impose taxes between the Member States,[293] the objective of combatting tax evasion and avoidance,[294] the effectiveness of fiscal supervision,[295] the need to safeguard the cohesion of the tax system,[296] the need to ensure effective collection of tax[297] as well as the promotion of research and development.[298] In the field of investment

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291 Case C-271/09 *Commission v Poland (pension funds),* ECLI:EU:C:2011:855, para 55; Case C-274/06 *Commission v Spain (golden shares)*, para 35; Case C-112/05 *Commission v Germany (golden shares – Volkswagen I)*, para 72; Case C-503/99 *Commission v Belgium (golden shares)*, para 45; Case C-174/04 *Commission v Italy (golden shares)*, para 35; Case C-309/99 *Wouters and others*, para 49; Case C-463/00 *Commission v Spain (golden shares)*, para 68.

292 Joined cases C-282/04 and C-283/04 *Commission v The Netherlands (golden shares)*, paras 32-33.

293 Case C-182/08 *Glaxo Wellcome*, paras 31 and 88.

294 Case C-282/12 *Itelcar*, paras 12 and 35.

295 Case C-446/04 *Test Claimants in the FII Group Litigation*, para 47; Case C-101/05 *Skatteverket v A*, para 55; Joined cases C-155/08 and C-157/08 *X and E. H. A. Passenheim-van Schoot v Staatssecretaris van Financiën,* ECLI:EU:C:2009:368, para 55; Case C-262/09 *Wienand Meilicke and Others v Finanzamt Bonn-Innenstadt,* ECLI:EU:C:2011:438, para 41; Case C-318/10 *Société d'investissement pour l'agriculture tropicale SA (SIAT) v État belge,* ECLI:EU:C:2012:415, para 36; Case C-326/12 *Rita van Caster and Patrick van Caster v Finanzamt Essen-Süd,* ECLI:EU:C:2014:2269, paras 46-47.

296 Case C-242/03 *Ministre des Finances v Jean-Claude Weidert and Élisabeth Paulus,* ECLI:EU:C:2004:465, paras 10 and 20-22; Case C-204/90 *Bachmann*, para 28; Case C-300/90 *Commission v Belgium*, para 21; Case C-55/98 *Skatteministeriet v Bent Vestergaard,* ECLI:EU:C:1999:533, para 24; Case C-436/00 *X and Y*, para 52; Case C-251/98 *Baars*, para 40; Case C-168/01 *Bosal,* ECLI:EU:C:2003:479, para 30; Case C-315/02 *Anneliese Lenz*, para 35. In a nutshell, in this case law, the Court explained that in order to be able to justify their national legislation granting tax relief under certain conditions on the need to safeguard the cohesion of the tax system, Member States must demonstrate that there is a direct link between the grant of a tax advantage and the offsetting of that advantage by a fiscal levy, and that link has to be maintained to preserve the cohesion of the tax system concerned.

297 Case C-318/10 *SIAT*, para 64; Case C-498/10 *X NV v Staatssecretaris van Financiën,* ECLI:EU:C:2012:635, para 39; Joined cases C53/13 and C80/13 *Stroji´rny Proste?jov et ACO Industries Tábor,* ECLI:EU:C:2014:2011, para 46; Case C-326/12 *Rita van Caster*, paras 46-47.

298 Case C-10/10 *Commission v Austria (Gifts for Teaching and Research Institutions),* ECLI:EU:C:2011:399, para 37; Case C-39/04 *Laboratoires Fournier,* ECLI:EU:C:2005:161, para 23.

in real estate, the case law acknowledges a town and country planning objective, such as maintaining a permanent population and an economic activity independent of the tourist sector in certain regions,[299] the need to preserve the farming of agricultural land by means of owner-occupancy and to ensure that agricultural property be occupied and farmed predominantly by the owners,[300] the need to preserve a permanent agricultural community, to sustain and develop viable agriculture and to encourage a reasonable use of the available land by resisting pressure on land and by preventing natural disasters[301] and the protection of the environment.[302] As regards direct investments, the Court has recognised that the objective of guaranteeing a service of general interest, such as universal postal service[303] or adequate investment in the electricity and gas distribution systems constitute overriding reasons in the public interests.[304] Requirements related to public housing policy in a Member State and to the financing of that policy are also regarded as overriding reasons in the public interest.[305] Finally, in relation to collective investment undertakings, the Court has held that the need to guarantee the stability and security of the assets administered by an undertaking for collective investment created by a severance fund, in particular by the adoption of prudential rules constitutes an imperative reason of public interest capable of justifying capital restrictions.[306]

The list of overriding reasons in the public interests is an open-ended list, which however, in principle does not cover interests of an economic nature. Indeed, according to the traditional internal market approach, grounds of a purely economic nature cannot constitute overriding reasons in the public interest justifying a restriction of a fundamental freedom guaranteed by the

299 Case C-302/97 *Konle*, para 40; Joined cases C-515/99, C-519/99 to C-524/99 and C-526/99 to C-540/99 *Reisch*, para 34.

300 Case C-370/05 *Festersen*, paras 27-28; The Court observed that these objectives are also consistent with those of the common agricultural policy.

301 Case C-452/01 *Margarethe Ospelt*, paras 38-40;

302 Joined cases C-515/99, C-519/99 to C-524/99 and C-526/99 to C-540/99 *Reisch*, para 34.

303 Joined cases C-282/04 and C-283/04 *Commission v The Netherlands (golden shares)*, para 38.

304 Joined cases C-105/12 to C-107/12 *Essent NV*, para 59; Case 72/83 *Campus Oil*, paras 34-35; Case Case C-503/99 *Commission v Belgium (golden shares)*, para 46; Case C-174/04 *Commission v Italy (golden shares)*, para 40.

305 Case C-567/07 *Sint Servatius*. The case concerned a Dutch institution active in the public housing sector in the Netherlands (and thus able to contract loans on particularly favourable terms) that was refused to be granted an authorisation for a construction project in Liège (Belgium) on the ground that the project would not be of benefit to the Netherlands housing market. The Court, while striking down the system of prior authorisation, it nevertheless accepted that it could be justified on reasons related to the public housing policy of the Member State.

306 Case C-39/11 *VBV – Vorsorgekasse*, paras 18 and 31. By analogy the same applies to pension funds, see Case C-271/09 *Commission v Poland (pension funds)*, para 57.

Treaties.[307] In the context of the free movement of capital, the Court has explicitly ruled out objectives such as choosing a strategic partner, strengthening the competitive structure of the market or modernising and increasing the efficiency of means of the production.[308] However, in recent case law, it seems that the Court is attempting to introduce certain nuances as to the economic nature of some interests. In particular, in *Essent*, it reasoned that national legislation might constitute a justified restriction on a fundamental freedom when it is dictated by reasons of an economic nature *in the pursuit of an objective in the public interest*.[309] This reasoning led to the conclusion that the objectives of combatting cross-subsidisation in order to achieve transparency in the electricity and gas markets and to prevent distortions of competition could constitute overriding reasons in the public interest capable of justifying restrictions on free movement of capital.[310] By the same token, the reasons underlying the choice of the rules of property ownership adopted by the national legislation within the scope of Article 345 TFEU were regarded as factors, which might be taken into consideration as circumstances capable of justifying restrictions on the free movement of capital.[311]

3.6 Proportionality

Once the Court has established that the restriction on capital movements is justified either by one of the explicit derogations of the Treaty or by the case law-made overriding reasons in the public interests, it proceeds to the final step, i.e. it examines whether the measure at issue is proportionate to the objective pursued. In theory, the proportionality assessment consists of a tripartite test: firstly, the *suitability* test, which examines whether the measure

307 Joined cases C-105/12 to C-107/12 *Essent NV*, para 51; Case C-388/01 *Commission v Italy (golden shares),* ECLI:EU:C:2003:30, para 22; Case C-109/04 *Karl Robert Kranemann v Land Nordrhein-Westfalen,* ECLI:EU:C:2005:187, para 34; Case C-35/98 *Verkooijen*, para 48; Case C-120/95 *Nicolas Decker v Caisse de maladie des employés privés,* ECLI:EU:C:1998:167, para 39; Case C-158/96 *Raymond Kohll v Union des caisses de maladie,* ECLI:EU:C:1998:171, para 41; Case C-398/95 *Syndesmos ton en Elladi Touristikon kai Taxidiotikon Grafeion v Ypourgos Ergasias,* ECLI:EU:C:1997:282, para 23; Case C-288/89 *Gouda and Others,* ECLI:EU:C:1991:323, para 11; Case 352/85 *Bond van Adverteerders and others v The Netherlands State,* ECLI:EU:C:1988:196, para 34. The origins of this settled case law go back to one of the oldest Internal Market cases (Case 7-61 *Commission v Italy,* ECLI:EU:C:1961:31), in which the Court held that Article 36 TFEU is 'directed to eventualities of a non-economic kind'. By introducing this 'economic rule', the Court wanted to send a signal that it would not tolerate protectionest measures which could undermine the functionning of the Internal Market. See in this regard Peter Oliver, 'When, if ever, can restrictions on free movement be justified on economic grounds' (2016) 41 *European Law Review* 147.

308 Case C-309/99 *Wouters and others*, para 52.

309 Joined cases C-105/12 to C-107/12 *Essent NV*, para 52.

310 Ibid, para 56 et seq.

311 Ibid, para 55.

is suitable/appropriate to achieve the objective pursued; secondly, the *necessity* test, which examines whether the measure is necessary in order to achieve the objective pursued, namely whether there are other less restrictive measures capable of producing the same result; and thirdly, the *proportionality stricto sensu*, which examines whether, in case there are no less restrictive means, the measure does not have an excessive effect on the applicant's interests.[312] However, in internal market case law, the third step is often subsumed within the second step and, as a result of this subsumption, the Court employs in essence a two-stage test consisting of the suitability and the necessity assessment.[313]

In the area of the free movement of capital, the principle of *legal certainty* appears sometimes as a third requirement in the proportionality assessment, in addition to the suitability and necessity tests. Legal certainty is a fundamental principle of EU law which requires that rules should be clear and precise so that individuals may ascertain unequivocally what their rights and obligations are and may take steps accordingly.[314] An illustration of the application of the principle of legal certainty is provided in *Eglise de Scientologie*,[315] where the Court held that the French system of prior authorisation for certain categories of direct foreign investments was not consistent with the principle of legal certainty and as such it constituted an infringement of the free movement of capital. Although the system was justifiable on public-policy and public-security grounds, in the end it was deemed to be incompatible with the free movement of capital, as the investors concerned were given no indication as to the specific circumstances in which prior authorisation was required.[316] Such lack of precision did not enable individuals to be apprised

312 Takis Tridimas, 'The principle of proportionality' in Robert Schu¨tze and Takis Tridimas (eds), *Oxford principles of European Union law Volume I, The European Union legal order* (Oxford University Press 2018), pp. 243-264, at p. 247; Takis Tridimas, *The General Principles of EU law* (Oxford University Press 2006), p. 139; Paul Craig, *EU Administrative Law* (Oxford University Press 2012), p. 592.

313 Vasiliki Kosta, 'The principle of proportionality in EU law: an interest-based taxonomy' in Joana Mendes (ed), *EU Executive Discretion and the Limits of Law* (Oxford University Press forthcoming 2019).

314 Case 169/80 *Administration des douanes v Société anonyme Gondrand Frères and Société anonyme Garancini,* ECLI:EU:C:1981:171, para 17; Case C-143/93 *Gebroeders van Es Douane Agenten BV v Inspecteur der Invoerrechten en Accijnzen,* ECLI:EU:C:1996:45, para 27; Case C-110/03 *Belgium v Commission,* ECLI:EU:C:2005:223, para 30; Case C-158/06 *Stichting ROM-projecten v Staatssecretaris van Economische Zaken,* ECLI:EU:C:2007:370, para 25; Case C-308/06 *The Queen, on the application of International Association of Independent Tanker Owners (Intertanko) and Others v Secretary of State for Transport,* ECLI:EU:C:2008:312, para 69; Case C-201/08 *Plantanol GmbH & Co KG v Hauptzollamt Darmstadt,* ECLI:EU:C:2009:539, para 46; Case C-344/04 *The Queen, on the application of International Air Transport Association and European Low Fares Airline Association v Department for Transport,* ECLI:EU:C:2006:10, para 68.

315 Case C-54/99 *Association Eglise de scientologie de Paris.*

316 Ibid, para 21.

of the extent of their rights and obligations deriving from Article 63 TFEU and, therefore, it was contrary to the principle of legal certainty.[317]

Systems of prior authorisation are usually regarded to be disproportionate when they lack precision or when a system of declaration could have achieved the same objective. An example can be drawn from the *Sanz de Lera* case.[318] In particular, the Court found that although the requirement of prior authorisation constituted a capital restriction, it could in principle be justified on the grounds of the general derogation clause of Article 73d (1) (b) of the Treaty (today Article 65 (1) (a) TFEU), allowing Member States:

> 'to take all requisite measures to prevent infringement of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information or to take measures which are justified on grounds of public policy or public security'.[319]

Furthermore, it was pointed out that measures intended to ensure effective fiscal supervision and to prevent illegal activities such as tax evasion, money laundering, drug trafficking or terrorism, which are permitted by Article 4 (1) of Directive 88/361, are also covered by Article 73d (1) (b) of the Treaty.[320]

Nevertheless, the measure failed the proportionality test. Although the Government had managed to put forward valid justification grounds, the system of prior authorisation was found to be disproportionate to the legitimate objectives it pursued. In particular, the Court repeated its judgment in *Bordessa* that:

> 'authorisation has the effect of suspending currency exports and makes them conditional in each case upon the consent of the administrative authorities, which must be sought by means of a special application'.[321]

> 'The effect of such a requirement is to cause the exercise of the free movement of capital to be subject to the discretion of the administrative authorities and thus be such as to render that freedom illusory'.[322]

A less restrictive measure would be a system of *declarations* requiring the competent authorities:

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317 Ibid, para 22.
318 Joined cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera*. The same reasoning was also followed in Joined cases C-358/93 and C-416/93 *Bordessa*, paras 25-27; Joined cases 286/82 and 26/83 *Luisi and Carbone*, para 34; and Case C-302/97 *Konle*, para 44.
319 Joined cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera*, para 20.
320 Ibid, para 22.
321 Ibid, para 24.
322 Ibid, para 25.

> 'to proceed with a rapid examination of the declaration and enable them, if necessary, to carry out in due time the investigations found to be necessary to determine whether capital was being unlawfully transferred and to impose the requisite penalties if national legislation was being contravened'.[323]

Thus, unlike a system of prior authorisation, such a system of declarations

> 'would not suspend the operation concerned but would nevertheless enable the national authorities to carry out, in order to uphold public policy, effective supervision to prevent infringements of national law and regulations'.[324]

In *Commission v France (golden shares)*, the Court tried to soften its position by acknowledging that a system of prior authorisation could be proportionate if it was based on objective, non-discriminatory and known in advance criteria and it provided legal remedies to the persons affected.[325] However, *in casu*, the authorisation procedure was disproportionate, as the discretionary power of the Minister to approve any shareholding exceeding certain limits constituted a serious interference with the free movement of capital that went beyond what was necessary in order to attain the legitimate objective of securing petroleum supplies in the event of a real threat.[326] The crucial pitfall that rendered this procedure disproportionate was the fact that the exercise of the right of approval was conditioned only on a general reference to the protection of the national interest. The investors concerned were given no indication whatsoever as to the specific, objective circumstances in which prior authorisation would be granted or refused and, in that sense, such a system was to be regarded as contrary to the principle of legal certainty.[327]

The only golden shares case in which the Court found that the special rights in question were consistent with the principle of proportionality was the *Belgian* case,[328] where the Court found that the national opposition scheme was based on *objective criteria* which were *subject to judicial review*, enabling thus the Belgian government to intervene with a view to ensuring compliance with the public service obligations incumbent on SNTC and Distrigaz, whilst at the same time observing the requirements of *legal certainty* (Chapter 4 Sections 3.3 and 3.4).[329]

323 Ibid, para 27.
324 Ibid, para 28.
325 Case C-483/99 *Commission v France (golden shares – Sociéte Nationale Elf-Aquitaine)*, para 48.
326 Ibid, para 51.
327 Ibid, para 50.
328 Case C-503/99 *Commission v Belgium (golden shares)*.
329 Ibid, para 52.

As a final remark, we should perhaps reflect upon the special nature of proportionality test applied in the field of taxation in relation to non-EU capital movements. As it has been explained, the *erga omnes* effect of Article 63 TFEU is to a certain extent offset by the additional derogation grounds that the Member States can avail themselves of in order to justify a restriction on capital movements. To this wider array of justifications, we should also add the deploying by the Court of a stricter proportionality test, which aims at ensuring that the interests of the Member States to prevent tax evasion and fraud are not being undermined or compromised by the external dimension of capital liberalisation. In particular, the Court has emphasised that the taxation of intra-EU economic activities is not always comparable to that of extra-EU economic activities, due to the higher degree of legal integration that exists in the EU compared to the one that governs the relations of Member States and third countries.[330] In particular, within the framework of the EU, Directive 77/799/EEC concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation[331] seeks to ensure cooperation between national tax authorities. Under this Directive, Member States' competent authorities are required to facilitate the exchange of tax information in an effort to strengthen administrative cooperation in order to combat tax evasion and avoidance in the EU. By contrast, such a coordinated administrative cooperation in tax matters does not exist (or at least the Court presumes so) between the Member States and third countries.

In light of the aforementioned, the ruling in *Établissements Rimbaud*[332] came as no surprise. The Court ruled that,

> 'where the legislation of a Member State makes the grant of a tax advantage dependent on satisfying requirements, compliance with which can be verified only by obtaining information from the competent authorities of an EEA country which is not a Member State of the European Union, it is in principle legitimate for the Member State to refuse to grant that advantage if – in particular, because that non-member State is not bound under an agreement to provide information – it proves impossible to obtain such information from that country'.[333]

In the case at hand, the French tax authorities were unable to obtain from the tax authorities of the Principality of Liechtenstein the information needed to

330 Case C-446/04 *Test Claimants in the FII Group Litigation*, para 170.

331 'Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation' (1977) *OJ L 336, 27.12.1977, p. 15-20*.

332 Case C-72/09 *Établissements Rimbaud SA v Directeur général des impôts and Directeur des services fiscaux d'Aix-en-Provence,* ECLI:EU:C:2010:645.

333 Ibid, para 44. The status of the EEA countries was explained in paras 16-23. See also Case C-521/07 *Commission v Netherlands,* ECLI:EU:C:2009:360, para 33.

exercise effective tax supervision.[334] Accordingly, the refusal of the French authorities to grant the tax advantage to the undertaking concerned was justified on grounds of prevention of tax evasion and avoidance, since the less restrictive measure of the administrative exchange of information was not available due to the refusal of the Lichtenstein authorities to cooperate.

However, the ruling of the Court was different in *ELISA*,[335] a case which concerned the exact same provision of the French legislation, but this time in relation to a company incorporated under Luxembourg law. The Court was categorical that a refusal to grant a tax advantage to an EU company cannot be justified on the ground that the competent administrative authorities of the home State do not provide the necessary information to the competent authorities of the host State. First, it noted that, in the context of the European Union, Directive 77/799 might be relied on by a Member State in order to obtain from the competent authorities of another Member State information which is necessary for the correct assessment of the taxes covered by the directive.[336] This administrative cooperation between the Member States, however, can be limited by Article 8 (1) of Directive 77/799, which does not oblige the tax authorities of the Member States to cooperate when they are prevented by their laws or administrative practices from carrying out the enquiries or from collecting or using this information for their own purposes. Even though this limitation in effect made impossible the request of information from the Luxembourgish authorities, the Court nevertheless found that the French authorities could request from the taxpayer the evidence which was deemed necessary to effect a correct assessment of the taxes and duties concerned and, where appropriate, refuse the exemption applied for if that evidence was not supplied.[337] This judgement reveals the double standards that the Court applies in relation to direct taxation depending on the origin of the taxpayer concerned. Overall, the different proportionality test applied in intra-EU and extra-EU situations is justified by the fact that Directive 77/799, which establishes a legal framework facilitating the exchange between the competent authorities of the Member States of information that may enable them to effect a correct assessment of taxes on income and on capital, is applicable only to Member States. To the contrary, extra-EU situations are not covered by Directive 77/799 and thus the administrative cooperation between a Member State and a third country is presumed to be more difficult.

334 Case C-72/09 *Établissements Rimbaud*, para 43.

335 Case C-451/05 *Européenne et Luxembourgeoise d'investissements SA (ELISA) v Directeur général des impôts and Ministère public,* ECLI:EU:C:2007:594.

336 Ibid, para 92, citing Case C-196/04 *Cadbury Schweppes*, para 71 and Case C-150/04 *Commission v Denmark,* ECLI:EU:C:2007:69, para 52.

337 Case C-451/05 *ELISA*, para 95.

4 Conclusion of Chapter 2

This Chapter has attempted to describe in detail the European legal framework governing the free movement of capital in order to shed light on the unique features of this freedom and its potentially intrusive effect on the regulatory autonomy of the Member States. This descriptive exercise is necessary in order to lay the groundwork for the overarching objective of this research, which is the normative assessment of legal parameters that need to be changed under the existing legal framework in order to allow room for State participation in the market for the purposes of protecting public interest objectives in the fields of privatisations and golden shares.

The free movement of capital under Article 63 TFEU constitutes an essential condition for the achievement of the EU's Internal Market and the successful realisation of the Economic and Monetary Union. At the same time the abolition of capital restrictions is of paramount importance for the establishment of the Capital Markets Union and the Banking Union, the two recent initiatives of the European Commission aiming at facilitating financial integration in the EU. However, despite its crucial role in the completion of financial integration in the EU, the free movement of capital has followed a slow historical development when compared to the other freedoms. This was probably due to the post-war scepticism towards free capital flows, which were notorious for causing financial crises and economic instability. Following the institutional approach of the Bretton Woods system, the EU respected the sovereign right of Member States to introduce restrictions on capital movements and the Court of Justice refused to recognise the direct effect of the Treaty provision on free movement of capital. The most important legislative development came in the late 1980s with the adoption of Directive 88/361, which brought about the full liberalisation of capital movements and gave the single market its full financial dimension.

The free movement of capital developed into a fully-fledged freedom of the EU's Internal Market in 1993 with the entry into force of the Maastricht Treaty and the introduction of the new provision on the free movement of capital (Article 73b of the Treaty, today Article 63 TFEU). Shortly after this development, the Court of Justice in *Sanz de Lera* recognised that the relevant provision on free capital movements was directly effective in *vertical* relations between an individual and the State. To date, the question of the *horizontal* applicability of Article 63 TFEU has not been sufficiently dealt with by the Court of Justice. The Court has very discretely avoided the question, by qualifying all national measures that have come under its scrutiny as *State measures*. However, the complicated nature of some company law requirements that are reviewed in the golden shares case law (some of which originate in private acts) has given

rise to a very interesting scholarly discussion regarding the possible horizontal applicability of Article 63 TFEU.

The most salient feature distinguishing the free movement of capital from the other freedoms is its expanded territorial scope, i.e. the fact that it applies not only to Member States but also to *third* countries (*erga omnes* effect). This unique feature elevates the free movement of capital to a whole different level, rendering it a potential gateway through which extra-EU investors can approach and ultimately access the EU's Internal Market.

Regarding its material scope, in the absence of any definition of capital movements in the Treaty, the Court has held that the non-exhaustive nomenclature in Annex I of Directive 88/361 has indicative value for the purposes of defining capital movements. This list includes a wide variety of capital movements, such as the physical import and export of financial assets and other capital payments, direct investments, investments in real estate, operations in securities, financial credits, mortgages, gifts and inheritances.

Although in principle the aforementioned types of transactions qualify as capital movements, it is sometimes difficult to determine which fundamental freedom is applicable. The most problematic is the relationship between the free movement of capital and the freedom of establishment. The general rule applied by the Court of Justice is that when the shareholding in question enables the investor to exercise *definite influence* over the company, it falls within the scope of establishment. In all other cases, the Court usually shows a preference to the free movement of capital, without however having established clear and consistent criteria for the determination of the applicable freedom. Regarding the relationship between capital and services, a question arising primarily when financial services are at stake, the Court has introduced the *predominant consideration* criterion. According to this criterion, the freedom to provide services is applicable whenever the restrictive effect on the concerned financial transaction is an *unavoidable consequence* of the restriction on the freedom to provide services. It should be noted that the external dimension of the free movement of capital has a significant bearing on the determination of the applicable freedom. When the Court wants to limit the territorial scope of its rulings to investors coming from Member States and to exclude third country investors, it upholds the application of the freedom of establishment or services. On the other hand, when the Court wants to expand the territorial scope of its rulings so as to cover third country investors as well, it promotes the application of the free movement of capital.

In relation to the scope of restrictions on capital movements, the wording of Article 63 TFEU goes beyond the mere elimination of unequal treatment on grounds of nationality and prohibits all restrictions on the movement of capital

between Member States and between Member States and third countries. Examples of restrictions include inter alia golden shares, authorisation requirements, residence requirements for investments in real estate, foreign currency arrangements in mortgages or other financial credits, nationality requirements in relation to dividend or corporate taxation etc.

The strikingly broad interpretation of the notion of capital restrictions is somehow counterbalanced by the wide range of derogations that can be invoked by Member States in order to justify those restrictions. In particular, the Treaty contains two categories of express derogations, one applying to intra- and extra-EU capital movements (Article 65 TFEU) and another applying exclusively to extra-EU capital movements (Articles 64, 65(4), 66 and 75 TFEU). This is a unique feature of the free movement of capital compared to the other freedoms. At the same time, the Court has recognised a number of overriding reasons in the public interest that can justify restrictions on capital movements. These include inter alia the objective of combatting tax evasion and avoidance, the effectiveness of fiscal supervision, the promotion of research and development, town and country planning, environmental protection, the objective of guaranteeing a service of general interest, public housing policy, the objectives of combatting cross-subsidization in order to achieve transparency in the electricity and gas markets and to prevent distortions of competition, as well as the reasons underlying the choice of property ownership under Article 345 TFEU.

Finally, the invoked derogation is accepted only when the national measure complies with the principle of proportionality. Just like in the other freedoms, the proportionality test consists of two steps, i.e. the suitability and the necessity test. However, in the capital case law, there is often a third step, which examines the compliance with the principle of *legal certainty*. If the national measure in question (which is often procedural in nature) lacks the requisite precision and gives national authorities excessively wide discretionary powers, it is not consistent with the requirements of legal certainty and therefore constitutes an infringement of Article 63 TFEU.

Having described the general legal framework on the free movement of capital in the EU, the second part of the thesis turns to the normative assessment of the two case studies of privatisations and golden shares. Within this context, it argues that the interpretative approach of the Court of Justice regarding Article 63 TFEU can limit significantly the regulatory autonomy of the Member States. For this reason, it attempts to illustrate certain changes in the adjudicative approach of the Court which can be used in order to permit the State to participate in the market and strike a fair balance between economic freedoms and social values, whilst at the same time ensuring that protectionist barriers do not hinder capital movements in the EU.

PART II

Implementation in the context of privatisations and golden shares

3 Free movement of capital and privatisations

1 INTRODUCTION

The first two Chapters of this thesis described the regulatory framework governing capital liberalisation at the International and European level. They provided the theoretical framework upon which the normative part of the thesis is based. The latter consists of Chapters 3 and 4, which zoom in on the two case-studies of privatisations and golden shares in the EU and seeks to examine whether the Court in interpreting Article 63 TFEU succeeds in striking a balance between free capital movements and the protection of public interest objectives pursued through State participation in the market.

More precisely, Chapter 3 examines the role that EU law has played in the advancement of privatisation as a multifaceted widespread phenomenon in European economies. Its primary objective is to investigate whether the interpretation of the Treaty provisions in the case law of the Court regarding privatisations allows sufficient room for Member States to protect societal values. In particular, this Chapter focuses on the *pre*-privatisation phase and the role that EU law plays in the decision of a national government to privatise or nationalise an undertaking – as opposed to Chapter 4 which deals with golden shares, i.e. the special shareholding that a Member State decides to retain once it has privatised an undertaking, thus in the *post*-privatisation phase. In the *pre*-privatisation phase, the decision to nationalise or privatise an undertaking touches upon the determination of the *national property ownership system*, which under Article 345 TFEU remains a national competence. Indeed, Article 345 TFEU, which enshrines the *principle of neutrality*, stipulates that '*the Treaties shall in no way prejudice the rules in Member States governing the system of property ownership*'. However, despite the proclaimed neutrality of the Treaties in relation to national property ownership systems, the Court has ruled that the decision not to privatise an undertaking constitutes a restriction on the free movement of capital. This interpretation poses limitations on the regulatory autonomy of the Member States and raises concerns regarding the division of competence between the EU and the Member States and the protection of public interest objectives.

In this context, Chapter 3 attempts to identify an interpretative approach that can reconcile the free movement of capital with the exercise of the national

competence to nationalise or privatise undertakings. For this purpose, firstly, it starts with the theoretical controversy surrounding the costs and benefits of privatisation. It argues that although private ownership might appear as economically more efficient than State ownership, economic theory suggests that this is not an open-and-shut case and that the economic efficiency of privatisation depends primarily on the relevant market conditions.[1] What matters most is not whether the ownership is public or private but whether the company operates under a competitive environment.[2] Privatisation can be beneficial for the society as a whole – and not for some special vested interests – only when it is combined with a comprehensive regulatory framework enforcing competition and information symmetry among market operators.[3]

Secondly, it seeks to investigate the role of EU law in the promotion of privatisation as an economic policy in the EU. In particular, drawing from the ideological foundations of the European Economic Constitution, it explores and synthesises the suggested interpretations of the principle of neutrality enshrined in Article 345 TFEU and argues that measures touching upon the sensitive competence to nationalise or privatise an undertaking are covered by Article 345 TFEU and, therefore, should be excluded from the scope of capital restrictions. In this way, Article 345 TFEU offers a legal tool which can be used in order to shield public ownership aiming at protecting public interest objectives from market forces.

2 The theoretical underpinnings of privatisation

2.1 Definition of privatisation

The question to privatise or not to privatise has always been at the centre of public discourse on State intervention in the market, raising crucial economic, political, social and legal issues. Historically associated with Ronald Reagan and Margaret Thatcher, privatisation has been championed by proponents

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* Certain sections of this Chapter are based on the published contribution to the following edited volume: Ilektra Antonaki, 'Free movement of Capital and Privatisation of Public Utilities' in Despina Anagnostopoulou, Lina Papadopoulou, Ioannis Papadopoulos (eds.), *The EU at a Crossroads: Challenges and Perspectives* (Cambridge Scholars Publishing 2016).

1 Gérard Roland (ed), *Privatization: Successes and Failures* (Columbia University Press 2008), p. 2.

2 Ibid.

3 Bruce Greenwald and Joseph Stiglitz, 'Externalities in Economies with Imperfect Information and Incomplete Markets' (1986) 101 *The Quarterly Journal of Economics* 229; David Sappington and Joseph Stiglitz, 'Privatization, Information and Incentives' (1987) 6 *Journal of Policy Analysis and Management* 567.

of *laissez-faire* capitalism as an economic policy leading to increased economic efficiency[4] and to a significant alleviation of public finances through the use of cash revenues for the purposes of redeeming public debt.[5] Although the rapid public sector expansion that took place in the 1960s and 1970s was regarded as a major contributor not only to economic growth but also to social and political stability, the general perception of the State's intervention in the market was seriously questioned in the mid-1970s as a result of the oil crises.[6] The inability of economies to adjust to external prices shocks led to a significant deterioration in macroeconomic performances and part of the blame was laid on the inflexible large public sectors.[7] In Europe, the *first* and most prominent privatisation wave started in the UK in the 1980s as part of the economic policy followed by Margaret Thatcher.[8] This privatisation wave marked the beginning of a new era of economic policy and political ideology, commonly referred to as 'neoliberalism'.[9] A conventional wisdom was developed that private management and ownership was better than public ownership, as it would

4 Ann P. Bartel and Ann E. Harrison, 'Ownership versus Environment: Disentangling the Sources of Public-Sector Inefficiency' (2005) 87 *The Review of Economics and Statistics* 135; Madanmohan Ghosh and John Whalley, 'State Owned Enterprises, Shirking and Trade Liberalization' (2008) 25 *Economic Modelling* 1206; William L. Megginson and Jeffry M. Netter, 'From State to Market: A Survey of Empirical Studies on Privatization' (2001) 39 *Journal of Economic Literature* 321; Muiris MacCarthaigh, 'Managing state-owned enterprises in an age of crisis: an analysis of Irish experience' (2011) 32 *Policy Studies* 215; Kathryn L. Dewenter and Paul H. Malatesta, 'State-owned and privately-owned firms: an empirical analysis of profitability, leverage, and labor intensity' (2001) 91 *American Economic Review* 320.

5 Bernardo Bortolotti, Marcella Fantini and Domenico Siniscalco, 'Privatization around the world: evidence from panel data' (2004) 88 *Journal of Public Economics Journal of Public Economics* 305.

6 Richard Hemming and Ali M. Mansoor, *Privatization and Public Enterprises* (IMF, Occasional Paper No 56, 1988), p. 1.

7 Ibid.

8 William Keegan, *Mrs. Thatcher's Economic Experiment* (Penguin 1984); Leaders, 'Privatisation – The $9 trillion sale' *The Economist* (11 January 2014); Tony Prosser and Michael Moran, 'Privatization and Regulatory Change: The Case of Great Britain' in Michael Moran and Tony Prosser (eds), *Privatization and Regulatory Change in Europe* (Open University Press 1994), pp. 35-49.

9 The controversial term of neoliberalism is used to describe the epochal shift in political economy from welfare-based *government* to competitiveness-driven *governance*. It is characterised by a number of principles including the view that (i) markets are the only efficient means to allocate scarce resources; (ii) international free trade is desirable; (iii) State intervention is not desirable; and (iv) labour market flexibility is necessary. See Kean Birch and Vlad Mykhnenko, 'Varieties of neoliberalism? Restructuring in large industrially dependent regions across Western and Eastern Europe' (2009) 9 *Journal of Economic Geography* 355, at p. 356 referring to Colin Hay, 'The normalizing role of rationalist assumptions in the institutional embedding of neoliberalism' (2004) 33 *Economy and Society* 500 and Wendy Larner, 'Neo-liberalism: policy, ideology, governmentality' (2000) 63 *Studies in Political Economy* 5.

bring economic efficiency and it would reduce corruption rates.[10] The ideological doctrine of unfettered free market, deregulation, liberalisation and privatisation became the orthodox economic thinking and the drive to cut State intervention soon spread to the rest of Europe at a remarkable rate.[11] After the fall of the Berlin Wall and the subsequent decline of Communism in Europe, Central and Eastern European countries experienced the *second* privatisation wave in the form of large privatisation schemes aiming at reducing the large public sectors associated with the former communist regimes and at increasing public revenues.[12] Finally, as a result of the eurocrisis, European states with a high public debt are experiencing the *third* privatisation wave: they have committed to implement an extensive privatisation programme of state-owned assets in a number of key sectors, such as energy, ports, airports, motorways, railways, mining, water supply, waste management, defence industries and real estate assets with a view to reduce the level of public debt and improve public finances.[13]

According to the IMF, privatisation is defined as a *transfer of ownership and control* from the public to the private sector, with particular reference to asset sales.[14] It is therefore equated to total or partial denationalization and it is the opposite of nationalization.[15] Similarly, according to the definition given

10 Joseph Stiglitz, 'Foreword' in Gérard Roland (ed), *Privatization: Successes and Failures* (Columbia University Press 2008), p. IX.

11 Elke Loeffler, Dominik Sobczak and Frankie Hine-Hughes, *Liberalisation and privatisation in the EU – Services of general interest and the roles of the public sector* (Multi-Science Publishing, European Union 2012)

12 Briefing, 'State-owned assets – Setting out the store' *The Economist* (11 January 2014).

13 Member States undergoing economic adjustment programmes have committed to reducing the strain on public finances among others by privatising SOEs. Arguably, the most extensive privatisation programme is currently being undertaken by Greece. In particular, as part of the third economic adjustment programme, Greece has committed to develop and implement a significantly scaled up privatisation programme with improved governance and transparency. An independent fund, managed by the Greek authorities under the supervision of the relevant EU institutions, has been established in order to privatise independently evaluated Greek State assets. At the same time, Greece has committed to adopt a comprehensive legislative framework in order to ensure transparent procedures and adequate asset sale pricing, in accordance with the OECD Principles and Standards on the management of SOEs. The funds that the privatisation programme is expected to yield will be used for (1) the repayment of recapitalisation of banks and other assets; (2) decreasing Greece's debt to GDP ratio; and (3) for investments to boost growth. See Eurosummit, *Euro Summit Statement, Brussels, 12 July 2015* (SN 4070/15, 2015).

14 Richard Hemming and Ali M. Mansoor, *Privatization and Public Enterprises* (1988), p. 1. In this paper, it is stated that the words 'privatise' and 'privatisation' appeared for the first time in the 1983 edition of the Webster's Ninth New Collegiate Dictionary, where their earliest recorded use is given as being in 1948. However, S.H. Hanke claims responsibility for popularising these words while serving on the U.S. President's Council of Economic Advisers in 1982 and 1982 (*Washington Post*, January 13, 1986).

15 Ibid.

by the OECD, privatisation is any material transaction by which the State's ultimate *ownership* of corporate entities is reduced.[16] This includes direct divestment by the State, divestment of corporate assets by government-controlled investment vehicles as well as the dilution of state positions in State-owned enterprises by secondary share offerings to the non-state shareholders.[17] It may also include some instances of divestment of subsidiaries by State-owned enterprises, when this is a result of government decisions rather than reflecting purely commercial considerations.[18] The definition of privatisation suggested by the OECD does not encompass the transfer of certain commercial activities from State-owned enterprises to private operators through different forms of public-private partnership such as through concessions, delegated management contracts or leasing.[19] By the same token, the dilution of government control over incorporated entities through cancellation of golden shares, share class unifications or changes to the articles of association are excluded from the definition of privatisation.[20] Therefore, the crucial element is the *transfer of corporate assets* from the State to private actors, not the mere transfer of commercial activities.[21]

The method through which privatisation is usually organised depends on the country's characteristics in terms of capital market development and legal infrastructure, the size and nature of the enterprise concerned and the objectives the privatisation seeks to achieve.[22] The most common methods of privatisation include (1) Initial Public Offerings in the capital markets; (2) trade sales to strategic investors; (3) management/employee buy-outs; and (4) asset sales, often following the liquidation of the State-owned enterprise concerned.[23]

2.2 Difference between privatisation and liberalisation

The term *privatisation* is to be distinguished from that of *liberalisation*. While privatisation refers to the transfer of ownership from the public to the private sector, liberalisation refers to the opening up of a specific market sector to competition. It represents essentially a programme of regulatory changes in

16 OECD, *Privatisation in the 21st Century: Recent Experiences of OECD Countries* (Report on Good Practices, 2009).
17 Ibid.
18 Ibid.
19 Ibid.
20 Ibid.
21 Ibid.
22 Stilpon Nestor and Ladan Mahboodi, 'Privatisation of public utilities: the OECD experience' in OECD (ed), *Privatisation, competition and regulation* (OECD 2000), p. 13.
23 Ibid, p. 13.

the direction of moving towards a free-market economy.[24] It is true that more often than not market liberalisation goes hand in hand with the privatisation of public assets, as evidenced in Europe in the early 1990s.[25] However, this does not mean that the one presupposes the other. In fact, the liberalisation of an economic sector can be effected without prior privatisation. In such a scenario, the public enterprise will continue to exist after the liberalisation, but it will no longer enjoy a monopolistic position in the market. It will have to compete with the new private entrants that will emerge as a result of the introduction of competition to the previously closed market. Conversely, a public monopoly can be privatised without a parallel liberalisation of the relevant market. In that case, the public monopoly is transformed into a private monopoly, which, in the absence of competition, will continue to act under the same monopolistic market conditions. Economic studies suggest that efficiency gains are most likely to result from the privatisation of public monopolies only if this is combined with the liberalisation of the relevant market.[26] The transfer of a public monopoly to the private sector, with its monopoly power left intact, may not achieve increased productive or allocative efficiency.[27] More importantly, evidence has shown that the privatisation of a previously public monopoly of a network industry, such as the railway system in the UK, may even threaten safety standards through the cutting of resources devoted to the maintenance of such safety standards.[28] It is for this reason that the economists of the IMF support the view that economic efficiency and respect for fundamental public interest considerations can only be achieved

24 John Black, Nigar Hashimzade and Gareth Myles, *A Dictionary of Economics*, (Oxford University Press 2009).

25 Erika Szyszczak, *The Regulation of the State in Competitive Markets in the EU* (Hart Publishing 2007), p. 3; Niamh Dunne, *Competition Law and Economic Regulation – Making and Managing Markets* (Cambridge University Press 2015), p. 149; Bertrand Badie, Dirk Berg-Schlosser and Leonardo Morlino, *International Encyclopedia of Political Science* (SAGE Publications 2011).

26 Richard Hemming and Ali M. Mansoor, *Privatization and Public Enterprises* (1988), p. 2.

27 Ibid, p. 2. Productive efficiency occurs when goods and services are produced at the lowest possible cost. To the contrary, allocative efficiency occurs when there is an optimal distribution of goods and services, taking into account consumers' preferences. It refers to a situation where, under conditions of perfect competition, goods and services are allocated between consumers according to the price they are prepared to pay and the price never rises above the marginal cost of production. See Tony Prosser, *The limits of competition law: markets and public services* (Oxford University Press 2005), p. 19 In antitrust law, the notion of 'allocative efficiency' largely coincides with the concept of 'consumer welfare'. See in particular the instrumental works of the two founders of the Chicago School of economic approach in antitrust law Richard Posner, *Antitrust Law* (The University of Chicago Press 2001) and Robert Bork, *Antitrust Paradox* (Simon & Schuster 1993), whose leitmotif is that considerations of allocative efficiency (consumer welfare) alone should guide antitrust policy.

28 The main area in which safety concerns have been expressed is regarding the privatisation of railways in the UK, where, after a series of serious accidents, the privatised Railtrack was accused of seriously neglecting safety and of failing to exercise sufficient control over its contracted-out maintenance functions. See Tony Prosser, *The limits of competition law: markets and public services* (Oxford University Press 2005), p. 22.

if privatisation is accompanied by *liberalisation* in order to foster competition and by *regulation* in order to prevent anticompetitive practices and socially disruptive results.[29] In the same vein, economists of the OECD underline that privatisation and competition need to be pursued *in tandem*.[30] In fact, the consensus position among OECD countries is that a government should not privatise an State owned enterprise before an appropriate regulatory framework has been established.[31] This appropriate regulatory framework consists of the introduction of a general and a sectorial anti-trust and enforcement mechanism and the creation of independent regulatory agencies.[32]

2.3 The case in favour of privatisation

The extensive privatisation schemes that were adopted during the previous decades led to a significant expansion of the scholarly research on the economic and social consequences of privatisation.[33] Today, the existing literature largely confirms that the process of privatisation can generate economic efficiency gains for the previously State-owned enterprises. Privatisation is regarded as a necessary dimension to the internationalisation of the economy.[34] The ideological embracement of privatisation is premised exactly on the economic objectives that are being achieved through the process of privatisation. From the standpoint of economic analysis, privatisation is primarily regarded as a means of improving the economic efficiency of enterprises.[35] In particular, privatisation limits the scope for corruption, clientelism and political interference in decision making,[36] increases managerial incentives by making man-

29 Richard Hemming and Ali M. Mansoor, *Privatization and Public Enterprises* (1988), p. 2.

30 Stilpon Nestor and Ladan Mahboodi, 'Privatisation of public utilities: the OECD experience' in OECD (ed), *Privatisation, competition and regulation* (OECD 2000), p. 18.

31 OECD, *Privatisation in the 21st Century: Recent Experiences of OECD Countries* (2009), p. 13.

32 Ibid, p. 13.

33 Gérard Roland (ed), *Privatization: Successes and Failures* (Columbia University Press 2008); John Vickers and Vincent Wright (eds), *The Politics of Privatisation in Western Europe* (Routledge 2005); Michael Moran and Tony Prosser (eds), *Privatization and Regulatory Change in Europe* (Open University Press 1994); Joseph Stiglitz, *The Economic Role of the State* (Blackwell 1989); Stilpon Nestor and Ladan Mahboodi, 'Privatisation of public utilities: the OECD experience' in OECD (ed), *Privatisation, competition and regulation* (OECD 2000); Raj Chari, *Life After Privatization* (Oxford University Press 2015).

34 Erika Szyszczak, 'Golden Shares and Market Governance' (2002) 29 Legal Issues of Economic Integration 255, p. 258.

35 Richard Hemming and Ali M. Mansoor, *Privatization and Public Enterprises* (1988), p. 6; Olivier Bouin, *The Privatisation in Developing Countries: Reflections on a Panacea* (OECD 1992).

36 Joseph Stiglitz notes that even advocates of State ownership, like Greece's socialist prime minister Andreas Papandreou, was aware of the challenges of 'socializing' the SOEs, and in particular the challenge to make them act in accordance with social objectives for the benefit of the society as a whole, and not just serving the interest of their managers and

agers responsible to shareholders who will monitor their performance better than governments and impose the financial discipline of private capital markets.[37] This combination of factors can lead to increased economic efficiency of previously State-owned enterprises. An example of a successful privatisation scheme was the one undertaken in the telecommunications sector in the EU. The privatisation of national telecommunications organisations together with the liberalisation of this market and establishment of a robust regulatory framework led to increased economic efficiency of the undertakings concerned, enhanced competition, lower prices for consumers and better customer services.[38]

The second argument in favour of privatisation relates to its impact on government finances. More precisely, privatisation may lead to a reduction of public deficit, especially if it concerns loss-making enterprises.[39] In fact, in cases of governments facing serious liquidity constraints, the financing of fiscal deficits with the privatisation proceeds is perhaps the most obvious objective of privatisation schemes.[40] In the same vein, governments facing long-lasting debt may use privatisation proceeds in order to reduce public debt.[41] A reduction in public debt leads in turn to a reduction in fiscal deficit through a decline in net interest payments.[42] This is particularly important for the Member States participating in the Economic and Monetary Union, which presupposes compliance with strict public debt and public deficit criteria. Research has shown that privatisation policies in southern Europe (Spain, Italy, Portugal and Greece) during the 1990s were used by national governments as a short-term economic policy intended to fulfil the convergence criteria in order to allow participation in monetary integration.[43] This in turn implied that privatisation schemes might not have been used in order to serve pure economic purposes (such as the economic restructuring and efficiency of the undertakings concerned), but to pursue wider political objectives.[44]

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trade unions. See Joseph Stiglitz, 'Foreword' in Roland (ed), *Privatization: Successes and Failures* (Columbia University Press 2008), p. X.

37 Richard Hemming and Ali M. Mansoor, *Privatization and Public Enterprises* (1988), p. 6.

38 Viktor Mayer-Schonberger and Mathias Strasser, 'Closer look at telecom deregulation: The european advantage' (1998) 12 *Harvard Journal of Law and Technology* 561.

39 Richard Hemming and Ali M. Mansoor, *Privatization and Public Enterprises* (1988), p. 6.

40 Stilpon Nestor and Ladan Mahboodi, 'Privatisation of public utilities: the OECD experience' in OECD (ed), *Privatisation, competition and regulation* (OECD 2000), p. 11.

41 Yannis Katsoulakos and Elissavet Likoyanni, *Fiscal and Other Macroeconomic Effects of Privatization* (FEEM Working Paper No 1132002, 2002), p. 19.

42 Ibid, p. 19.

43 Venilde Jeronimo, José Pagán and Gökçe Soydemir, 'Privatization and European Economic and Monetary Union' (2000) 26 *Eastern Economic Journal* 321.

44 Ibid, p. 325.

Furthermore, privatisation has significant benefits for the development of a capital market and a market for corporate control.[45] More specifically, enterprises can gain access to private sector financing through privatisation and can spur the development of domestic capital markets as a means of channelling savings in the economy.[46] The British extensive privatisation programme constitutes one of the most successful examples of how privatisation can contribute to the development of equity markets and to the creation of a wide share owning class.[47] If the public assets in question are attractive also to small investors and middle classes, this can broaden share ownership (ownership diffusion) and foster popular capitalism.[48]

Finally, privatisation may also benefit enterprises that remain within the public sector after the privatisation process, primarily through improvements to existing incentive and control mechanisms.[49] The remaining public enterprises (not programmed for sale) may be subject to increased corporate governance rigour and may be forced to implement reforms and to modernize their production systems so as to better respond to consumers' demands and to remain competitive in liberalised market.[50] Furthermore, governments can transfer certain commercial enterprises to the private sector and can focus better on the performance of public enterprises that pursue certain social objectives.

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45 Yannis Katsoulakos and Elissavet Likoyanni, *Fiscal and Other Macroeconomic Effects of Privatization* (2002), p. 6. In relation to the market for capital control, the authors emphasise that the development of a fully competitive market for capital control may be hindered by the continued state control through partial shareholdings (such as golden shares). For a general overview of the market of corporate control see Charlie Weir, 'The Market for Corporate Control' in Douglas Michael Wright, Donald S. Siegel, Kevin Keasey and Igor Filatotchev (eds), *The Oxford Handbook of Corporate Governance* (Oxford University Press 2013), pp. 329-346.

46 Richard Hemming and Ali M. Mansoor, *Privatization and Public Enterprises* (1988), p. 6.

47 Bernardo Bortolotti and Valentina Milella, 'Privatization in Western Europe: Stylized Facts, Outcomes, and Open Issues' in Gérard Roland (ed), *Privatization: Successes and Failures* (Columbia University Press 2008), p. 50.

48 Richard Hemming and Ali M. Mansoor, *Privatization and Public Enterprises* (1988), p. 6; Bernardo Bortolotti and Valentina Milella, 'Privatization in Western Europe: Stylized Facts, Outcomes, and Open Issues' in Roland (ed), *Privatization: Successes and Failures* (Columbia University Press 2008), p. 60. The authors note that privatisation is politically motivated and can strengthen the electoral power of conservative governments. For instance, in the UK where the Thatcherite privatisations programme was followed by five consecutive victories by the Conservatives. By making equity investment attractive for the middle classes through under-pricing of the public assets, privatisation can create a constituency with an interest in increasing the value of its assets that is therefore averse to the redistribution policies of the left. In this way privatisation can be a rational strategy for raising the probability of electoral success of right-wing market-oriented governments.

49 Richard Hemming and Ali M. Mansoor, *Privatization and Public Enterprises* (1988), p. 6.

50 Stilpon Nestor and Ladan Mahboodi, 'Privatisation of public utilities: the OECD experience' in OECD (ed), *Privatisation, competition and regulation* (OECD 2000), p. 19.

2.4 The case against privatisation

While privatisation has gained ground as an economic policy that improves economic efficiency of State-owned enterprises, there are still many legitimate economic and non-economic arguments in favour of public ownership or even explicitly against privatisation.

First, public ownership is regarded to be conducive to the attainment of social objectives.[51] In particular, through public ownership of certain enterprises the State can achieve distributional objectives, such as public-service delivery and widespread access to essential goods and services at reasonable and affordable prices for the consumers.[52] Additionally, public ownership can be used to create employment or to prevent rising unemployment and to combat social inequalities especially in developing countries.[53] Conversely, private ownership or the privatisation of public assets has been associated with adverse employment consequences, such as collective redundancies or insecure employment relations,[54] cutbacks in redistribution and has stirred popular discontent in many countries because of the corruption and cronyism that have stained the reputation of many privatisation processes.[55] An example of this can be found in the 'voucher privatisation programs' (transfer of public assets for free or nominal cost) undertaken by the former Soviet Union and many Eastern European countries that ultimately led to the creation of oligarch-controlled private monopolies.[56]

Furthermore, public ownership can be regarded as a response to the failure of private markets to secure efficient outcomes, particularly in countries with weaker regulatory frameworks or in 'network industries' characterised by natural monopoly, such as electricity and gas distribution, water provision and railways.[57] Natural monopolies have traditionally been perceived as rendering competition undesirable or even unfeasible, as the duplication of the network is economically and environmentally difficult and in some case

51 Richard Hemming and Ali M. Mansoor, *Privatization and Public Enterprises* (1988), p. 3.
52 Ibid, p. 3; OECD, *The Size and Sectoral Distribution of SOEs in OECD and Partner Countries* (OECD Publishing 2014).
53 Richard Hemming and Ali M. Mansoor, *Privatization and Public Enterprises* (1988), p. 4.
54 Ibid, p. 4.
55 Gérard Roland (ed), *Privatization: Successes and Failures* (Columbia University Press 2008), pp. 1-2.
56 Jomo Kwame Sundaram, 'A Critical Review of the Evolving Privatization Debate' in Gérard Roland (ed), *Privatization: Successes and Failures* (Columbia University Press 2008), p. 200; John Nellis, *The World Bank, privatization, and enterprise reform in transition economies: a retrospective analysis* (The World Bank Operations Evaluation Department, 2002).
57 Przemyslaw Kowalski and others, *State-Owned Enterprises, Trade Effects and Policy Implications* (OECD Trade Policy Papers No 147, 2013).

even impossible.[58] In the absence of competition, a privatisation of a natural monopoly linked to the performance of 'universal service obligations' could lead to abuse and distortion of competition, as private monopolists may produce and price at levels which are not socially optimal.[59] In this respect, the privatisation of British railways is often cited as an example of an unsuccessful privatisation which has led to higher prices for consumers, delays, reduced quality of services as well as lower investment in infrastructure and innovation.[60]

Moreover, the maintenance of State control over sectors considered of 'strategic' national interest, such as oil and gas is considered to be another important reason justifying public ownership.[61] Nationalisation of strategic enterprises can act as a safety net to guarantee that the country will not depend on potentially unreliable external sources of supply.[62]

Finally, public ownership can also be used to foster sectors that are considered economically undesirable and that would not otherwise be developed through private investment: for instance, private investors might be reluctant to finance research and development if the gains are difficult to capitalise on.[63] Other examples of services, which are usually provided by the public sector, include defence and police, environmental protection and the public provision of medical care.[64] In the same vein, many developing countries can benefit from public production in order to develop their infrastructure and their markets, especially in cases where private returns to investment are not sufficiently attractive to private investors.[65]

These arguments explain why, despite ambitious privatisation programmes undertaken in recent decades, many governments nonetheless maintain public ownership in commercial enterprises in strategically sensitive sectors such as electricity and gas, transportation and finance. More precisely, according to a recent OECD report on State-ownership in 34 countries (of which 31 are OECD members), State-owned enterprises value at over USD 2 trillion and employ

58 Richard Whish and David Bailey, *Competition Law* (Oxford University Press 2012), p. 10.
59 Przemyslaw Kowalski, Max Bu¨ge, Monika Sztajerowska and Matias Egeland, *State-Owned Enterprises, Trade Effects and Policy Implications* (2013).
60 Editorial, 'The Guardian view on rail privatisation: going off the tracks' *The Guardian* (05-12-2017) <https://www.theguardian.com/commentisfree/2017/dec/05/the-guardian-view-on-rail-privatisation-going-off-the-tracks> accessed 31-12-2019.
61 OECD, *The Size and Sectoral Distribution of SOEs in OECD and Partner Countries* (OECD Publishing 2014).
62 Richard Hemming and Ali M. Mansoor, *Privatization and Public Enterprises* (1988), p. 4.
63 Przemyslaw Kowalski, Max Bu¨ge, Monika Sztajerowska and Matias Egeland, *State-Owned Enterprises, Trade Effects and Policy Implications* (2013)
64 Richard Hemming and Ali M. Mansoor, *Privatization and Public Enterprises* (1988), p. 3.
65 Ibid, p. 3.

about 6 million people.[66] Interestingly, the largest SOE sectors in the OECD are found in four European countries: Norway, France, Slovenia and Finland.[67]

3 Privatisation and EU law

This section seeks to investigate the role of EU law in the promotion of privatisation as an economic policy in the EU. For this purpose, first, it examines the politico-economic context regarding privatisation as an economic policy and analyses the impact of the German theory of Ordoliberalism and the French theory of 'service public' on the formation of the European Economic Constitution (Section 3.1). Secondly, turning to the current legal framework, it explores the nature and the interpretations of the principle of neutrality enshrined in Article 345 TFEU (Section 3.2). It is argued that measures touching upon the sensitive competence to nationalise or privatise an undertaking should in principle be covered by Article 345 TFEU and, therefore, excluded from the scope of capital restrictions. In this way, Article 345 TFEU offers a legal tool which can be used in order to shield public ownership aiming at protecting public interest objectives from market forces.

3.1 The politico-economic context: The impact of the German theory of Ordoliberalism and the French theory of 'service public' on the European Economic Constitution

The question of State participation in the market has shaped the political and economic debate in Europe. Since its very creation, the European project has been conceived as an arduous endeavour to achieve a political compromise between different national interests and to strike a balance between market-driven integration and social objectives. The dividing line between public and private sphere in the economy is not drawn uniformly across the EU.[68] While privatisation has indeed become a widespread phenomenon in all Member States, resulting in major shifts of resources from the public to the private

66 OECD, *The Size and Sectoral Distribution of SOEs in OECD and Partner Countries* (OECD Publishing 2014), p. 7. See also Hans Christiansen, *The Size and Composition of the SOE Sector in OECD Countries* (OECD Corporate Governance Working Papers, No 5, 2011).

67 OECD, *The Size and Sectoral Distribution of SOEs in OECD and Partner Countries* (OECD Publishing 2014).

68 Wolf Sauter and Harm Schepel, *State and Market in European Union Law – The Public and Private Spheres of the Internal Market before the EU Courts* (Cambridge University Press 2009), p. 21.

sector, it nevertheless follows different methods in each Member State and leads to different limitations on State participation in the market.[69]

The degree of State participation in the market within individual Member States has been determined by national economic policy objectives. These objectives have often been translated into politico-economic ideologies and have deeply affected not only the market economy systems of the Member States but also the European Economic Constitution.[70] The European Economic Constitution is broadly described as consisting of the constitutional principles of direct effect and supremacy and of the substantive rules on the Internal Market and Competition Law, complemented by the rules on the Economic and Monetary Union and the Common Commercial Policy.[71] Its content has been inspired primarily by the German Ordoliberal tradition focusing on market liberalisation, private autonomy, economic freedoms, strict adherence to competition rules, fiscal discipline and a diminished public sector.[72] Although over the years Ordoliberalism might have become diluted throught the influence of neo-classic mainstream economics and the difference between Anglo-Saxon and ordoliberal traditions might have become practically ever less visible,[73] its historical legacy has at the same time been strengthened.[74] The Ordoliberal theory or 'the Freiburg school of law and economics',[75] as

69 Ibid, pp. 19-21.

70 Wolf Sauter, 'The Economic Constitution of the European Union' (1998) 4 *Columbia Journal of European Law* 27; Christian Joerges, 'The European Economic Constitution and its Transformation Through the Financial Crisis' in Dennis Patterson and Anna So¨dersten (eds), *A Companion to European Union law and International Law* (Wiley & Sons 2013); Joseph Weiler, 'The Transformation of Europe' (1991) 100 *The Yale Law Journal* 2403; Martin Shapiro, 'Comparative Law and Comparative Politics' (1980) 53 *California Law Review* 537; Wolf Sauter and Harm Schepel, *State and Market in European Union Law – The Public and Private Spheres of the Internal Market before the EU Courts* (Cambridge University Press 2009), pp. 11-18; Leontin-Jean Constantinesco, 'La constitution économique de la C.E.E' (1977) 13 *Revue Trimestrielle de Droit Européen* 244; Wolf Sauter and Harm Schepel, *State and Market in European Union Law – The Public and Private Spheres of the Internal Market before the EU Courts* (Cambridge University Press 2009), p. 11.

71 Erika Szyszczak, *The Regulation of the State in Competitive Markets in the EU* (Hart Publishing 2007), p. 29.

72 Wolf Sauter, 'The Economic Constitution of the European Union' (1998) 4 Columbia Journal of European Law 27, p. 49.

73 The differences between ordoliberalism and classical liberalism were defined by Michel Foucault in 1970 and with the republication of his lectures they have attracted anew scholarly attention. See Michel Foucault, *The Birth of Biopolitics: Lectures at the Collège de France 1978-1979* (Basingstoke: Palgrave-Macmillan 2008); Josef Hien and Christian Joerges, *Ordoliberalism, Law and the Rule of Economics* (Hart Publishing 2017), p. 2.

74 Josef Hien and Christian Joerges, *Ordoliberalism, Law and the Rule of Economics* (Hart Publishing 2017), p. 2.

75 The most important representatives of Ordoliberalism were the economist Walter Eucken, who is regarded as the 'father of Ordoliberalism', and the lawyer and economist Franz Böhm. Friedrich A. von Hayek tried to bridge the Freiburg School with the neo-liberal Austrian and Chicago Schools by conceptualizing the system of undistorted competition

described in the Ordo Manifesto of 1936,[76] represents an effort to combine the economic theory of classical liberalism with a strict legal framework which is intended to guarantee and protect the optimal functioning of the market.[77]

In more detail, ordoliberalism opposes any form of State intervention in the economy and considers that the role of the State is limited to safeguarding the economic order through the adoption and strict enforcement of an 'Economic Constitution' (*Wirtschaftsverfassung*).[78] The Economic Constitution contains a strong normative bias in favour of a liberal market economy and provides a coherent legal framework, which is essential for the protection of the fundamental principle of private autonomy and individual economic freedoms.[79] Private law is endowed with normative superiority over public intervention and the private law society is endowed with moral superiority over political decision-making procedures.[80] The role of the Economic Constitution is instrumental in the prevention of concentration of both public and private economic power through the prohibition of monopolies, cartels, State planning, and corporatism.[81] Therefore, its mission is both to shield the economy from abuses of political power and to protect the political system from succumbing to economic interests.[82]

At the same time, however, the project of European integration has been also influenced by the French theory of 'service public', which has contributed significantly to the formation and consolidation of the concept of 'social market economy' as an overarching principle underpinning the European project and reinforcing the social component of market integration.[83] This theory ('*service*

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and thus introduced a re-orientation of ordoliberalism which is known as 'neo-ordoliberalism'. See Friedrich A. von Hayek, *Der Wettbewerb als Entdeckungsverfahren* (Kiel 1968); Josef Hien and Christian Joerges, *Ordoliberalism, Law and the Rule of Economics* (Hart Publishing 2017), p. 3; Manfred Streit, 'Economic Order, Private Law and Public Policy: The Freiburg School of Law and Economics in Perspective' (1992) 148 *Journal of International and Theoretical Economics* 675.

76 Franz Böhm, Walter Eucken and Hans Großmann-Dörth, 'Palgrave Macmillan UK' in Alan Peacock and Hans Willgerodt (eds), *Germany's Social Market Economy: Origins and Evolution* (1989).

77 Wolf Sauter, 'The Economic Constitution of the European Union' (1998) 4 Columbia Journal of European Law 27, p. 47.

78 Ibid, p. 46.

79 Ibid, p. 46.

80 Wolf Sauter and Harm Schepel, *State and Market in European Union Law – The Public and Private Spheres of the Internal Market before the EU Courts* (Cambridge University Press 2009), p. 15.

81 Ibid, p. 14.

82 Ibid, p. 14.

83 There is an abundant French literature on the theory of 'service public' under French administrative law. See, for instance, the following representative accounts (some of them with an EU-dimension as well): Emmanuel Cadeau, Didier Linotte and Raphaël Romi, *Droit*

public à la française') constitutes the foundation of French administrative law and is widely regarded as 'a defining element of French political philosophy and an icon of national identity'.[84] The emergence of this theory coincides with the progress of political liberalism and the development of solidaristic ideologies.[85] Its origins lie in the works of the eminent French legal scholar Léon Duguit (1859-1928), principal representative of the '*École de Bordeaux*' (or '*École du service public*').[86] According to Duguit, the concept of 'service public' encompasses 'every activity whose fulfilment must be reassured, regulated and controlled by the government, because the fulfilment of this activity is indispensable to the realisation and development of the social interdependence, and it is of such nature that it can only be realised completely by the intervention of the governing force'.[87] The State's *raison d'être* is to

du service public (LexisNexis 2014); Didier Linotte and Raphaël Romi, *Droit public économique* (LexisNexis 2012); Jean-Paul Valette, *Le service public à la française* (Paris: Ellipses 2000); Jacques Chevallier, *Le service public* (Paris: PUF [1987] 2008); Stéphane Braconnier, *Droit des services publics* (Paris: PUF 2007); Claudine Desrieux, 'La gestion contractuelle des services publics: Une critique de l'approche par les droits de propriété' (2007) 59 *Revue économique* 451; Marceau Long, 'Service public et réalités économiques du XIXe siècle au droit communautaire' (2001) *Revue française de droit administratif (RFDA)* 1161; Didier Linotte and Raphaël Romi, *Services publics et droit public économique* (LexisNexis 2001); Robert Kovar, 'Droit communautaire et service public' (1996) *Revue trimestrielle de Droit Européen (RTD Eur)* 215; Jean-Marie Pontier, 'Sur la conception française du service public' (1996) *Recueil Dalloz Sirey* 9; Marceau Long, 'Service public, services publics: déclin ou renouveau?' (1995) *Revue française de droit administratif (RFDA)* 497; Michel Bazex, 'L'appréhension des services publics par le droit communautaire' (1995) *Revue française de droit administratif (RFDA)* 295; Philippe Jourdan, 'La formation du concept de service public' (1987) *Revue du droit public et de la science politique en France et à l'étranger* 99; Nicole Belloubet-Frier, 'Service public et droit communautaire' (1994) *Actualité juridique du droit administratif (AJDA)* 270.

84 Wolf Sauter and Harm Schepel, *State and Market in European Union Law – The Public and Private Spheres of the Internal Market before the EU Courts* (Cambridge University Press 2009), p. 16.

85 Marceau Long, 'Service public, services publics: déclin ou renouveau?' (1995) Revue française de droit administratif (RFDA) 497; Jean-Philippe Colson and Pascale Idoux, *Droit Public Économique* (L.G.D.J. 2008), p. 94. The term 'solidaristic ideologies' refers here to ideologies based on the value of social solidarity as opposed to 'individualistic ideologies' based on the value of individual freedom. For a more comprehensive analysis, see Hartley Dean, *Social Policy* (Polity Press 2012), p. 22.

86 In Duguit's view, the State was not a mythical Sovereign inherently superior to all its subjects, but merely a group of people engaged in 'public service', the activity constituting and legitimising the existence and the exercise of State power. Some of his influential works include: Léon Duguit, *Traité de droit constitutionnel* (Paris: De Boccard [1911] 1930); Léon Duguit, *Souveraineté et liberté, Leçons faites à l'Université Columbia (New-York) en 1920-1921* (Librairie F. Alcan 1921); Léon Duguit, 'Des fonctions de l'Etat moderne: étude de sociologie juridique ' (1894) *Revue internationale de sociologie* 161; Léon Duguit, *L'État, le droit objectif et la loi positive* (Paris: Dalloz [1901] 2003); Léon Duguit, *Les transformations du droit public* (Hachette Livre BNF [1913] 2014).

87 Personal translation of the original French text: '[…]C'est toute activité dont l'accomplissement doit être assuré, réglé et contrôlé par les gouvernants, parce que l'accomplissement de cette activité est indispensable à la réalisation et au développement

perform the tasks necessary for the promotion of 'social interdependence'.[88] This means that governmental power derives from the duty of the State to provide its citizens with the necessary public services.[89] Accordingly, the idea of 'service public' both legitimises and limits the exercise of public power.[90] '*Le service public est le fondement et la limite du pouvoir gouvernemental*'.[91]

Within the framework of the theory of 'service public', public intervention in order to pursue objectives in the *general interest* (a notion which inextricably linked to the concept of 'service public') is elevated to a higher order compared to private law mechanisms for the protection of individual rights and freedoms. At the same time, the functioning of the 'service public' is governed by the fundamental principles of equality, continuity and adaptability (*égalité*, *continuité* et *adaptabilité*).[92] These three principles constitute the famous '*lois de Rolland*'[93] and have been recognised by the French *Conseil Constitutionnel* as '*exigences du service public*' or as principles governing '*le bon fonctionnement du service public*'.[94]

Within the category of activities that constitute 'services publics', there is a further distinction between '*services publics constitutionnels*' and '*services publics industriels et commerciaux*'.[95] According to the French *Conseil Constitutionnel*, the '*services publics constitutionnels*' correspond to the functions of sovereignty (such as national defence, police, foreign affairs or justice[96]) and cannot be subject to privatisation.[97] To the contrary, the '*services publics industriels et commerciaux*' can in principle be subject to privatisation.[98] However, there

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de l'interdépendance sociale, et qu'elle est de telle nature qu'elle ne peut être réalisé complètement que par l'intervention de la force gouvernante'. Léon Duguit, *Traité de droit constitutionnel* (Paris: De Boccard [1911] 1930), II, p. 55.

88 Wolf Sauter and Harm Schepel, *State and Market in European Union Law – The Public and Private Spheres of the Internal Market before the EU Courts* (Cambridge University Press 2009), p. 16, referring to the writings of Léon Duguit.

89 Ibid, p. 16.

90 Ibid, p. 16.

91 Léon Duguit, *Traité de droit constitutionnel* (Paris: De Boccard [1911] 1930), II, p. 62.

92 Jean-Philippe Colson and Pascale Idoux, *Droit Public Économique* (L.G.D.J. 2008), p. 147.

93 Louis Rolland, *Précis de droit administratif* (Dalloz 1933), p. 17.

94 Décision n° 2003-480 DC du 31 juillet 2003 *Loi relative à l'archéologie préventive,* ECLI:FR:CC:2003:2003480DC (Conseil Constitutionnel); Décision n° 2002-460 DC du 22 août 2002 *Loi d'orientation et de programmation pour la sécurité intérieure,* ECLI:FR:CC:2002:2002460DC (Conseil Constitutionnel).

95 Nicole Belloubet-Frier, 'Service public et droit communautaire' (1994) Actualité juridique du droit administratif (AJDA) 270.

96 Nicolas Thirion, 'Existe-t-il des limites juridiques à la privatisation des entreprises publiques?' (2002) XVI *Revue internationale de droit économique* 627, p. 646.

97 Décision n° 86-207 DC du 26 juin 1986 *Loi autorisant le Gouvernement à prendre diverses mesures d'ordre économique et social,* ECLI:FR:CC:1986:86207DC (Conseil Constitutionnel).

98 Nicole Belloubet-Frier, 'Service public et droit communautaire' (1994) Actualité juridique du droit administratif (AJDA) 270.

are certain activities falling in the latter category, such as the supply of energy, which could potentially have serious implications for the national security.[99] The privatisation of these activities raises important issues relating not only to the economic efficiency of the undertakings concerned, but also to strategic national interests. Therefore, the legality of such privatisation is a multidimensional question, which requires a complex legal analysis of the nature of the activities concerned and the possible reconciliation of the various conflicting interests.

3.2 The legal framework: The principle of neutrality under Article 345 TFEU

The legal framework regarding privatisations in the EU covers two grids of primary law provisions: the Treaty provisions on the fundamental freedoms governing the content of privatisations (especially Article 49, 56 and 63 TFEU) and the Treaty provisions on staid aid governing the procedure of privatisations (Article 107 TFEU).[100] At the same time, this framework is complemented by sector-specific secondary legislation (such as energy, telecommunications, postal services etc.) covering important aspects of the liberalisation process.

The aforementioned legal framework is based on the fundamental provision of Article 345 TFEU, which stipulates that 'The Treaties shall in no way prejudice the rules in Member States governing the system of property ownership'. This provision establishes the *principle of neutrality* of the Treaties with respect

99 Ibid.

100 The Commission has published a Staff Working Document providing guidance on state aid-compliant financing, restructuring and privatisation of SOEs, according to which public authorities involved in economic transactions concerning SOEs should act in accordance with the well-established Market Economy Investor Principle (MEIP) test, which in a privatisation context translates into the Market Economy Vendor Principle (MEVP) test. The application of the MEVP test in the context of a privatisation entails that when a Member State is selling an SOE, it must in principle behave as a market economy vendor, seeking to maximise the revenues or minimise the loss from the sale. If the Member State does not respect this principle, the privatisation process may involve a foregoing of State resources to the benefit of the buyer or the privatised company, which presumably constitutes state aid. The safest way for a government to ensure that its actions are state aid-compliant is to effect the envisaged privatisation by means of an Initial Public Offer (IPO) or sale of shares on the stock exchange. By opting for this method, the government is presumed to behave as a market economy vendor, as the sale price will be the market price defined by the stock exchange. This in turn means that no prior notification to the Commission is required. See European Commission, *Commission Staff Working Document, Guidance Paper on state-aid-compliant financing, restructuring and privatisation of State-owned enterprises* (Brussels, swd(2012) 14 final, 2012).

to the property ownership systems of the Member States.[101] The 'agnosticism' in relation to the regime of ownership means that the mere fact that an economic activity is carried out by public or private undertakings is not contrary to the Treaties.[102] Consequently, the Treaties, in principle, do not preclude the nationalisation[103] or privatisation of undertakings.[104] In formal terms, Article 345 TFEU protects the competence of the Member States to choose between public or private ownership systems.[105] This allows Member States to organise independently their national economies, giving thus room for a harmonious coexistence of *varieties of capitalism* in Europe.

The symbolic and perhaps enigmatic nature of this provision has given rise to various interpretations. In his annotation on the *Essent* case,[106] Pieter Van Cleynenbreugel distinguished two interpretations of Article 345 TFEU: (1) the *shield* interpretation according to which Article 345 TFEU completely shields or exempts the property ownership rules from the Court's internal market scrutiny and (2) the *sword* interpretation according to which Article 345 TFEU does not mean that national property ownership choices are not subject to the fundamental rules of the Treaty.[107] The present section builds on and further develops this distinction. In particular, it is argued here that one could distinguish three different interpretative approaches in relation to this nebulous provision corresponding to three different degrees of State participation in

101 Robert Kovar, 'Nationalisations–privatisations et droit communautaire' in Jürgen Schwarze (ed), *Discretionary Powers of the Member States in the Field of Economic Policies and their Limits under the EEC Treaty: Contributions to an International Colloquium of the European University Institute held in Florence on 14–15 May 1987* (Nomos 1988), p. 97.

102 Paul Craig and Gráinne De Búrca, *EU Law: Text, Cases and Materials* (Oxford University Press 2011), p. 1073.

103 Case 6-64 *Flaminio Costa v E.N.E.L.*, ECLI:EU:C:1964:66, p. 598.

104 Case C-244/11 *Commission v Greece (golden shares)*, para 17.

105 For a comprehensive overview of Article 345 TFEU see: Pieter Van Cleynenbreugel, 'No privatisation in the service of fair competition? Article 345 TFEU and the EU market-state balance after Essent' (2014) 39 *European Law Review* 264; Bram Akkermans and Eveline Ramaekers, 'Article 345 TFEU (ex Article 295 EC), Its Meanings and Interpretations' (2010) 16 *European Law Journal* 292; Fernando Losada Fraga and others, 'Property and European Integration: Dimensions of Article 345 TFEU' (2012) 148 *Tidskrift utgiven av Juridiska föreningen i Finland* 203; Wouter Devroe, 'Privatizations and Community Law: Neutrality Versus Policy' (1997) 34 *Common Market Law Review* 267; Robert Kovar, 'Nationalisations–privatisations et droit communautaire' in Schwarze (ed), *Discretionary Powers of the Member States in the Field of Economic Policies and their Limits under the EEC Treaty: Contributions to an International Colloquium of the European University Institute held in Florence on 14–15 May 1987* (Nomos 1988); Thomas Papadopoulos, 'Privatized Companies, Golden Shares and Property Ownership in the Euro Crisis Era: A Discussion after Commission v. Greece' (2015) 12 *European Company and Financial Law Review* 1.

106 Joined cases C-105/12 to C-107/12 *Essent NV*.

107 Pieter Van Cleynenbreugel, 'No privatisation in the service of fair competition? Article 345 TFEU and the EU market-state balance after Essent' (2014) 39 European Law Review 264.

the market: (1) the 'maximalist shield' interpretation; (2) the 'reductionist shield' interpretation and (3) the 'sword' interpretation.

3.2.1 The 'maximalist shield' interpretation

The 'maximalist shield' interpretation was expressed by Advocate General Ruiz-Jarabo Colomer in his Opinion in the first generation of golden shares cases.[108] The cases concerned restrictions in the acquisition of shares imposed by legislative provisions that conferred special rights to Portugal, France and Belgium in privatised undertakings active primarily in the energy sector.[109]

In his Opinion, Advocate General Colomer first underlined the historic importance of Article 345 TFEU, noting that it was the only provision of the Treaties to be directly inspired by the Schuman Declaration of 9 May 1950. Its position in Part Seven of the TFEU devoted to 'General and Final Provisions' and its forceful and unconditional expression 'in no way' reinforced its 'specific nature and symbolic importance'.[110] However, exactly due to this symbolic importance, the interpretation of Article 345 TFEU was an intricate legal exercise. The Advocate General suggested that a purely *literal* interpretation would not be appropriate, as its terms were rather imprecise and the expression 'system of property ownership' was not a legal but an economic concept.[111] Because of its programmatic nature, only a *historical* and *teleological* interpretative approach could ensure its effectiveness.

In this regard, the *travaux préparatoires* of the Treaty demonstrated that the aim of Article 345 TFEU was to declare the neutrality of the Treaty with respect to the ownership *of the undertakings* in the economic sense, i.e. *as means of production*. Thus, the expression 'system of property ownership' contained in Article 345 TFEU refers not to the civil rules concerning property relations but to *any* interventionist measure which allows the State to contribute to the organisation of the national economy.[112] This includes not only rules, which

108 Case C-309/99 *Wouters and others*; Case C-483/99 *Commission v France (golden shares – Société Nationale Elf-Aquitaine)*; Case C-503/99 *Commission v Belgium (golden shares)*.

109 The Portuguese legislation imposed a cap on foreign investment and an authorisation procedure for the acquisition of a holding in certain Portuguese undertakings in excess of a specified level; similarly the French legislation imposed an authorisation procedure of the acquisition of shares exceeding certain limits as well as an opposition procedure regarding corporate decisions to transfer or use as security the majority of the capital of four subsidiaries of Société Nationale Elf-Aquitaine; and finally, the Belgian legislation provided an opposition procedure with respect to certain management decisions regarding the transfer of strategic assets or decisions contrary to the country's energy policy.

110 *Opinion of Advocate General Colomer in Cases C-367/98, C-483/99 and C-503/99 Commission v Belgium, Commission v France and Commission v Portugal*, ECLI:EU:C:2001:369, paras 43-45.

111 Ibid, para 47.

112 Ibid, paras 54-56.

determine the public or private ownership status of undertakings, but also rules on special rights ('golden shares') that Member States retain in privatised strategically important undertakings, as public interventionist means of implementing national economic-policy objectives.[113] This reasoning echoed the common-sense maxim invoked by the Spanish Government '*he who is able to do the most, can also do the least*' (*argumentum a maiore ad minus*).[114]

In this way, Advocate General Colomer endorsed a 'maximalist shield' interpretative approach of Article 345 TFEU, which in principle *shields* national measures regarding the property ownership systems of undertakings as means of production from the Treaty provisions on the four freedoms. However, he explained that Article 345 TFEU 'does not detract from application of the fundamental rules of the Treaty', in particular the prohibition of discrimination on grounds of nationality.[115] What Article 345 TFEU implies is that measures regarding the property ownership of undertakings 'are not considered to be per se as incompatible with the Treaty: they are covered by the presumption of validity conferred on them by the legitimacy of Article [345 TFEU]'.[116] He furthermore emphasised that

> 'the various ways of organising undertakings that are subject to certain form of public supervision, are not, viewed in the abstract, contrary to the Treaty. Their compliance with the fundamental principles of Community law must be assessed specifically, by means of a case-by-case examination of the nature and mode of the operation of the legal situation at issue […]'.[117]

On the basis of the aforementioned considerations, he concluded that

> 'the special prerogatives of the public authorities with which the present infringement proceedings are concerned constitute rules governing public intervention in the activities of certain undertakings, with the aim of imposing economi-policy objectives, and that they are on the same footing as forms of ownership of the undertakings whose organisation is a matter for the Member States by virtue of Article [345 TFEU]. The existence of such rules is not in itself contrary to the fundamental freedoms established by the Treaty, although the specific manner in which they are applied may indeed be so'.[118]

Therefore, he proposed that the Commission's action should be dismissed.[119]

113 Ibid, paras 61 and 91.
114 Ibid, para 66.
115 Ibid, para 67.
116 Ibid.
117 Ibid, para 90.
118 Ibid, para 91.
119 Ibid, para 92.

The 'maximalist shield' interpretation excludes any national measure which affects the property ownership system of undertakings from the scope of the fundamental freedoms as a matter of principle. However, it requires a second assessment of the application of the contested measure in a concrete case, which might then restrict one of the fundamental freedoms. This two-fold test seems to have very little practical value, since although the *existence* of a measure might be exempted from the scope of the fundamental freedoms, its *application* must nevertheless be reviewed under the Treaty provisions.

3.2.2 The 'reductionist shield' interpretation

Contrary to Advocate General Colomer, the Commission was of the opinion that Article 345 TFEU was not relevant to 'golden shares', since they did not concern the public or private ownership system of a company, but rather certain rights and powers relating to the distribution of property ownership of that company between private persons.[120] The rationale behind this argument is that once the Member State has proceeded to privatisation, it must ensure that the privatised undertaking functions in full accordance with the principles of a liberal market economy. Therefore, in the Commission's view, 'golden shares' are not covered by the presumption of validity of Article 345 TFEU.

However, when it comes to *stricto sensu* property ownership rules, the Commission purports to remain reverently neutral: it 'has always scrupulously ensured neutrality in its dealings with different forms of ownership'[121] and 'has nothing to say on whether companies responsible for providing general interest services should be public or private and is therefore not requiring privatisation'.[122]

This view was also defended by Advocate General Jääskinen in the *Essent* case,[123] which is perhaps the most important case regarding the relationship between free movement of capital and the principle of neutrality under Article 345 TFEU. Before delving into the interpretation of Article 345 TFEU suggested by Advocate General Jääskinen, it is necessary to provide a brief summary of the factual background of the case.

120 Case C-503/99 *Commission v Belgium (golden shares)*, paras 41-42.
121 European Commission, *Bulletin of the European Commission* (No 7/8, Vol 24, 1991), Section 1.2.75.
122 European Commission, *Services of General Interest in Europe* (OJ C281/3, 1996), p. 5.
123 *Opinion of Advocate General Jääskinen in Joined cases C-105/12 to C-107/12 Staat der Nederlanden v Essent NV*, ECLI:EU:C:2013:242.

In the *Essent* case, the Court was called upon to appraise the compatibility of the Dutch legislation concerning ownership unbundling of energy suppliers and distributors with the free movement of capital under Article 63 TFEU. The request for a preliminary ruling was made by the Hoge Raad der Nederlanden in proceedings between the Staat der Nederlanden and four companies active in the generation/production, supply and trade of electricity and gas in the Netherlands (Essent NV, Essent Nederland BV, Eneco Holding NV and Delta NV). The national provisions at issue imposed three prohibitions: first, the '*prohibition of privatisation*' (the prohibition of the sale to private investors of shares held in the electricity and gas distribution system operators active in the Netherlands); second, the '*group prohibition*' (the prohibition of any ownership or control links between, on the one hand, companies which are members of the same group as an operator of such distribution systems and, on the other, companies which are members of the same group as an undertaking which generates/produces, supplies or trades in electricity or gas in the Netherlands); and third, '*the prohibition of unrelated activities*' (the prohibition of engagement by such an operator and by the group of which it is a member in transactions or activities which may adversely affect the operation of the system concerned).

This legislation was adopted with the view to transpose the Second Energy Package,[124] which imposed the obligation of *legal unbundling* between on the one hand transmission and distribution networks and on the other hand the commercial activities of electricity and gas companies (production and supply of energy). However, the prohibitions imposed by the Dutch legislation (particularly the group prohibition and the prohibition of unrelated activities) amounted to an *ownership unbundling* and as such they went beyond what was required under the Second Energy Package in force at that time. The *ownership unbundling* was only introduced with the Third Energy Package,[125] which

124 'Directive 2003/54/EC concerning common rules for the internal market in electricity and repealing Directive 96/92/EC' (2003) *OJ L 176, 15/07/2003, pp. 37-56*; 'Directive 2003/55/EC concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC' (2003) *OJ L 176, 15/07/2003, pp. 57-78*; 'Regulation (EC) No 1228/2003 on conditions for access to the network for cross-border exchanges in electricity' (2003) *OJ L 176, 15/07/2003, pp. 1-10*; 'Regulation (EC) No 1775/2005 on conditions for access to the natural gas transmission networks' (2005) *OJ L 289, 03/11/2005, pp. 1-13*.

125 'Directive 2009/72/EC concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC' (2009) *OJ L 211, 14/08/2009, pp. 55-93*; 'Directive 2009/73/EC concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC' (2009) *OJ L 211, 14/08/2009, pp. 94-136*; 'Regulation (EC) No 713/2009 establishing an Agency for the Cooperation of Energy Regulators' (2009) *OJ L 211, 14/08/2009, pp. 1-14*; 'Regulation (EC) No 714/2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003' (2009) *OJ L 211, 14/08/2009, pp. 15-35*; 'Regulation (EC) No 715/2009 on conditions for access to the natural gas

was, however, not applicable *ratione temporis*.[126] Nevertheless, the Dutch government decided to impose an ownership unbundling of the distribution networks considering that the form of ownership unbundling was most appropriate to pursue the objective of combating cross-subsidisation in the broad sense, including exchange of strategic information, in order to achieve transparency in the electricity and gas markets and to prevent distortions of competition.[127]

The question of the relationship between the free movement of capital under Article 63 TFEU and the principle of neutrality under Article 345 TFEU arose in relation to the prohibition of privatisation. In particular, the Dutch government argued that the prohibition of privatisation constituted a body of rules governing the system of property ownership within the meaning of Article 345 TFEU. Therefore, the prohibition of privatisation was excluded from the scope of application of Internal Market rules. In other words, according to the Dutch government, by virtue of the presumption of validity under Article 345 TFEU, the prohibition of privatisation escaped the scrutiny of the rules on free movement of capital.[128]

In his Opinion, Advocate General Jääskinen distinguished the situation at issue from the 'golden shares' case law.[129] More precisely, he explained that 'golden shares' could only exist in *already privatised* companies. Thus, the granting of 'golden shares' to the State *presupposes prior privatisation* of the companies concerned. As the State has already exercised its sovereign right in favour of privatisation, the privileged treatment it retains for itself within an essentially *private* property ownership system is not exempted from the Treaty provisions on fundamental freedoms. However, in the case at hand, the Netherlands had not applied a privatisation policy. To the contrary, the national legislation at issue established a *prohibition of privatisation* of the energy distributor system operators. This prohibition was flowing *ineluctably* from the public ownership of the Dutch energy distribution system and as such it was covered by the presumption of validity of Article 345 TFEU.[130] To the extent that this prohibition constituted an *intrinsic consequence* of the ownership system chosen by the Netherlands, it could not be regarded as an obstacle to the free movement

transmission networks and repealing Regulation (EC) No 1775/2005' (2009) *OJ L 211, 14/08/2009, pp. 36-54*.

126 For the sake of completeness, it should be noted that the Third Energy Package only introduces the ownership unbundling between the *transmission* networks and the production/supply of energy. The ownership unbundling of the energy *distribution* networks pursued by the Dutch legislation is still not required by EU law.

127 Joined cases C-105/12 to C-107/12 *Essent NV*, para 49.

128 Ibid, para 24.

129 *Opinion of AG Jääskinen in Joined cases C-105/12 to C-107/12 Essent*, para 46.

130 Ibid, para 49.

of capital in so far as this system is not discriminatory. On the other hand, any restrictive *indirect consequences* other than those directly and inevitably stemming from the public or private system of ownership were to be subject to the fundamental freedoms of the Treaty.[131] This distinction between, on the one hand, *intrinsic/direct/inevitable* consequences of the property ownership system of a Member State and, on the other hand, *indirect* consequences were instrumental in his interpretative approach. The first were to be covered by the presumption of validity under Article 345 TFEU, whereas the latter were to be subject to the scrutiny of the free movement provisions.

Thus, the Commission together with Advocate General Jääskinen adopted the 'reductionist shield' interpretation of Article 345 TFEU, according to which Article 345 TFEU creates a shield against internal market scrutiny only with respect to measures *intrinsically* connected with the ownership system established in a Member State (such as a prohibition of privatisation), but not with respect to measures that only *indirectly* relate to that ownership system (such as golden shares). This interpretative approach is methodologically consistent, as it protects the fundamental right of Member States to opt for either a private or public ownership status of undertakings whilst at the same time subjecting State privileges (golden shares) to the internal market scrutiny.

3.2.3 The 'sword' interpretation

However, the 'reductionist shield' interpretation was not accepted by the Court. Contrary to Advocate General Jääskinen and the Commission, the Court adopted the third interpretative approach – the 'sword' interpretation of Article 345 TFEU – which corresponds to the least possible degree of State intervention in the market. In the words of Pieter Van Cleynenbreugel, 'rather than creating a shield against internal market scrutiny, Article 345 TFEU neutrality should be interpreted as providing a sword to establish an even more refined balance between economic freedom and state intervention in the market'.[132] While recognising the *competence* of the Member States to determine their property ownership systems, the Court subjects the *exercise* of this competence to the rules of the Internal Market. Following this classic *mantra*, the Court rejects the presumption of validity under Article 345 TFEU in both the 'golden shares' case law and in the *Essent* case on the prohibition of privatisation, ruling that this provision merely signifies that each Member State may organise as it

131 Ibid, para 42.

132 Pieter Van Cleynenbreugel, 'No privatisation in the service of fair competition? Article 345 TFEU and the EU market-state balance after Essent' (2014) 39 European Law Review 264, p. 265.

thinks fit the system of ownership of undertakings whilst at the same time respecting the fundamental freedoms enshrined in the Treaty.[133]

In general, Article 345 TFEU has been construed *narrowly* so as not to prevent the application of fundamental rules of the Treaties. In *Fearon*, the Court ruled that

> '[…] although [Article 345 TFEU] does not call in question the Member States' right to establish a system of compulsory acquisition by public bodies, such a system remains subject to the fundamental rule of non-discrimination which underlies the chapter of the Treaty relating to the right of establishment'.[134]

The narrow scope of Article 345 TFEU has also been recognised in the field of intellectual property rights. In particular, it has been established that this provision 'does not exclude any influence whatever of Community law on the exercise of national industrial property rights'[135] and 'cannot be interpreted as reserving to the national legislature, in relation to industrial and commercial property, the power to adopt measures which would adversely affect the principle of free movement of goods within the common market as provided for and regulated by the Treaty'.[136] Thus, although the system of property ownership continues to be a national competence under Article 345 TFEU, that provision does not have the effect of exempting such a system from the fundamental rules of the Treaty.[137]

In the same vein, in *Opinion 2/15 on the Singapore Agreement*, the Court rejected the argument of the Council and the Member States that certain provisions of the envisaged agreement fell within the competence of the Member States alone in the field of property law.[138] It held that although Article 345 TFEU expresses the neutrality of the EU in relation to the rules existing in Member States governing the system of property ownership, it does not mean that those rules are not subject to the fundamental rules of the EU.[139] The Court explained that the specific provision of the Singapore Agreement did not contain any commitment relating to the rules in Member States governing the

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133 Case C-309/99 *Wouters and others*, para 28; Case C-483/99 *Commission v France (golden shares – Sociéte Nationale Elf-Aquitaine)*, para 23; Case C-503/99 *Commission v Belgium (golden shares)*, para 22.

134 Case 182/83 *Robert Fearon & Company Limited v Irish Land Commission,* ECLI:EU:C:1984:335, para 7.

135 Joined cases 56 and 58-64 *Établissements Consten S.à.R.L. and Grundig-Verkaufs-GmbH v Commission,* ECLI:EU:C:1966:41, p. 345.

136 Case C-30/90 *Commission v UK,* ECLI:EU:C:1992:74, para 18.

137 Case C-302/97 *Konle*, para 38; Case C-309/99 *Wouters and others*, para 48; Case C-300/01 *Doris Salzmann,* ECLI:EU:C:2003:283, para 39; Case C-452/01 *Margarethe Ospelt*, para 24.

138 *Opinion 2/15*, para 106.

139 Ibid, para 107.

system of property ownership.[140] It sought solely to make any nationalization or expropriation decisions subject to limits which are intended to guarantee investors that such a decision will be adopted under equitable conditions and in compliance with general principles and fundamental rights, in particular with the principle of non-discrimination.[141] Therefore, it reflected the simple fact that, whilst the Member States remain free to exercise their competences regarding property law and to amend accordingly the rules governing the system of property ownership, they are nonetheless not absolved from compliance with those principles and fundamental rights.[142] In this way, the Court exported the internal market rationale to the field of common commercial policy of the EU.

Similarly, in the *Essent* case, the Court, while recognising that the prohibition of privatisation of distributor system operators fell within the scope of Article 345 TFEU, it nonetheless held that this did not exclude the application of the free movement of capital enshrined in Article 63 TFEU.[143] Such a prohibition constituted an 'impediment' for the purposes of Article 63 TFEU since, first, it was liable to prevent or limit the acquisition of shares in the undertakings concerned or to deter investors of other Member States from investing in their capital[144] and, secondly, it constituted an obstacle to the raising of capital by the undertakings concerned, since the acquisition of shares was being restricted.[145]

3.2.4 Assessment of the three interpretations

3.2.4.1 Criticism of the 'sword' interpretation and the legal consistency of the 'reductionist shield' interpretation

The sword interpretation is arguably susceptible to criticism, as it is liable to render Article 345 TFEU devoid of any meaning whatsoever. Some commentators have argued that the dismissal of Article 345 TFEU as irrelevant 'signifies a bias in favour of Community law competence to assess the compatibility

140 Ibid.
141 Ibid.
142 Ibid.
143 Joined cases C-105/12 to C-107/12 *Essent NV*, para 37.
144 Ibid, para 41.
145 Ibid, para 42. It is interesting to note that in the national proceedings Eneco challenged only the group prohibition, not the prohibition of privatisation as such. Therefore, when the case was brought back to the Hoge Raad der Nederlanden (Supreme Court of the Netherlands), the latter refrained from ruling on the compatibility of the prohibition of privatisation with Article 63 TFEU. Rather, it focused its analysis on the group prohibition and found that although the latter constituted a restriction on the free movement of capital, it was nevertheless justified by overriding reasons in the public interest. See *De Staat der Nederlanden/Eneco Horlding N.V.,* ECLI:NL:HR:2015:1728 (Hoge Raad).

of all Member State action and economic policy against the Community norms'.[146] The presumption of neutrality under Article 345 TFEU has been transformed into 'a presumption of illegality of State intervention in the market'.[147]

However, the fact that Article 345 TFEU is a symbolic provision does not mean that it is deprived of any legal content. Its symbolic importance lies in the fact that it reflects the fundamental compromise between State and market that was achieved in the post-war construction of Europe. To deprive Member States of the possibility to opt for a public ownership system could be regarded as amounting to an overt endorsement of the neoclassical economic model despite the proclaimed principle of neutrality of the Treaties. It could in fact be interpreted as meaning that the mere fact that the State owns shares in a company is a restriction on the free movement of capital.[148]

While it is true that the European Economic Constitution favours economic freedoms, deregulation and trade liberalisation, it nonetheless respects the competence and the discretion of the Member States to choose between public and private property. And as the EU is an international organisation governed by the fundamental principle of conferral of powers,[149] respect for the division of competences between the Member States and the EU is of paramount importance for the harmonious coexistence of various actors with conflicting interests and the smooth and constructive evolution of the European project. The role of the judiciary in this sensitive division of competences is all the more crucial, especially in light of the fact that there is no secondary legislation in relation to privatisations, and therefore the interpretative approach of the Court regarding Article 345 TFEU has far-reaching implications for the economic systems of the Member States.

Consequently, it is suggested here that the most legally consistent interpretation of Article 345 TFEU is the *'reductionist shield' interpretation*. Measures *intrinsically* connected with the ownership system established in a Member State (such as a prohibition of privatisation) should be shielded against internal market scrutiny, whereas measures that only *indirectly* relate to that ownership system (such as golden shares) should in principle be subject to the Treaty provisions

146 Erika Szyszczak, 'Golden Shares and Market Governance' (2002) 29 Legal Issues of Economic Integration 255, p. 279.

147 Erika Szyszczak, *The Regulation of the State in Competitive Markets in the EU* (Hart Publishing 2007), p. 14.

148 Jukka Snell, 'Economic Justifications and the Role of the State' in Panos Koutrakos, Niamh Nic Shuibhne and Phil Syrpis (eds), *Exceptions from EU Free Movement Law: Derogation, Justification and Proportionality* (Hart Publishing 2016), p. 25.

149 Arts. 3 (6), 4 (1), 5 (1)-(2) and 13 (2) TEU.

on the fundamental freedosm (especially the free movement of capital) if they fulfil the conditions of capital restrictions, which are explained in Chapter 4.

3.2.4.2 The compromise: the use of Article 345 TFEU as a justification

Aware of the sensitive nature of the case and the possible consequences of its judgement, the Court tried to moderate its approach: with an enigmatic and ambiguous language it implicitly accepted that Article 345 TFEU could be used as a *justification* ground for restrictions on capital movements. Even though in earlier case law it had explicitly excluded the possibility of invoking Article 345 TFEU in order to justify a restriction on the free movement of capital,[150] it nonetheless explained that:

> '[t]hat does not however mean that the interest underlying the choice of the legislature in relation to the rules on the public or private ownership of the electricity or gas distribution system operator may not be taken into consideration as an overriding reason in the public interest'.[151]

The Court emphasised that the *Essent* case should be clearly distinguished from the golden shares case law, as the former related to '*an absolute prohibition of privatisation*', whereas the latter '*concerned restrictions created by privileges which the Member States attached to their position as a shareholder in a privatised undertaking*'.[152] For these reasons, the Court held that:

> 'the reasons underlying the choice of the rules of property ownership adopted by the national legislation within the scope of Article 345 TFEU constitute factors which may be taken into consideration as circumstances capable of justifying restrictions on the free movement of capital'.[153]

This reasoning seems somehow artificial and creates an arguably unnecessary fragmentation in the use of justifications in the free movement case law. The Court does not provide an adequate explanation as to why Article 345 TFEU can be used as a justification in case of a prohibition of privatisation, but cannot be used as such in the golden shares case law. Indeed, one might wonder what is the distinguishing factor that renders possible the use of Article 345 TFEU as a justification in the first scenario, but not in the second. Perhaps

150 Case C-171/08 *Commission v Portugal (golden shares – Portugal Telecom SGPS SA)*, para 64.
151 Joined cases C-105/12 to C-107/12 *Essent NV*, para 53.
152 Ibid, para 54.
153 Ibid, para 55. It should be noted that with respect to the other two prohibitions, the Court acknowledged that the objectives of combating cross-subsidisation in the broad sense, including exchange of strategic information, in order to achieve transparency in the electricity and gas markets, and to prevent distortions of competition could be regarded as overriding reasons in the public interest justifying restrictions on the free movement of capital.

the rationale behind this rather perplexing differentiation is the same as the rationale used by the Commission and Advocate General Jääskinen in the 'reductionist shield' interpretation: a prohibition of privatisation amounts to a *direct* and *inevitable* consequence of the choice of property ownership system, whereas golden shares presuppose the privatisation of strategic undertakings, which means that the Member State has already exercised its competence regarding property ownership systems and has opted for a model that favours private ownership. Within the framework of a private ownership model, the State, in its capacity as a shareholder, must reverently respect the rules of the game and must not avail itself of special prerogatives in the management of the company that could deter foreign investors.

However, it should be reminded that this approach focused on a prior step, namely that of whether the national measure *falls within the scope of the free movement of capital*. In that regard, the Commission and Advocate General Jääskinen argued that a prohibition of privatisation benefits from the presumption of validity under Article 345 TFEU and thus escapes Internal Market scrutiny, whereas golden shares remain subject to Internal Market scrutiny. Nevertheless, despite its objective appeal, this approach was rejected by the Court in relation to the question of whether the measure falls within the scope of free movement rules, only to be later accepted in relation to the question whether the national measure was justified under Article 345 TFEU. It seems that the Court chose to adopt this reasoning in order to remain loyal to the traditional Internal Market approach that dictates first, that the four freedoms must be interpreted widely, whereas exceptions must be construed narrowly and secondly, that although a measure might fall within the competence of the Member States, the *exercise* of that competence must be in accordance with the free movement provisions (although arguably a prohibition of privatisation such as the one in Essent referes to the *existence* of the national competence to opt for a public ownership system, rather than the *exercise* of that competence). But the fact still remains that retaining golden shares in privatised undertakings can be regarded as equivalent to a reduced form of public ownership. If this view is adopted, then the differentiated approach in the use of Article 345 TFEU as a justification seems rather inconsistent and not entirely convincing.

Furthermore, the use of Article 345 TFEU as a justification raises another important issue: it might be regarded as opening the door for the use of *economic considerations* for the purpose of justifying restrictions on the fundamental freedoms. According to settled case law, *purely economic grounds cannot serve as justification for obstacles prohibited by the Treaty*.[154] This 'economic rule' was

154 Case C-398/95 *SETTG*, paras 22-23; Case C-35/98 *Verkooijen*, para 47-48; Case C-309/99 *Wouters and others*, para 52; Case C-201/15 *AGET Iraklis*, para 72.

established as early as in 1961 in *Commission v Italy (pork meat)* concerning an Italian rule suspending imports of certain pork-related products from other Member States, where the Court held that Article 36 TFEU is 'directed to eventualities of a non-economic kind'.[155] The rationale of this rule was that the Internal Market, as the cornerstone of the EU, would be seriously undermined if protectionist measures were allowed.[156] Thus, the original target of the general rule prohibiting economic justifications were protectionist measures.

Since then, the 'economic rule' has evolved and has been somewhat attenuated by subsequent case law, most notably by the *Campus Oil* judgment, in which the Court introduced an important qualification: a restriction on free movement is lawful whenever a measure is based equally on economic grounds and on grounds which are admissible under the Treaty.[157] This is known as the 'further purpose' doctrine, under which it is exceptionally possible to justify protectionist measures if, apart from their economic objective, they pursue simultaneously another non-economic objective.[158] Thus, in *Campus Oil*, the Court found that the Irish legislation requiring importers of refined petroleum products to purchase certain products from a state-owned refinery was justified on grounds of public security. It held that:

> 'petroleum products, because of their exceptional importance as an energy source in the modern economy, are of fundamental importance for a country's existence since not only its economy but above all its institutions, its essential public services and even the survival of its inhabitants depend upon them'.[159]

In light of the seriousness of the consequences that an interruption in supplies of petroleum products may have for a country's existence, the aim of ensuring a minimum supply of petroleum products at all times is to be regarded as transcending purely economic considerations and thus as capable of constituting an objective covered by the concept of public security.[160] As long as the measure in question pursues an objective that falls within the ambit of one of the derogation grounds provided for under the Treaty (such as public security), the fact that it might also pursue economic considerations cannot exclude the application of the public interest justification in question.[161]

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155 Case 7-61 *Commission v Italy (pork),* ECLI:EU:C:1961:31 at 329.
156 Peter Oliver, 'When, if ever, can restrictions on free movement be justified on economic grounds' (2016) 41 European Law Review 147.
157 Case 72/83 *Campus Oil*, paras 35-36.
158 Sue Arrowsmith, 'Rethinking the approach to economic justifications under the EU's free movement rules' (2015) 68 *Current Legal Problems* 307, p. 320.
159 Case 72/83 *Campus Oil*, para 34.
160 Ibid, para 35.
161 Ibid, para 36.

In recent case law, the Court has further developped the approach followed in *Campus Oil* and has expanded even more the 'further purpose' doctrine so as to cover not only objectives with an economic dimension which fall within the ambit of one of the Treaty derogations, but also objectives with an economic dimension which fall within the ambit of an overriding reason in the public interest. In particular, in *AGET Iraklis*, the Court achknowledged that 'considerations connected with the maintenance of employment may, under certain circumstances and conditions, be acceptable justifications'.[162] These considerations include the 'protection of workers' recognised as an overriding reason in the public interest[163] as well as 'the encouragement of employment and recruitment which, being designed in particular to reduce unemployment, constitutes a legitimate aim of social policy'.[164] Drawing from this ruling, in a recent case concerning the reprivatisation of the Portuguese airline TAP, Advocate General Campos Sánchez-Bordona explained that the 'economic rule'

> 'does not mean that the Court of Justice is impervious to Member States' economic interests when these are put forward as grounds for hindering freedom of establishment in pursuit of a legitimate social policy objective'.[165]

In his paper on the use of economic objectives as justifications, Peter Oliver[166] discusses the evolution of the case law and the departure from the strict application of the 'economic rule' in the following fields: the financial balance of social and healthcare systems,[167] higher education,[168] the cohesion of the tax system[169] and social protection.[170] He notes that economic exceptions

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162 Case C-201/15 *AGET Iraklis*, para 75.

163 Ibid, para 73.

164 Ibid, para 74.

165 *Opinion of Advocate General Campos Sánchez-Bordona in Case C-563/17 Associação Peço a Palavra,* ECLI:EU:C:2018:937, para 95

166 Peter Oliver, 'When, if ever, can restrictions on free movement be justified on economic grounds' (2016) 41 European Law Review 147.

167 Case C-157/99 *B.S.M. Geraets-Smits v Stichting Ziekenfonds VGZ and H.T.M. Peerbooms v Stichting CZ Groep Zorgverzekeringen,* ECLI:EU:C:2001:404, paras 74, 79 and 106; Case C-158/96 *Kohll v Union des Caisses de Maladie,* para 50; Case C-120/95 *Decker v Caisse de Maladie des Employés Privés*, par 39; Case C-512/08 *Commission v France (medical equipment),* ECLI:EU:C:2010:579, para 42; Case C-385/99 *V.G. Müller-Fauré v Onderlinge Waarborgmaatschappij OZ Zorgverzekeringen UA and E.E.M. van Riet v Onderlinge Waarborgmaatschappij ZAO Zorgverzekeringen,* ECLI:EU:C:2003:270, para 73.

168 *Opinion of AG Jacobs in Case C-147/03 Commission v Austria (conditions of access to university education),* ECLI:EU:C:2005:40, para 32; Case C-209/03 *The Queen, on the application of Dany Bidar v London Borough of Ealing and Secretary of State for Education and Skills,* ECLI:EU:C:2005:169, para 56; Case C-20/12 *Elodie Giersch and Others v État du Grand-Duché de Luxembourg,* ECLI:EU:C:2013:411, paras 51-56.

169 Case 823/79 *Criminal proceedings against Giovanni Carciati,* ECLI:EU:C:1980:230, paras 9-10; Case C-478/98 *Commission v Belgium*, paras 37-39; Case C-318/07 *Persche*, para 52.

which are expressly provided for by the Treaty, such as the right of non-economically active citizens to reside in another Member State under Article 21 TFEU or services of general economic interest under Article 106 TFEU, are excluded from the scope of his inquiry as they are inherent in the Treaty. This means that economic considerations expressly provided for by the Treaty are not caught by the 'economic' rule, as the Treaty itself allows their use as justification grounds by the Member States. By the same token, the same could be argued for Article 65 (1) (b) TFEU, which allows Member States to take all requisite measures to prevent infringements of national law and regulation in the field of taxation (see the analysis in Chapter 2, Section 3.5.1.1.1).

The same could be argued with respect to Article 345 TFEU. Indeed, the property ownership systems of the Member States necessarily entail economic considerations, which in principle cannot be used as justification grounds according to the 'economic rule'. However, the fact that this is an explicit provision of the Treaty renders the 'economic rule' inapplicable. Therefore, Article 345 TFEU can be used as a justification ground despite the fact that it inevitably serves economic interests. Furthermore, the choice of national property ownership system does not only pursue economic objectives, but also other objectives of a non-economic nature that could perhaps fall within the scope of the Treaty derogations. Accordingly, on the basis of the 'further purpose' doctrine, Article 345 could be used as a justification ground. This was in essence the approach that was implicitly chosen in *Essent*, where the Court ruled that reasons underlying the choice of a public ownership system under Article 345 TFEU could be taken into consideration as circumstances capable of justifying restrictions on the free movement of capital resulting from an absolute prohibition of privatisation.

It should be acknowledged that the approach that was ultimately chosen by the Court in the *Essent* case appears to be an important *compromise* aiming to strike a delicate balance between the fundamental freedoms and the public ownership of undertakings intended to safeguard public interest objectives. The departure from a strict application of the 'economic' rule was perhaps inevitable in light of the fact that there are certain economic objectives which

170 Case C-346/06 *Dirk Rüffert v Land Niedersachsen*, ECLI:EU:C:2008:189, para 37-43; Case C-341/05 *Laval un Partneri Ltd v Svenska Byggnadsarbetareförbundet, Svenska Byggnadsarbetareförbundets avdelning 1, Byggettan and Svenska Elektrikerförbundet*, ECLI:EU:C:2007:809, para 1007; Case C-438/05 *International Transport Workers' Federation and Finnish Seamen's Union v Viking Line ABP and OÜ Viking Line Eesti*, ECLI:EU:C:2007:772, paras 76-77. Peter Oliver notes that despite the fact that the right to take collective action was enshrined in the Charter, the fact still remains that the argument of the trade unions was 'economic' in nature, even though it was framed in fundamental rights terms. See Peter Oliver, 'When, if ever, can restrictions on free movement be justified on economic grounds' (2016) 41 European Law Review 147, p. 167.

are so inextricably linked with or dictated by social objectives that they cannot be separated from each other. Thus, the use of Article 345 TFEU as a justification for the restriction imposed on the free movement of capital by the prohibition of privatisation can be regarded as a recognition by the Court of the exceptionally sensitive nature of the political choice between public and private ownership and as an effort to mitigate the profound consequences of a possible deprivation of Article 345 TFEU of any legal meaning.

However, the distinction between the use of Article 345 TFEU as an *exemption* from the scope of capital restrictions as opposed to the use of Article 345 TFEU as a *justification* is of paramount importance and can have significant consequences for the outcome of the case. This is because in the first scenario the national measure is excluded altogether from internal market scrutiny, whereas in the second scenario the measure constitutes a restriction which then needs to be balanced against the conflicting public interest objective subject to a strict proportionality assessment. From a legal consisteny perspective, a measure such as a prohibition of privatisation touches upon the *essence* of the national competence to opt for a public ownership system and, therefore, should be excluded from the scope of the Internal Market provisions according to the *'reductionist shield' interpretation*, which is regarded here as the most consistent from a legal perspective. Furthermore, although in *Essent* the use of Article 345 TFEU as a justification ultimately resulted in a compromise between the fundamental freedoms and the national competence to determine the property ownership system, it is not guaranteed that the same outcome will be reached in future cases. In fact, in the recent *Associac¸a~o Pec¸o a Palavra* case regarding the tender specifications of the reprivatisation scheme of the Portuguese airline TAP, Advocate General Campos Sánchez-Bordona seems to follow the golden shares approach under which Article 345 TFEU can neither exclude a measure from the scope of the fundamental freedoms nor justify a restriction on them.[171] It remains to be seen whether the Court will follow his reasoning.

4 Conclusion of Chapter 3

Privatisation is a particularly complex economic policy issue which involves different stakeholders and conflicting economic and societal interests that need to be reconciled. Some argue that privatisation should be a priority for national governments, as it brings significant efficiency gains and reduces the level of public debt, while some others believe that privatisation is not always desirable especially when it comes to public utilities that are essential for the society as a whole and networks industries where it is difficult or even im-

171 *Opinion of Advocate General Campos Sánchez-Bordona in Case C-563/17 Associação Peço a Palavra*, para 46.

possible to achieve well-functioning competitive markets. In light of the inconclusive economic evidence, the OECD does not take a position in favour or against the public ownership of enterprises. However, it emphasises that a State that owns enterprises should ensure that these enterprises have committed to high standards of corporate governance and operate within an effective legal and regulatory framework establishing a level playing field between State-owned enterprises and other companies.[172] At the same time, the predominant view and the consensus position among OECD countries is that a government should not privatise a State-owned enterprise before an appropriate regulatory framework for the privatised entity has been established.[173] Indeed, privatisation may not yield the expected efficiency gains and may in fact lead to distortions of competition and concessions to government-friendly private interests[174] if it is not combined with a transparent and adequate competition system backed by effective enforcement mechanisms.

At the EU level, this Chapter argues that the social dimesion of Europe can be strengthened by the rediscovery of Article 345 TFEU, a provision which enshrines the principle of neutrality in relation to the property ownership of the Member States. In particular, the inclusion of this provision ensures that the Treaty itself does not take an ideological stance regarding the public or private ownership of enterprises operating in the Member States. However, its nebulous wording has given rise to different interpretations of its meaning: (1) the 'maximalist shield' interpretation; (2) the 'reductionist shield' interpretation and (3) the 'sword' interpretation. In the *Essent* case regarding the prohibition of privatisation of the Dutch energy distribution network operators, the Court opted for the 'sword' interpretation thereby establishing that national rules relating to the property ownership of the Member States cannot be excluded from Internal Market scrutiny. This thesis takes issue with the 'sword interpretation' and argues that a prohibition of privatisation is the *quintessence* of a measure touching upon the sensitive national competence to determine the national property ownership system, which is covered by the principle of neutrality under Article 345 TFEU. Therefore, it should be excluded from the scope of capital restrictions. In other words, it is argued here that the most consistent interpretation of Article 345 TFEU from a legal perspective is the 'reductionist shield' interpretation, according to which, for measures intrinsically linked with the national property ownership system, Article 345 TFEU should have been used as an exemption, not as a derogation from Article 63 TFEU.

172 OECD, *Privatisation in the 21st Century: Recent Experiences of OECD Countries* (2009), p. 3.
173 Ibid, p. 13.
174 George Pagoulatos, 'The Politics of Privatisation: Redrawing the Publi-Private Boundary' (2005) 28 *Western European Politics* 358, at p. 372.

However, notwithstanding the objections that one might have regarding the legal consistency of the Court's reasoning in *Essent*, it should be acknowledged that, in light of the politically sensitive nature of the case, the Court tried to mitigate the effects of its judgment by ruling that the reasons underlying the choice of a public ownership system under Article 345 TFEU could be used as a justification for the capital restriction imposed by the prohibition of privatisation. This can be regarded as a compromise aiming at reconciling capital liberalisation with public interest objectives. The underlying rationale of the legal reasoning in *Essent* is the acknowledgment that in certain sensitive sectors public ownership can protect essential social objectives, which would otherwise be threatened by market forces. This is linked to the overarching theme of this thesis, which is the fundamental clash between economic freedoms and social values and the efforts to strengthen the social component of the European edifice and achieve a 'social market economy', as enshrined in Article 3 (3) TEU. The next and final Chapter attempts to identify legal tools to achieve the same reconciliation in the *post*-privatisation phase, i.e. when the Member States decide to retain golden shares in privatised companies.

4 Free movement of capital and golden shares

1 INTRODUCTION

This Chapter constitues the second component of the normative part of this thesis. It zooms in on the second case-study relating to golden shares in the EU and seeks to investigate whether the interpretation of Article 63 TFEU in the golden shares case law allows room for State participation in the Market for the purposes of protecting public interest objectives and respects the division of competences between the EU and the Member States in the field of corporate governance, whilst at the same time ensuring that Member States do not impose protectionist measures liable to hinder the market access of foreign investors.

The notion of golden shares refers to the special rights that Member States maintain in strategically sensitive privatised companies (telecommunications, electricity and energy production and distribution, postal services, car industries etc.).[1] These special rights allow the State to control changes in ownership and/or veto certain strategic decisions in order to prevent hostile takeovers, to guarantee the provision of services of general interest, to safeguard public security and other public interest objectives.[2] The use of golden shares became a widespread phenomenon in Europe in the 1990s and 2000s. Examples of companies in which Member States established special shareholding (either through national legislation or through the Articles of Association of the companies) included, amongst others, Portugal Telecom, the Italian ENEL, the Spanish Repsol, the French Société Nationale Elf-Aquitaine, the Belgian Société Nationale d'Investissement, the Greek Organisation for Telecommunications, the British Airports Authority, the Dutch KPN and the German Volkswagen.

1 Oxera, *Special rights of public authorities in privatised EU companies: the microeconomic impact* (Report prepared for the European Commission, 2005); Stefan Grundmann and Florian Möslein, 'Golden Shares – State Control in Privatised Companies: Comparative Law, European Law and Policy Aspects' (2001-2002) 4 EUREDIA 623.

2 European Commission, *Special rights in privatized companies in the enlarged Union – a decade full of developments* (Commission Staff Working Document, 2005).

The Commission regarded the establishment of special holdings in national champions as an expression of national economic protectionism restricting the free movement of capital in the EU.[3] Fearing that this trend could severely obstruct the functioning of the Internal Market, it initiated a number of infringement proceedings against the Member States with special rights in privatised companies.

The golden shares case law raises important legal, political and economic questions, as it addresses issues that lie at the heart of the fundamental interplay between the State and the Market. The conclusion that can be drawn after more than 20 years of litigation[4] is that golden shares constitute in principle

3 Ibid, p. 5. The concept of 'economic protectionism' implies the 'assertion of selfish interests in defiance of market forces, by those in a position to influence the outcome to that end by legal means', see Jonathan Rickford, 'Protectionism, Capital Freedom and the Internal Market' in Bernitz and Ringe (eds), *Company Law and Economic Protectionism – New Challenges to European Integration* (Oxford University Press 2010), p. 55; Jonathan Rickford, 'Free movement of capital and protectionism after Volkswagen and Viking Line' in Tison and Wymeersch (eds), *Perspectives in Company Law and Financial Regulation – Essays in Honour of Eddy Wymeersch* (Cambridge University Press 2009), p. 62. It is argued that the concept of 'economic protectionism' should be distinguished from the concept of 'economic patriotism'. On the one hand, 'economic protectionism' refers to a political and economic system where national authorities protect the domestic industry from any type of foreign invasion. The State is entitled to organise and operate social and industrial schemes, while avoiding any exposure to international competition. On the other hand, 'economic patriotism' can be conceived as an expression of support and encouragement of national production not only by the State but also by consumers and enterprises. It also refers to those interventionist mechanisms that public authorities put in place in order to maintain control over the decision-making process of strategic companies within national territory. This is what the French call '*patriotisme à la Colbert*', a type of economic interventionism aiming at preserving the sovereign powers (*pouvoirs régaliens*) of the State acting as a 'strategist' *(État stratège*) in order to promote the economic interests of national champions in strategic and sensitive sectors and to protect the national industrial fabric. See Jérémie Houet, *Les Golden Shares en droit de l'Union Européenne* (Larcier 2015), p. 296-297 citing also Corinne Boulogne-Yang-Ting, 'Patriotisme économique et mécanismes du droit des societies et boursier' in Georges Virassamy (ed), *Entreprise et patriotisme économique* (L'Harmattan 2008). The term 'economic patriotism' was first used by the former Prime Minister of France, Dominique de Villepin, in his speech on 27 July 2005, in which he warned the US company PepsiCo not to launch a hostile takeover bid for Danone, the publicly owned French foods company. He urged his compatriots to rally behind the concept of 'economic patriotism' to ensure they compete more effectively in a globalizing world. See John Thornhill and Adam Jones, 'De Villepin stands by calls for 'economic patriotism'' *Financial Times* (22 September 2005) <https://www.ft.com/content/028bacac-2b94-11da-995a-00000e2511c8> accessed 01-09-2018. Ever since, the term 'economic patriotism' has played a leading role in the French public discourse and has appeared in many works by scholars and politicians, such as the well-known book published in 2006 by the former MP Bernard Carayon. See Bernard Carayon, *Patriotisme économique, de la guerre à la paix économique* (Editions du Rocher 2006).

4 Case C-58/99 *Commission v Italy (golden shares – ENI/Telecom Italia)*; Case C-309/99 *Wouters and others*; Case C-483/99 *Commission v France (golden shares – Sociéte Nationale Elf-Aquitaine)*; Case C-503/99 *Commission v Belgium (golden shares)*; Case C-463/00 *Commission v Spain (golden shares)*; Case C-98/01 *Commission v UK (golden shares)*; Case C-174/04 *Commission*

a *restriction* on the free movement of capital because of their *dissuasive* effect on investment. However, they may be justified on grounds of legitimate objectives in the public interest if the State provides sufficient evidence that the measures at issue comply with a proportionality test, which, in addition to the suitability and the necessity components, assesses also the compliance with the procedural requirements of the principle legal certainty.[5] Therefore, just like with the other freedoms, the Court is confronted with the challenge of striking a fair balance between economic freedom (here in the form of foreign direct or portfolio investments in privatised companies) and public interest objectives pursued through certain forms of State intervention in the market. Only here the implications of its rulings are far more profound, as they affect the structure and the organisation of national corporate governance systems, one of the core aspects of national economic policy and one of the main factors determining the type of capitalism established at national level.

The present chapter seeks to assess the far-reaching implications of the golden shares case law not only for the corporate governance systems of the Member States and the organisation of their industrial policies, but also for the broader discussion about the division of competences between the EU and the Member States. In order to do so, it first examines the theoretical controversy surrounding special rights in privatised companies from a corporate governance perspective (combining political economy with socio-legal theory) (Chapter 4, Section 2) and then turns to the specific legal issues arising from the case law of the Court of Justice (Chapter 4, Section 3). It argues that the golden shares case law has been characterised by an admittedly rigorous application of the rules on the free movement of capital, which in most cases does not allow Member States to maintain special shareholding over privatised companies. By prioritising the interests of foreign investors, the Court favours the constitutional foundations and institutional arrangements of *liberal market economies*[6]

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v Italy (golden shares); Joined cases C-282/04 and C-283/04 *Commission v The Netherlands (golden shares)*; Case C-112/05 *Commission v Germany (golden shares – Volkswagen I)*; Joined cases C-463/04 and C-464/04 *Federconsumatori (AEM/Edison)*; Case C-274/06 *Commission v Spain (golden shares)*; Case C-207/07 *Commission v Spain (golden shares in the energy sector)*; Case C-326/07 *Commission v Italy (golden shares)*; Case C-543/08 *Commission v Portugal (golden shares – EDP)*; Case C-171/08 *Commission v Portugal (golden shares – Portugal Telecom SGPS SA)*; Case C-212/09 *Commission v Portugal (golden shares – GALP Energia SGPS SA)*; Case C-244/11 *Commission v Greece (golden shares)*; Case C-95/12 *Commission v Germany (golden shares – Volkswagen II)*.

5 So far only on one occasion did the Court find that the contested special rights were justified by public interest requirements and were also consistent with the principles of proportionality and legal certainty and that was in Case C-503/99 *Commission v Belgium (golden shares)*.

6 The structural bias of negative integration in favour of liberal market economies as opposed to social market economies has been thoroughly addressed by eminent scholars of the Max Planck Institute for the Study of Societies; see Fritz W. Scharpf, 'The Double Asymmetry of European Integration Or: Why the EU Cannot Be a Social Market Economy' (2010) 8

(as opposed to the ones of *coordinated market economies*) and promotes a company law regime that endorses *the principle of proportionality between ownership and control* and *the principle of shareholders' primacy*.[7] This in turn might lead to an erosion of the *varieties of capitalism* that exist in Europe and to a *judicially driven convergence* into a specific model of market economy, which might give rise to concerns regarding the respect of the division of competences between the EU and the Member States. For this reason, this Chapter argues that the Court should adopt a more restrictive (*Keck*-inspired) interpretation of the concept of 'capital restrictions' in order to delineate in a more consistent way the scope of 'capital restrictions' and allow room for State participation in the market.

2 UNDERSTANDING THE THEORETICAL CONTROVERSY SURROUNDING GOLDEN SHARES

In order to evaluate the interpretation of Article 63 TFEU in the golden shares case law and its implications for the corporate governance regime of the Member States, it is necessary first to introduce and understand the theoretical controversy surrounding golden shares. In this regard, this section introduces the definition of golden shares (section 2.1) and explains why golden shares constitute control enhancing mechanisms (section 2.2) deviating from the principle of proportionality between ownership and control (section 2.3). Subsequently, it introduces the influential theory of varieties of capitalims, upon which the distinction between liberal and coordinated market economies is based (section 2.4)

Socio-Economic Review 211; Martin Höpner and Armin Schäfer, *Integration among unequals: How the heterogeneity of European varieties of capitalism shapes the social and democratic potential of the EU* (MPIfG Discussion Paper, No 12/5 Cologne, Max Planck Institute for the Study of Societies, 2012); Martin Höpner and Armin Schäfer, *A New Phase of European Integration: Organized Capitalisms in Post-Ricardian Europe* (2007); Martin Höpner and Armin Schäfer, 'Embeddedness and Regional Integration. Waiting for Polanyi in a Hayekian Setting' (2012) 66 International Organization 429. In his recent opinion in *AGET Iraklis*, Advocate General Wahl stated – in the very first paragraph – that the 'European Union is based on a free market economy, which implies that undertakings must have the freedom to conduct their business as they see fit'. This rather sweeping statement seems to disregard the reference to 'social market economy' in Art. 3 TEU. See *Opinion of Advocate General Wahl in Case C-201/15 AGET Iraklis*, para 1.

7 Carsten Gerner-Beuerle, 'Shareholders Between the Market and the State. The VW Law and other Interventions in the Market Economy' (2012) 49 Common Market Law Review 97. See also Martha O'Brien, 'Case C-452/04, Fidium Finanz AG v. Bundesanstalt für Finanzdienstleistungsaufsicht, judgment of the Court of Justice (Grand Chamber) of 3 October 2006' (2007) 44 Common Market Law Review 1483, p. 260, who criticises the Court for being 'very strict in its refusal to allow Member States to exercise control over ownership of shares, voting rights and management decision-making in private companies through golden share mechanisms'.

2.1 Definition of golden shares

Golden shares are a variety of *priority shares* in which the beneficiary is a public authority. They are defined as the special rights that governments retain in privatised companies, especially the ones considered 'national champions' ('Crown Jewels'), in order to pursue certain public interests objectives or to determine the industrial policy of the national economy.[8] These special rights usually take the form of: (1) a cap on the level of foreign investment, (2) a cap or a prior authorisation procedure for foreign investment and voting rights above certain thresholds, (3) exclusive veto rights on strategic corporate management decisions (such as the winding-up, merger or de-merger of the undertaking, the disposal of certain assets, significant changes to the constitution or the articles of association of the company etc.) and (4) the power to appoint members of the company's Board of Directors. They are set up by governments regardless of their holdings (they might have minority stake or no participation at all in the company) in order to prevent takeovers primarily from foreign companies or to prevent the management of the company from taking actions that are not in line with the national government policy for the sector in which they operate.[9] These special rights are laid down either in *national legislation* (it can be either a *framework law* accompanied by *decree-laws* adopted for the purposes of large privatisation schemes or an *ad hoc company-specific legislation*) or in private instruments such as the *Articles of Association* of a company.[10]

2.2 Golden shares as Control Enhancing Mechanisms

According to corporate governance theory, golden shares belong to the broader category of *Control Enhancing Mechanisms*. These are institutional arrangements (i.e. created by the company itself) introducing a discrepancy in the relation between financial ownership (shareholding) and voting power (voting rights).[11] This means that through these institutional arrangements a shareholder can increase his control over the management of the company without holding a proportional stake of equity.[12] Control Enhancing Mechanisms include a wide variety of mechanisms such as shares with multiple voting rights, shares with loyalty schemes that may increase their voting rights, non-voting shares (with or without preference), participating bonds, voting rights

8 European Commission, *Special rights in privatized companies in the enlarged Union – a decade full of developments* (2005).
9 Ibid.
10 Ibid.
11 European Commission, *Impact Assessment on the Proportionality between Capital and Control in Listed Companies* (Commission Staff Working Document, 2007), p. 10.
12 Ibid, p. 10.

ceilings, priority shares, golden shares,[13] pyramid structures, depository certificates of shares sponsored by the company, supermajority requirements, ownership ceilings, share transfer restrictions, staggered/classified board of directors provisions etc.[14]

A study that was conducted by ISS Europe, Shearman and Sterling and the European Corporate Governance Institute in 2007 at the request of the European Commission (as part of its Action Plan for Modernising Company Law and enhancing Corporate Governance in the European Union[15]) showed that Control Enhancing Mechanisms are relatively common across the EU.[16] Of all the 464 European companies considered, 44% had one or more corporate Control Enhancing Mechanisms (or other alternative mechanisms).[17] The countries with the highest proportion of companies featuring at least one of these mechanisms were France, Sweden, Spain, Hungary and Belgium.[18]

2.3 The principle of proportionality between ownership and control

The reason why Control Enhancing Mechanisms have attracted institutional and scholarly attention is because they constitute an important deviation from *the principle of proportionality between ownership and control*. This principle (often referred to as *'one share-one vote' principle*) implies that any shareholder should own the same fraction of cash flow rights and voting rights.[19] In other words, according to the principle of proportionality between ownership and control, the number of votes should correspond to the number of shares that a shareholder holds in the company's share capital. This principle is said to promote

13 It should be noted that golden shares are regarded as CEMs only when they are created by the company itself (i.e. when they are enshrined in the company's Articles of Association or in a shareholders' agreement).

14 European Commission, *Impact Assessment on the Proportionality between Capital and Control in Listed Companies* (2007), p. 10.

15 European Commission, *Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward* (Communication from the Commission to the Council and the European Parliament, 2003).

16 European Commission, *Impact Assessment on the Proportionality between Capital and Control in Listed Companies* (2007), p. 4.

17 Ibid, p. 4.

18 Ibid, p. 4.

19 OECD, *Lack of Proportionality Between Ownership and Control: Overview and Issues for Discussion* (OECD Steering Group on Corporate Governance, 2007), p. 6. See also George Psarakis, 'One Share – One Vote and the Case for a Harmonised Capital Structure' (2008) 19 *European Business Law Review* 709; Guido Ferrarini, 'One Share – One Vote: A European Rule?' (2006) 3 *European Company and Financial Law Review* 147.

'shareholder democracy',[20] a somewhat delusive notion referring to the decision-making process in a corporation which is based on the amount of *each shareholder's capital contribution* (not the number of shareholders), as opposed to democracy as a political system, which is based on the premise of free elections in which *every citizen* has one vote, irrespective of his background, income or sex.[21]

The theoretical debate on *the principle of proportionality between ownership and control* centres on the potential problems arising from the separation of ownership and control and the need to prevent a potential abusive extraction of private benefits by executive directors and controlling shareholders (the so-called 'private benefits extraction' problem).[22] This relates to the general 'agency problem', the primary problem that corporate law is intended to address. The 'agency problem' arises whenever the welfare of one party ('the principal') depends upon actions taken by another party ('the agent').[23] The problem lies in motivating the agent to act in the principal's interest rather than simply in the agent's own interest.[24] According to corporate governance theory, three generic 'agency problems' may arise within a corporation: (1) the conflict between the firm's owners/shareholders (viewed as 'the principals')

20 On the intriguing question of 'shareholders' democracy' see the following very interesting contributions: John Edward Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (Oxford University Press 1995), p. 160-199; Steef Bartman, 'Shareholder Democracy à la Dworkin' (2010) 7 *European Company Law* 5; Nicola De Luca, 'Unequal Treatment and Shareholders' Welfare Growth: Fairness v. Precise Equality' (2009) 34 *Delaware Journal of Corporate Law* 853; Mieke Olaerts and C. A. Schwarz, *Shareholder democracy: an analysis of shareholder involvement in corporate policies* (Eleven international publishing 2012). Nicola de Luca argues that the majority principle on the basis of which decisions are taken within a corporation is an expression of inequality, as minority shareholders – because of their minority shareholding – are essentially excluded from the management of the corporation. However, he underlines that the majority rule is a fundamental device to solve the deadlock which absolutely equal parties would unavoidably face (see p. 895). In the seminal *Audiolux SA*, the Court of Justice ruled that there is no general principle of EU law of equality of shareholders, under which minority shareholders are protected by an obligation on the dominant shareholder, when acquiring or exercising control of a company, to offer to buy their shares under the same conditions as those agreed when a shareholding conferring or strengthening the control of the dominant shareholder was acquired. Such a principle proposed by Audiolux is characterised by a degree of detail requiring legislation to be drafted and enacted at EU level by a measure of secondary EU law, whereas general principles of EU law have constitutional status. See Case C-101/08 *Audiolux SA e.a v Groupe Bruxelles Lambert SA (GBL) and Others and Bertelsmann AG and Others*, ECLI:EU:C:2009:626, paras 63-64.

21 Steef Bartman, 'Shareholder Democracy à la Dworkin' (2010) 7 European Company Law 5, p. 5.

22 European Commission, *Impact Assessment on the Proportionality between Capital and Control in Listed Companies* (2007), p. 14.

23 Reinier Kraakman and others, *The Anatomy of Corporate Law – A Comparative and Functional Approach* (Oxford University Press 2009), p. 35.

24 Ibid, p. 35.

and the hired managers (viewed as 'the agents'); (2) the conflict between the controlling shareholders (viewed as 'the agents') and the non-controlling/minority shareholders (viewed as 'the principals'); and (3) the conflict between the firm itself (viewed as 'the agent') and other parties with whom the firm contracts, such as creditors, employees and consumers (viewed as 'the principals').[25] In the first conflict, the 'agency problem' lies in assuring that the managers are responsive to the shareholders' interests rather than pursuing their own personal interests.[26] In the second conflict, the 'agency problem' lies in assuring that the non-controlling/minority shareholders are not expropriated by the controlling shareholders.[27] Finally, in the third conflict, the 'agency problem' lies in assuring that the firm does not behave opportunistically towards these various other principals, such as by expropriating creditors, exploiting workers or misleading consumers.[28]

The 'agency problems', especially the conflict between shareholders and managers, were identified as early as in the 18th century by Adam Smith, who in his seminal work *The Wealth of Nations* wrote that

> 'the directors of such companies [joint stock companies] however being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. […] Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company'.[29]

The principle of proportionality between ownership and control relates primarily to the second conflict between controlling and non-controlling shareholders. In particular, shareholders who control a proportion of total voting rights much larger than their ownership (and dividend) rights have an incentive to extract value from the company at the expense of non-controlling shareholders.[30] It is argued that discrepancies between ownership and control can exacerbate the misalignment of the incentives of controlling and non-controlling shareholders and at the same time the separation of voting and cash-flow right may compromise the efficiency of markets for corporate control.[31] However, the empirical studies on this issue, included in the aforementioned Report by ISS

25 Ibid, p. 36.
26 Ibid, p. 36.
27 Ibid, p. 36.
28 Ibid, p. 36.
29 Adam Smith, *The Wealth of Nations* (W. Strahan and T. Cadell, London 1776). See also Christine Mallin, *Corporate Governance* (Oxford University Press 2004), p. 11.
30 European Commission, *Impact Assessment on the Proportionality between Capital and Control in Listed Companies* (2007), p. 14.
31 OECD, *Lack of Proportionality Between Ownership and Control: Overview and Issues for Discussion* (2007), p. 4.

Europe, Shearman and Sterling and the European Corporate Governance Institute, do not provide sufficient evidence on the existence and extent of private benefit extraction resulting from lack of proportionality. Nevertheless, the Report notes that investors perceive negatively all Control Enhancing Mechanisms, and especially priority shares, golden shares, multiple voting shares and voting right ceilings.[32]

The European Commission took into account this Report and subsequently adopted an Impact Assessment on the Proportionality between Capital and Control in Listed Companies, which, after stressing the lack of conclusive evidence regarding the negative effects of Control Enhancing Mechanisms, concluded that it is inadvisable even to recommend prohibiting the ones separating ownership from control, as this could have undesirable effects in terms of, inter alia, hindering long-term policy of companies, hindering companies' access to the capital markets or increasing the monitoring cost for shareholders.[33] Instead, the most suitable solution would be to increase *transparency* regarding them. The Commission could adopt a Recommendation, which would leave Member States the freedom to evaluate which of the transparency options suit best the respective specificities of each legal and industrial system.[34] In the absence of empirical evidence on the existence and extent of shareholder expropriation, adopting further measures could entail a risk of imposing significant costs to issuers and controlling shareholders without a proportional benefit.[35] Thus, after weighing the arguments advanced, Commissioner McCreevy decided that there was no need for action at the EU level on this issue. Therefore, DG Internal Market and Services terminated their work in this area. This should be regarded as an indication that the political institutions of the Union decided to maintain their neutrality with respect to the principle of proportionality between ownership and control and to respect the Member States' right to organise their corporate governance systems as they deem appropriate for their national economies.

Despite the explicit political decision not to adopt any legislative measures prohibiting Control Enhancing Mechanisms and imposing the principle of proportionality between ownership and control as the dominant corporate governance model in Europe, the Court of Justice, through its golden shares case law, seems to suggest a different pathway. As will be shown in the following sections, by ruling that golden shares are incompatible with the free movement of capital, the Court has implicitly endorsed the principle of

32 European Commission, *Impact Assessment on the Proportionality between Capital and Control in Listed Companies* (2007), p. 6 and 84.
33 Ibid, p. 5.
34 Ibid, p. 6.
35 Ibid, p. 6.

proportionality between ownership and control as the overarching principle governing the European corporate governance regime (if one can speak of a such a 'European' regime) and has potentially opened the door to all sorts of claims from *intra* and *extra*-EU investors challenging not only golden shares, but also any kind of Control Enhancing Mechanism that might exist in the corporate governance systems of the Member States. Through the vehicle of *negative integration*, the Court advances a rigid jurisprudential reasoning regarding special holdings in privatised undertakings, which gradually leads to a convergence of the various national models of capitalism into one specific model of market economy, that of a *liberal market economy*.

2.4 Varieties of capitalism: liberal market economies v coordinated market economies

The theory of *Varieties of Capitalism* is an influential political economy theory, developed by Peter Hall and David Soskice, representing a useful framework for understanding the institutional convergences and divergences among the developed economies.[36] It forms part of the political theory of *Comparative Capitalism*, which was developed in the 1990s and sought to identify the differences between distinct forms of developed economies (especially between the two paradigm variants of *liberal market economies* and *coordinated market economies*).[37] Its main contribution is that it offers a theoretical counter-argu-

36 Peter Hall and David Soskice, *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford University Press 2001). Following this seminal work, the literature on *Varieties of Capitalism* has been flourishing, especially in relation to European Integration. See in particular Jukka Snell, 'Varieties of Capitalism and the Limits of European Economic Integration' (2012) 13 *Cambridge Yearbook of European Legal Studies* 415; Peer Zumbansen and Daniel Saam, 'The ECJ, Volkswagen and European Corporate Law: Reshaping the European Varieties of Capitalism' (2007) 8 German Law Journal; Daniel Kinderman, *Challenging Varieties of Capitalism's Account of Business Interests – The New Social Market Initiative and German Employers' Quest for Liberalization, 2000-2014* (Max Planck Institute for the Studies of Societies, Cologne, MPIfG Discussion Paper 14/16, 2014); Matthew Allen, 'The Varieties of Capitalism Paradigm: Not Enough Variety?' (2004) 2 *Socio-economic Review* 87.

37 Chris Brewster, Marc Goergen and Geoffrey Wood, 'Corporate Governance Systems and Industrial Relations' in Adrian Wilkinson and Keith Townsend (eds), *The Future of Employment Relations: New Paradigms, New Developments* (Palgrave Macmillan 2011); Richard Deeg and Gregory Jackson, 'Comparing Capitalisms: The Implications of National Diversity for the Study of International Business' (2008) 39 *Journal of International Business Studies* 540; Ronald Dore, *British Factory, Japanese Factory: The Origins of National Diversity in Industrial Relations* (University of California Press 1973); Jeffrey Hart, *Rival Capitalists: International Competitiveness in the United States, Japan, and Western Europe* (Cornell University Press 1994); James R. Lincoln and Arne L. Kalleberg, *Culture, Control, and Commitment: A Study of Work Organization in the United States and Japan* (Cambridge University Press 1990); Michael E. Porter, *The Competitive Advantage of Nations* (Free Press, New York 1990).

ment to the *globalisation convergence* theory and the *neoliberal political paradigm*, according to which the forces of globalisation would inevitably lead to a convergence of the various economic models into the neoliberal model characterised by financial liberalisation, labour deregulation and privatisation of public assets.[38] Contrary to the predictions of the *globalisation convergence* theory, the *Varieties of Capitalism* theory is based on the hypothesis that the distinctive features shaping the various capitalist models will persist despite the converging forces of globalisation and that national governments and economic players will continue to support national institutional arrangements and economic structures.[39]

The *Varieties of Capitalism* doctrine draws from the theory of *Comparative Capitalism* and borrows the distinction between *liberal market economies* and *coordinated market economies*, as the two ideal models of advanced economies with distinct features and distinct comparative institutional advantages.[40] This distinction is based primarily on the different ways that *companies*, regarded as the most crucial actors in a capitalist economy, deal with the various coordination problems that they encounter in the organisation of their corporate life.[41]

On the one hand, *liberal market economies* (represented primarily by the UK and the US – the 'Anglo-Saxon model') have an institutional advantage in supporting *radical innovation*, which is primarily needed for fast-moving technology sectors based on pioneering scientific research, such as biotechnology, semiconductors, software development etc.[42] The reason is that the institutional arrangements of *liberal market economies* allow for (1) deregulated, flexible and highly mobile labour markets which enable companies to hire highly skilled

38 Christian Schweiger, *The EU and the Global Financial Crisis, New Varieties of Capitalism* (Edward Elgar Publishing 2014), p. 4; Hans-Werner Sinn, 'The Dilemma of Globalisation: A German Perspective' (2004) 4 *Economie Internationale* p. 111; Christel Lane, 'Institutional Transformation and System Change: Changes in Corporate Governance of German Corporations' in Glenn Morgan, Richard Whitley and Eli Moen (eds), *Changing Capitalisms? Internationalization, Institutional Change and Systems of Economic Organisation* (Oxford University Press 2006), pp. 78-109; Robert Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy* (Princeton University Press 1984); Samir Amin and David Luckin, 'The Challenge of Globalization' (1996) 3 *Review of International Political Economy* p. 216.

39 Peter Hall and David Soskice, *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford University Press 2001), p. 57; Peter Hall and Daniel Gingerich, 'Varieties of Capitalism and Institutional Complementarities in the Political Economy: An Empirical Analysis' in Bob Hancké (ed), *Debating Varieties of Capitalism: A Reader* (Oxford University Press 2009), p. 169; Christian Schweiger, *The EU and the Global Financial Crisis, New Varieties of Capitalism* (Edward Elgar Publishing 2014), p. 17-18.

40 Peter Hall and David Soskice, *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford University Press 2001), p. 8 and 36.

41 Ibid, p. 6.

42 Ibid, p. 39.

and specialised workers, knowing that they can fire them if the project proves unprofitable; (2) extensive equity markets with dispersed shareholders and a regulatory framework that is favourable to mergers and acquisitions; and (3) the presence of venture capital (i.e. a form of financing to start-up companies) that allows scientists and engineers to bring their own ideas to the market.[43]

On the other hand, *coordinated market economies* (represented primarily by Germany – the 'German/Continental European model') have an institutional advantage in supporting *incremental innovation*, which is needed in order to attract consumer loyalty and secure continuous improvements in the production process of goods such as machine tools, factory equipment, consumer durables, engines and transport equipment.[44] The reason is that the institutional arrangements of *coordinated market economies* allow for a labour law regime that provides workers with secure employment and a corporate law regime that gives them the possibility to participate in the management and the decision-making process of the company.[45] This combination incentivises workers to have a genuine interest in the long-term profitability of the company and to develop high levels of industry-specific technical skills.[46] At the same time, inter-firm coordination and corporate governance rules that insulate firms against hostile takeovers and reduce their exposure to volatile capital flows encourage long-term employment and strategies based on product differentiation rather than intense product competition, thus fostering *incremental* rather than *radical innovation*.[47] Finally, in *coordinated market economies* capital is provided by banks and long-term investors aiming at ensuring the long-term economic sustainability of the company and the existence of various associations allows the development of cooperation schemes among companies (not always consistent with the anti-trust regulations of *liberal market economies*).[48]

2.5 Corporate governance and EU law

Corporate governance is defined as a set of relationships between a company's management, its board, its shareholders and other stakeholders.[49] It provides the structure through which the objectives of the company and the means of

43 Ibid, p. 40.
44 Ibid, p. 39.
45 Ibid, p. 39.
46 Ibid, p. 39.
47 Ibid, p. 40.
48 Jukka Snell, 'Varieties of Capitalism and the Limits of European Economic Integration' (2012) 13 Cambridge Yearbook of European Legal Studies 415, p. 1.
49 OECD, *G20/OECD Principles of Corporate Governance* (OECD Publishing 2015).

attaining them are determined.[50] An effective corporate governance framework is essential for economic efficiency and long-term financial stability, as it promotes competition and economic sustainability of corporations, which are regarded as the backbone of the modern globalised market economy system.[51] This holds true particularly for the EU's Internal Market, which must accommodate divergent national corporate systems and institutional arrangements in order to create the optimal market conditions that will ensure the most effective and competitive operation of undertakings and will promote consumer welfare.

Despite the fact that the functioning of an appropriate and efficient corporate governance system is first and foremost the responsibility of the company concerned, the role of the applicable national legal framework is of paramount importance for the establishment of a sustainable corporate governance system which will ensure that certain rules and codes of behaviour are respected in the course of corporate operations.[52] So far, this legal framework remains to a great extent national. Despite some efforts to establish common international rules on the conduct of corporate entities,[53] corporate law and corporate governance is still regulated primarily at national level. This is the case also in the EU. To borrow the famous *dictum* of the Court of Justice, '*companies are creatures of national law*'.[54] There have been efforts to harmonise the field of company law and corporate governance, but they have proved to be a very difficult endeavour in light of the significant national discrepancies in the institutional structures of national corporate governance regimes and the political controversies arising from the different approaches in national industrial policies. The efforts to establish a common regulatory framework in the EU have thus focused on certain specific issues of company law for which a political compromise was deemed feasible and have avoided the most sensitive legal issues dealing with the core of the different national institutional arrangements in the field of corporate governance and industrial relations. As a result, the harmonisation process in the field of company law has resulted

50 Ibid.

51 European Commission, *Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies* (Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, 2012). See also Ronald J. Gilson, 'From Corporate Law to Corporate Governance' in Jeffrey N. Gordon and Wolf-Georg Ringe (eds), *The Oxford Handbook of Corporate Law and Governance* (Oxford University Press 2018), p. 4-27.

52 European Commission, *Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies* (2012).

53 See primarily the OECD Principles of Corporate Governance, which were adopted in 1999 and provide an indispensable and globally recognised benchmark for assessing and improving corporate governance.

54 Case 81/87 *The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc.,* ECLI:EU:C:1988:456, para 20.

in a rather fragmented legal terrain, which consists of several instruments of secondary law (directives and regulations)[55] covering areas such as the formation of limited liability companies,[56] capital and disclosure requirements,[57] accounting and financial reporting rules,[58] domestic mergers and divisions,[59] cross-border mergers and setting up branches in another EU country,[60] business registers,[61] as well as rules on the European Company (SocietasEuro-

55 For an overview, see European Commission, 'Company Law and Corporate Governance' <https://ec.europa.eu/info/business-economy-euro/doing-business-eu/company-law-and-corporate-governance_en> accessed 31-01-2019.

56 'Directive 2012/30/EU of the European Parliament and of the Council of 25 October 2012 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 54 of the Treaty on the Functioning of the European Union, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent' (2012) *OJ L 315, 14.11.2012, p. 74-97*.

57 'Directive 2009/101/EC of the European Parliament and of the Council of 16 September 2009 on coordination of safeguards which, for the protection of the interests of members and third parties, are required by Member States of companies within the meaning of the second paragraph of Article 48 of the Treaty, with a view to making such safeguards equivalent' (2009) *OJ L 258, 1.10.2009, p. 11-19*

58 'Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC' (2013) *OJ L 182, 29.6.2013, p. 19-76*; 'Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC' (2006) *OJ L 157, 9.6.2006, p. 87-107*.

59 'Directive 2011/35/EU of the European Parliament and of the Council of 5 April 2011 concerning mergers of public limited liability companies ' (2011) *OJ L 110, 29.4.2011, p. 1-11*; 'Sixth Council Directive 82/891/EEC of 17 December 1982 based on Article 54 (3) (g) of the Treaty, concerning the division of public limited liability companies' (1982) *OJ L 378, 31.12.1982, p. 47-54*.

60 'Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State' (1989) *OJ L 395, 30.12.1989, p. 36-39*; 'Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies' (2005) *OJ L 310, 25.11.2005, p. 1-9*.

61 'Directive 2012/17/EU of the European Parliament and of the Council of 13 June 2012 amending Council Directive 89/666/EEC and Directives 2005/56/EC and 2009/101/EC of the European Parliament and of the Council as regards the interconnection of central, commercial and companies registers' (2012) *OJ L 156, 16.6.2012, p. 1-9*.

pea),[62] the European Cooperative Society[63] and the European Economic Interests Groupings.[64]

In its 2012 Action Plan, the Commission acknowledged that the fragmented legal framework of European Company law makes it difficult for users to have a clear overview of the applicable law and carries the risk of unintended gaps and overlaps.[65] It therefore stressed the need for a codification of the rules applicable in this policy area. After conducting a public consultation, the Commission finally adopted a proposal to codify and merge a number of existing company law Directives,[66] which eventually led to the adoption of Directive 2017/1132 relating to certain aspects of company law.[67] This Directive constitutes an important, albeit partial, codification of six Company Law Directives, which are henceforth repealed.[68] Its objective is to make EU company law more reader-friendly and to reduce the risk of inconsistencies and

62 'Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE)' (2001) *OJ L 294, 10.11.2001, p. 1-21*.

63 'Council Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE)' (2003) *OJ L 207, 18.8.2003, p. 1-24*.

64 'Council Regulation (EEC) No 2137/85 of 25 July 1985 on the European Economic Interest Grouping (EEIG)' (1985) *OJ L 199, 31.7.1985, p. 1-9*.

65 European Commission, *Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies* (2012), p. 15.

66 European Commission, *Proposal for a Directive of the European Parliament and of the Council relating to certain aspects of company law (codification)* (COM(2015) 616 final, 2015/0283 (COD), 2015).

67 'Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law' (2017) *OJ L 169, 30.6.2017, p. 46-127*.

68 'Sixth Council Directive 82/891/EEC of 17 December 1982 based on Article 54 (3) (g) of the Treaty, concerning the division of public limited liability companies' (1982) *OJ L 378, 31.12.1982, p. 47-54*; 'Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State' (1989) *OJ L 395, 30.12.1989, p. 36-39*; 'Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies' (2005) *OJ L 310, 25.11.2005, p. 1-9*; 'Directive 2009/101/EC of the European Parliament and of the Council of 16 September 2009 on coordination of safeguards which, for the protection of the interests of members and third parties, are required by Member States of companies within the meaning of the second paragraph of Article 48 of the Treaty, with a view to making such safeguards equivalent' (2009) *OJ L 258, 1.10.2009, p. 11-19*; 'Directive 2011/35/EU of the European Parliament and of the Council of 5 April 2011 concerning mergers of public limited liability companies ' (2011) *OJ L 110, 29.4.2011, p. 1-11*; 'Directive 2012/30/EU of the European Parliament and of the Council of 25 October 2012 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 54 of the Treaty on the Functioning of the European Union, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent' (2012) *OJ L 315, 14.11.2012, p. 74-97*.

ambiguities, without however amending the substantive content of the provisions it codifies.[69]

2.6 The Takeover Directive and the golden shares case law

The most controversial directive that has been adopted in the field of EU company law is undoubtedly the 2004 Takeover Directive.[70] The primary objective of the Takeover Directive is to achieve harmonization of national rules on takeover bids in order to create a level playing field at the European level in the market for corporate control.[71] A 'takeover bid' under Article 2 of the Directive is a public offer made to the holders of securities of a company to acquire all or some of those securitites, whether mandatory or voluntary, which follows or has as its objective the acquisition of control of the offeree company in accordance with national law. Voluntary bids can be either *tender (friendly) offers* or *hostile takeovers*. A tender offer occurs when the incumbent majority shareholder or the management of the company agree on the takeover bid.[72] By contrast, a hostile takeover occurs when a bidder attempts to take over a target company whose management is unwilling to approve it.[73]

Due to the politically sensitive nature of hostile takeover regulation, the Directive largely reflects a political compromise[74] and gives Member States the possibility to 'opt-out' from its two most controversial rules, i.e. the *board neutrality rule* (Article 9 of the Directive) and the *break-through rule* (Article

69 European Commission, *Proposal for a Directive of the European Parliament and of the Council relating to certain aspects of company law (codification)* (2015), p. 3.

70 'Directive 2004/25/EC of the European Parliament and of the Council of 21 april 2004 on takeover bids' (2004) *OJ L 142, 30.4.2004, p. 12-23*.

71 Nicola De Luca, *European Company Law: Text, Cases and Materials* (Cambridge University Press 2017), p. 398.

72 Ibid, p. 402.

73 Ibid, p. 402.

74 There is a rich literature on the Directive, its controversial provisions and the politically turbulent process of adoption. See in particular Vanessa Edwards, 'The Directive on Takeover Bids – Not Worth the Paper It's Written On?' (2004) 1 *European Company and Financial Law Review* 416; Frank Wooldridge, 'The Recent Directive on Takeover Bids' (2004) 15 *European Business Law Review* 147; Heribert Hirte, 'The Takeover Directive – A Mini-Directive on the Structure of the Corporation: Is it a Trojan Horse?' (2005) 2 *European Company and Financial Law Review* 1; Steef Bartman, 'The EC Directive on Takeover Bids: Opting in as a Token of Good Corporate Governance' in Steef Bartman (ed), *European Company Law In Accelerated Progress* (Kluwer Law International 2006); Thomas Papadopoulos, *EU Law and Harmonization of Takeovers in the Internal Market* (Kluwer Law International 2010); Joseph A. McCahery and Erik P.M. Vermeulen, 'The Case Against Reform of the Takeover Bids Directive' (2011) 22 *European Business Law Review* 541; Jonathan Mukwiri, 'Reforming EU Takeover Law Remains on Hold' (2015) 12 *European Company Law* 186; Jeremy Grant, *European Takeovers: The Art of Acquisition* (Euromoney Institutional Investor 2018).

11 of the Directive), which are intended to neutralise *ex-post* and *ex-ante* defensive mechanisms which can be adopted by the target company in order to counteract hostile takeovers.[75]

In particular, the *board neutrality/passivity rule* requires the target company's board of directors to abstain from taking any *ex-post* defensive measures that could frustrate the bid.[76] In other words, it requires the board of directors[77] to 'stay passive' or 'be neutral' once a takeover bid has been launched, whilst it confers the general meeting of shareholders the authority to decide upon the adoption of frustrating actions.[78] *Ex-post* defensive devices to counteract a hostile takeover include shares' repurchases restricting the number of the free floating shares available, mergers increasing the value and number of shares granting control over the company or capital increases, the sale of company's best assets ('crown jewels') etc.[79]

The *break-through rule* entails the suspension of *ex-ante* defensive measures, i.e. clauses embedded in the company's instruments of incorporation or statutes deterring potential interested investors from making their bids.[80] The *break-through rule* neutralises shares conferring multiple voting rights, targeting primarily the Nordic multiple voting rights model.[81] It should be noted that there is an exception to the breakthrough rule in relation to golden shares which are compatible with the Treaty. More precisely, Article 11 (7) of Directive 2204/25 provides that the *break-trhough rule* does not apply either where

75 Alessandro Spano, 'Free Movement of Capital and Golden Shares: A New Perspective on Corporate Control? (Joined Cases C-463/04 and C-464/04 Federconsumatori and Others v Comune di Milano)' (2010) 13 *International Trade and Business Law Review* 291, p. 300.

76 For an extensive discussion about the significance or the triviality of the board neutrality rule see Carsten Gerner-Beuerle, David Kershaw and Matteo Solinas, 'Is the Board Neutrality Rule Trivial? Amnesia about Corporate Law in European Takeover Regulation' (2011) 22 *European Business Law Review* 559.

77 Interestingly, it has been suggested that the neutrality rule should bind not only the board of directors but also activist shareholders opposing the takeover bid, see Thomas Papadopoulos, 'Infringements of Fundamental Freedoms within the EU Market for Corporate Control' (2012) 9 *European Company and Financial Law Review* 221, p. 260.

78 Nicola De Luca, *European Company Law: Text, Cases and Materials* (Cambridge University Press 2017), p. 423.

79 Ibid, p. 423.

80 Ibid, p. 415.

81 Peter O. Mülbert, 'Make It or Break It: The Break-Through Rule as a Break-Through for the European Takeover Directive?' in Guido Ferrarini, Klaus J. Hopt, Jaap Winter and Eddy Wymeersch (eds), *Reforming Company and Takeover Law in Europe* (Oxford University Press 2004); Ulf Bernitz, 'The Attack on the Nordic Multiple Voting Rights Model: The Legal Limits under EU Law' (2004) 15 *European Business Law Review* 1423; Rolf Skog, 'The Takeover Directive, the "Breakthrough" Rule and the Swedish System of Dual CLass Common Stock' (2004) 15 *European Business Law Review* 1439; Paul Krüger Andersen, 'The Takeover Directive and Corporate Governance: The Danish Experience' (2004) 15 *European Business Law Review* 1461.

Member States hold securities in the offeree company which confer special rights on the Member States which are compatible with the Treaty, or to special rights provided for in national law which are compatible with the Treaty or to cooperatives. The first category of special rights refers to golden shares originated in the UK, where the *Articles of Association* of privatised companies used to provide for the issuance of special shareholding on behalf of the government.[82] Conversely, the second category of special rights refers to the privatisation schemes in countries like France and Italy, where it is usually the *national legislation* that attributes special rights to public authorities.[83]

It should be noted, however, that the official endorsement of the *board neutrality* and the *break-through rule* provoked fierce political reaction and, in the end, it was decided that these rules would be included in the Directive but only as optional arrangements, not as mandatory rules. Thus, under Article 12 (1) Directive 2004/25, Member States may 'opt-out' from both the *board neutrality* and the *break-through rule* if they consider that the market for corporate control must be restricted in order to achieve other objectives. However, if they 'opt-out', they should allow listed companies established within their territories to voluntarily 'opt-in' (Article 12 (2) Directive 2004/25).

The possibility to 'opt-out' from the *board neutrality* and the *break-through rule* admittedly leads to national discrepancies which might give rise to unequal treatment of some companies. In particular, this can occur when a listed company having its registered office in Member State A, where both the board neutrality and the breakthrough rules apply, is the target of a hostile takeover bid by a company having its registered office in Member State B, which has 'opted-out' from the board neutrality and the breakthrough rule.[84] In order to prevent this unequal treatment, Article 12 (3) Directive 2004/25 introduces the *principle of reciprocity*, which allows Member States to decide whether to apply less stringent measures than those arising from the two rules when the bidding company is not subject to the same restrictions.

It has been argued that through its capital case law, the Court of Justice is in effect trying to achieve what the EU legislator failed to achieve when adopting the Takeover Directive, i.e to abolish all restrictions in the market for corporate control. Some scholars claim that, in the absence of political consensus, the application of the golden shares standards to national company law will undoubtedly advance the harmonisation process in the field of take-

82 Guido Ferrarini, 'One Share – One Vote: A European Rule?' (2006) 3 European Company and Financial Law Review 147, p. 168.

83 Ibid, p. 169.

84 Nicola De Luca, *European Company Law: Text, Cases and Materials* (Cambridge University Press 2017), p. 430.

over bids.[85] It has actually been suggested that the possibility of a Member State to 'opt-out' from the *board neutrality* and the *break-through rule* should be subject to judicial review for conformity with the free movement of capital.[86] This is because, as it is argued, the Takeover Directive is only a minimum harmonisation directive and the stricter rules that can be adopted by the Member States must be compatible with the fundamental freedoms.[87] The case law indeed confirms that the stricter rules adopted within the framework of a minimum harmonisation directive are subject to judicial review in order to ensure their conformity with the fundamental freedoms.[88] However, this approach is legally questionable as it disregards the decision of the EU legislator to leave discretion to the Member States in relation to some politically sensitive issues.

In the field of corporate governance, if the rationale of the golden shares case law is applied by the Court to all company law arrangements – and especially to the ones relating to takeover regulation – it will inevitably lead to a liberalisation of the market for corporate control through negative integration, despite the explicit decision of the EU legislator to grant discretion to the Member States as to whether they wish to keep in place defensive mechanisms against hostile takeovers. This judicially driven liberalisation of the market for corporate control is open to criticism not only in relation to its political legitimacy but also in relation to its economic justification. It is in fact disputed whether the *principle of proportionality between ownership and control/'one share one vote principle'* (which constitutes the underlying rationale of the break-through rule) is justified by economic efficiency.[89]

In view of the far-reaching implications of the application of the free movement of capital to national takeover regulation for the corporate governance systems of the Member States, it is necessary to develop a concrete and coherent legal test for the determination of what constitutes a capital restriction. As explained in the following sections, company law arrangements and in particular defensive mechanisms against hostile takeovers (even the ones contained in private

85 Alberto Artés, 'Advancing Harmonization: Should the ECJ Apply Golden Shares' Standards to National Company Law?' (2009) 20 *European Business Law Review* 457, p. 481.

86 Mads Andenas, Tilmann Gütt and Matthias Pannier, ''Free Movement of Capital and National Company Law' (2005) 16 European Business Law Review 757, p. 785.

87 Ibid.

88 Case C-201/15 *AGET Iraklis*, where the Court held that Directive 98/59 cannot, in principle, be interpreted as precluding a national regime which confers upon a public authority the power to prevent collective redundancies by a reasoned decision adopted after the documents in the file have been examined and predetermined substantive criteria have been taken into account (para 34), but nevertheless examined the compatibility of the national legislation in questions with the freedom of establishment under Article 49 TFEU.

89 Guido Ferrarini, 'One Share – One Vote: A European Rule?' (2006) 3 European Company and Financial Law Review 147, p. 173-177.

acts) can in principle be subject to Internal Market scrutiny, but they should not be regarded as capital restrictions if they do not derogate from ordinary company law and they do not grant an undue advantage to the State as opposed to private investors. The analysis that follows focuses on the most controversial legal issues arising from the golden shares case law and explores the legal ramifications of a possible extrapolation of the golden shares rationale to all company law mechanisms.

2.7 Provisional conclusion

The reason why golden shares are so controversial is because they constitute Control Enchancing Mechanisms deviating from the *principle of proportionality between ownership and control* (*one share-one vote principle*) and granting the State special rights over the management of the company without holding a proportionate stake of equity. While this principle is an important element of some national corporate governance systems, not all Member States adhere to it. Furthermore, in view of the fact that there is no conclusive economic evidence suggesting that Control Enhancing Mechanisms have negative effects on the economic efficiency of undertakings, the Commission decided not to propose any legislative measures harmonising corporate governance and introducing the principle of proportionality between ownership and control in the EU. At the same time, the Takeover Directive gives Member States the possibility to opt-out from the *board neutrality rule* and the *break-through rule*, thus allowing undertakings in those Member States to adopt defensive measures that could frustrate a hostile takeover. This means that the EU legislator has not abolished so far all restrictions in the market for corporate control. However, as will be shown below, both the principle of proportionality between ownership and control and the liberalisation of the market for corporate control has indirectly been promoted though the golden shares case law.

3 Legal issues arising from the golden shares case law

This section seeks to analyse the legal reasoning adopted by the Court in the golden shares case law and to identify possible changes in the interpretation of Article 63 TFEU that could allow room for State participation in the market for the purposes of pursuing public interest objectives. In order to do so, it attempts to answer the following sub-questions:

- Is it possible and/or desirable to grant horizontal effect to Article 63 TFEU?
- Does the golden shares case law allow enough room for Member States to justify the restrictions imposed by the special holding they retain in privatised undertakings?

- What is the proportionality assessment adopted by the Court in the golden shares case law? Is it appropriate?
- Is there a need to delineate the scope of 'capital restrictions' in a more consistent way through the introduction of a *Keck*-inspired approach?

In a nutshell, this section focuses on three main legal issues: the horizontal effect of Article 63 TFEU; the justifications/proportionality regime in the golden shares case law; and finally, the delineation of the 'scope' of capital restrictions. In particular, it is argued that in light of the private nature of many company law instruments which could have an effect on capital movements, it is possible that Article 63 TFEU will be granted horizontal effect. However, a horizontal application of Article 63 TFEU would broaden significantly the reach of the free movement of capital and could threaten the principle of private autonomy. Nevertheless, the intrusive effect into private autonomy can be prevented through the introduction of a *Keck*-inspired test that could define in a more consistent way the scope of 'capital restrictions'. This is all the more necessary in light of the unsuccessful invocation of justification grounds by the Member States and the failure to comply with the requirements of the proportionality assessment as applied by the Court of Justice in the golden shares case law.

3.1 The horizontal application of Article 63 TFEU in the golden shares case law

While it is true that the focus of this thesis is on the pursuit of public interest objectives through State measures (golden shares granted to the State), the question of the horizontal applicability of Article 63 TFEU appears relevant in light of the private nature of some instruments granting golden shares to public authorities that have been scrutinised by the Court and its importance becomes even more evident when considering the width of private company law arrangements (Articles of Association, bylaws shareholders' agreements, codes of conduct etc.) that can be challenged through the use of the free movement of capital. So far, the Court has not given any precise answer. It has obliquely avoided the question whether the free movement of capital can be invoked in relations between private parties.

A possible recognition of the horizontal effect of Article 63 TFEU would allow individuals to challenge a wide spectrum of private instruments, thus expanding even more the already broad scope of measures affecting capital movements. For instance, the corporate governance model of the Scandinavian countries (Sweden, Finland and Denmark), which grants multiple voting rights through dual class share structures, might be challenged before the Court of

Justice as a restriction on capital movements.[90]This might have an intrusive effect into the sphere of private autonomy. However, as will be shown below, the intrusion into the sphre of private autonomy can be prevented either through a delineation of the scope of 'capital restrictions' or through a balancing exercise between economic freedoms and social values at the justifications/ proportionality level.

The present section focuses on the horizontal effect of Article 63 TFEU and aims to explore whether it is *feasible* and *desirable* in view of its broader implications for the principle of private autonomy and the choice of market economy model within the Member States. In order to achieve this, it proceeds in three main steps. The fist part explores the theoretical underpinnings of the concept of horizontality (or 'third-party effect') as a controversial topic in national constitutional law (Chapter 4, Section 3.1.1). This is necessary in order to understand the origins and the rationality of horizontality and to illustrate that the reasons justifying the horizontal application of fundamental rights in the context of constitutional and international law apply *mutatis mutandis* in the context of EU law. The second part briefly outlines the jurisprudential developments in EU law in relation to the horizontal direct effect of the free movement of goods, persons, services and certain provisions of the Charter of Fundamental Ruights and sketches the academic debate so far (Chapter 4, Section 3.1.2). Finally, the third part seeks to expound the possibility of a horizontal application of Article 63 TFEU under the existent golden shares case law and to propose a comprehensive solution that balances all conflicting interests and promotes the effective and uniform application of EU law (Chapter 4, Section 3.1.3).

3.1.1 The concept of 'horizontality' in constitutional law

The doctrine of horizontal direct effect of Treaty provisions in EU law originates from the controversial concept of 'horizontality' or 'third-party effect' (*Drittwirkung*) of the fundamental rights enshrined in national constitutions. In particular, in national constitutional law there is a long-standing debate regarding the scope of application of the fundamental rights protected under the constitution. Thus, over the years, two main approaches to human rights protection have been developped. On the one hand, the *vertical* theory holds that fundamental rights can be invoked by individuals only against the State.

90 Institutional Shareholder Services Inc., 'Analysis: Differentiated Voting Rights in Europe' <https://www.issgovernance.com/analysis-differentiated-voting-rights-in-europe/> accessed 31-01-2019; Niclas Hagelina, Martin Holménb and Bengt Pramborgc, 'Family ownership, dual-class shares, and risk management' (2006) 16 *Global Finance Journal* 283; Ben Amoako-Adu, Vishaal Baulkaran and Brian F. Smith, 'Executive compensation in firms with concentrated control: The impact of dual class structure and family management' (2011) 17 *Journal of Corporate Finance* 1580.

On the other hand, the *horizontal* theory expands the scope of application of fundamental rights so as to cover relations between private individuals as well.[91] It should be noted that the concept of horizontal effect can take three distinct manifestations: (1) '*direct* horizontal effect', i.e. imposition of direct fundamental rights obligations on private individuals and possibility of bringing direct claims against individuals for breaches of fundamental rights; (2) '*indirect* horizontal effect', i.e. judicial interpretation of the law applicable in a private dispute in the light of and in conformity with fundamental rights provisions; and (3) 'state-mediated effect'/'positive obligations', i.e. the obligation imposed on the State to take all necessary measures in order to ensure the effective protection of fundamental rights not only in the public sphere but also in the private sphere.[92]

The theoretical underpinnings of the two theories reflect different political philosophies and different views about the interconnection between the public and the private sphere. In particular, the vertical approach to human rights protection is inspired by the political and economic theory of *classical liberalism*[93] and is premised on a rigid distinction between public and private sphere.[94] Supporters of the vertical theory argue that most human rights instruments 'have been forged in the crucible of flagrant abuses of State power' and that, therefore, the purpose of human rights protection is 'to preserve the integrity of the private sphere against coercive intrusion by the State'.[95] It is not the purpose of human rights law to interfere with legal relations between

91 For an overview of the rich constitutional debate regarding the dichotomy between vertical and horizontal approach to human rights protection see: Murray Hunt, 'The "horizontal effect" of the Human Rights Act' (1998) *Public Law* 423; Deryck Beyleveld and Shaun D. Pattinson, 'Horizontal applicability and horizontal effect' (2002) 118 *Law Quarterly Review* 623; H.W.R. Wade, 'Horizons of horizontality' (2000) 116 *Law Quarterly Review* 217; Jonathan Morgan, 'Questioning the True Effect of the Human Rights Act' (2002) 22 *Legal Studies* 259; Gavin Phillipson and Alexander Williams, 'Horizontal Effect and the Constitutional Constraint' (2011) 74 *Modern Law Review* 878; Stephen Gardbaum, 'The "Horizontal Effect" of Constitutional Rights' (2003) 102 *Michigan Law Journal* 387.

92 Eleni Frantziou, 'The Horizontal Effect of the Charter of Fundamental Rights of the EU: Rediscovering the Reasons for Horizontality' (2015) 21 *European Law Journal* 657, p. 662.

93 David Dyzenhaus, 'The New Positivists' (1989) 39 *University of Toronto Law Journal* 361.

94 Murray Hunt, 'The "horizontal effect" of the Human Rights Act' (1998) Public Law 423, p. 424; Andrew Clapham, *Human Rights in the Private Sphere* (Clarendon Press, Oxford 1996); William P. Marshall, 'Diluting Constitutional Rights: Rethinking State Action' (1985) 80 *Northwestern University Law Review* 558; Cass R. Sustein, *The Partial Constitution* (Harvard University Press 1998); Erwin Chemerinsky, 'Rethinking State Action' (1985) 80 *Northwestern University Law Review* 503; Brian Slattery, 'Charter of Rights and Freedoms – Does it Bind Private Persons' (1985) 63 *Canadian Bar Review* 148; Andrew S. Butler, 'Constitutional Rights in Private Litigation: A Critique and Comparative Analysis' (1993) 22 *Anglo-American Law Review* 1; Stephen Gardbaum, 'The Place Of Constitutional Law in the Legal System' in Michel Rosenfeld and András Sajó (eds), *The Oxford Handbook of Comparative Constitutional Law* (Oxford University Press 2012).

95 Murray Hunt, 'The "horizontal effect" of the Human Rights Act' (1998) Public Law 423.

private individuals. Relations between private individuals must remain outside the reach of human rights protection. The sanctity and maximisation of this shielded private sphere should be the ultimate goal of the society.[96] Liberal autonomy presupposes that private actors are able to operate in a private domain, where their reasons for acting in a certain way or another are free from public scrutiny.[97]

On the other end of the spectrum, advocates of the horizontal approach to human rights protection reject the view that there is a pre-political/natural private sphere that precedes the State as a fallacy of classical liberalism.[98] They show greater commitment to *social democratic norms*, which regard the State as having not only *negative* obligations, which essentially require the State not to interfere with the exercise of individual rights, but also *positive* obligations, which in practice require national authorities to take all necessary measures to safeguard human rights ('bestowing of entitlements from the State').[99] The doctrine of *positive obligations* is linked to the political theory of 'active State', which is the theoretical foundation of both *direct* and *indirect* horizontal effect.[100] An active State is a State which ensures that fundamental rights are fully protected within its jurisdiction not only in State-citizen relations but also in relations between private individuals, either by making sure that the legislature enacts laws protecting human rights and abolishing discrimination or by allowing the judiciary to apply human rights horizontally (directly or indirectly).[101] Adherents of the horizontal approach express their fear that concentration of private power can be as dangerous as coercive State power. In fact, they argue that the power to deprive someone of the opportunity to earn a living sometimes poses as great a threat to liberty as does the exercise of State power to imprison someone.[102] Therefore, in their view, all types of law (both legislation and common law governing relations between

96 Ibid.

97 Mark Tushnet, 'The issue of state action/horizontal effect in comparative constitutional law' (2003) 1 *International Journal of Constitutional Law* 79, p. 89.

98 Murray Hunt, 'The "horizontal effect" of the Human Rights Act' (1998) Public Law 423.

99 Mark Tushnet, 'The issue of state action/horizontal effect in comparative constitutional law' (2003) 1 International Journal of Constitutional Law 79, p. 90. For the distinction between negative and positive obligations in Human Rights Law see Dinah Shelton and Ariel Gould, 'Positive and Negative Obligations' in Dinah Shelton (ed), *The Oxford Handbook of International Human Rights Law* (Oxford University Press 2013); Jean-Franc¸ois Akandji-Kombe, *Positive obligations under the European Convention on Human Rights – A guide to the implementation of the European Convention on Human Rights* (Human rights handbooks, No 7, Council of Europe, 2007); Hugh Breakey, 'Positive Duties and Human Rights: Challenges, Opportunities and Conceptual Necessities' (2015) 63 *Political Studies* 1198.

100 Mark Tushnet, 'The issue of state action/horizontal effect in comparative constitutional law' (2003) 1 International Journal of Constitutional Law 79, p. 90.

101 Ibid.

102 Ibid, p. 91.

private parties) should be subject to judicial review in order to ensure their compatibility with human rights.[103] This, they claim, does not spell the end of private autonomy, as the arrangements chosen by private parties might still pass the justification and proportionality test.[104]

Ultimately, the issue of horizontality boils down to a more fundamental question: what is the function of a constitution? Some might reasonably argue that it is merely a law for lawmakers, a Hobbesian social contract between rulers and ruled, whereas some others might convincingly assert that it should be regarded as a normative charter governing the relations between individuals in a society, as a Lockean social contract among equal citizens.[105] Adherents of the vertical approach proclaim values such as private autonomy, privacy and market efficiency.[106] They espouse the view that the most crucial function of a constitution is to provide the law for the lawmaker, not for the citizen.[107] Conversely, supporters of the horizontal approach regard the constitution as expressing a society's most fundamental values and therefore as applicable to all its members.[108] These fundamental values are threatened at least as much by powerful private actors as by governmental institutions, especially in light of the widespread recent privatisation of many governmental activities.[109] At the same time, they question the validity of the argument based on private autonomy, arguing that private actors are in any case regulated by other types of legislation, and therefore it is unclear why private autonomy is 'especially or distinctively threatened by constitutional regulation'.[110]

Although the vertical and the horizontal theory represent two polarized extremes, they mark the outer edges of a wide spectrum of possible scenarios where the application of human rights instruments might be triggered either by the State acting in its private capacity (for instance, as a landlord or an employer) or by private parties exercising collective regulatory powers or being in a dominant position of power (for instance, a sport association, a trade union or a corporation imposing certain terms on consumers or employees). Although not purely vertical, these scenarios contain a *quasi-public* element, which renders them without much hesitation susceptible to judicial review in order to ensure compliance with human rights. The judiciary in charge of adjudicating such

103 Murray Hunt, 'The "horizontal effect" of the Human Rights Act' (1998) Public Law 423.
104 Ibid.
105 Stephen Gardbaum, 'The Place Of Constitutional Law in the Legal System' in Rosenfeld and Sajó (eds), *The Oxford Handbook of Comparative Constitutional Law* (Oxford University Press 2012), p. 178.
106 Ibid, p. 177.
107 Ibid, p. 177.
108 Ibid, p. 177.
109 Ibid, p. 177.
110 Ibid, p. 177.

a dispute might employ various legal remedies in order to give effect to the rights of individuals, without necessarily recognising the direct horizontal effect of human rights provisions.

This intermediate third position in between the two polarised extremes of vertical and direct horizontal effect is known as the concept of *indirect* horizontal effect. This concept originates from national constitutional judgments establishing the duty of the judiciary to uphold and protect fundamental rights and freedoms also in disputes between individuals. The two most prominent examples are the landmark *Lüth* ruling[111] of the German Federal Constitutional Court which established the German doctrine of '*mittelbare Drittwirkung*' (*in casu* in relation to the freedom of expression),[112] and the *Shelley v Kraemer* ruling[113] of the US Supreme Court, which expanded the scope of the 'state action' doctrine[114] so as to cover not only governmental conduct but also court orders and granted *indirect* horizontal effect to the 'equal protection clause' of the Fourteenth Amendment.[115]

3.1.2 Horizontal effect in EU law

The question of horizontality in EU law has been adressed in several landmark judgments of the Court of Justice and has sparked an animated debate among

111 *Lüth,* BVerfGE 7, 198 (1958) (Bundesverfassungsgericht).

112 Greg Taylor, 'The Horizontal Effect of Human Rights Provisions, the German Model and Its Applicability to Common-Law Jurisdictions' (2002) 13 *King's College Law Journal* 187; Basil S. Markesinis, 'Privacy, freedom of expression, and the horizontal effect of the Human Rights Bill: lessons from Germany' (1999) 115 *Law Quarterly Review* 47; Ulrich Preuß, 'The German Drittwirkung Doctrine and Its Socio-Political Background' in András Sajó and Renáta Uitz (eds), *The Constitution in Private Relations: Expanding Constitutionalism* (Eleven International Publishing 2005); Georg Sommeregger, 'The Horizontalization of Equality: The German Attempt to Promote Non-Discrimination in the Private Sphere via Legislation' in András Sajó and Renáta Uitz (eds), *The Constitution in Private Relations: Expanding Constitutionalism* (Eleven International Publishing 2005).

113 *Shelley v. Kraemer,* 334 US 1 (1948) (United States Supreme Court).

114 For the academic debate in the US regarding the state action issue see: Stephen Gardbaum, 'Where the (state) action is' (2006) 4 *International Journal of Constitutional Law* 760; András Sajó and Renáta Uitz (eds), *The Constitution in Private Relations: Expanding Constitutionalism* (Eleven International Publishing 2005); Harold W. Horowitz, 'The Misleading Search for State Action under the Fourteenth Amendment' (1957) 30 *Southern California Law Review* 208; Larry Alexander, 'The Public/Private Distinction and Constitutional Limits on Private Power' (1993) 10 *Constitutional Commentary* 361; Richard S. Kay, 'The State Action Doctrine, the Public-Private Distinction, and the Independence of Constitutional Law' (1993) 10 *Constitutional Commentary* 329; Erwin Chemerinsky, 'Rethinking State Action' (1985) 80 Northwestern University Law Review 503.

115 Mark Tushnet, 'The issue of state action/horizontal effect in comparative constitutional law' (2003) 1 International Journal of Constitutional Law 79, p. 81.

scholars. In view of the rich literature on the topic,[116] this section restricts itself to a brief overview of the case law and the most prominent scholarly opinions expressed thereon in order to summarize the main controversies surrounding the horizontal application of the fundamental freedoms in the private sphere. This jurisprudential and scholarly background is in turn hoped to shed light on the salient question whether and to what extent the judicial reasoning regarding the horizontal effect of the other freedoms can be extrapolated to the free movement of capital.

116 Stefaan Van den Bogaert, 'Horizontality: The Court Attacks?' in Catherine Barnard and Joanne Scott (eds), *The Law of the Single European Market – Unpacking the Premises* (Hart Publishing 2002); Christoph Krenn, 'A missing piece in the horizontal effect "jigsaw": Horizontal direct effect and the free movement of goods' (2012) 49 *Common Market Law Review* 177; Harm Schepel, 'Constitutionalising the Market, Marketising the Constitution, and to Tell the Difference: On the Horizontal Application of the Free Movement Provisions in EU Law' (2012) 18 *European Law Journal* 177; Miguel Poiares Maduro, 'The Chameleon State – EU Law and the blurring of the private/public distinction in the market' in Rainer Nickel (ed), *Conflict of Laws and Laws of Conflict in Europe and Beyond – Patterns of Supranational and Transnational Juridification* (Intersentia 2010); Kara Preedy, 'Fundamental Rights and Private Acts – Horizontal Direct or Indirect Effect? – A Comment' (2000) 8 *European Review of Private Law* 125; Erica Howard, 'ECJ Advances Equality in Europe by Giving Horizontal Direct Effect to Directives' (2011) 17 *European Public Law* 729; Pedro Cabral and Ricardo Neves, 'General Principles of EU Law and Horizontal Direct Effect' (2011) 17 *European Public Law* 437; Paul Verbruggen, 'The Impact of Primary EU Law on Private Law Relationships: Horizontal Direct Effect under the Free Movement of Goods and Services' (2014) 22 *European Review of Private Law* 201; Eva Julia Lohse, 'Fundamental Freedoms and Private Actors – towards an 'Indirect Horizontal Effect' (2007) 13 *European Public Law* 159; Justin Nogarede, 'Levelling the (Football) Field: Should Individuals Play by Free Movement Rules?' (2012) 39 *Legal Issues of Economic Integration* 381; Vassilios Skouris, 'Effet Utile Versus Legal Certainty: The Case-law of the Court of Justice on the Direct Effect of Directives' (2006) 17 *European Business Law Review* 241; Michael Dougan, 'When worlds collide! Competing visions of the relationship between direct effect and supremacy' (2007) 44 *Common Market Law Review* 931; Filippo Fontanelli, 'General Principles of the EU and a Glimpse of Solidarity in the Aftermath of Mangold and Kücükdeveci' (2011) 17 *European Public Law* 225; Harm Schepel, 'The Enforcement of EC Law in Contractual Relations: Case Studies in How Not to 'Constitutionalize' Private Law' (2004) 12 *European Review of Private Law* 661; Rufat Babayev, 'Contractual Discretion and the Limits of Free Movement Law' (2015) 23 *European Review of Private Law* 875; Alan Dashwood, 'Viking and Laval: Issues of Horizontal Direct Effect' (2007) 10 *Cambridge Yearbook of European Legal Studies* 525; Peter Oliver and Wulf-Henning Roth, 'The internal market and the four freedoms' (2004) 41 Common Market Law Review 407; Lawrence W. Gormley, 'Private Parties and the Free Movement of Goods: Responsible, Irresponsible, or a Lack of Principles?' (2015) 38 *Fordham International Law Journal* 993; Sacha Prechal and Sybe De Vries, 'Seamless web of judicial protection in t he internal market?' (2009) 34 *European Law Review* 5;Sacha Prechal, 'Direct Effect Reconsidered, Redefined and Rejected' in Jolande M Prinssen and Annette Schrauwen (eds), *Direct Effect-Rethinking: A Classic of EC Legal Doctrine* (Europa Law Publishing 2002); Arthur Hartkamp, 'The Effect of the EC Treaty in Private Law: On Direct and Indirect Horizontal Effects of Primary Community Law' (2010) 3 *European Review of Private Law* 529; Stefan Enchelmaier, 'Horizontality: the application of the four freedoms to restrictions imposed by private parties' in Panos Koutrakos and Jukka Snell (eds), *Research Handbook on the Law of the EU's Internal Market* (Edward Elgal Publishing 2017).

3.1.2.1 Defrenne: horizontality of equal pay

Most legal analyses of the question of horizontality in EU law starts with *Defrenne*,[117] a landmark judgment concerning the horizontal direct effect of Article 119 EEC Treaty (today Article 157 TFEU) on equal pay between men and women. While *Defrenne* focused on Article 157 TFEU, it nevertheless set the tone for the case law that followed regarding the horizontal application of the fundamental freedoms. The question was whether the principle that men and women should receive equal pay for equal work could be relied on by an air hostesse against her employer, a private airline company, before the Cour du travail of Brussels. The Court answered in the affirmative. Rejecting the argument based on a strict textual approach that Article 157 TFEU refers expressly only to 'Member States'. It clarified that the fact that certain Treaty provisions are formally addressed to the Member States does not prevent rights from being conferred at the same time on any individual who has an interest in the performance of the duties thus laid down.[118] Following a reasoning similar to the one adopted by the US supreme Court in *Shelley v Kraemer* (see above Chapter 4, Section 3.1.1.1), the Court in Luxembourg accepted that the reference to 'Member States' in Article 157 TFEU includes also the national courts, which have a duty to interpret national legislation, collective agreements but also private contracts in light of the fundamental principle of equal pay between men and women.[119] This cannot be regarded as an undue interference with the principle of private autonomy, since Article 157 TFEU is mandatory in nature and applies not only to the action of public authorities, but also extends to collective labour agreements and individual labour contracts.[120]

3.1.2.2 Walrave & Koch and Bosman: horizontal application of the free movement of workers to federation exercising regulatory powers

In the field of the fundamental freedoms, the first case raising the question of the horizontal effect of the free movement of workers was *Walrave and Koch*.[121] The case concerned the compatibility of a rule of the International Cycling Union relating medium-distance world cycling championships behind motorcycles, according to which the pacemaker had to be of the same nationality as the strayer, with Articles 7, 48 and 59 EEC Treaty (today Articles 18, 45

117 Case 43-75 *Gabrielle Defrenne v Société anonyme belge de navigation aérienne Sabena*, ECLI:EU:C:1976:56.
118 Ibid, para 31.
119 Ibid, para 37.
120 Ibid, paras 38-39.
121 Case 36-74 *B.N.O. Walrave and L.J.N. Koch v Association Union cycliste internationale*, ECLI:EU:C:1974:140.

and 56 TFEU). The Court, emphasizing the *regulatory powers* of the *association* in question, found that the prohibition of discrimination on the basis of nationality enshrined in the abovementioned provisions does not apply only to the action of public authorities but extends likewise to rules of any other nature regulating in a *collective manner* gainful employment and the provision of services.[122] This extension was justified by the *effet utile* argument,[123] according to which the abolition of obstacles to freedom of movement between Member States would be compromised if the abolition of barriers of national origin could be neutralised by obstacles resulting from the exercise of their legal autonomy by associations or organisation which do not come under public law.[124] Furthermore, the Court put forward the *uniform application* argument[125] according to which working conditions are regulated not only by means of legislation, but also by means of collective agreements or individual contracts and therefore limiting the prohibition of discrimination to acts of public authorities would risk creating inequality in their application.[126] Finally, the Court underlined the *general wording*[127] of the provisions in question, which made no distinction between the source of the restrictions to be abolished and were therefore deemed to be applicable to the dispute rule of the International Cycling Union.[128]

Two decades later, in the seminal *Bosman* judgment,[129] the Court reiterated that Article 45 TFEU applies horizontally to rules of *sporting associations regulating in a collective manner* the working conditions of athletes.[130] More importantly, it added that the horizontal effect of Article 45 TFEU does not concern only measures discriminating on the basis of nationality, but extends likewise to *non-discriminatory restrictions* on the free movement of workers. In other words, it expanded the 'material scope' of the horizontal effect of Article 45 TFEU. The case concerned the compatibility with EU law (in particular Article 45, 101 and 102 TFEU) of the FIFA and UEFA 'football transfer rules', according to which a professional football player was not free to move to a new club

122 Ibid, para 17.
123 Stefaan Van den Bogaert, 'Horizontality: The Court Attacks?' in Barnard and Scott (eds), *The Law of the Single European Market – Unpacking the Premises* (Hart Publishing 2002), p. 125.
124 Case 36-74 *Walrave and Koch*, para 18.
125 Stefaan Van den Bogaert, 'Horizontality: The Court Attacks?' in Barnard and Scott (eds), *The Law of the Single European Market – Unpacking the Premises* (Hart Publishing 2002), p. 125.
126 Case 36-74 *Walrave and Koch*, para 19.
127 Stefaan Van den Bogaert, 'Horizontality: The Court Attacks?' in Barnard and Scott (eds), *The Law of the Single European Market – Unpacking the Premises* (Hart Publishing 2002), p. 125.
128 Case 36-74 *Walrave and Koch,* para 20-21.
129 Case C-415/93 *Union royale belge des sociétés de football association ASBL v Jean-Marc Bosman,* ECLI:EU:C:1995:463.
130 See Stefaan Van den Bogaert, 'Bosman: The Genesis of European Sports Law' in Miguel Poiares Maduro and Loïc Azoulai (eds), *The Past and Future of EU Law: The Classics of EU Law Revisited on the 50th Anniversary of the Rome Treaty* (Hart Publishing 2010), p. 493.

without the payment of a transfer fee, even if his contract with his previous club had expired. The Court repeated the *effet utile* and the *uniform application argument* it had previously advanced in *Walrave and Koch*.[131] Furthermore, it rejected the *justification argument* according to which only Member State are able to rely on limitations justified on grounds of public policy, public security or public health, holding that there is nothing to preclude individuals from relying on those justification grounds.[132] In this way, it firmly established that Article 45 TFEU was applicable to the FIFA and UEFA football transfer rules, which constituted a disproportionate restriction on the free movement of workers.[133]

3.1.2.3 Angonese: horizontal application of the free movement of workers to discriminatory private conduct

Then came the *Angonese* judgment,[134] which expanded the 'personal scope' of the horizontal effect of Article 45 TFEU so as to cover not only associations with regulatory powers but also private individuals, but only in relation to measures discriminating on the basis of nationality (not restrictions). In particular, the case concerned Mr Angonese, a bilingual (Italian-German) Italian national, who was denied admission to a competition for a post with a private bank in Bolzano because of the fact that he did not possess a certificate of bilingualism which was issued only by the local authorities in Bolzano. The Court reiterated the *effet utile*, *uniform application* and *general wording* arguments it had previously presented in *Walrave and Koch*.[135] Furthermore, it repeated the *Defrenne* argument that provisions which are *mandatory in nature*, such as Article 45 TFEU, which lays down a fundamental freedom and which constitutes a specific expression of the general prohibition of discrimination under Article 18 TFEU, apply not only in the public but also in the private sphere.[136] On the basis of this reasoning, it ruled that the prohibition of discrimination on grounds of nationality laid down in Article 45 TFEU is applicable not only to public authorities but also to private persons, and actually to *all* private persons, not only the ones holding collective regulatory powers.

It has been argued that *Angonese* as well as *Defrenne* are characterised by a 'fundamental rights twist', in the sense that they both concern cases of the

131 Case C-415/93 *Bosman,* paras 82-84.
132 Ibid, paras 85-86.
133 Ibid, para 114.
134 Case C-281/98 *Roman Angonese v Cassa di Risparmio di Bolzano SpA,* ECLI:EU:C:2000:296.
135 Ibid, paras 31-33.
136 Ibid, paras 30-36.

fundamental principle of non-discrimination in the employment sector.[137] This 'fundamental rights twist' is perhaps the reason why the Court was willing to accord an 'extended' horizontal effect to the non-discrimination principle so as to cover *all* private individuals, regardless of whether they exercise regulatory powers or not.[138] However, so far, this 'extended' horizontal effect concerns only discriminatory measures cases, not restrictions on the fundamental freedoms.

3.1.2.4 Viking and Laval: horizontal application of the freedom of establishment and the free movement of services to trade unions

In *Viking*[139] and *Laval*,[140] two landmark judgments in the field of social rights which sparked a contentious debate among scholars, [141] the Court

137 Sacha Prechal and Sybe De Vries, 'Seamless web of judicial protection in t he internal market?' (2009) 34 European Law Review 5, p. 17; Eleni Frantziou, 'The Horizontal Effect of the Charter of Fundamental Rights of the EU: Rediscovering the Reasons for Horizontality' (2015) 21 European Law Journal 657, p. 665.

138 Sacha Prechal and Sybe De Vries, 'Seamless web of judicial protection in t he internal market?' (2009) 34 European Law Review 5, p. 17.

139 Case C-438/05 *Viking.*

140 Case C-341/05 *Laval.*

141 The academic literature on the far-reaching implications of Viking and Laval both in terms of the interplay between economic freedoms and social rights and in terms of the horizontal applicability of the freedoms is remarkably rich. See in particular: Mark Freedland and Jeremias Prassl (eds), *Viking, Laval and Beyond* (Hart Publishing 2014); Andreas Bücker and Wiebke Warneck (eds), *Reconciling Fundamental Social Rights and Economic Freedoms After Viking, Laval and Ruffert* (Nomos 2011); Niamh Nic Shuibhne, 'Settling Dust? Reflections on the Judgments in Viking and Laval' (2010) 21 *European Business Law Review* 681; Taco van Peijpe, 'Collective Labour Law after Viking, Laval, Rüffert, and Commission v. Luxembourg' (2009) 25 *International Journal of Comparative Labour Law and Industrial Relations* 81; Claire Kilpatrick, 'Has Polycentric Strike Law Arrived in the UK? After Laval, After Viking, After Demir?' (2014) 30 *International Journal of Comparative Labour Law and Industrial Relations* 293; Loïc Azoulai, 'The Court of Justice and the social market economy: The emergence of an ideal and the conditions for its realization' (2008) 45 Common Market Law Review 1335; Jonas Malmberg and Tore Sigeman, 'Industrial actions and EU economic freedoms: The autonomous collective bargaining model curtailed by the European Court of Justice' (2008) 45 *Common Market Law Review* 1115; Ulf Bernitz and Norbert Reich, 'Case No. A 268/04, The Labour Court, Sweden (Arbetsdomstolen) Judgment No. 89/09 of 2 December 2009, Laval un Partneri Ltd. v. Svenska Bygggnadsarbetareförbundet et al.' (2011) 48 *Common Market Law Review* 603; Stephanie Reynolds, 'Explaining the constitutional drivers behind a perceived judicial preference for free movement over fundamental rights' (2016) 53 *Common Market Law Review* 643; Tonia Novitz, 'The Internationally Recognized Right to Strike: A Past, Present and Future Basis upon Which to Evaluate Remedies for Unlawful Collective Action?' (2014) 30 *International Journal of Comparative Labour Law and Industrial Relations* 357; Gareth Davies, 'Freedom of Movement, Horizontal Effect, and Freedom of Contract' (2010) 20 *European Review of Private Law* 805; Kristina Lovén Seldén, 'Laval and Trade Union Cooperation: Views on the Mobilizing Potential of the Case' (2014) 30 *International Journal of Comparative Labour Law and Industrial Relations* 87; Claire Kilpatrick, 'Laval's regulatory conundrum: collective standard-setting and the Court's new approach to posted

recognised the horizontal effect of the freedom of establishment under Article 49 TFEU and the freedom to provide services under Article 56 TFEU in relation to trade unions exercising their right to take collective action. The Court in effect agreed with Advocates General Maduro and Mengozzi that under certain conditions private action may very well obstruct the proper functioning of the Internal Market.[142] Reasoning along the lines of the case law on the horizontal application of the free movement of workers, in *Viking* the Court referred to its well-established case law in the field of non-discrimination and free movement of workers[143] and emphasized that Article 49 TFEU may be relied on by a private undertaking against a trade union or an association of trade unions participating in the drawing up of agreements seeking to regulate paid work collectively.[144] Furthermore, it clarified that it does not follow from the case law that the horizontal application concerns only quasi-public organisations or associations exercising a regulatory task and having quasi-

workers' (2009) 34 *European Law Review* 844; Phil Syrpis and Tonia Novitz, 'Economic and social rights in conflict: political and judicial approaches to their reconciliation' (2008) 33 *European Law Review* 411; Brian Bercusson, 'The Trade Union Movement and the European Union: Judgment Day' (2007) 13 *European Law Journal* 279; Damjan Kukovec, 'Law and the Periphery' (2015) 21 *European Law Journal* 406; Christian Joerges and Florian Rödl, 'Informal Politics, Formalised Law and the 'Social Deficit' of European Integration: Reflections after the Judgments of the ECJ in Viking and Laval' (2009) 15 *European Law Journal* 1; Diamond Ashiagbor, 'Unravelling the Embedded Liberal Bargain: Labour and Social Welfare Law in the Context of EU Market Integration' (2013) 19 *European Law Journal* 303; Catherine Barnard, 'Viking and Laval: An Introduction' (2007-2008) 10 *Cambridge Yearbook of European Legal Studies* 463; Mia Rönnmar, 'Free Movement of Services versus National Labour Law and Industrial Relations Systems: Understanding the Laval Case from a Swedish and Nordic Perspective' (2007-2008) 10 *Cambridge Yearbook of European Legal Studies* 493; Alan Dashwood, 'Viking and Laval: Issues of Horizontal Direct Effect' (2007-2008) 10 *Cambridge Yearbook of European Legal Studies* 525; Tonia Novitz, 'A Human Rights Analysis of the Viking and Laval Judgments' (2007-2008) 10 *Cambridge Yearbook of European Legal Studies* 541; Silvana Sciarra, 'Viking and Laval: Collective Labour Rights and Market Freedoms in the Enlarged EU' (2007-2008) 10 *Cambridge Yearbook of European Legal Studies* 563; Simon Deakin, 'Regulatory Competition after Laval' (2007-2008) 10 *Cambridge Yearbook of European Legal Studies* 581; Anne Davies, 'One Step Forward, Two Steps Back? The Viking and Laval Cases in the ECJ' (2008) 37 *Industrial Law Journal* 126; Alicia Hinarejos, 'Laval and Viking: The Right to Collective Action versus EU Fundamental Freedoms' (2008) 8 *Human Rights Law Review* 714; Catherine Barnard, 'Social dumping or dumping socialism?' (2008) 67 *The Cambridge Law Journal* 262; Phil Syrpis and Tonia Novitz, 'Economic and social rights in conflict: Political and judicial approaches to their reconciliation' (2008) 33 *European Law Review* 411.

142 *Opinion of Advocate General Poiares Maduro in Case C-438/05 The International Transport Workers' Federation and The Finnish Seamen's Union v Viking Line ABP and OÜ Viking Line Eesti,* ECLI:EU:C:2007:292, paras 35-38; *Opinion of Advocate General Mengozzi in Case C-341/05 Laval un Partneri Ltd v Svenska Byggnadsarbetareförbundet and Others,* ECLI:EU:C:2007:291, paras 156-161.

143 Case 43-75 *Defrenne,* paras 31 and 39; Case 36-74 *Walrave and Koch*, para 18; Case C-415/93 *Bosman*, para 83; Joined cases C-51/96 and C-191/97 *Christelle Deliège v Ligue francophone de judo et disciplines associées ASBL,* ECLI:EU:C:2000:199, para 47; Case C-281/98 *Angonese*, para 32; Case C-309/99 *Wouters and others*, para 120.

144 Case C-438/05 *Viking,* paras 60-61, 66.

legislative powers.[145] To the contrary, the Court emphasized that the prohibition on prejudicing a fundamental freedom applies to *all agreements intended to regulate paid labour collectively*.[146] In exercising their autonomous power to negotiate with employers the conditions of employment and pay of workers, the trade unions participated in the conclusion of agreements seeking to regulate paid work collectively.[147] The power of the trade unions to collectively regulate employment was deemed as a sufficient condition to bring their actions within the scope of the freedom of establishment and services.

In the same vein, in *Laval* the Court underlined that compliance with Article 56 TFEU is also required in the case of rules which are not public in nature but which are designed to *regulate collectively* the provision of services[148] and concluded that Article 56 TFEU could be relied on by a company against a trade union striking in order to protect the workers against possible social dumping.[149] Thus, Articles 49 and 56 TFEU can be invoked not only against the State (as broadly construed in *Marshall*[150] and *Foster*[151]), but also against private entities exercising *regulatory powers*.[152] Whether the application of the freedom of establishment and services to private bodies exercising collective regulatory powers amounts to a recognition of a horizontal applicability of the freedoms to purely private scenarios is a question that remains to be answered.

3.1.2.5 Dansk Supermarked, Van de Haar and Fra.bo: horizontal effect of the free movement of goods

In the field of free movement of goods, the situation is rather different. The judgment in *Dansk Supermarked*[153] is often cited as a one-off case where the Court implicitly recognised the *indirect* horizontal effect of Article 34 TFEU.[154] In particular, Imerco ordered a British manufacturer to manufucture certain dinning china with the intention to sell them exclusively to its shareholder.

145 Ibid, para 64.
146 Ibid, para 58.
147 Ibid, para 65.
148 Case C-341/05 *Laval,* para 98.
149 Ibid, para 99.
150 Case 152/84 *M. H. Marshall v Southampton and South-West Hampshire Area Health Authority (Teaching),* ECLI:EU:C:1986:84, para 49.
151 Case C-188/89 *A. Foster and others v British Gas plc.,* ECLI:EU:C:1990:313, para 17.
152 Paul Craig and Gráinne De Búrca, *EU Law: Text, Cases and Materials* (Oxford University Press 2011), p. 799.
153 Case 58/80 *Dansk Supermarked A/S v A/S Imerco,* ECLI:EU:C:1981:17.
154 Arthur Hartkamp, Carla Sieburgh and Wouter Devroe, *Cases, Materials and Text on European Law and Private Law* (Hart Publishing 2017), p. 174; Stefaan Van den Bogaert, 'Horizontality: The Court Attacks?' in Barnard and Scott (eds), *The Law of the Single European Market – Unpacking the Premises* (Hart Publishing 2002), p. 130 and the literature cited in footnote 35.

The agreement prohibited the exportation of any item in Denmark. Notwithstanding this prohibition, Dansk Supermarked imported some of the items into Denmark and Imerco argued that Dansk Supermarked had infringed the Danish law on unfair competition. Dansk Supermarked invoked the principle of mutual recognition enshrined in Article 34 TFEU as a defence and the Court indeed interpreted the pertinent Danish legislation in light of Article 34 TFEU, ruling that

> '[…] it is impossible in any circumstances for agreements between individuals to derogate from the mandatory provisions of the Treaty on the free movement of goods. It follows that an agreement involving a prohibition on the importation into a Member State of goods lawfully marketed in another Member State may not be relied upon or taken into consideration in order to classify the marketing of such goods as an improper or unfair commercial practice'.[155]

However, this judgment has not been cited in subsequent case law and therefore it is questioned whether it is still good law.[156]

To the contrary, in *Van de Haar*,[157] which concerned the sale of tobacco products to persons other than resellers at prices lower than those appearing on the excise label, the Court excluded the application of Article 34 TFEU to private agreements, advancing the well-known argument according to which the conduct of private undertakings is regulated by the competition law provisions whereas the conduct of public authorities is regulated by the free movement provisions. In particular, the Court held that Article 101 TFEU belongs to the rules on competition which are addressed to undertakings and association of undertakings and which are intended to maintain effective competition in the common market.[158] On the other hand, Article 34 TFEU belongs to the rules which seek to ensure the free movement of goods and, to that end, to eliminate measures taken by Member States which might in any way impede such free movement.[159] In the same vein, in *Vlaamse Reisbureaus*,[160] the Court held that Article 34 TFEU concerns only public measures and not the conduct of undertakings.[161]

155 Case 58/80 *Dansk Supermarked A/S v A/S Imerco*, para 17.
156 Stefaan Van den Bogaert, 'Horizontality: The Court Attacks?' in Barnard and Scott (eds), *The Law of the Single European Market – Unpacking the Premises* (Hart Publishing 2002), p. 131.
157 Joined cases 177 and 178/82 *Criminal proceedings against Jan van de Haar and Kaveka de Meern BV,* ECLI:EU:C:1984:144.
158 Ibid, para 11.
159 Ibid, para 12.
160 Case 311/85 *ASBL Vereniging van Vlaamse Reisbureaus v ASBL Sociale Dienst van de Plaatselijke en Gewestelijke Overheidsdiensten,* ECLI:EU:C:1987:418.
161 Ibid, para 30.

However, in 2012 came the *Fra.bo* judgment,[162] which is regarded as recognising the horizontal effect of the free movement of goods, albeit only in relation to private-law bodies entrusted with standardisation and certification activities. The Court ruled that a private-law body in charge of drawing up technical standards for products used in the drinking water supply sector and of cerifying products on the basis of these standards, is subject to the free movement of goods in the light of the legislative and regulatory context in which this body operates.[163] The underlying reason why the Court ruled in favour of the horizontal application of Article 34 TFEU *in casu* was that

> 'a body such as the DVGW, by virtue of its authority to certify the products, in reality holds the power to regulate the entry into the German market of products such as the copper fittings at issue in the main proceedings'.[164]

3.1.2.6 AMS and Egenberger: horizontal application of the Charter of Fundamental Rights

The question of horizontality has been raised also in relation to the EU Charter of Fundamental Rights,[165] which with the entry into force of the Lisbon Treaty has been elevated into primary law with the same legally binding force as the Treaties. The starting point of every discussion about possible horizontality of the Charter is Article 51 (1) of the Charter which stipulates that

> 'The provisions of this Charter are addressed to *the institutions and bodies of the Union* with due regard for the principle of subsidiarity and to *the Member States* only when they are implementing Union law […]'.

The absence of any mention of private individuals has been interpreted as an argument against the horizontal applicability of the Charter.[166]

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162 Case C-171/11 *Fra.bo SpA v Deutsche Vereinigung des Gas- und Wasserfaches eV (DVGW) – Technisch-Wissenschaftlicher Verein,* ECLI:EU:C:2012:453.

163 Ibid, para 26.

164 Ibid, para 31.

165 Some representative scholarly contributions regarding the horizontal application of the Charter include Eleni Frantziou, 'The Horizontal Effect of the Charter of Fundamental Rights of the EU: Rediscovering the Reasons for Horizontality' (2015) 21 European Law Journal 657; Dorota Leczykiewicz, Sas?a Sever Dorota Leczykiewicz, 'Horizontal application of the Charter of Fundamental Rights' (2013) 38 *European Law Review* 479; Sas?a Sever, 'Horizontal Effect and the Charter' (2014) 10 *Croatian Yearbook of European Law and Policy* 39; Schim Seifert, 'L'effet horizontal des droits fondamentaux' (2012) 48 *Revue Trimestrielle de Droit Européen* 801.

166 Eleni Frantziou, 'The Horizontal Effect of the Charter of Fundamental Rights of the EU: Rediscovering the Reasons for Horizontality' (2015) 21 European Law Journal 657, p. 659 citing *Opinion of Advocate General Trstenjak in Case C-282/10 Maribel Dominguez v Centre informatique du Centre Ouest Atlantique and Préfet de la région Centre* ECLI:EU:C:2011:559, paras 80-88; Koen Lenaerts, 'Exploring the Limits of the EU Charter of Fundamental Rights'

However, it has been counterargued that Article 51 (1) of the Charter does not explicitly exclude the horizontal effect of the Charter[167] and, furthermore, the Court, in *Defrenne*, expressly rejected a strict textual interpretation of the Treaties, ruling that

> 'the fact that certain provisions […] are formally addressed to the Member States does not prevent rights from being conferred at the same time on any individual who has an interest in the performance of the duties thus laid down'.[168]

By the same token, the Court could reject a similar strict textual interpretation of the Charter.

However, until very recently, the case law of the Court was pointing towards the opposite direction. In *AMS*,[169] the Court refused to accord horizontal effect to the Charter. In particular, the case concerned the wrongful implementation of Directive 2002/14 establishing a general framework for informing and consulting employees into the French legal order, and more specifically, the exclusion of certain categories of employees from the fundamental right to information and consultation. The Court reiterated its well-established case law that directives cannot be applied horizontally in a dispute between private individuals and found that, in the case at hand, *indirect effect* (duty of consistent/harmonious interpretation) was not possible, as it would entail a *contra legem* interpretation of the national legislation. Finally, the Court ruled that Article 27 of the Charter protecting the fundamental workers' right to information and consultation within the undertaking does not create a right specific enough to be directly invoked in a dispute between private individuals in order to assess the compliance with EU law of a national measure implementing the directive.[170]

Scholars seem unsatisfied with this judgment and have criticized the Court for not embarking on a much-needed interpretation of the content of Article 27 of the Charter and for not following an approach similar to the one adopted in *Mangold*[171] *and Kücükdeveci*,[172] in which the Court resorted to the use

(2012) 8 *European Constitutional Law Review* 375, footnote 11; Julianne Kokott and Christoph Sobotta, *The Charter of Fundamental Rights of the European Union after Lisbon* (EUI Working Papers, Academy of European Law (2010) No 2010/06, 2010), p. 14.

167 Eleni Frantziou, 'The Horizontal Effect of the Charter of Fundamental Rights of the EU: Rediscovering the Reasons for Horizontality' (2015) 21 European Law Journal 657, p. 659.

168 Case 43-75 *Defrenne*, para 31.

169 Case C-176/12 *Association de médiation sociale v Union locale des syndicats CGT and Others,* ECLI:EU:C:2014:2.

170 Ibid, paras 45-46, 51.

171 Case C-144/04 Werner Mangold v Rüdiger Helm, ECLI:EU:C:2005:709.

172 Case C-555/07 *Seda Kücükdeveci v Swedex GmbH & Co. KG.,* ECLI:EU:C:2010:21.

of the 'general principles' mechanism in order to grant direct horizontal effect to the principle of non-discrimination as enshrined in Article 21 of the Charter and given specific expression in Directive 2000/78/EC establishing a general framework for equal treatment in employment and occupation.[173]

In his recent Opinion regarding the horizontal application of Article 31 (2) of the Charter (in particular the right to an annual period of paid leave), Advocate General Bot expressed the view that in *AMS*, the Court implicitly recognised

> 'the *summa divisio* between the principles proclaimed by the Charter, the enforceability of which is limited and indirect, and the rights recognised by the Charter, which, fore their part, are fully and directly enforceable'.[174]

He furthermore considers that the recognition of horizontal effect of the Charter is not contrary to Article 51 of the Charter,

> 'since that recognition is intended to ensure that Member States, to which the provisions of the Charter apply, respect the fundamental rights recognised therein when implementing EU law'.[175]

In fact, he argues that Article 52 (5) of the Charter expressly permits the possibility of relying directly on a Charter provision recognising a 'principle' before a national court for the purpose of reviewing the legality of national measures implementing EU law.[176]

Very recently, in *Egenberger*,[177] the Court re-evaluated its position and recognised that not only Article 21 of the Charter but also Article 47 of the Charter are capable of being horizontally applicable in a dispute between private individuals. In particular, the case concerned a dispute between Ms

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173 Eleni Frantziou, 'The Horizontal Effect of the Charter of Fundamental Rights of the EU: Rediscovering the Reasons for Horizontality' (2015) 21 European Law Journal 657, p. 667 citing Eleni Frantziou, 'Case C-176/12 Association de Médiation Sociale: Some Reflections on the Horizontal Effect of the Charter and the Reach of Fundamental Employment Rights in the European Union' (2014) 10 *European Constitutional Law Review* 332; Nicole Lazzerini, 'Case C-176/12, Association de Médiation Sociale v. Union Locale des Syndicats CGT and Others, Judgment of the Court of Justice (Grand Chamber) of 15 January 2014' (2014) 51 *Common Market Law Review* 907; Cian C. Murphy, 'Using the EU Charter of Fundamental Rights Against Private Parties after Association De Médiation Sociale'' (2014) *European Human Rights Law Review* 170.

174 *Opinion of Advocate General Bot in Joined Cases C569/16 and C570/16 Stadt Wuppertal v Maria Elisabeth Bauer and Volker Willmeroth* ECLI:EU:C:2018:337, para 70.

175 Ibid, para 77.

176 Ibid, para 68.

177 Case C-414/16 *Vera Egenberger v Evangelisches Werk für Diakonie und Entwicklung e.V.*, ECLI:EU:C:2018:257.

Vera Egenberger and Evangelisches Werk für Diakonie und Entwicklung eV concerning a claim by Ms Egenberger for compensation for discrimination on grounds of religion allegedly suffered by her in a recruitment procedure. The Court convincingly held that:

> 'a national court hearing a dispute between two individuals is obliged, where it is not possible for it to interpret the applicable national law in conformity with Article 4(2) of Directive 2000/78, to ensure within its jurisdiction the judicial protection deriving for individuals from Articles 21 and 47 of the Charter and to guarantee the full effectiveness of those articles by disapplying if need be any contrary provision of national law'.[178]

A careful analysis of this statement reveals that the Court advances first the *indirect* horizontal effect of Article 21 and 47 of the Charter, i.e. the duty of harmonious interpretation, and if this fails, national courts are obliged to resort to the *direct* horizontal effect of the provisions in question. Scholars have welcomed this jurisprudential development as affirming unequivocally that the rights to non-discrimination and to effective judicial protection enshired in Article 21 and 47 of the Charter respectively are capable of producing direct horizontal effect and as offering a methodologically comprehensive account of how such an interpretation can be reached.[179] Similarly, in the *IR v JQ* case, the Court emphasised that:

> 'a national court cannot validly claim that it is impossible for it to interpret a provision of national law in a manner that is consistent with EU law merely because that provision has consistently been interpreted in a manner that is incompatible with EU law'.[180]

Rather, if it considers that it is impossible to interpret the national provision in a manner compatible with EU law, it is:

> 'under an obligation to provide […] the legal protection which individuals derive from EU law and to ensure the full effectiveness of that law, disapplying if need be any provision of national legislation contrary to the principle prohibiting discrimination on grounds of religion or belief'.[181]

178 Ibid, para 82.

179 Eleni Frantziou, 'Mangold Recast? The ECJ's Flirtation with Drittwirkung in Egenberger' (*European Law Blog*, 24 April 2018) <http://europeanlawblog.eu/2018/04/24/mangold-recast-the-ecjs-flirtation-with-drittwirkung-in-egenberger/> accessed 31-01-2019.

180 Case C-68/17 *IR v JQ*, ECLI:EU:C:2018:696, para 65.

181 Ibid, para 68.

Finally, in the recent *Bauer* case,[182] the Court went so far as to regcognise the horizontal effect of Article 31 (2) of the Chater. In particular, the Court held that:

> 'the right to a period of paid annual leave, affirmed for every worker by Article 31(2) of the Charter, is thus, as regards its very existence, both mandatory and unconditional in nature […]. It follows that that provision is sufficient in itself to confer on workers a right that they may actually rely on in disputes between them and their employer in a field covered by EU law and therefore falling within the scope of the Charter'.[183]

Therefore, it concluded that:

> 'in the event that the referring court is unable to interpret the national legislation at issue in a manner ensuring its compliance with Article 31(2) of the Charter, it will be required […] to ensure, within its jurisdiction, the judicial protection for individuals flowing from that provision and to guarantee the full effectiveness thereof by disapplying if need be that national legislation'.[184]

3.1.3 Horizontal effect of Article 63 TFEU

So far, the Court has not dealt explicitly with the question of the horizontal application of Article 63 TFEU. It has been argued that the majority of the capital case law concerns the field of taxation, a quintessentially vertical issue, and this is why the thorny question of horizontality of the free movement of capital has not been answered until now (Chapter 2, Section 3.3.2).[185] Furthermore, in the field of golden shares, national governments acting in their capacity as shareholders have tried to escape from judicial scrutiny by arguing that the contested measure does not constitute a 'State measure' and therefore does not fall within the scope of the free movement of capital, an argument which implies that Member States oppose the idea of granting horizontal effect of Article 63 TFEU. However, until now, the Court has rejected this argument on the basis of a broad interpretation of the notion of 'State measure' covering all measures taken by public authorities even when acting in their private capacity. This has allowed the Court to treat these situations as vertical and to review the compatibility of those measures with the fundamental freedoms, without having to give an explicit answer to the question whether Article 63 TFEU is horizontally applicable. However, in light of the multilevel regulatory

182 Case C-569/16 *Stadt Wuppertal v Maria Elisabeth Bauer and Volker Willmeroth v Martina Broßonn,* ECLI:EU:C:2018:871.

183 Ibid, Para 85.

184 Ibid, Para 91.

185 Catherine Barnard, *The Substantive Law of the EU: The Four Freedoms* (Oxford University Press 2016), p. 526.

regime governing corporate governance systems and financial operations (consisting of not only national legislation but also of *private* instruments, such as shareholders' agreements, articles of associations, codes of conduct etc.), it seems reasonable to predict that sooner or later the Court will be faced with the question whether Article 63 TFEU is horizontally applicable. Drawing from the evolution of the case law on the horizontal application of the other fundamental freedoms (especially workers, services and establishment), the Court might in fact be inclined to recognise the horizontal effect of the free movement of capital (at least in its indirect form). Although the fears regarding the possible intrusion into private autonomy resulting from such a recognition might be well-founded, it is argued here that granting horizontal effect to the free movement of capital can actually be regarded as a methodologically consistent approach aiming at advancing the *effectiveness* of EU law, especially in a field dominated by private corporations and financial institutions which can exercise quasi-regulatory powers over other market participants. Besides, it is suggested that the far-reaching effect of a possible recognition of horizontal effect of Article 63 TFEU can be thwarted by a contraction of the *material* scope of Article 63 TFEU (i.e through a more restrictive interpretation of the notion of 'capital restrictions').

3.1.3.1 The case law regarding the horizontal effect of Article 63 TFEU

In the *Eurobond* case,[186] the Commission initiated infringement proceedings against Belgium arguing that the prohibition contained in a Royal Decree on the acquisition by persons resident in Belgium of securities of a public loan issued in German marks constituted a restriction on the free movement of capital. The Royal Decree in question provided for a waiver of withholding tax on interest payable on the loan. This meant that if Belgian residents were able to subscribe to this loan, they could take advantage of the waiver in order to evade tax on the interest received. The prevention of tax evasion was according to the Belgian Government the underlying purpose of the contested measure. The Government started its defence by arguing that the contested measure had been taken by the Belgian State not in its capacity as a public authority, but *in its capacity as a private operator* and thus it did not fall within the scope of Article 63 TFEU. Essentially, the Belgian Government tried to escape from the scrutiny of the Court by arguing that it had acted as a *normal private market operator*. The Court dismissed the argument on the facts, as the waiver of withholding tax on interest payable on the loan *contained in the Royal Decree* constituted a *regulatory* measure, which only the State in its capacity as public authority was authorised to take.[187] This waiver together with the

186 Case C-478/98 *Commission v Belgium*.
187 Ibid, para 22.

prohibition imposed on Belgian residents was clearly adopted by the Belgian State acting as a public authority exercising its regulatory powers on matters of fiscal policy.[188] Consequently, the Court concluded that in the case at hand Article 63 TFEU was *vertically* applicable, as the contested measure had been adopted by the State in its capacity as a public authority. Thus, it did not deal explicitly with the question of horizontal applicability of the free movement of capital.

The question was brought up again some years later in the *Dutch Golden Shares* case.[189] The Court was called upon to appraise the compatibility with the free movement of capital of the golden shares that the Kingdom of the Netherlands had retained in the privatised companies Koninklijke KPN NV and TPG NV. The golden shares were maintained in the memorandum and the articles of association of the companies and had the form of special rights to approve certain decisions of the competent organs of companies in question. The Dutch Government argued that the shares at issue could not qualify as 'State measures', as it did not hold them in its capacity as a public authority, but instead *as a private shareholder without departing from normal national company law*.

Advocate General Maduro disagreed with the argument put forward by the Dutch Government. He expressed the view that the free movement rules imposed obligations on the Member States regardless of whether they acted in their capacity as public authorities or as entities under private law.[190] He further explained that the crucial factor rendering Member States subject to the free movement rules was not their *functional* capacity as a public authority, but their *organic* capacity as signatories of the Treaty. He therefore argued that the free movement of capital was applicable even when the public authorities were acting like any other shareholder under general company law. Legislation enabling some shareholders to obtain certain special rights in order to shield them from the market process could itself constitute a restriction on the free movement of capital.[191]

188 Ibid, paras 24-25.

189 Joined cases C-282/04 and C-283/04 *Commission v The Netherlands (golden shares)*.

190 *Opinion of Advocate General Maduro in Joined cases C-282/04 and C-283/04 Commission v The Netherlands (golden shares)*, ECLI:EU:C:2006:234, para 22.

191 Ibid, para 24. See also *Opinion of Advocate General Maduro in Case C-446/03 Marks & Spencer*, ECLI:EU:C:2005:201, paras 37-40; *Opinion of Advocate General Maduro in Joined Cases C-94/04 and C-202/04 Federico Cipolla v Rosaria Fazari*, ECLI:EU:C:2006:76, paras 55-56;*Opinion of Advocate General Maduro in Joined Cases C-158/04 and C-159/04 Alfa Vita Vassilopoulos AE*, ECLI:EU:C:2006:212 , paras 54-55. For an interesting comment see Stefan Grundmann and Florian Möslein, 'Golden Shares – State Control in Privatised Companies: Comparative Law, European Law and Policy Aspects' (2001-2002) 4 EUREDIA 623.

The Court followed the Advocate's General suggestion to qualify the golden shares in question as 'State measures' despite the fact that they were adopted by the State in its private capacity as a shareholder. This way, it avoided again dealing with the question of horizontal application of Article 63 TFEU. It concluded that the contested golden shares could be classified as 'State measures', as the introduction of the special shares into the memorandum and the articles of association of KPN and TPG was the result of decisions taken by the Netherlands State in the course of the privatisation of the companies with a view to reserving a certain number of special rights under the companies' statutes.[192]

Equally, in the seminal *Volkswagen* case,[193] the Court refrained from explicitly ruling on the crucial question of horizontal direct effect of Article 63 TFEU. The provisions of the German Volkswagen Law concerning the capping of voting rights at 20% and the fixing of the blocking minority at 20%, and the right of the Federal State and the Land of Lower Saxony to appoint each two representatives to the supervisory board, were found to be contrary to Article 63 TFEU. In its defence Germany argued that the Volkswagen Law merely reproduced an agreement concluded in 1959 between the workers and the trade unions in the form of a private contract.[194] This agreement had deep historical roots and it served social and political considerations: the privatisation of Volkswagen relinquished any claims to ownership rights of the workers over the company and thus, the underlying purpose of the agreement was to secure the assurance of workers' protection against any large shareholder, which might gain control of the company.[195]

The Court rejected this argument on the grounds that the incorporation of an agreement into national legislation sufficed for it to be considered as a 'State measure' for the purposes of the free movement of capital.[196] It emphatically underlined that 'the exercise of legislative power by the national authorities duly authorised to that end is a manifestation *par excellence* of State power'.[197] Furthermore, the provisions of the contested law could no longer be amended solely at the will of the parties to the initial agreement. To the contrary, any modification required the adoption of new legislation in accordance with the procedure prescribed by the German Constitution.[198] Thus, the Court con-

192 Joined cases C-282/04 and C-283/04 *Commission v The Netherlands (golden shares)*, para 22.
193 Case C-112/05 *Commission v Germany (golden shares – Volkswagen I)*.
194 Ibid, para 22.
195 Ibid.
196 Ibid, para 26.
197 Ibid, para 27.
198 Ibid, para 28.

cluded that the Volkswagen Law was a 'State measure' for the purposes of the free movement of capital.[199]

Nevertheless, in one of the first *Portuguese Golden Shares* case,[200] the Court seemed to rule out the view that even when the State acts as a normal *shareholder* Article 63 TFEU is still applicable. The case concerned national legislation granting to the Portuguese State and to other public shareholders golden shares in the company EDP – Energias de Portugal, the principal licensed distributor of electricity in Portugal and the undertaking acting as last resort supplier. The special rights at stake included (a) the right of veto in respect of certain resolutions of the general meeting of the company's shareholders; (b) the right to appoint a director, where the State has voted against the nominees successfully elected as directors, and (c) the exemption of the State from the voting ceiling of 5% laid down in relation to the casting of votes.

Despite the fact that the Portuguese State admittedly conceded that the contested golden shares qualified as 'State measures' and thus focused primarily on the absence of any hindrance to the market access of foreign investors, the Court in an *obiter dictum* in paragraph 62, implied that there might be no restriction on capital movements when the State acts as any other *shareholder* and introduces special rights which are available to *all* shareholders. In particular, it found that the right to appoint a director constituted a restriction on the free movement of capital since it departed from general company law and was laid down by a national legislative measure for the sole benefit of the public authorities.[201] However, it made a very interesting general statement recognising that such a right to appoint a director can be conferred by legislation as a right of a qualified minority on the condition that it is accessible to *all* shareholders and not reserved exclusively to the State.[202] It has been argued that this excerpt should be interpreted in the sense that if the Member State just makes use of the rights available for all shareholders, it may not impinge upon Article 63 TFEU.[203]

The aforementioned case law reveals that the qualification of a measure as 'State measure' is sometimes confused with the finding of a 'restriction'. In principle, these should be treated as two distinct steps in the legal reasoning,

199 Ibid, para 29.
200 Case C-543/08 *Commission v Portugal (golden shares – EDP)*.
201 Ibid, para 60.
202 Ibid, para 62.
203 Karsten Engsig Sørensen, 'Company Law as a Restriction to Free Movement – Examination of the Notion of 'Restriction' Using Company Law as the Frame of Reference' (2014) 11 *European Company Law* 178 at p. 186. See also the cited books Stefan Grundmann, *European Company Law – Organization, Finance and Capital Markets* (Intersentia 2012); Alan Dashwood and others, *Wyatt and Dashwood's European Union Law* (Hart Publishing 2011).

as the first one concerns primarily the *procedural* question whether the case concerns a vertical situation in which an individual can bring a claim against the State, whereas the latter concerns the *substantive* question whether the contested measure obstructs the free movement of capital. However, more often than not, in the capital case law these two distinct questions are treated as one. While this is perhaps understandable from a judicial economy perspective, it nevertheless reveals the strikingly broad interpretation of 'capital restrictions' adopted by the Court, which covers virtually all measures that qualify as 'State measures'.

3.1.3.2 Scholarly opinions on the horizontal effect of Article 63 TFEU

Scholars have expressed different views regarding the horizontal effect of Article 63 TFEU, both in relation to the question whether Article 63 TFEU applies when the State acts as a shareholder/market participant under private law ('extended vertical effect') and in relation to the *stricto sensu* horizontal effect of Article 63 TFEU covering acts of private parties.

Commenting on the *Volkswagen* case, Barnard argues that if the Court considered that Article 63 TFEU was horizontally applicable, it would have rejected Germany's argument that Volkswagen Law merely reproduced a private agreement on that ground.[204] In other words, it would have said that despite its private nature, this agreement is still caught by Article 63 TFEU. The fact that it chose to classify the measure at issue as a *State measure* is an indication of its unwillingness to grant horizontal direct effect to Article 63 TFEU.

Conversely, Rickford, who interprets the Court's rulings in *Viking* and *Laval* as endorsing the concept of horizontal effect of Articles 49 and 56 TFEU, contends that the same applies to capital as well.[205] Firstly, he espouses the 'extended vertical effect' of Article 63 TFEU, arguing that there is no doubt that the obligation not to obstruct capital movements binds Member States not only when they exercise their sovereign powers under public law, but also when they act *in their private capacity under private law*.[206] This view is reinforced by the principle of sincere cooperation enshrined in Article 4 (3) TFEU, according to which Member States are obliged to abstain from any measure that could

204 Catherine Barnard, *The Substantive Law of the EU: The Four Freedoms* (Oxford University Press 2016), p. 526.

205 Jonathan Rickford, 'Protectionism, Capital Freedom and the Internal Market' in Bernitz and Ringe (eds), *Company Law and Economic Protectionism – New Challenges to European Integration* (Oxford University Press 2010), p. 77.

206 Jonathan Rickford, 'Free movement of capital and protectionism after Volkswagen and Viking Line' in Tison and Wymeersch (eds), *Perspectives in Company Law and Financial Regulation – Essays in Honour of Eddy Wymeersch* (Cambridge University Press 2009), p. 83-84.

jeopardise the attainment of the objectives of the Treaty.[207] He agrees with Advocate General Maduro in KPN where he famously stated that

> 'Member States are subject to the rules on free movement, of which they are clearly addressees, not on account of their *functional* capacity as public authority, but on account of their *organic* capacity as signatory of the Treaty'.[208]

Secondly, he ponders over the extent to which private persons are bound by the free movement of capital and, drawing from *Angonese*, he thinks that there is reason to believe that a discriminatory practice by a private individuals might be caught by Article 63 TFEU. At the same time, he draws a parallel with the *Viking* and *Laval* rulings on the basis of which he contends that, by the same token, the free movement of capital applies to private persons exercising regulatory powers.[209] In other words, he considers that where a private party is *entrusted with public functions* under private law, the free movement of capital applies because that private party acts *as a surrogate for the State*.[210] As an illustration of this configuration he refers to three examples of *private acts with a public purpose* which might be subject to the scrutiny of the free movement of capital: (1) the private law golden share in the UK Reuters Trust aiming at ensuring that control changes in the company will not jeopardise the editorial independence; (2) certain company law arrangements in Nordic countries offering voting shares with enhanced powers exercisable for the benefit not of the shareholders but of the company in the widest sense, including its continuity, the protection of its workers and the interests of the society as a whole; and (3) the powers of company boards in certain Member States to frustrate the success of takeover bids from companies with a less open structure than their own (a possibility which is stems from the fact that the 'board neutrality rule' under Article 9 of Directive 2004/25/EC on Takeovers[211] is *optional* under Article 12 thereof). He regards these private acts as subject to the Internal Market scrutiny because of the fact that they have a *public purpose* and the private parties exercising them act as *surrogate for the State*. However, he expresses doubts as to whether private parties engaging for purely private

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207 Jonathan Rickford, 'Protectionism, Capital Freedom and the Internal Market' in Bernitz and Ringe (eds), *Company Law and Economic Protectionism – New Challenges to European Integration* (Oxford University Press 2010), p. 78.

208 *Opinion of Advocate General Maduro in Joined cases C-282/04 and C-283/04 Commission v The Netherlands (golden shares)*, para 22.

209 Jonathan Rickford, 'Free movement of capital and protectionism after Volkswagen and Viking Line' in Tison and Wymeersch (eds), *Perspectives in Company Law and Financial Regulation – Essays in Honour of Eddy Wymeersch* (Cambridge University Press 2009), p. 86.

210 Ibid, p. 87.

211 'Directive 2004/25/EC of the European Parliament and of the Council of 21 april 2004 on takeover bids' (2004) *OJ L 142, 30.4.2004, p. 12-23.*

purposes in conduct which falls short of discrimination are bound by the free movement of capital.[212]

Similarly, Ringe strongly advocates the 'extended vertical effect' of Article 63 TFEU, arguing that there is 'no escape into private law' for the Member States.[213] All State action, regardless of whether it is based on public authority or not, should be classified as 'State measure' and should therefore be subject to the free movement of capital.[214] He effectively agrees with Advocate General Maduro that 'Member States, when operating as a market participant, may be subject to constraints that do not apply to other market participants'[215] and he compares golden shares with the area of public procurement where the State, even when acting under private law, is subject to additional and more restrictive requirements of transparency and accountability which do not bind private parties.[216] Similarly, he considers that, despite the 'private market actor' test, the very existence of State aid rules reveals that the State is treated with more suspicion than private parties.

In relation to the *stricto sensu* horizontal effect of Article 63 TFEU, he draws from the settled case law in the other fields (*Bosman*, *Viking*, *Laval*, *Defrenne*, *Angonese*) and concludes that when powerful federations act in a quasi-regulatory manner, they are subject to the free movement rules because the effect of their action can be equalised with the effect of State legislation (the 'private governance' argument).[217] At the same time, because of its eminent status as a fundamental value, the principle of non-discrimination is applied horizontally even when there is no private governance.[218] In the context of the interaction between company law and free movement of capital, Ringe ponders the question whether a commercial company, which collectively decides for all investors, fulfils the 'private governance' test (which has traditionally be

212 Jonathan Rickford, 'Free movement of capital and protectionism after Volkswagen and Viking Line' in Tison and Wymeersch (eds), *Perspectives in Company Law and Financial Regulation – Essays in Honour of Eddy Wymeersch* (Cambridge University Press 2009), p. 87.

213 Wolf-Georg Ringe, 'Company Law and Free Movement of Capital' (2010) 69 Cambridge Law Journal 378, p. 396. See also Wolf-Georg Ringe, 'Case C-112/05, Commission v. Germany ("VW law"), Judgment of the Grand Chamber of 23 October 2007, nyr.' (2008) 45 Common Market Law Review 37; Wolf-Georg Ringe, 'Is Volkswagen the New Centros? Free movement of Capital's Impact on Company Law' in Prentice and Reisberg (eds), *Corporate Finance Law in the UK and EU* (Oxford University Press 2011).

214 Wolf-Georg Ringe, 'Company Law and Free Movement of Capital' (2010) 69 Cambridge Law Journal 378, p. 397-398

215 *Opinion of Advocate General Maduro in Joined cases C-282/04 and C-283/04 Commission v The Netherlands (golden shares)*, para 22.

216 Wolf-Georg Ringe, 'Company Law and Free Movement of Capital' (2010) 69 Cambridge Law Journal 378, p. 397.

217 Ibid, p. 392.

218 Ibid, p. 392-393.

linked to the 'intermediary powers' of federations and trade unions issuing collective rules) and thus can be subject to the Treaty provisions on the free movement of capital.[219] In this respect, he estimates that decisions of a single company will not necessarily cross this threshold in the absence of any particular circumstances.[220]

By contrast, Andrea Biondi follows a more nuanced approach in relation to the 'extended vertical effect' of Article 63 TFEU.[221] He considers that the golden shares case law carries an element of risk in the sense that every action attributable to the State might be caught by capital scrutiny, leaving thus very limited leeway for Member States to organise their economic and industrial policies and to pursue public policy objectives.[222] Inspired by state aid law, he suggests that this risk might be prevented through the adoption of a 'private market investor' principle, whereby State conduct is immune from scrutiny if proven to be subject to the normal rules of the operation of the market.[223]

Carsten Gerner-Beuerle agrees with the other scholars that the vertical effect of Article 63 TFEU covers not only regulatory acts of the State (*ius imperii*), but also acts taken by the State in the course of its operation as a normal shareholder without *ius imperii*.[224] However, in the latter scenario, only measures discriminating between domestic and foreign investment should fall within the scope of the free movement of capital.[225] In relation to the horizontal application of Article 63 TFEU, he expresses his fear that if the Court accords horizontal effect to Article 63 TFEU, this could potentially open the door to an avalanche of claims challenging any type of Control Enhancing Mechanisms (Chapter 4, Section 2.2) contained in a company's Articles of Association as capital restrictions.[226] However, from a conceptual point of view, it is not self-evident why the free movement of capital should restrict the private autonomy of companies opting to include Control Enhancing Mechanisms in their Articles of Association.[227] Furthermore, while it is true that some Control Enhancing Mechanisms might have a deterrent effect on foreign investment, it cannot be excluded that a possible prohibition on them might

219 Ibid.
220 Ibid.
221 Andrea Biondi, 'When the State is the Owner – Some Further Comments on the Court of Justice 'Golden Shares' Strategy' in Bernitz and Ringe (eds), *Company Law and Economic Protectionism: New Challenges to European Integration* (Oxford University Press 2010).
222 Ibid, p. 97.
223 Ibid, p. 101.
224 Carsten Gerner-Beuerle, 'Shareholders Between the Market and the State. The VW Law and other Interventions in the Market Economy' (2012) 49 Common Market Law Review 97, p. 131.
225 Ibid, p. 131.
226 Ibid, p. 133.
227 Ibid, p. 134.

actually have the same deterrent effect on foreign investment.[228] Indeed, some investors might be discouraged by the existence of Control Enhancing Mechanisms in the undertaking concerned, while some others might be discouraged by their very absence. Moreover, convincing statistical evidence might be required in order to assess the deterrent effect private actions might have on cross-border investment and it is questionable whether the Court is well-equipped to devise and employ such evidence.[229] He therefore concludes that, apart from cases of flagrant discrimination like the one in *Angonese* and *Defrenne*, which however are of limited practical use in the capital case law, special rights included in the Articles of Association of a company without any involvement of public authorities should not fall within the scope of Article 63 TFEU.[230]

Finally, Harm Schepel believes that the Court will sooner or later recognise the horizontal direct effect of Article 63 TFEU, since the *Walrave* rationale of *effet utile and uniform application* apply *a fortiori* in the field of free movement of capital due to the nature of the rules defining the corporate governance systems of the Member States in the EU.[231] These rules include a transnational patchwork of private agreements, a number of codes, a plethora of different rules included in the Articles of Association of companies as well as diverging mandatory and optional rules of national company law.[232] However, it is argued that the recognition of horizontal effect of Article 63 TFEU together with the strikingly broad interpretation of capital restrictions will most likely place all company law structures deviating from the one share/one vote principle and from the principle of shareholders' primacy under judicial review for conformity with the free movement of capital.[233]

228 Ibid, p. 134.
229 Ibid, p. 135.
230 Ibid, p. 136.
231 Harm Schepel, 'Constitutionalising the Market, Marketising the Constitution, and to Tell the Difference: On the Horizontal Application of the Free Movement Provisions in EU Law' (2012) 18 European Law Journal 177.
232 Carsten Gerner-Beuerle, 'Shareholders Between the Market and the State. The VW Law and other Interventions in the Market Economy' (2012) 49 Common Market Law Review 97, p. 193.
233 Harm Schepel, 'Constitutionalising the Market, Marketising the Constitution, and to Tell the Difference: On the Horizontal Application of the Free Movement Provisions in EU Law' (2012) 18 European Law Journal 177, p. 193.

3.1.3.3 Suggested solution: Granting horizontal effect to Article 63 TFEU for reasons of legal consistency and equality between the State and private parties as market participants

The aforementioned scholarly contributions provide a thorough analysis of all the legal, political and social dimensions of ascribing horizontal effect to Article 63 TFEU and reveal the intricate legal issues arising from a possible horizontality of the free movement of capital in view of the multifaceted nature of the various corporate governance arrangements that exist in the Member States. It is submitted here that, for reasons of legal consistency, if one accepts that when the State acts in its private capacity as a normal shareholder its actions are not caught by the free movement of capital by virtue of the private market operator test, then *a fortiori* it should be acknowledged that private parties are not at all bound by Article 63 TFEU. If, however, one accepts that the free movement of capital binds the State even when it acts as a shareholder, the same should apply to all private parties, especially when given their dominant position they exercise quasi-regulatory powers over other market participants. It is argued here that when acting in their private capacity as market participants, both the State and private parties should operate under equal conditions. The more restrictive requirements imposed on the State in the field of public procurement through the adoption of specific secondary legislation, cannot justifiably be extrapolated to the free movement of capital.

Given that the Court has established that State action (both as regulator and as shareholder) is always subject to the free movement of capital,[234] reasons of legal consistency and equality require that the same should apply to private operators, especially when they hold a dominant position in the market which gives them the power to impose conditions on other market participants (such as consumers, creditors, suppliers, other competitors etc.). Private parties are important market operators (in many instances much more important than the State) and their actions can have far-reaching economic and social implications. This is all the more true if one accepts the theory of horizontality of fundamental rights which regards private individuals as not existing in a legal vacuum, but as part of a solidaristic society in which individuals are responsible for their actions towards other individuals. To reject horizontality on the basis of the argument of self-regulation of the market and respect of private autonomy, although admittedly appealing, disregards firstly the shortcomings of self-regulation and secondly the fact that private autonomy is in any case regulated by national legislation.

234 See cases mentioned above in Chapter 4, Section 3.1.3.1, with the exception of the *obiter dictum* in the Portuguese case.

It should be noted, however, that the fears expressed by some scholars above are well-founded. Indeed, it seems that the golden shares case law amounts to a 'quality control' review of all company law arrangements and this could perhaps be exacerbated if the Court accords horizontal effect to Article 63 TFEU, as this would bring under judicial scrutiny *all* (both public and private) corporate governance instuments derogating from the *principle of proportionality between ownership and control* and the *principle of shareholders' primacy*. However, despite the undisputed merits of this argument, it is claimed here that this intrusive function of the free movement of capital can be thwarted by a more restrictive interpretation of the notion of 'capital restrictions', not by refusing to grant horizontal effect.

Indeed, horizontal effect relates more to the question whether private parties can judicially invoke their free movement rights against other private parties. This is different from the question whether the substantive content of the specific private act constitutes indeed a restriction on capital movements. Concerns over the potentially invasive effect of the free movement of capital for the corporate governance systems of Member States are more adequately adressed in the following steps of the legal reasoning, i.e. the one concerning whether the measure in question constitutes a capital restriction and the next one concerning possible justification of that restriction.

The same holds true for concerns relating to the potential interference with private autonomy and with the freedom to conduct a business under Article 16 of the Charter as a result of the horizontal application of the free movement provisions. In particular, in his interesting analysis, Rufat Babayev argues that if all free movement provisions were attributed full horizontal effect this would negate the freedom to conduct a business under Article 16 of the Charter.[235] To resolve the conflict between free movement rights and freedom to conduct a business, he puts forward a 'double proportionality' test under which the realisation of both must be presumed to constitute a legitimate objective.[236] On the basis of this test, he argues that, when there is no 'dominance' (i.e. when the private actors in question do not exert power the outcome of which other private actors are not able to avoid), the 'minor' interference with free movement rigths cannot justify the 'major' interference with the freedom to conduct a business.[237] Conversely, when there is 'dominance' (i.e when the private actors impose obligations which other private actors cannot avoid), the 'major' interference with the free movement rights can justify the 'minor'

235 Rufat Babayev, 'Private Autonomy at Union Level: On Article 16 CFREU and Free Movement Rights' (2016) 53 *Common Market Law Review* 979.
236 Ibid, p. 1000.
237 Ibid, p. 1004.

interference with the freedom to conduct a business.[238] It is submitted here that, in reality, this intellectually challenging analysis does not concern the limits imposed on horizontality by Article 16 of the Charter, but rather the balancing exercise at the justification/proportionality level between the fundamental freedoms of the Treaty and the freedom to conduct a business under Article 16 of the Charter. Thus, it proves the point being made here that concerns relating to possible interference with private autonomy are better addressed at a later stage, i.e. when examining the justification grounds and when conducting the proportionality assessment.

3.2 Public interest objectives as justification grounds in the golden shares case law

The Court has recognised that, in principle, the free movement of capital may be restricted by national measures justified on the grounds set out in Article 65 TFEU or by overriding reasons in the general interest to the extent that there is no harmonization at the EU level providing for measures necessary to ensure the protection of those interests.[239] Member States have also attempted to justify capital restrictions on the basis of other Treaty provisions, such as Article 106 (2) TFEU and Article 345 TFEU. In the absence of harmonisation, the Court, in principle, accepts that it is generally for the Member States to decide on the degree of protection they wish to afford to such legitimate interests and on the way in which such protection is to be achieved, while ensuring that they respect the principle of proportionality.[240] However, in all but one golden shares case (the *Belgian* case), the above-mentioned justification grounds have been rejected either due to a lack of evidence proving that the special shareholding in question is actually suitable and necessary in order to pursue the legitimate objective invoked or due to a failure to comply with the principle of legal certainty. This stems partly from the fundamental adjudicative principle of Internal Market case law that the four freedoms must be interpreted widely, whereas exceptions must be construed narrowly. But it also stems from the ideological premise that golden shares are protectionist measures and as such they are inherently incompatible with the Internal Market. The following section provides a typology of the justification grounds unsuccessfully that have been invoked by the Member States.

238 Ibid.
239 Joined cases C-463/04 and C-464/04 *Federconsumatori (AEM/Edison)*, para 39.
240 Ibid, para 40.

3.2.1 *The objective of safeguarding energy supplies in the event of a crisis as covered by public security under Article 65 (1) (b) TFEU*

One of the most frequently used legitimate objectives in the golden shares case law is the *safeguarding of energy supplies in the event of a crisis*.[241] This is because most of the privatised undertakings in which the Member States maintain special rights are active in the *energy sector*. For instance, in one of the early golden shares cases, the French Government argued that the prior administrative authorisation scheme for the acquisition of shares in privatised undertakings was essential in order to safeguard supplies of petroleum products in the event of a crisis, which, in *Campus Oil*,[242] had been recognised as an objective covered by the concept of *public security*.[243] In this regard, the Court recognised that the objective of safeguarding supplies of petroleum products fell undeniably within the ambit of a legitimate public interest which could justify an obstacle to the free movement of goods and the same could apply to obstacles to the free movement of capital, inasmuch as public security was also one of the justification grounds referred to in Article 65 (1) (b) TFEU.[244] Similarly, in the *Belgian golden shares* case, the Court accepted that the national opposition scheme in question could be justified on grounds of safeguarding energy supplies in the event of a crisis, which fell within the ambit of public security as a derogation ground under Article 65 (1) (b) TFEU.[245]

At the same time, however, the Court has clarified that public security as a derogation from the fundamental freedoms must be interpreted strictly, with the result that its scope cannot be determined unilaterally by each Member State without any control by the institutions of the European Union.[246] It can be relied on only if there is a genuine and sufficiently serious threat to a fundamental interest of society.[247] Merely making a general statement

241 The golden shares cases in which this justification ground was used include: Case C-367/98 *Commission v Portugal (golden shares)*, ECLI:EU:C:2002:326; Case C-483/99 *Commission v France (golden shares – Sociéte Nationale Elf-Aquitaine)*; Case C-503/99 *Commission v Belgium (golden shares)*; Case C-463/00 *Commission v Spain (golden shares)*; Case C-174/04 *Commission v Italy (golden shares)*; Case C-274/06 *Commission v Spain (golden shares)*; Case C-207/07 *Commission v Spain (golden shares in the energy sector)*; Case C-326/07 *Commission v Italy (golden shares)*; Case C-543/08 *Commission v Portugal (golden shares – EDP)*; Case C-212/09 *Commission v Portugal (golden shares – GALP Energia SGPS SA)*; Case C-244/11 *Commission v Greece (golden shares)*.

242 Case 72/83 *Campus Oil*, paras 34-35.

243 Case C-483/99 *Commission v France (golden shares – Sociéte Nationale Elf-Aquitaine)*, para 28.

244 Ibid, para 47.

245 Case C-503/99 *Commission v Belgium (golden shares)*, para 46.

246 Case C-212/09 *Commission v Portugal (golden shares – GALP Energia SGPS SA)*, para 83.

247 Case C-207/07 *Commission v Spain (golden shares in the energy sector)*, para 47; Case C-244/11 *Commission v Greece (golden shares)*, para 67.

asserting the relevance of the safequarding of enegy supplies as a legitimate objective is not sufficient to meet the required standard of proof.[248] Thus, in *Commission v Portugal (EDP – Energias de Portugal)* the Court rejected Portugal's argument that a State could legitimately equip itself with the means required to guarantee the fundamental interest of security of energy supplies even if there was no imminent threat.[249] In particular, the Portuguese government had argued that since the risk of serious threats to the security of energy supply could not be excluded and since such threats were by definition sudden and, in the majority of cases, unforeseeable, it was the duty of the Member State concerned to ensure that adequate mechanisms were put in place to enable it to react rapidly and effectively to guarantee that the security of that supply was not interrupted.[250] While acknowledging the merit of this argument, the Court nevertheless rejected the justification on the ground that the Portuguese government had done no more than raise the ground relating to the security of the energy supply, without stating clearly the exact reasons why it considered that the special rights at issue would make it possible to prevent such an interference with a fundamental interest of society.[251]

3.2.2 *The objective of ensuring availability of the telecommunications network in the event of a crisis as covered by public security under Article 65 (1) (b) TFEU*

By analogy, in the field of telecommunications, it has been accepted that the objective of ensuring availability of the telecommunications network in case of crisis, war or terrorism may constitute a ground of public security under Article 65 (1) (b) TFEU.[252]

3.2.3 *The objective of guaranteeing a service of general interest as an overriding reason in the public interest*

In the *Dutch golden shares* case, the Court acknowledged that the guarantee of a service of general interest, such as universal postal service, may constitute an overriding reason in the general interest capable of justifying an obstacle to the free movement of capital.[253] In *Federconsumatori*, the Court used a more generous formulation and held that

248 Niamh Nic Shuibhne and Marsela Maci, 'Proving Public Interest: The Growing Impact of Evidence in Free Movement Case Law' (2015) 50 *Common Market Law Review* 965, p. 980.
249 Case C-543/08 *Commission v Portugal (golden shares – EDP)*, para 86.
250 Ibid, para 86.
251 Ibid, para 87.
252 Case C-171/08 *Commission v Portugal (golden shares – Portugal Telecom SGPS SA)*, para 72.
253 Joined cases C-282/04 and C-283/04 *Commission v The Netherlands (golden shares)*, para 38 citing Joined cases C388/00 and C429/00 *Radiosistemi Srl v Prefetto di Genova,* ECLI:EU:C:2002:390, para 44.

'it is undeniable that certain concerns may justify the retention by Member States of a degree of influence within undertakings that were initially public and subsequently privatised, where those undertakings are active in fields involving the provision of services in the public interest or strategic services'.[254]

3.2.4 *Article 106 (2) TFEU*

In *Commission v Portugal (GALP Energia SGPS SA)*, the Portuguese governement argued that the right to veto certain important decisions of the company and the right to appoint the chairman of the Board of Directors were required under Article 106 (2) TFEU in order to enable GALP to carry out appropriately its tasks of managing services of general economic interest entrusted to it by the State.[255] The Court rejected this argument on the basis of the fact that the national provisions in question did not involve the granting of special or exclusive rights to GALP or the classification of GALP's activities as services of general economic interest, but were concerned with the lawfulness of attributing to the Portuguese State, as a shareholder of that company, special rights in connection with golden shares which it holds in the share capital of GALP.[256] Moreover, the Court emphasized that the Portuguese government had not provided any reasons why the performance of services of general economic interest would be jeopardised if the special rights in question were abolished.[257] Therefore, Article 106 (2) TFEU was not applicable *in casu*.[258] The same conclusion was reached in *Commission v Portugal (EDP)*.[259]

3.2.5 *Protection of workers and of minority shareholders*

In *Commission v Germany (Volkswagen I)*, which epitomizes the conflict between internal market and social objectives,[260] the Court accepted that the protection

254 Joined cases C-463/04 and C-464/04 *Federconsumatori (AEM/Edison)*, para 41.
255 Case C-212/09 *Commission v Portugal (golden shares – GALP Energia SGPS SA)*, para 80.
256 Ibid, para 93.
257 Ibid, para 94.
258 Ibid, para 95.
259 Case C-543/08 *Commission v Portugal (golden shares – EDP)*, paras 93-96. Similarly, in the recent *Commission v Hungary*, the Court found that a national monopoly of mobile payment services constitutes a restriction of the freedom to provide services that could not be justified on Article 106 (2) TFEU, as Hungary failed to prove why the performance of the particular task with which the service concerned was entrusted required the creation of a monopoly by granting exclusive rights to the undertaking in question. See Case C-171/17 *Commission v Hungary*, ECLI:EU:C:2018:881, para 93.
260 Jonathan Rickford, 'Protectionism, Capital Freedom and the Internal Market' in Bernitz and Ringe (eds), *Company Law and Economic Protectionism – New Challenges to European Integration* (Oxford University Press 2010), p. 67.

of workers[261] and the protection of minority shareholders[262] could be regarded as overriding reasons in the public interests capable of justifying a restriction on capital movements.[263] However, it found that Germany had failed to explain how the special rights in question could protect the workers and the minority shareholders.[264]

3.2.6 Economic rule

The Court has confirmed the validity of the 'economic rule' in the golden shares case law and has ruled that economic considerations cannot justify a restriction on capital movements (see also the analysis in Chapter 3, section 3.2.4.2). In particular, in the first *Portuguese golden shares* case, the Portuguese Government claimed that its legislation, imposing a cap on foreign investment and an authorisation procedure for the acquisition of shares, was justified by overriding requirements of the general interest, since it was intended to safeguard its financial interests and the economic policy objectives pursued by the pre-privatisation process, such as choosing a strategic partner where the activities of the undertaking were to assume an international dimension, or strengthening the competitive structure of the market concerned, or moderniz-

261 Case 279/80 *Criminal proceedings against Alfred John Webb,* ECLI:EU:C:1981:314, para 19; Case C-288/89 *Stichting Collectieve Antennevoorziening Gouda and others v Commissariaat voor de Media,* ECLI:EU:C:1991:323, paras 13–14; Case C-106/16 *Polbud – Wykonawstwo sp. z o.o.,* ECLI:EU:C:2017:804, para 54; Joined cases C-369/96 and C-376/96 *Criminal proceedings against Jean-Claude Arblade and Arblade & Fils SARL and Bernard Leloup, Serge Leloup and Sofrage SARL,* ECLI:EU:C:1999:575, para 36; Case C-411/03 *SEVIC Systems AG,* ECLI:EU:C:2005:762, para 28; Case C-438/05 *Viking*, para 77; Case C-201/15 *AGET Iraklis*, para 73. Similarly, it has also been accepted that the encouragement of employment and recruitment which, being designed in particular to reduce unemployment, constitutes a legitimate aim of social policy. See, Case C-208/05 *ITC Innovative Technology Center GmbH v Bundesagentur für Arbeit,* ECLI:EU:C:2007:16, para 38; Case C-385/05 *Confédération générale du travail and Others,* ECLI:EU:C:2007:37, para 28; Case C-379/11 *Caves Krier Frères Sàrl v Directeur de l'Administration de l'emploi,* ECLI:EU:C:2012:798, para 51. Moreover, the protection of workers has been recognised as a justification ground alongside consumer protection in the Services Directive, see 'Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market' (2006) *OJ L 376, 27.12.2006, p. 36-68*, Recital 40. For a comprehensive analysis of the relevant case law, see Catherine Barnard, 'The Worker Protection Justification: Lessons from Consumer Law' in Panos Koutrakos, Niamh Nic Shuibhne and Phil Syrpis (eds), *Exceptions from EU Free Movement Law: Derogation, Justification and Proportionality* (Hart Publishing 2016), p. 106-130, in which the author distinguishes between 'worker welfare' and 'worker protection' (p. 110); see also Sophie Robin-Olivier, 'Bargaining in the shadow of free movement of capital' (2012) 8 *European Review of Contract Law* 167.

262 Case C-106/16 *Polbud*, para 54; Case C-411/03 *SEVIC Systems*, para 28; Case C-208/00 *Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC),* ECLI:EU:C:2002:632, para 92.

263 Case C-112/05 *Commission v Germany (golden shares – Volkswagen I)*, paras 72-80.

264 Ibid, paras 74-77.

ing and increasing the efficiency of means of production.[265] Not surprisingly, the Court replied that neither the *general financial interests* of a Member State nor the *economic policy objectives* could constitute adequate justification, as according to settled case law economic grounds can never serve as justification for obstacles prohibited by the Treaty.[266] In the same vein, in *Commission v Italy*, the Court held that an interest in generally strengthening the competitve structure of the market could not constitute valid justification for restrictions on the free movement of capital.[267] Finally, in *Commission v Portugal (Portugal Telecom SGPS SA)*, the Court found that an interest in ensuring the conditions of competition on a particular market and the need to prevent a possible disruption of the capital market could not constitute valid justifications for restrictions on the free movement of capital.[268]

3.3 Proportionality in the golden shares case law

The proportionality test applied by the Court in its case law on the fundamental freedoms consists of two separate steps: 1) whether the national measure in question is sutable/appropriate to achieve the legitimate objective pursued (*suitability test*); and 2) whether it is necessary to achieve this objective, i.e. whether there are other less restrictive means capable of attaining the objective in question (*necessity test*).[269] In order to prove that the contested national measure is compatible with the principle of proportionality, Member States are required to provide sufficient evidence capable of *substantiating* this conclusion.[270] In view of the general rule that exceptions from the fundamental freedoms are to be construed narrowly, the burden of proof of the Member States – although admittedly not strictly defined[271] – is in practice very high and often difficult to be met. The Court is usually strict in the review of the justifications invoked by the Member States and quite tough when assessing the proportionality of the contested measure.[272]

265 Case C-367/98 *Commission v Portugal (golden shares)*, para 31.
266 Ibid, para 52.
267 Case C-174/04 *Commission v Italy (golden shares)*, para 37.
268 Case C-171/08 *Commission v Portugal (golden shares – Portugal Telecom SGPS SA)*, paras 70-71.
269 In the majority of the cases, proportionality *stricto sensu*, as the third step in the traditional proportionality assessment stemming from German Constitutional Law, is not applied by the Court. See Paul Craig and Gráinne De Búrca, *EU Law: Text, Cases and Materials* (Oxford University Press 2011), p. 551.
270 Case C-542/09 *Commission v Netherlands (access to education)*, ECLI:EU:C:2012:346, para 82.
271 Niamh Nic Shuibhne and Marsela Maci, 'Proving Public Interest: The Growing Impact of Evidence in Free Movement Case Law' (2015) 50 Common Market Law Review 965, p. 975.
272 Catherine Barnard, 'Derogations, Justifications and the Four Freedoms: Is State Interest Really Protected?' in Catherine Barnard and Okeoghene Odudu (eds), *The Outer Limits of European Union Law* (Hart Publishing 2009), p. 299.

The golden shares case law provides a typical example of rigorousness in the application of the standard of proof in the proportionality assessment. The Court requires a high degree of evidence in order to establish the legal claim that the contested special rights are justified and proportionate to the objective pursued. The intensity of the judicial review comes as no surprise as it reflects the underlying rationale that golden shares are inherently incompatible with free movement of capital and it confirms the generally stringent jurisprudential approach to proportionality in Internal Market litigation. What is more interesting, however, is the additional step that emerges from the proportionality assessment of golden shares and characterises the capital case law in general. This additional step examines the compatibility with the principle of *legal certainty* and it is governed by a *procedural* rather than substantive rationality.

Procedural elements of proportionality such as *policy coherence*, *consistency* and *transparency* are discerned in other fields of Internal Market case law, primarily the ones touching upon morally contientious issues. Floris de Witte argues that in these fields the 'procedural proportionality' test is used to rationalize the process of national legislation and is more respectful of the normative policy aims of the Member States.[273] The 'procedural proportionality' test is juxtaposed with the 'substantive proportionality' test which seeks to rationalise the content of national legislation, leaving little normative leeway for Member States.[274] It is argued that for morally and ethically contentious questions, the 'procedural proportionality' test is better suited, as it respects the substance of national moral and ethical choices and focuses only on teasing out discriminatory or protectionist biases by assessing the normative coherence of national policies, the consistent application of sanctions and the legislative transparency.[275]

The main field in which the 'procedural proportionality' test has been widely applied is gambling, a field in which the process of market liberalisation has not been very successful and Member States continue to enjoy a wide margin of discretion in defining their regulatory framework. Stefaan Van den Bogaert and Armin Cuyvers argue that the relaxation of the internal market requirements in the gambling cases comes down to virtual dismantling.[276] In par-

273 Floris De Witte, 'Sex, Drugs & EU Law: The Recognition of Moral and Ethical Diversity in EU Law' (2013) 50 *Common Market Law Review* 1545, p. 1566.

274 Ibid.

275 Ibid, p. 1573.

276 Stefaan Van den Bogaert and Armin Cuyvers, '"Money for nothing": The case law of the EU Court of Justice on the regulation of gambling' (2011) 48 *Common Market Law Review* 1175, p. 1208; Alan Littler, 'Regulatory perspectives on the future of interactive gambling in the internal market' (2008) 33 *European Law Review* 211; Allan Littler, *Member States versus the European Union – The Regulation of Gambling* (Brill Academic Publishers 2011). See also the annotations: Marek Szydło, 'Continuing the judicial gambling saga in Berlington' (2016)

ticular, in its gambling case law,[277] the Court has granted a general margin of appreciation to the Member States in choosing how to regulate gambling services and has accepted a whole array of public interest objectives capable of justifying restrictions on the fundamental freedoms (such as the fight against gaming addiction, the reduction of gambling opportunities, the fight against crime, the general need to preserve public order, protection of consumers of games of chance against fraud on the part of operators etc). At the same time it has refined the *suitability* test so as to include the requirement of *consistency*: restrictions on gaming activities are suitable to achieve their public interest objectives only insofar as these objectives are being pursued 'in a consistent and systematic manner'.[278] The consistency test *prima facie* imposes an additional procedural requirement in the proportionality assessment: Member States must not take, facilitate or tolerate measures that would run counter to the achievement of the legitimate objectives pursued.[279] In practice, however,

53 *Common Market Law Review* 1089; Thomas Beukers, 'Case C-409/06, Winner Wetten GmbH v. Bu¨rgermeisterin der Stadt Bergheim, Judgment of the Court (Grand Chamber) of 8 September 2010, not yet reported' (2011) 48 *Common Market Law Review* 1985; Armin Cuyvers, 'Joined Cases C-338/04, C-359/04 and C-360/04, Massimiliano Placanica, Christian Palazzese and Angelo Sorricchio (Placanica)' (2008) 45 *Common Market Law Review* 515; Vassilis Hatzopoulos, 'Case C-275/92, Her Majesty's Customs and Excise v. Gerhart and Jorg Schindler, [1994] ECR 1-1039' (1995) 32 *Common Market Law Review* 841.

277 Case C-275/92 *Schindler*; Case C-124/97 *Markku Juhani Läärä, Cotswold Microsystems Ltd and Oy Transatlantic Software Ltd v Kihlakunnansyyttäjä (Jyväskylä) and Suomen valtio (Finnish State),* ECLI:EU:C:1999:435; Case C-67/98 *Questore di Verona v Diego Zenatti,* ECLI:EU:C:1999:514; Case C-6/01 *Associação Nacional de Operadores de Máquinas Recreativas (Anomar) and Others v Estado português,* ECLI:EU:C:2003:446; Case C-243/01 *Criminal proceedings against Piergiorgio Gambelli and Others,* ECLI:EU:C:2003:597; Case C-338/04 *Criminal proceedings against Massimiliano Placanica, Christian Palazzese and Angelo Sorricchio,* ECLI:EU:C:2007:133; Case C-409/06 *Winner Wetten GmbH v Bürgermeisterin der Stadt Bergheim,* ECLI:EU:C:2010:503; Case C-42/07 *Liga Portuguesa de Futebol Profissional and Bwin International,* ECLI:EU:C:2009:519; Case C-316/07 *Markus Stoß, Avalon Service-Online-Dienste GmbH and Olaf Amadeus Wilhelm Happel,* ECLI:EU:C:2010:504; Case C-46/08 *Carmen Media Group Ltd v Land Schleswig-Holstein and Innenminister des Landes Schleswig-Holstein,* ECLI:EU:C:2010:505; Case C-64/08 *Criminal proceedings against Ernst Engelmann,* ECLI:EU:C:2010:506; Case C-203/08 *Sporting Exchange Ltd v Minister van Justitie,* ECLI:EU:C:2010:307; Case C-258/08 *Ladbrokes Betting & Gaming and Ladbrokes International,* ECLI:EU:C:2010:308; Case C-447/08 *Criminal proceedings against Otto Sjöberg and Anders Gerdin* ECLI:EU:C:2010:415; Case C-347/09 *Criminal proceedings against Jochen Dickinger and Franz Ömer,* ECLI:EU:C:2011:582; Case C-186/11 *Stanleybet International Ltd, William Hill Organization Ltd, William Hill plc, Sportingbet plc v Ipourgos Oikonomias kai Oikonomikon Ipourgos Politismou,* ECLI:EU:C:2013:33; Case C-463/13 *Stanley International Betting and Stanleybet Malta,* ECLI:EU:C:2015:25; Case C-98/14 *Berlington Hungary Tanácsadó és Szolgáltató kft and Others v Magyar Állam,* ECLI:EU:C:2015:386; Case C-336/14 *Criminal proceedings against Sebat Ince,* ECLI:EU:C:2016:72; Case C-375/14 *Criminal proceedings against Rosanna Laezza,* ECLI:EU:C:2016:60; Case C-3/17 *Sporting Odds Limited v Nemzeti Adó- és Vámhivatal Központi Irányítása,* ECLI:EU:C:2018:130 (Court of Justice).

278 Case C-169/07 *Hartlauer Handelsgesellschaft mbH v Wiener Landesregierung and Oberösterreichische Landesregierung,* ECLI:EU:C:2009:141, para 55; Case C-42/07 *Liga Portuguesa*, para 61.

279 European Commission, *Commission Staff Working Document: Online gambling in the Internal Market* (SWD(2012) 345 final, 2012), p. 35.

the *consistency* test means that if the legitimate objectives are pursued in a 'consistent and systematic manner', the national regulatory framework on gambling will generally pass the proportionality assssement, without really examining the substantive content of the legislation in question and without really applying the suitability and necessity test as applied in other fields of Internal Market litigation. This is all the more true when considering that the *necessity* requirement plays virtually no role in assessing the regulation of gambling services.[280] Member States have a sufficient degree of latitude to set the level of protection desired according to the national scale of values and it is up to them 'to assess not only whether it is necessary to restrict the activities of lotteries but also whether they should be prohibited'.[281] Overall, it has been argued that *consistency* makes restrictions more easily acceptable: a measure as restrictive as a public monopoly, which however forms part of a *consistent* policy, is easier to justify than a far less restrictive licensing requirement fraught with inconsistencies.[282]

Floris de Witte argues that this 'light-touch proportionality review' in the gambling case law offers a perfect example of how free movement should operate in areas which fall within the competence of the Member States.[283] At the same time, however, he notes that, below the surface, Member States are primarily concerned with the economic imperative of maximising tax revenues,[284] but – because of the rule that economic objectives cannot jutify restriction on the fundamental freedoms – they invoke social, moral and cultural values as justification grounds for their restrictive regulatory choices.[285] The Court, in applying the requirement of *coherence* and *consistency* of the national gambling policy in the proportionality assessment, holds Member States *accountable for their own regulatory framework* on gambling services.[286] In this way, the Court not only respects the regulatory choices of the Member States (ranging from national monopolies to complete liberalisation), but it also enforces the domestic normative aspirations *against*

280 Stefaan Van den Bogaert and Armin Cuyvers, '"Money for nothing": The case law of the EU Court of Justice on the regulation of gambling' (2011) 48 Common Market Law Review 1175, p. 1207.

281 Case C-275/92 *Schindler*, para 61; Case C-124/97 *Läärä*, para 39; Case C-67/98 *Zenatti*, para 33; Case C-6/01 *Anomar*, para 87; Case C-243/01 *Gambelli*, para 63.

282 Gjermund Mathisen, 'Consistency and Coherence as Conditions for Justification of Member State Measures Restricting Free Movement' (2010) 47 *Common Market Law Review* 1021, p. 1047.

283 Floris De Witte, 'The constitutional quality of the free movement provisions: looking for context in the case law on Article 56 TFEU' (2017) 42 *European Law Review* 313, p. 332.

284 Des Laffey, Vincent Della Sala and Kathryn Laffey, 'Patriot games: the regulation of online gambling in the European Union' (2016) 23 *Journal of European Public Policy* 1425.

285 Floris De Witte, 'The constitutional quality of the free movement provisions: looking for context in the case law on Article 56 TFEU' (2017) 42 European Law Review 313, p. 332.

286 Ibid, p. 336.

the Member States themselves, forcing them to take seriously the social, moral and cultural objectives they claim to pursue.[287] He concludes that from a constitutional perspective, this approach offers an interesting and convincing example of an adjudicative method that respects both the division of competences between the EU and its Member States and the specific regulatory and normative choices made on the national level.[288]

The 'procedural proportionality test' has also been described as 'good governance' model by Jotte Mulder who seeks to develop an adjudicative model capable of ensuring the 'social responsiveness' and 'social legitimacy' of EU free movement law.[289] Drawing from the case law of the Court in various fields, he distinguishes between three models of adjudication: 1) The *substantive efficiency model*, which examines the substantive content of a measure and its necessity (a representative example can be found the *Beer Purity* case[290]); 2) The *margin of appreciation model*, which grants a margin of discretion to the Member States when the restriction is considered to be 'sensitive', i.e. primarily when fundamental rights or fundamental values are being invoked in order to justify a restriction on the fundamental freedoms (such as the *Schmidberger* case[291]); 3) The *good governance model*, which reviews the procedural aspects of the contested measure, focusing on principles of transparency, coherence and consistency (for instance, the aforementioned gambling case law).[292]

Applying this theoretical framework in the *Volkswagen* case,[293] he argues that the judicial scrutiny of the Volkswagen law should have been based on principles of good governance (i.e. coherence and transparency of the decision making process, availability of judicial remedies, and broader coherence of the Germany policy) and not on substantive efficiency.[294] The application of the *good governance model* would not necessarily have led to a different outcome of the case, but it would have allowed diverging corporate governance models to co-exist in accordance with good governance standards, i.e. it would have respected *national regulatory diversity* while stimulating *EU procedural unity*.[295]

287 Ibid, p. 336.
288 Ibid, p. 339.
289 Jotte Mulder, 'Responsive Adjudication and the 'Social Legitimacy' of the Internal Market' (2016) 22 *European Law Journal* 597, p. 599.
290 Case 178/84 *Commission v Germany (Beer Purity),* ECLI:EU:C:1987:126.
291 Case C-112/00 *Eugen Schmidberger, Internationale Transporte und Planzüge v Republik Österreich,* ECLI:EU:C:2003:333.
292 Jotte Mulder, 'Responsive Adjudication and the 'Social Legitimacy' of the Internal Market' (2016) 22 European Law Journal 597, p. 606-613.
293 Case C-112/05 *Commission v Germany (golden shares – Volkswagen I).*
294 Jotte Mulder, 'Responsive Adjudication and the 'Social Legitimacy' of the Internal Market' (2016) 22 European Law Journal 597, p. 616.
295 Ibid, p. 616, 617.

The application of the good governance model in the golden shares case law is very interesting and indeed worthy of further consideration. A proportionality assessment based on the procedural standards of the legal instruments granting golden shares in privatised undertakings can guarantee an objective judicial review that respects national regulatory diversity in a sensitive field that is not harmonised at the EU level, whilst at the same time ensuring compliance with procedural requirements that create a *transparent* legal framework protecting the *legitimate expectations* of foreign investors and providing *effective judicial remedies* against arbitrary decisions of public authorities. The adoption of a *good governance adjudicative model* shifts the discussion away from politically and ideologically fraught questions (such as the conflict between liberal market economy and coordinated market economy, or the conflict between a corporate governance model that advances shareholders' primacy or one that promotes other stakeholders' interests) to procedural questions which can be objectively reviewed by the Court.

The judicial scrutiny of procedural requirements such as compliance with the principle of legal certainty, transparency, consistency of national policies and availability of effective judicial remedies falls undoubtedly within the competence of the Court and can effectively promote *procedural uniformity* in the EU, which can in turn significantly facilitate cross-border investment. In fact, it can be argued that the existence of procedural discrepancies and the lack of transparency often pose more obstacles to cross-border capital flows than the mere participation of the State in the shareholding of privatised undertakings. This is why the application of the *good governance model* in the proportionality assessment of the golden shares case law offers a better adjudicative approach, one that provides all the procedural guarantees necessary for the promotion of foreign investment, whilst at the same time respecting the discretion of the Member States in the field of corporate governance and promoting a 'pluralism of values' in the EU.[296]

The Court has indeed been responsive to concerns relating to compliance with procedural standards in order to incentivise and facilitate foreign investment and has developed an additional step in the proportionality assessment that examines the compatibility of the measure in question with the fundamental *principle of legal certainty*. This additional step reflects the broader discussion about the protection of *legitimate expectations* of foreign investors as part of the *Fair and Equitable Treatment* standard in international investment law.[297]

296 Niamh Nic Shuibhne, 'Margins of appreciation: national values, fundamental rights and EC free movement law' (2009) 34 *European Law Review* 230, p. 255.

297 Nicolas Angelet, *Fair and Equitable Treatment*, (Max Planck Encyclopedia of Public International Law, 2011); Stephen Vasciannie, 'The Fair and Equitable Treatment Standard in International Investment Law and Practice' (1999) 70 *British Yearbook of International Law*

In EU law, the protection of legitimate expectations is usually framed as compliance with the *principle of legal certainty*. The Court has examined legal certainty as an additional step in the proportionality assessment in the *Beglian* golden shares case,[298] which is actually the only case where the Court found that the special rights that the Belgian government had retained in the undertakings concerned were justified by public interest objectives in accordance with the principle of proportionality. In particular, the contested Belgian legislation gave the Belgian government the right to oppose (a) any transfer of strategic assets of SNTC and Distrigaz and (b) certain management decisions regarded as contrary to the guidelines for the country's energy policy. The Court found that this 'opposition procedure' was justified by the objective of safeguarding supplies of petroleum products in the event of a crisis, and more importantly, it was in conformity with the principle of proportionality. In particular, the Court noted that the opposition procedure was predicated on the principle of respect for the *decision-making autonomy of the undertaking* concerned.[299] Moreover, the public authorities were obliged to adhere to *strict time limits* and the opposition regime was limited only to certain decisions concerning the *strategic assets* of the companies in question.[300] Finally, the responsible Minister could oppose only when there was a *threat* to the objectives of the energy policy and only on the condition that any such opposition was supported by a *formal statement of reasons* and could be the subject of an *effective review* by the courts.[301] Accordingly, the Court concluded that the opposition scheme was consistent with the principle of proportionality, since it was based on *objective criteria* which were *subject to judicial review*,[302] enabling thus Belgium to intervene with a view to ensuring compliance with the public service obligations incumbent on SNTC and Distrigaz, whilst at the same time observing the requirements of *legal certainty*.[303]

99; Barnali Choudhury, 'Evolution or Devolution? – Defining Fair and Equitable Treatment in International Investment Law' (2005) 6 *Journal of World Investment and Trade* 297; Rudolf Dolzer, 'Fair and Equitable Treatment – A Key Standard in Investment Treaties' (2005) 39 *The International Lawyer* 87; Elizabeth Snodgrass, 'Protecting Investors' Legitimate Expectations – Recognizing and Delimiting a General Principle' (2006) 21 *ICSID Review – Foreign Investment Law Journal* 1; Ioana Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment* (Oxford University Press 2008).

298 Case C-503/99 *Commission v Belgium (golden shares)*.

299 Ibid, para 49.

300 Ibid, para 50.

301 Ibid, para 51.

302 See the analysis of Johannes Adolff, 'Turn of the Tide?: The "Golden Share" Judgments of the European Court of Justice and the Liberalization of the European Capital Markets' (2002) 3 *German Law Journal* 20, who concludes that if Member States take good care to identify exactly which aspects of the activities of an enterprise active in a vital sector such as defence or energy they need to control and if they devise a transparent legal framework, they can retain golden shares without disproportionately obstructing the free movement of capital.

303 Case C-503/99 *Commission v Belgium (golden shares)*, para 52.

The *Belgian* case offers a prime example of how the *principle of legal certainty* can operate in the golden shares case law so as to respect the regulatory autonomy of the Member States in the field of corporate governance and property ownership whilst at the same time applying procedural standards that can guarantee the protection of foreign investment. Ever since the *Belgian* case, the Court has attempted to apply the same standard of judicial review to most of the golden shares cases, but on no occasion was the restriction found to be justified. It is true that in some instances the Court might have been strict in the application of the standard of proof, requiring further (and often vaguely defined) evidence in order to prove that the special rights in question actually pursue the objective invoked by the government.[304] However, the fact still remains that in the majority of the golden shares cases the Court rejected the justification because of the rather general and imprecise manner in which the conditions were formulated, which, in turn, confered on the national authorities 'a latitude so discretionary in nature that it [could not] be regarded as proportionate to the objectives pursued'.[305] It is surprising that the Member States did not try to comply with the procedural requirements of legal certainty set out in the *Belgian* case or failed to prove compliance with these requirements.

Given the general application of the procedural proportionality test (based on the *Belgian* case) in the golden shares case law, it is surprising why the Court did not use the same standard of judicial review in the *Volkswagen* case. Indeed, the question as to why the Court decided to abandon the legal certain-

304 See, for instance Joined cases C-282/04 and C-283/04 *Commission v The Netherlands (golden shares)*, paras 39-40, in which the Court, in a rather vague statement, held that the Dutch golden shares went beyond what was necessary in order to safeguard the solvency and continuity of the provider of the universal postal service, because of the fact that they were not limited to the company's activities as provider of a universal postal service. However, it should be noted that this was not the only reason why the Court rejected the invoked justification. It also found that the special rights in question were not based on any precise criterion and did not have to be backed by any statement of reasons, which made any effective judicial review impossible. See also Case C-174/04 *Commission v Italy (golden shares)*, para 40, in which the Court rejected the justification on the ground that the Italian Government had not explained why it was necessary for the shares of undertakings operating in the energy sector in Italy to be held by private shareholders or by public shareholders quoted on regulated financial markets for the undertakings concerned to be able to guarantee sufficient and uninterrupted supplies of electricity and gas in the Italian market.

305 Case C-212/09 *Commission v Portugal (golden shares – GALP Energia SGPS SA)*, paras 88-90; Case C-543/08 *Commission v Portugal (golden shares – EDP)*, paras 90-92; Case C-171/08 *Commission v Portugal (golden shares – Portugal Telecom SGPS SA)*, paras 75-77; Case C-244/11 *Commission v Greece (golden shares)*, paras 82-86; Case C-274/06 *Commission v Spain (golden shares)*, paras 50-52; Case C-207/07 *Commission v Spain (golden shares in the energy sector)*, paras 55-57; Case C-326/07 *Commission v Italy (golden shares)*, paras 66-72; Case C-463/00 *Commission v Spain (golden shares)*, paras 77-80; Case C-483/99 *Commission v France (golden shares – Sociéte Nationale Elf-Aquitaine)*, paras 50-52.

ty requirement in the *Volswagen* case has not been answered to date. The judicial reasoning is worthy of closer examination. The two justification grounds invoked by the German government (i.e. the protection of workers and the protection of minority shareholders) were rejected by the Court due to lack of evidence. In particular, the Court found that

> 'the Federal Republic of Germany [had] not shown why, in order to protect the general interests of minority shareholders, it [was] appropriate or necessary to maintain such a position for the benefit of the Federal and State authorities'[306]

and

> 'failed to explain, beyond setting out general considerations as to the risk that shareholders [might] put their personal interests before those of the workers, why the provisions of the VW Law criticised by the Commission [were] appropriate and necessary to preserve the jobs generated by Volkswagen's activity'.[307]

However, the crux of the matter is hidden in a general statement the Court made regarding the interests which a company is expected to serve. More precisely, the Court held that

> 'it cannot be ruled out that, in certain special circumstances, the Federal and State authorities in question may use their position in order to defend general interests which might be contrary to the economic interests of the company concerned, and therefore, contrary to the interests of its other shareholders'.[308]

This statement takes an ideological stance on perhaps the most controversial politico-economic question that a corporate governance system is supposed to resolve: whose interests should a corporation serve?

By ruling that the public interest objectives can be contrary to the economic objectives of the company and by equating the latter with the interests of its shareholders, the Court, driven by ideological considerations, implicitly promotes a corporate governance system governed by *shareholders' primacy* and the *principle of proportionality between ownership and control* with a view to liberalising the market for corporate control. However, as explained in Chapter 4, Section 3.2.4, the choice of corporate governance model is a fundamental political question, which depends on various socio-economic factors that differ significantly among Member States. The salience of the issue becomes apparent if one considers that the regulation of corporate control affects the most important aspects of a capitalist economy, influencing a nation's employment

306 Case C-112/05 *Commission v Germany (golden shares – Volkswagen I)*, para 78.
307 Ibid, para 80.
308 Ibid, para 79.

level, the conditions of work and production, as well as the distribution of wealth.[309] Whether corporate governance should be dominated by the *shareholders' primacy norm* or by the *stakeholders' primacy norm* is a sensitive national choice, which should be clearly distinguished from the objective of market integration pursued by the Treaties. Consequently, a judicially-driven convergence into a European corporate governance model governed by shareholders' primacy is legally and politically questionable. This relates to the general *problématique* of the legal structure of the free movement provisions, which sometimes fails to respect the vertical balance of competence between the EU and the Member States and does not ensure that the normative values underpinning the socio-economic European space are articulated through a political process that can legitimise them in a democratic way.[310]

Drawing from the *contextual* reading of the case law in relation to the other fundamental freedoms,[311] it is submitted here that, in light of the politically and economically contentious context of golden shares, the most appropriate adjudicative approach is the 'procedural proportionality' or 'good governance model'. Through this approach the Court can be more deferential towards national policy objectives in a field of law that falls outwith the legislative competences of the EU, whilst at the same time disapplying discriminatory measures or special shareholding that derogate from ordinary company law and grant an undue advantage to the Member States to the detriment of private investors. This 'procedural proportionality' or 'good governance model' is based upon the *principle of legal certainty* and includes the review of elements such as respect for the decision-making autonomy of the undertaking concerned, strict time limits, objective criteria, obligation to provide a formal statement of reasons when adopting certain decisions and availability of effective judicial remedies. The judicial review of these elements as conducted in the *Belgian* case has an important pedagogical value as it can be used as a guiding principle upon which Member States can structure their special shareholding in privatised undertakings in order to be compatible with the free movement of capital.

309 Benjamin Werner, 'National responses to the European Court of Justice case law on Golden Shares: the role of protective equivalents' (2016) 24 *Journal of European Public Policy* 989, at p. 993.

310 Floris De Witte, 'The constitutional quality of the free movement provisions: looking for context in the case law on Article 56 TFEU' (2017) 42 European Law Review 313, p. 337-339.

311 Ibid, where the author explores the constitutional implications of the freedom to provide services by examining the case law in the field of labour law, healthcare and gambling and he suggests that a *contextual* reading of the fundamental freedoms is necessary in order to ensure that that the Court remains sensitive to the distinct and diverse policy context that the free movement provisions touch upon.

3.4 The definition of 'capital restrictions' in the golden shares case law

The analysis above showed that in the golden shares case law the Court has left very limited room for the Member States to justify their special rights in privatised undertakings. In light of the unsuccessful invocation of the aforementioned derogation grounds and the high standard of proof required in the proportionality assessment, it is essential to go a step back in the judicial reasoning and to explore the precise contours of the scope of 'capital restrictions'.[312] This is because a more appropriate delineation of the notion of 'capital restrictions' can allow a better drawing of the dividing line between the competence of the EU and the Member States in the field of corporate governance and can accordingly give Member States sufficient room to exercise their regulatory autonomy to protect public interest objectives, within the contours of the Internal Market.

In particular, the golden shares case law, the Court has adopted the 'deterrent effect test', which leads to a strikingly broad interpretation of the notion of 'capital restrictions' encompassing *all* measures liable to deter/discourage foreign investors. This over-inclusive definition is reminiscent of the broad *Dassonville* formula[313] in the area of free movement of goods. Although the Court is notoriously known for not easily retreating from its previous case law, the *Keck* ruling[314] in the area of free movement of goods constitutes the prime example where the Court explicitly reconsidered the broad interpretation of 'measures having equivalent effect to a quantitative restriction' and introduced the concept of 'selling arrangements' in an attempt to restrict the scope of Article 34 TFEU.

The present section draws from the jurisprudential developments in the area of free movement of goods and investigates whether a concept similar to the *Keck* notion of 'selling arrangements' could or should be introduced in the free movement of capital in order to delimit the boundaries of Article 63 TFEU.[315] Such a concept could take the form of an 'investment arrangements'

312 It should be noted that this part constitutes a modified and extended version of the published journal article: Ilektra Antonaki, 'Keck in Capital? Redefining "Restrictions" in the "Golden Shares" Case Law' (2016) *Erasmus Law Review* 177.

313 Case 8-74 *Dassonville*, para 5: 'All trading rules enacted by Member States which are capable of hindering, directly or indirectly, actually or potentially, intra-Community trade are to be considered as measures having an effect equivalent to quantitative restrictions'.

314 Joined cases C-267/91 and C-268/91 *Criminal proceedings against Bernard Keck and Daniel Mithouard,* ECLI:EU:C:1993:905.

315 Wolf-Georg Ringe, 'Company Law and Free Movement of Capital' (2010) 69 Cambridge Law Journal 378, p. 402; Anne Looijestijn-Clearie, 'All that glitters is not gold: European Court of Justice strikes down golden shares in two Dutch companies' (2007) 8 *European Business Organization Law Review* 429, p. 452; Florian Sanders, 'Case C-112/05, European Commission v. Federal Rebublic of Germany: The Volkswagen Case and Art. 56 EC – A

test,[316] whereby measures that do not derogate from ordinary company law and that respect equality between the State and private parties as market participants escape from the material scope of the free movement of capital and therefore cannot be regarded as 'capital restrictions'. The section is divided into four parts. The first part seeks to explore the evolution of the concept of restrictions in the free movement of goods through a brief overview of the relevant case law (section 3.4.1). The second part examines the transposition of the *Keck* ruling in the area of workers, services and establishment (section 3.4.2). The third part analyses the Court's negative reaction to the attempts of the Member States to invoke the *Keck* test in the golden shares case law (section 3.4.3). Finally, the fourth part attempts to put forward a novel legal test for the delimitation of the scope of 'capital restrictions' on the basis of which certain measures can escape from judicial scrutiny if they satisfy two conditions: first, they do not derogate from ordinary company law; and second, they respect the principle of equality between the State and private parties as market participants (section 3.4.4).

3.4.1 The concept of 'restrictions' in the free movement of goods

3.4.1.1 The pre-Keck case law on MEEQRs

The establishment and development of the EU's Internal Market has been to a large extent supported and promoted by the dynamics of negative integration. It was the Luxembourg Court that stepped in and took the lead in overcoming the political stagnation of the 1960s/1970s and facilitating the process of economic integration. With the two landmark decisions in *Dassonville*[317] and *Cassis de Dijon*,[318] the Court unleashed the powers of negative integration and inaugurated a new era, where any national rule capable of hindering, directly or indirectly, actually or potentially, intra-Community trade could be regarded as a 'measure having equivalent effect to a quantitative restriction'.[319]

The far-reaching consequences did not take too long to make themselves felt: in the aftermath of the two rulings, a wave of speculative national litigation mushroomed, calling for all sorts of indistinctly applicable national regulatory

Proper Result, Yet Also a Missed Opportunity?' (2007-2008) 14 Columbia Journal of European Law 359, p. 368.

316 Andrea Biondi, 'When the State is the Owner – Some Further Comments on the Court of Justice 'Golden Shares' Strategy' in Bernitz and Ringe (eds), *Company Law and Economic Protectionism: New Challenges to European Integration* (Oxford University Press 2010), p. 96.

317 Case 8-74 *Dassonville*.

318 Case 120/78 *Cassis de Dijon*.

319 Case 8-74 *Dassonville*, p. 5.

requirements to be disapplied as contrary to the free movement provisions.[320] These legal actions against national rules regulating marketing and selling conditions were perceived as an intrusion into the domain of national regulatory autonomy and it was increasingly suggested that the Court should clarify and delineate the boundaries of Article 34 TFEU.[321] In the same vein, Advocate General Tesauro in *Hünermund* admitted that he had changed his mind in relation to his views in previous case law[322] and he opined that the all-inclusive *Dassonville* formula could not be construed as meaning that a potential reduction in imports caused solely and exclusively by a more general (and hypothetical) contraction of sales, could constitute an MEEQR.[323] Accordingly, he asserted that rules which regulated the manner in which a trading activity was carried out were in principle to be regarded as falling outside the scope of Article [34 TFEU], insofar as they did not intend to regulate trade itself and they were not liable to render market access less profitable (and thus indirectly

320 Jukka Snell, 'The Notion of Market Access: A Concept or a Slogan?' (2010) 47 *Common Market Law Review* 437. See for example Case 286/81 *Oosthoek's Uitgeversmaatschappij BV*, ECLI:EU:C:1982:438 concerning a Dutch rule prohibiting the offering of free gifts for sales promotion purposes; Case 155/80 *Summary proceedings agains Sergius Oebel,* ECLI:EU:C:1981:177 regarding a German prohibition on night-work in bakeries; *Opinion of Mr Advocate General Darmon in Case C-69/88 H. Krantz GmbH & Co. v Ontvanger der Directe Belastingen and Netherlands State,* ECLI:EU:C:1989:627 on a Dutch rule granting tax authorities the power to seize goods sold on instalment terms with reservation of title in case the purchasers were not able to repay their tax debts; Case C-145/88 *Torfaen Borough Council v B & Q plc.,* ECLI:EU:C:1989:593 on the British prohibition of Sunday trading; Case C-23/89 *Quietlynn Limited and Brian James Richards v Southend Borough Council,* ECLI:EU:C:1990:300 regarding the British legislation prohibiting the sale of lawful sex articles from unlicensed sex establishments; Case 382/87, *R. Buet*, [1989] ECR -01235 concerning a French prohibition on canvassing in connection with the sale of English-language teaching material; Case C-271/92 *Laboratoire de Prothèses Oculaires v Union Nationale des Syndicats d'Opticiens de France and Groupement d'Opticiens Lunetiers Détaillants and Syndicat des Opticiens Français Indépendants and Syndicat National des Adapteurs d'Optique de Contact,* ECLI:EU:C:1993:214 dealing with a provision in the French Code de la Santé Publique reserving solely to holders of an optician's certificate (Diplôme d' opticien-lunetier) the sale of optical appliances and corrective lenses; Case C-126/91 *Schutzverband gegen Unwesen in der Wirtschaft e.V. v Yves Rocher GmbH,* ECLI:EU:C:1993:191 on a German rule prohibiting advertisements using price comparisons (displaying the new price and comparing it with the old one so as to catch the eye).

321 Eric L. White, 'In Search Of The Limits To Article 30 Of The EEC Treaty' (1989) 26 *Common Market Law Review* 235; L.W. Gormley, 'Case 145/88, Torfaen Borough Council v. B&Q PLC (formerly B&Q Retail Ltd.), Preliminary reference under Art. 177 EEC by the Cwmbran Magistrates' Court on the interpretation of Arts. 30 & 36 EEC. Judgment of the Court of Justice of the European Communities of 23 November 1989' (1990) 27 *Common Market Law Review* 141; Anthony Arnull, 'What shall we do on Sunday?' (1991) 16 *European Law Review* 112; Kamiel Mortelmans, 'Article 30 of the EEC Treaty and Legislation Relating to Market Circumstances: Time to Consider a New Definition?' (1991) 28 *Common Market Law Review* 115; J. Steiner, 'Drawing the line: Uses and abuses of Article 30 EEC' (1992) 29 *Common Market Law Review* 749.

322 *Opinion of Advocate General Tesauro in Case C-292/92 Ruth Hünermund,* ECLI:EU:C:1993:863, para 26.

323 Ibid, para 25.

more difficult) for importers.[324] He believed that this approach was in line with the principle of mutual recognition established in *Cassis de Dijon* and did not in any way undermine its truly integrationist inspiration.[325] A different (i.e. more intrusive) interpretation of Article [34 TFEU] 'would ultimately render nugatory the Treaty provisions … or in any event devalue them'.[326]

3.4.1.2 The Keck ruling and the introduction of the concept of 'selling arrangements'

In 1993, with the *Keck* ruling, the Court introduced the 'selling arrangements' test in an effort to clarify the boundaries of the broad definition of MEEQR. The facts of the case are widely known. Mr Keck and Mr Mithouard, owners of a French supermarket, were prosecuted for reselling products in an unaltered state at prices lower than their actual purchase price ('resale at a loss') contrary to the pertinent French legislation. In their defence, they argued that a prohibition on resale at a loss was contrary to the free movement of goods under Article [34 TFEU]. The Court was faced with a dilemma: to continue the line of case law advocating a broad interpretation of Article 34 TFEU or to reconsider its position in view of the fact that the contested measure had arguably no effect on inter-State trade. It chose to do the latter.

In particular, it explicitly expressed its intention to re-examine and clarify its case law in view of the increasing tendency of traders to invoke Article 34 TFEU as a means of challenging any rules whose effect was to limit their commercial freedom even where such rules were not aimed at products from other Member States.[327] Thus, it introduced the famous (or rather infamous) concept of 'selling arrangements'. According to the Court's reasoning, rules that restricted or prohibited certain selling arrangements were not such as to hinder directly or indirectly, actually or potentially trade between Member States as long as two conditions were fulfilled: (i) they applied to all relevant traders operating within the national territory; and (ii) they affected in the same manner, in law and in fact, the marketing of domestic products and of those from other Member States.[328] These 'selling arrangements' were excluded from the scope of Article 34 TFEU, which meant that the national measure at issue was permissible without there being a need to examine possible justification grounds.

324 Ibid.
325 Ibid.
326 Ibid, par 27.
327 Joined cases C-267/91 and C-268/91 *Keck and Mithouard*, para 14.
328 Ibid, para 16.

The exact content of the concept of 'selling arrangements' was revealed in subsequent case law: rules on shop opening hours,[329] rules requiring processed milk for infants be sold only in pharmacies[330] and certain restrictive rules on advertising[331] are some examples of the type of national regulatory provisions that were captured by the concept of 'selling arrangements' and were thus excluded from the scope of Article 34 TFEU. In general terms, rules relating to the place and time of sales as well as to the marketing of specific products were in principle considered to be caught by the *Keck*-formula.[332]

However, the somewhat artificial dichotomy between 'product requirement' and 'selling arrangements' rules proved rigid and artificial[333] and sparked an academic debate.[334] Lawrence Gormley noted that the exclusion of 'selling arrangements' from the scope of Article 34 TFEU would lead to a lack of judicial review of ostensibly innocent measures, which could however constitute

329 Joined cases C-401/92 and C-402/92 *Criminal proceedings against Tankstation 't Heukske vof and J. B. E. Boermans,* ECLI:EU:C:1994:220; Joined cases C-69/93 and C-258/93 *Punto Casa SpA v Sindaco del Comune di Capena and Comune di Capena and Promozioni Polivalenti Venete Soc. coop. arl (PPV) v Sindaco del Comune di Torri di Quartesolo and Comune di Torri di Quartesolo,* ECLI:EU:C:1994:226; Joined cases C 418/93 et al. *Semeraro Casa Uno Srl v Sindaco del Comune di Erbusco,* ECLI:EU:C:1996:242; Case C-483/12 *Pelckmans Turnhout NV v Walter Van Gastel Balen NV and Others,* ECLI:EU:C:2014:304.

330 Case C-391/92 *Commission v Greece (infant milk),* ECLI:EU:C:1995:199.

331 Case C-292/92 *Ruth Hünermund and others v Landesapothekerkammer Baden-Württemberg,* ECLI:EU:C:1993:932; Case C-412/93 *Société d'Importation Edouard Leclerc-Siplec v TF1 Publicité SA and M6 Publicité SA,* ECLI:EU:C:1995:26; Joined cases C-34/95, C-35/95 and C-36/95 *Konsumentombudsmannen (KO) v De Agostini (Svenska) Förlag AB and TV-Shop i Sverige AB,* ECLI:EU:C:1997:344; Case C-405/98 *Konsumentombudsmannen (KO) v Gourmet International Products AB (GIP),* ECLI:EU:C:2001:135.

332 Case C-71/02 *Karner*, para 38.

333 Stefaan Van den Bogaert and Pieter Van Cleynenbreugel, 'Free Movement of Goods' in Pieter Jan Kuijper, Fabian Amtenbrink, Deirdre Curtin, Bruno De Witte, Alison McDonnell and Stefaan Van den Bogaert (eds), *The Law of the European Union, Fifth Edition* (Wolters Kluwer 2018), pp. 485-537, at p. 519.

334 The *Keck* judgment and its implications for the functioning of the internal market have been extensively analysed by legal scholars. See indicatively: Lawrence W. Gormley, 'Reasoning Renounced? The Remarkable Judgment in Keck & Mithouard?' (1994) 5 *European Business Law Review* 63; Miguel Poiares Maduro, 'Keck: The end? The beginning of the end? Or just the end of the beginning' (1994) 3 *Irish Journal of European Law* 30; Nicolas Bernard, 'Discrimination and Free Movement in E.C. Law' (1996) 45 *International and Comparative Law Quarterly* 82; Catherine Barnard, 'Fitting the remaining pieces into the goods and persons jigsaw?' (2001) 26 *European Law Review* 35; Alina Tryfonidou, 'Was Keck a Half-baked Solution After All?' (2007) 34 *Legal Issues of Economic Integration* 167; Ioannis Lianos, 'Shifting Narratives in the European Internal Market: Efficient Restrictions of Trade and the Nature of "Economic" Integration' (2010) 21 *European Business Law Review* 705; Catherine Barnard, 'What the Keck? Balancing the needs of the single market with state regulatory autonomy' (2012) 2 *European Journal of Consumer Law* 201; Stephen Weatherill, 'The Road to Ruin: 'Restrictions on Use' and the Circular Lifecycle of Article 34 TFEU' (2012) 2 *European Journal of Consumer Law* 359.

disguised restrictions on inter-State trade.[335] Stephen Weatherill, while recognising that the ruling excluded from the scope of the Treaty certain regulatory choices that do not damage the realisation of economies of scale, nevertheless considered that it had a 'disturbingly formalistic tone' and it was 'flawed by the absence of an adequate articulation of just why it was possible to conclude that no sufficient impact on trade between States was shown'.[336] He thus proposed a refined *Keck*-test that would allow Member States to apply national regulatory measures to imported goods as long as they would apply equally in law and in fact to domestic and foreign goods and they would not impose *direct* or *substantial* hindrance to market access.[337] The origin of this refined test can be traced back to the Advocate General Jacobs' opinion in *Leclerc-Siplec*,[338] where he expressed his famous objection to the *Keck*-inspired presumption of lawfulness of 'selling arrangements' and he proposed the adoption of a test based on '*substantial* restriction of market access' for determining whether non-discriminatory rules infringed Article 34 TFEU. In his highly cited and illustrative excerpt, he emphasised that

> 'If an obstacle to inter-State trade exists, it cannot cease to exist simply because an identical obstacle affects domestic trade. … If a Member State imposes a *substantial barrier* on access to the market for certain products … and a manufacturer of those products in another Member State suffers economic loss as a result, he will derive little consolation from the knowledge that a similar loss is sustained by his competitors in the Member State which imposes the restriction'.[339]

The *substantial barrier* test was also espoused by other Advocates General[340] and legal scholars as a criterion for establishing the existence of a 'measure having equivalent effect to a quantitative restriction'.[341] It was argued that

335 Lawrence W. Gormley, 'Two Years After Keck' (1996) 19 *Fordham International Law Journal* 866.

336 Stephen Weatherill, 'After *Keck*: Some Thoughts on How to Clarify the Clarification' (1996) 33 *Common Market Law Review* 885.

337 Ibid, p. 903.

338 *Opinion of Advocate General Jacobs in Case C-412/93 Leclerc-Siplec,* ECLI:EU:C:1994:393.

339 Ibid, para 39.

340 *Opinion of Advocate General Stix- Hackl in Case C-322/01 DocMorris NV,* ECLI:EU:C:2003:147, para 78, where he underlined that 'The decisive factor should therefore be whether or not a national measure *significantly* impedes access to the market'. See also *Opinion of Advocate General Van Gerven in Case C-145/88 Torfaen,* ECLI:EU:C:1989:279, para 24, where he argued that there was no room for a *de minimis* test, because Article 34 TFEU already presupposes a *serious*, and therefore a *more than appreciable*, obstruction to trade between Member States.

341 Max S. Jansson and Harri Kalimo, 'De Minimis Meets "Market Access": Transformations in the Substance – and the Syntax- of EU Free Movement Law?' (2014) 51 *Common Market Law Review* 523. It is interesting to note that the authors of this article distinguish three substantive groups of *de minimis* thresholds: the magnitude (severity) of the restrictive effect, the probability of the restrictive effect and the causality between the measure and the restrictive effect. See also J. Steiner, 'Drawing the line: Uses and abuses of Article 30 EEC'

the case law offered room for *de minimis* considerations in free movement law, in the sense that 'minimal restrictive effects' did not affect market access, while several trade restrictions hindered *significantly* market access and thus impinged on Article 34 TFEU.[342] However, the position of the Court was less clear. Although it had ostensibly rejected the adoption of a *de minimis* test in the free movement assessment,[343] it effectively accepted a similar test by acknowledging that if the effect on market access was 'too uncertain or indirect'[344] or 'purely hypothetical'[345] then the contested measure did not infringe free movement provisions.[346] By contrast, measures which *significantly* impeded market access constitute 'measure having equivalent effect to a quantitative restriction' within the meaning of Article 34 TFEU.[347]

(1992) 29 Common Market Law Review 749; Catherine Barnard and Steve Peers (eds), *European Union Law* (Oxford University Press 2017), p. 352; Helen Toner, 'Non-discriminatory obstacles to the exercise of Treaty Rights – Articles 39, 43, 49, and 18 EC' (2004) 23 *Yearbook of European Law* 275, p. 285. Conversely c.f. Stephen Weatherill, 'After *Keck*: Some Thoughts on How to Clarify the Clarification' (1996) 33 Common Market Law Review 885, who refrains from describing the 'direct or substantial hindrance to market access' test as a *de minimis* threshold.

342 Max S. Jansson and Harri Kalimo, 'De Minimis Meets "Market Access": Transformations in the Substance – and the Syntax- of EU Free Movement Law?' (2014) 51 Common Market Law Review 523, p. 526.

343 Joined cases 177 and 178/82 *Van de Haar*, at 13; Case C-67/97, *Ditlev Bluhme*, [1998] ECR I-08033, para 20; Joined cases C-1/90 and C-176/90 *Aragonesa de Publicidad and Publivi´a v Departamento de Sanidad,* ECLI:EU:C:1991:327, para 24; Joined cases C-277/91, C-318/91 and C-319/91 *Ligur Carni Srl and Genova Carni Srl v Unità Sanitaria Locale n. XV di Genova and Ponente SpA v Unità Sanitaria Locale n. XIX di La Spezia and CO.GE.SE.MA Coop a r l,* ECLI:EU:C:1993:927, para 37.

344 Case C-69/88 *H. Krantz GmbH & Co. tegen Ontvanger der Directe Belastingen en Staat der Nederlanden,* ECLI:EU:C:1990:97, para 11; Case C-190/98 *Volker Graf v Filzmoser Maschinenbau GmbH,* ECLI:EU:C:2000:49, para 25 (in the field of free movement for workers). Conversely, in Case C-415/93 *Bosman,* ECLI:EU:C:1995:463, para 103 the Court found that the transfer rules at issue *directly* affected players access to the employment market in other Member States and were thus capable of impeding the freedom of movement for workers. Similarly, in Case C-384/93 *Alpine Investments BV v Minister van Financiën,* ECLI:EU:C:1995:126, the Court ruled that the prohibition of cold calling by telephone for financial services *directly* affected access to the market in services in the other Member States and was thus capable of hindering intra-Community trade in services.

345 Case C-299/95 *Friedrich Kremzow v Republik Österreich,* ECLI:EU:C:1997:254, para 16, where the Court interestingly ruled that whilst any deprivation of liberty may impede a person from exercising his right to free movement, a purely hypothetical prospect of exercising that right does not establish a sufficient connection with Community law to justify the application of free movement provisions.

346 Stephen Weatherill, 'After *Keck*: Some Thoughts on How to Clarify the Clarification' (1996) 33 Common Market Law Review 885, p. 900; Dimitrios Doukas, 'Untying the market access knot: Advertising restrictions and the free movement of goods and services' (2007) 9 *Cambridge Yearbook of European Legal Studies* 177.

347 Case C-108/09 *Ker-Optika bt v ÀNTSZ Dél-dunántúli Regionális Intézete,* ECLI:EU:C:2010:725, para 54. By the same token but in a different context, recently the Court found that the Spanish legislation prohibiting tobacco retailers from importing tobacco products and forcing

3.4.1.3 The post-Keck 'market access' test

Although the Court never overruled explicitly the *Keck*-test, progressively it clarified its content and its precise requirements. In particular, in subsequent case law the Court interpreted the two conditions contained in paragraph 16 of *Keck* as meaning that certain 'selling arrangements' could not escape the scrutiny of the free movement provisions if they were discriminatory or they imposed additional burdens on imported goods (in the sense of the 'dual burdens' that the principle of mutual recognition was intended to eliminate under the *Cassis de Dijon* judgment). Cases such as *Familiapress*,[348] *De Agostini*,[349] *Gourmet*[350] and *Alfa Vita*[351] signalled the transition from an approach based on a formalistic distinction between 'product rules' and 'selling arrangements' to a more straightforward test based on 'market access hindrance'.[352] In *Commission v Italy (trailers)*[353] and *Mickelsson and Roos*,[354] without departing from *Keck*, the Court seemed to focus more on a 'market access' test according to which rules restricting the *use* of products hinder the market access of foreign products and therefore constitute 'measures having equivalent effect to a quantitative restriction' prohibited under Article 34 TFEU.[355] Thus,

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them to procure their supplies from authorised wholesalers hindered the access of these products to the market. This was despite the contentions of the Commission and the Spanish Government that the legislation at issue had to be assessed in the light of Article 37 TFEU, since it concerned the operation of a monopoly of a commercial character and the restrictions on trade which are inherent in the existence of such a monopoly. See Case C-456/10 *Asociación Nacional de Expendedores de Tabaco y Timbre (ANETT) v Administración del Estado,* ECLI:EU:C:2012:241, paras 21, 43.

348 Case C-368/95 *Vereinigte Familiapress Zeitungsverlags- und vertriebs GmbH v Heinrich Bauer Verlag,* ECLI:EU:C:1997:325.

349 *Joined cases C-34/95, C-35/95 and C-36/95 De Agostini.*

350 Case C-405/98 *Gourmet*.

351 Joined cases C-158 & 159/04 *Alfa Vita Vassilopoulos AE and Carrefour Marinopoulos AE v Elliniko Dimosio and Nomarchiaki Aftodioikisi Ioanninon,* ECLI:EU:C:2006:562, para 19.

352 For the notion of the market access, see Jukka Snell, 'The Notion of Market Access: A Concept or a Slogan?' (2010) 47 Common Market Law Review 437; Gareth Davies, 'Understanding Market Access: Exploring the Economic Rationality of Different Conceptions of Free Movement Law' (2010) 11 *German Law Journal* 671; Catherine Barnard, 'Restricting Restrictions: Lessons for the EU from the US?' (2009) 68 *Cambridge Law Journal* 575; Eleanor Spaventa, 'From Gebhard to Carpenter: Towards a (non-)economic European constitution' (2004) 41 Common Market Law Review 743; Peter Oliver and Stefan Enchelmaier, 'Free movement of goods: Recent developments in the case law' (2007) 44 *Common Market Law Review* 674.

353 Case C-110/05 *Commission v Italy (trailers),* ECLI:EU:C:2009:66.

354 Case C-142/05 *Åklagaren v Percy Mickelsson and Joakim Roos,* ECLI:EU:C:2009:336.

355 For an academic discussion, see for instance Luca Prete, 'Of Motorcycle Trailers and Personal Watercrafts: the Battle over Keck' (2008) 35 *Legal Issues of Economic Integration* 133; Peter Pecho, 'Good-Bye Keck?: A Comment on the Remarkable Judgment in Commission v. Italy, C-110/05' (2009) 36 *Legal Issues of Economic Integration* 257; Pal Wenneras and Ketil Boe Moen, 'Selling Arrangements, Keeping Keck' (2010) 35 *European Law Review* 387; Peter Oliver, 'Of Trailers and Jet Skis: Is the Case Law on Article 34 TFEU Hurtling in a New Direction?'

the Italian prohibition on motorcycles towing trailers and the Swedish prohibition on the use of personal watercraft on waters other than general navigable waterways were regarded as trade restrictions, which could however be justified on road safety[356] and environmental protection grounds.[357]

3.4.2 *The application of Keck in the other freedoms (workers, services and establishment)*

Despite the change of terminology and the adoption of the broader 'market access' test, in the area of free movement of goods the Court has never officially abandoned the *Keck*-test. In the field of workers and services, although the Court has not ruled out the possibility of using a *Keck*-inspired approach, in practice it has refrained from doing so given the fact that most of the contested measures have been not found to be comparable to selling arrangements. In particular, in relation to the free movement of workers (Article 45 TFEU), in *Bosman*,[358] the Court ruled that:

> 'although the rules in issue in the main proceedings apply also to transfers between clubs belonging to different national associations within the same Member State and are similar to those governing transfers between clubs belonging to the same national association, they still directly affect players' access to the employment market in other Member States and are thus capable of impeding freedom of movement for workers. They cannot, thus, be deemed comparable to the rules on selling arrangements for goods which in Keck and Mithouard were held to fall outside the ambit of Article 30 of the Treaty'.[359]

Similarly, in relation to the freedom to provide services (Article 56 TFEU), in *Alpine Investments*,[360] the Court found that the *Keck*-test could not be applied by analogy *in casu*, because:

> 'a prohibition such as that at issue is imposed by the Member State in which the provider of services is established and affects not only offers made by him to addressees who are established in that State or move there in order to receive services but also offers made to potential recipients in another Member State. It

(2011) 33 *Fordhman International Law Journal* 1423; Gareth Davies, 'The Court's jurisprudence on free movement of goods: pragmatic presumptions, not philosophical principles' (2012) 2 *European Journal of Consumer Law* 25.

356 Case C-110/05 *Commission v Italy (trailers)*, para 69.

357 Case C-142/05 *Mickelsson and Roos*, para 36, provided that the competent national authorities designated within reasonable period waters other than general navigable waterways on which personal watercraft could be used.

358 Case C-415/93 *Bosman*.

359 Ibid, para 103.

360 Case C-384/93 *Alpine Investments*.

> therefore directly affects access to the market in services in the other Member States and is thus capable of hindering intra-Community trade in services'.[361]

However, it seems that the Court has indirectly and tacitly accepted the transposition of a *Keck*-like approach to the freedom of establishment. More precisely, in the *Kornhaas* case,[362] the Court implicitly distinguished between (innocent) '*business-related rules*' and '*establishment-related rules*' (requiring justification).[363] The case concerned a company incorporated under English law, which carried out most of its business (thus had its 'centre of main interests') in Germany through a branch. The dispute arose between the liquidator of the company and its director regarding an action for reimbursement of payments, which the latter had made as a managing director of the debtor company after it had become insolvent. The Court, after ruling that the law applicable to the insolvency proceedings was the German law pursuant to Article 4(1) of Regulation No 1346/2000, found that the pertinent German provision on the personal liability of the managing directors did not infringe the freedom of establishment under Article 49 TFEU, since such a provision:

> 'in no way concerns the formation of a company in a given Member State or its subsequent establishment in another Member State, to the extent that that provision of national law is applicable only after that company has been formed, in connection with its business […]'.[364]

This ruling has been interpreted as departing from the liberal approach adopted in *Centros*[365] and introducing a distinction between company law and insolvency law for the purposes of assessing their compatibility with EU free movement law.[366] In particular, in *Centros*, the Court had opened up the market for incorporations by ruling that provisions of national company law which prohibit the incorporation of a company in a Member State in which the company does not conduct business were contrary to the freedom of establishment.[367] In the light of this ruling, German (and other) companies registered their offices in England in order to benefit from the liberal English company law regime, while maintaining their economic activities exclusively in Germany or in the other Member States of origin. The *Kornhaas* case con-

361 Ibid, para 38.

362 Case C-594/14 *Simona Kornhaas v Thomas Dithmar als Insolvenzverwalter über das Vermögen der Kornhaas Montage und Dienstleistung Ltd*, ECLI:EU:C:2015:806.

363 Wolf-Georg Ringe, 'Case Comment: Kornhaas and the challenge of applying Keck in establishment' (2017) 42 *European Law Review* 270.

364 Case C-594/14 *Kornhaas*, para 28.

365 Case C-212/97 *Centros Ltd. v Erhvervs-og Selskabbsstyrelsen*, ECLI:EU:C:1999:126.

366 Wolf-Georg Ringe, Kornhaas and the Limits of Corporate Establishment, https://www.law.ox.ac.uk/business-law-blog/blog/2016/05/kornhaas-and-limits-corporate-establishment

367 Case C-212/97 *Centros*, para 39.

cerned the question whether such a company incorporated in England but operating exclusively in Germany was subject to German insolvency law and whether the latter constituted a restriction on the freedom of establishment. The Court ruled that the company was indeed subject to German insolvency law and that the national provision on the personal liability of the managing directors was not contrary to the freedom of establishment. The distinction between, on the one hand, rules of company concerning incorporation and establishment which can impose restrictions on the freedom of establishment and, on the other hand, rules of insolvency law concerning the business behaviour of the company which do not affect the freedom of establishment has been interpreted as reminiscent of the *Keck* doctrine.[368] Although the Court did not mention explicitly *Keck* in its judgment, it seems that the rationale behind this distinction was to create a category of 'business-related arrangements', which would fall outside the scope of the freedom of establishment.

The *Kornhaas* ruling received criticism from scholars arguing that:

> 'the scope of art. 49 TFEU (unlike art. 34 TFEU) does not differentiate but rather applies broadly to "the right to take up and pursue activities as self-employed persons and to set up and manage undertakings" without there being room for a differentiated interpretation'.[369]

Although this criticism is certainly worthy of consideration, the Court, aware of the legal controversies of the case, tried to pre-empt the critiques by clarifying that the legal capacity of the debtor company is in no way called into question[370] and that the German provision is in fact applicable only from the time when the company must be considered to be insolvent or when its over-indebtedness is recognised in accordance with the applicable national law.[371] As the referring court rightly pointed out, the German provision in question does not govern the conditions in which a company established in accordance with the law of another EU State may install its administrative office in Germany, but only the legal consequences of such a decision and of wrong-

368 Wolf-Georg Ringe, 'Kornhaas and the Limits of Corporate Establishment' (*Oxfrod Business Law Blog*, 25 May 2016) <https://www.law.ox.ac.uk/business-law-blog/blog/2016/05/kornhaas-and-limits-corporate-establishment> accessed 31-01-2019.

369 Wolf-Georg Ringe, 'Case Comment: Kornhaas and the challenge of applying Keck in establishment' (2017) 42 European Law Review 270, p. 276.

370 Case C-594/14 *Kornhaas*, para 26.

371 Ibid, para 28.

ful conduct of its managing directors.[372] Therefore, the freedom of establishment is not affected.[373]

The refusal of the Court to qualify the German provision on the personal liability of the managing directors regarding payments that were made after the company became insolvent as a restriction on the freedom of establishment sends a strong signal that the Court is not willing to undertake a quality control of all company, insolvency, labour or tax law requirements of the Member States as this would be against not only the letter but also the spirit of the fundamental freedoms protected under the Treaties and the rationale of the whole project of market integration in the EU. The implicit transposition of the *Keck*-ruling in the area of establishment provides support and reinforces the argument that a similar approach should be adopted in the area of free movement of capital. As will be analysed below, the crucial factor that makes the transposition of *Keck* to the free movement of capital (and establishment) so imperative is that more often than not the national measures that are challenged as capital restrictions constitute regulatory requirements which *structure the market itself*, rather than imposing obstacles to the *market access* of foreign investors.

3.4.3 'Selling arrangements' in the golden shares case law

In the golden shares case law, the Member States have consistently expressed their strong opposition to the strikingly broad interpretation of 'capital restrictions', arguing that it essentially deprives them of their right to choose and determine the corporate governance regime that suits best to the structure of their economy and corresponds to the needs of their industrial policy. Among their various defences, some Member States attempted to draw a parallel between 'golden shares' and 'selling arrangements', arguing that a *Keck*-like approach should apply in relation to the special shareholding retained in privatised companies. They asked the Court to relativise its rigid legal reasoning in order to prevent a replication of the legal ramifications that we

372 Ibid, para 10.

373 Ibid, para 10. One could argue that the same approach could have been adopted in *AGET Iraklis* which concerned the Greek legislation imposing a ministerial authorisation requirement for a company wishing to effectuate a collective redundancies scheme. The Court could have said that the ministerial authorisation requirement does not affect the establishment, legal capacity or even the pursuing of business activities of the undertaking concerned and therefore cannot qualify as a restriction on the freedom of establishment. However, the Court held that the freedom of establishment entails the freedom to scale down or even give up an economic activity and therefore the legislation in question constitutes a significant interference with the freedom of an undertaking to take such a fundamental decision as the decision to effectuate collective redundancies. See Case C-201/15 *AGET Iraklis*, paras 53-55.

witnessed as a result of the over-extensive application of the free movement of goods in the aftermath of *Dassonville* and *Cassis de Dijon*. This argument has so far been invoked unsuccessfully five times: once by Spain,[374] once by the UK[375] and three times by Portugal.[376]

The first case where the argument that a *Keck*-like approach could be applied in the field of the free movement of capital concerned Britain's biggest airport operator, the British Airports Authority (BAA).[377] BAA was privatised in 1986 as part of the privatisation policy pursued by Margaret Thatcher. The privatisation process was governed by the Airports Act 1986. The UK Government retained control over the newly formed company that took over the functions of the previously state-owned enterprise by retaining a special shareholding. In particular, the Articles of Association of the privatised BAA provided for a rule that prevented the acquisition of more than 15 % of the voting shares in the company. Furthermore, they introduced a procedure, which empowered the UK Government to give consent to certain major operations of the company, such as disposal of assets, control of subsidiaries and winding-up. It is noteworthy that under the Airports Act 1986, the Articles of Association were approved by the Secretary of State and as such the rules at issue amounted to 'State measures', despite the fact that they were permitted by national company law.[378]

The Commission was of the opinion that although the provisions at issue applied without distinction, they could nevertheless *hinder* or *render less attractive* the exercise of the free movement rights of foreign investors.[379] In its response, the UK Government, after explaining that the existence of different classes of shares was consistent with national company law, put forward an inventive and eloquent argument: it invited the Court to interpret the contested special rights in the light of the ruling in *Keck and Mithouard*. The application of the *Keck*-formula would entail the exclusion of the contested special rights from the scope of capital restrictions under Article 63 TFEU. It reminded the Court of its own efforts to keep a tight rein on the speculative litigation that emerged in the field of goods after *Dassonville* and *Cassis de Dijon* by adopting a more moderate approach in *Keck and Mithouard*. It thus warned the Court that if the Commission's view prevailed, the negative implications of the broad definition of 'measures having equivalent effect to a quantitative restriction'

374 Case C-463/00 *Commission v Spain (golden shares)*.
375 Case C-98/01 *Commission v UK (golden shares)*.
376 Case C-171/08 *Commission v Portugal (golden shares – Portugal Telecom SGPS SA)*; Case C-543/08 *Commission v Portugal (golden shares – EDP)*; Case C-212/09 *Commission v Portugal (golden shares – GALP Energia SGPS SA)*.
377 Case C-98/01 *Commission v UK (golden shares)*.
378 Ibid, para 24.
379 Ibid, para 20.

would be replicated in the context of the free movement of capital.[380] It also added the criterion of *directness*, similar to the one that was used by the Court in the other freedoms, emphasising that the system of prior approval related to eventualities that were too *uncertain* or *indirect* to amount to a capital restriction.[381]

Furthermore, the UK Government contended that the measures at issue applied equally to foreign and domestic investors and did not restrict market access. Rules of private law such as the ones in the BAA's Articles of Association that *did not derogate from normal company law* and merely determined the characteristics of the special shareholding could not possibly amount to a restriction on market access.[382] It was persuasively argued that the Member States were entitled to engage in economic activities on the same basis as private market operators, within the framework of contracts governed by private law. As there was no secondary legislation on this particular matter, Community law could not impose on a company the obligation to be placed under market control or to attach to its shares the rights which all actual or potential investors might wish to see attached to them.[383] It was argued that if the UK special shareholding were open to challenge, this would mean that holders of ordinary shares could rely on the Treaty in order to renegotiate the rights attached to the shares they had bought.[384] In other words, ordinary shareholders would be allowed to convert their ordinary shares into special shares. However, this interpretation could not be accepted. Community law could not impose a specific model of corporate governance. This was – and still remains – a domain reserved for the national legislator.

In its reply, the Commission contended – rather obscurely – that the issue at hand was not the *manner* in which shares might be acquired or dealt with, but the *actual acquisition* of shares and thus the negation of a fundamental aspect of the free movement of capital.[385] It underlined that in *Alpine Investments*[386] and *Bosman*[387] the Court had refused to transpose the doctrine of 'selling arrangements' to the free movement of services and workers.[388] However, a careful reading of the judgments in *Alpine Investments* and *Bosman* would reveal that the Court did not reject the argument that the doctrine of 'selling arrangements' could *in principle* apply by analogy to the other

380 Ibid, para 28.
381 Ibid, para 36.
382 Ibid, para 29.
383 Ibid, para 31.
384 Ibid, para 35.
385 Ibid, para 34.
386 Case C-384/93 *Alpine Investments*, para 36-38.
387 Case C-415/93 *Bosman*, para 103.
388 Case C-98/01 *Commission v UK (golden shares)*, para 34.

freedoms; rather it ruled that the national measures *at issue* (i.e. prohibition of cold calling by telephone for financial services and the sporting rules on the transfer of players) were not comparable to the rules on 'selling arrangements' of goods, as they directly affected access to the market (for service providers and players respectively) in other Member States and thus were capable of hindering intra-Community trade and impeding freedom of movement for workers. But the fact remained that *in principle* the *Keck*-test could be transposed to the other freedoms.

The Court was faced with a unique opportunity to reconsider anew the application of the *Keck*-test in the free movement of capital. However, it did not do so. By contrast, it sided with the Commission and followed the well-beaten path of 'direct hindrance of market access'. Although *in principle* it did not exclude the possibility of developing a concept of 'selling arrangements' in the free movement of capital, it nevertheless rejected it on the facts, by stating that the measures at issue were not comparable to the rules concerning 'selling arrangements'. It reiterated the famous paragraph 16 in *Keck*, and without further substantiating its conclusion, the Court found that while the contested measures were not discriminatory, they nonetheless affected the position of a person acquiring a shareholding as such and were thus liable to deter investors from other Member States from making such investments and consequently affected their access to the market.[389]

In the same vein and without any addition to its legal reasoning, the Court dismissed the *Keck*-argument in *Commission v Spain*.[390] The case concerned a Spanish privatisation law which granted special government control in five strategic undertakings: Respol (petroleum and energy), Telefónica (telecommunications), Argentaria (banking), Tabacalera (tobacco) and Endesa (electricity). More specifically, the Spanish legislation provided for a system of prior administrative approval with respect to major corporate decisions relating to voluntary winding-up, demerger or merger of the undertaking, disposal of assets or shareholdings necessary for the attainment of the undertaking's object, a change in the undertaking's object etc. As was expected, the Commission invoked the ruling in *Eglise de Scientologie*[391] where it was held that a provision of national law which makes a direct foreign investment subject to prior authorisation constitutes a restriction on the free movement of capital,[392] as it causes the exercise of the free movement of capital to be

389 Ibid, para 47.
390 Case C-463/00 *Commission v Spain (golden shares)*.
391 Case C-54/99 *Association Eglise de scientologie de Paris*, para 14.
392 Case C-463/00 *Commission v Spain (golden shares)*, para 33.

subject to the discretion of the administrative authorities and thus be such as to render that freedom illusory.[393]

The Spanish government counter-argued that the privatisation process was perfectly legal under national law,[394] that the system of prior approval applied without restriction on grounds of nationality[395] and that it should be regarded as compatible with EU law as a result of the application of the principle of neutrality with regard to the property ownership systems of the Member States under Article 345 TFEU.[396] In support of the Spanish Government, the UK – which had a particular interest in the outcome of the case as the ruling on its special shareholding in BAA was delivered on the same day – relied again on *Keck and Mithouard* and argued that the measure at issue did not restrict market access and thus did not infringe Article 63 TFEU.[397]

Using exactly the same wording, the Court repeated its ruling in *Commission v UK*[398] and found that the measures at issue did not have comparable effects to those of the rules that according to the *Keck*-formula qualified as 'selling arrangements'. Although non-discriminatory, the system of prior approval had a deterrent effect on foreign capital inflows and was thus regarded as affecting the access of foreign investors to the relevant Spanish market.[399] Similarly, in *Commission v Portugal I*,[400] the Portuguese Republic invited the Court to apply the logic underlying the judgment in *Keck*, as the case concerned non-discriminatory rules regarding the *management* of shareholdings in the company and not rules regarding the *acquisition* of those shareholdings. However, the Court rejected once again the application of the concept of 'selling arrangements' in the golden shares case law.

3.4.4 In search of a refined test for 'capital restrictions'

In order to develop an appropriate legal test for determining the scope of capital restrictions, it is first necessary to understand the logic behind the Court's rigorous interpretation of the free movement of capital in the golden

393 Joined cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera*, para 25.
394 Case C-463/00 *Commission v Spain (golden shares)*, para 39.
395 Ibid, para 55. Such an argument was of course rejected by the Court, since the free movement of capital goes beyond the mere elimination of unequal treatment on grounds of nationality as between operators on the financial markets and prohibits 'all restrictions on the movement of capital between Member States and between Member States and third countries'.
396 Ibid, para 41.
397 Ibid, para 58.
398 Case C-98/01 *Commission v UK (golden shares)*.
399 Ibid, para 61.
400 Case C-171/08 *Commission v Portugal (golden shares – Portugal Telecom SGPS SA)*.

shares case law. The underlying rationale of this interpretation is that golden shares, by their very nature, are inherently incompatible with EU law. This is a rather political argument which stems from the general ideological premise that State participation in the market should be limited and reflects a political choice favouring the model of *liberal market economy* as opposed to the model of *coordinated market economy* that allows the existence of corporate governance regimes with Control Enhancing Mechanisms (Chapter 4, Section 2.4). In the field of corporate governance, this view finds more concrete expression in the embracement of two principles, namely the *principle of proportionality between ownership and control* and the *principle of shareholders' primacy.*

Indeed, in the golden shares case law, the Court seems to endorse the *principle of proportionality between corporate ownership and control* (Chpater 4, Section 2.3), implying that any shareholder should in principle own the same fraction of cash flow rights and voting rights. Its legal reasoning starts from the premise that the *principle of proportionality between ownership and control* should be respected, and thus any structure or mechanism that derogates from this principle should be disapplied as it discourages investors from acquiring shares in the undertaking concerned. According to this reasoning, the State's interference in the management of the company through the vehicle of golden shares is capable of *depressing the value of the shares*, thus *reducing the attractiveness* of an investment in that company.[401] The reason is that the State might exercise its special rights in order to pursue public interest objectives, 'which might be contrary to the economic interests of the company'.[402]

The concerns relating to the 'depression of the share value' and the protection of 'the economic interests of the company' reveal that the Court implicitly adheres to *shareholders' primacy value* as the principal normative foundation upon which the free movement of capital should operate and on the basis of which national corporate governance regimes should be structured. In this way, it promotes a policy choice advancing the maximisation of shareholders' profit as the ultimate objective of a corporation. To the contrary, State participation in preferred holding is regarded as having a deterrent effect on foreign investment because it serves interests other than the interests of the share-

401 Ibid, para 54.

402 Joined cases C-282/04 and C-283/04 *Commission v The Netherlands (golden shares)*, para 30. A similar view was expressed by Advocate General Maduro in *Federconsumatori*, where he opined that public ownership of shareholding does not reduce the attractiveness of investing in the company concerned, only insofar as the State respects the normal rules of operation of the market with a view to maximising its return on investment. *See* Opinion of *Advocate General Maduro in Joined cases C-463/04 and C-464/04 Federconsumatori and Others,* ECLI:EU:C:2006:524, paras 25-26. In this case, for the first time, a shareholders' association successfully challenged the golden shares maintained by the Italian Government in the company Azienda Elettrica Milanese SpA active in the gas and electricity sector.

holders. The Court seems to endorse the corporate governance school of thought that advocates *shareholders' primacy* as the ultimate objective of company law and seems to disregard the interests of other stakeholders such as employees, suppliers, creditors and ultimately the society as a whole.[403]

However, the maximisation of shareholders' profit is not the only consideration to be taken into account in the governance of a corporation.[404] In fact, it has rightly been pointed out that it is not a universal principle of company law that shareholders' powers must be exercised in the economic interest of the company (whatever that means) and even when such principle operates it is not the competence of the EU to ensure that it is upheld.[405] It has been argued that this legal reasoning of the Court is based on three assumptions, whose acceptance though is far from evident: it implies that, first, the interests of the company are those of the shareholders, secondly, the shareholders' interests are embodied in the share value[406] and, thirdly, the existence of golden shares diminishes the value of the share.[407] All three assumptions raise highly

403 Carsten Gerner-Beuerle, 'Shareholders Between the Market and the State. The VW Law and other Interventions in the Market Economy' (2012) 49 Common Market Law Review 97. See also Martha O'Brien, 'Case C-326/07, Commission of the European Communities v. Italian Republic, Judgment of the Court of Justice (Third Chamber) of 26 March 2009' (2010) 47 *Common Market Law Review* 245, p. 260, who criticises the Court for being 'very strict in its refusal to allow Member States to exercise control over ownership of shares, voting rights and management decision-making in private companies through golden share mechanisms'.

404 Andrea Biondi, 'When the State is the Owner – Some Further Comments on the Court of Justice 'Golden Shares' Strategy' in Bernitz and Ringe (eds), *Company Law and Economic Protectionism: New Challenges to European Integration* (Oxford University Press 2010), p. 102.

405 Jonathan Rickford, 'Protectionism, Capital Freedom and the Internal Market' in Bernitz and Ringe (eds), *Company Law and Economic Protectionism – New Challenges to European Integration* (Oxford University Press 2010), p. 66.

406 Carsten Gerner-Beuerle, 'Shareholders Between the Market and the State. The VW Law and other Interventions in the Market Economy' (2012) 49 Common Market Law Review 97, p. 124.

407 However, this assumption is not empirically proven. In 2005, Oxera, authorised by the European Commission, provided an overview of the special rights retained by public authorities in privatised companies in the EU and an evaluation of their economic impact on the performance of affected companies. The Report examined six companies (Cimpor, Volkswagen, Repsol YPF, KPN, Portugal Telecom and BAA) and concluded that special rights held by public authorities tend to have a negative impact on the longer-term economic performance of EU privatised companies because four of the six companies examined tended to underperform relative to comparable companies not subject to special rights. However, the remaining two companies outperformed their comparators and, thus, this contradictory evidence was not consistent with the hypothesis that the impact of special rights is negative. Accordingly, Oxera concluded that: '… although there is some indication of a negative impact of special rights, the evidence obtained from the benchmarking analysis is disparate and does not allow any strong conclusions to be drawn. However, the results do not imply that special rights have no negative impact on companies' long-term performance'. *See*

controversial questions in the field of corporate governance and political economy regarding the role of a corporation in a society and the interests it should serve. In his insightful contribution, Harm Schepel argues that the golden shares case law so far has advanced the rule that corporations should be governed with a view to maximise shareholders' profit to such an extent that it has turned Article 63 TFEU into a 'Charter of Shareholder Rights'.[408] It has managed to elevate the *shareholders' primacy* principle to a constitutional norm underpinning capital liberalisation.[409]

The underlying narrative of the Court's reasoning is based on a utopian nostalgia for the traditional forms of capitalism. However, the transformations of modern economy have led to a high degree of 'financialisation', which is currently associated with economic stagnation, rising social inequalities and high levels of unemployment.[410] Furthermore, such a reading of the Treaty is open to question. Surely, the wording of Article 63 TFEU provides for the prohibition of 'all restrictions' on capital movements without any allusion to discrimination. However, this cannot be regarded as a *carte blanche* to abolish *all* national company law requirements that derogate from the *principle of proportionality between ownership and control* or that do not adhere completely to *shareholders' primacy* on the assumption that they render investment less attractive. The choice of corporate governance model is a fundamental political question, which depends on various socio-economic factors that differ significantly among Member States. Carsten Gerner-Beuerle is right in doubting whether the Court of Justice is the appropriate institution to decide upon sensitive political questions concerning the choice of national economic policy.[411] This essentially boils down to the observance of the fundamental principle of separation of powers in the EU polity. The Court has been on several occasions accused of engaging in judicial activism,[412] which causes

Oxera, *Special rights of public authorities in privatised EU companies: the microeconomic impact* (2005), p. 68.

408 Harm Schepel, 'Of Capitalist Nostalgia and Financialisation: Shareholder Primacy in the Court of Justice' in Joerges and Glinski (eds), *The European Crisis and the Transformation of Transnational Governance* (Hart Publishing 2014).

409 Ibid, para 144.

410 Ibid, para 152. On the highly topical issue of the interplay between capital liberalisation and social inequalities, see the recent bestseller of Thomas Piketty, *Capital in the Twenty-First Century* (The Belknap Press of Harvard University Press 2014).

411 Carsten Gerner-Beuerle, 'Shareholders Between the Market and the State. The VW Law and other Interventions in the Market Economy' (2012) 49 Common Market Law Review 97, p. 125, especially in the light of the political controversies during the negotiations for the adoption of the European Takeover Directive.

412 The problem of securing respect for the rule of law by the Union itself and the debate about 'competence creep' by the Union institutions (including the Court of Justice in the exercise of its judicial functions) has been aptly addressed by the recent Editorial of the Common Market Law Review, wondering whether this is a Union that sacrifices its own rule of law on the altar of political expediency. *See* Editorial Comments, 'The Rule of Law in the Union,

confusion as to its role as the judicial institution of the EU. Although sometimes this might be an overstatement, the fact still remains that, under Article 19 TEU, the role of the Court is to ensure that in the interpretation and application of the Treaties, the 'law' is observed. Whether corporate governance should be dominated by the *shareholders' primacy norm* or by the *stakeholders' primacy norm* is a political question and should be clearly distinguished from the objective of market integration pursued by the Treaties.[413] It is doubtful whether the Court is the appropriate institution to design the corporate governance policy of the Member States. It is therefore argued that the rigorous interpretation of the free movement of capital, according to which all company law requirements derogating from the *principle of proportionality between ownership and control* and the *principle of shareholders' primacy* are incompatible with EU law, cannot be reconciled with the wording and the spirit of Article 63 TFEU and the discretion of the Member States in the field of corporate governance.

This by no means should be interpreted as leaving room for suspicious State interferences that could lead to serious market abuses and distortions of competition. The Court should not refrain from disapplying distinctly or indistinctly national measures that obstruct capital flows and undermine the process of financial integration. However, it should respect the division of competences between the EU and the Member States and the discretion of the Member States to determine the corporate governance regime of their national economy, and it should intervene only when the national choices seriously undermine the objectives of market integration either by *discriminating* against foreign investors or by *hindering the market access* of foreign investors *in derogation from ordinary company law*. Its prime objective should not be the maximisation of shareholders' profit, but the establishment of a well-functioning and integrated market economy, which respects the national policy choices as expressed through various mechanisms of national company law. This is why the question of whether the contested measure *derogates from domestic company law* has been a recurring theme in the golden shares case law and rightly so. It has been argued that it is the only criterion that can contribute to the development of a reasonable and coherent test to assess whether special shareholdings in privatised undertakings amounts to restrictions on capital movements.[414]

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the Rule of Union Law and the Rule of Law by the Union: Three interrelated problems' (2016) 53 *Common Market Law Review* 597.

413 Carsten Gerner-Beuerle, 'Shareholders Between the Market and the State. The VW Law and other Interventions in the Market Economy' (2012) 49 Common Market Law Review 97, p. 126.

414 Ibid, p. 108. However, the author admits that company law is a highly complex field of law with many different variations, exceptions and special provisions, making the determination of what complies with or derogates from ordinary company law a rather intricate and challenging exercise, at 138.

Indeed, the *derogation from ordinary company law* has been elevated into a predominant criterion determining the existence of a capital restriction. The Court has used this criterion in the golden shares case law in order to delineate the scope of the free movement of capital. For instance, in *Commission* v. *Portugal (I) (Portugal Telecom SGPS SA)*,[415] the Court found that the contested special shareholding amounted to a State measure liable to restrict the free movement of capital. The special rights at issue included, among others, a right to elect at least one-third of the total number of directors, including the chairman of the board of directors, a right to elect one or two of the members of the executive committee and an approval procedure for important decisions, such as the appropriation of net income of the year, alterations to the articles of association and increases in share capital, and relocation of its registered office. Although the preferred shares were introduced in the Articles of Association, the Court noted that these Articles were adopted not only immediately after the adoption of the decree-law authorising the creation of golden shares within Portugal Telecom, but in particular at a time when the Portuguese Republic had a majority holding in the company's share capital and thus exercised control over that company.[416] More importantly, as underlined by Advocate General Mengozzi, the creation of the golden shares in question *was not the result of a normal application of company law*, as they were not transferable, in derogation from the Portuguese Commercial Companies Code.[417] Therefore, in those circumstances, the Court regarded the introduction of golden shares in Portugal Telecom as a 'State measure' liable to restrict the free movement of capital. The Portuguese Government had departed from the ordinary provisions of company law in order to avail itself of a privileged position in the privatised telecommunications company.

Similarly, in *Commission v Portugal (GALP Energia SGPS SA)*,[418] the Court held that the right of the State to appoint the chairman of the Board of Directors in GALP Energia SGPS SA was not stemming from a normal application of company law, since the Portuguese Commercial Companies Code expressly precluded the right to appoint certain directors being attached to certain

415 Case C-171/08 *Commission v Portugal (golden shares – Portugal Telecom SGPS SA)*.

416 Ibid, p. 53. Nevertheless, it should be noted that it is disputed whether the fact that a State makes use of its majority shareholding in order to introduce special rights in the Articles of Association – when this is allowed by national company law – is sufficient to qualify this act as a 'State measure'. Special rights are usually introduced by those in control, either in the initial phase of incorporation or after an amendment of the Articles in view of a planned divestiture. See Carsten Gerner-Beuerle, 'Shareholders Between the Market and the State. The VW Law and other Interventions in the Market Economy' (2012) 49 Common Market Law Review 97, p. 118.

417 *Opinion of Advocate General Mengozzi in Case C-171/08 Commission v. Portugal (I) (golden shares)*, ECLI:EU:C:2010:412, para. 62.

418 Case C-212/09 *Commission v Portugal (golden shares – GALP Energia SGPS SA)*.

categories of shares.[419] The national law at issue and GALP's Articles of Association *derogated from general company law* with the sole intention of benefitting the public authorities.[420] Consequently, the right of the State to appoint the chairman of GALP's Board of Directors was attributable to the Portuguese State and was thus falling within the scope of Article 63 TFEU.[421]

By contrast, in the *Commission v UK (BAA)* case, regrettably, the Court did not take into account the UK Government's claim that the contested provisions in the BAA's Articles of Association *did not derogate from normal company law* but merely determined the characteristics of the special shareholding and therefore they could not possibly amount to a restriction on market access of foreign investors.[422]

The application of the *derogation from ordinary company law criterion* was more complicated in *Commission v Germany (Volkswagen I)* case.[423] In particular, at stake were three provisions of the controversial Volkswagen Law: (1) the capping of the voting rights of every shareholder to 20% of Volkswagen's share capital; (2) the fixing of the blocking minority at 20% for the most important decisions of the general meeting of shareholders; and (3) the right of the Federal State and the Land of Lower Saxony each to appoint two representatives to the company's supervisory board.

Regarding the third provision, the finding that it derogated from ordinary company law was a rather straightforward exercise. The entitlement of the Federal State and the Land of Lower Saxony to appoint a total of four persons in the supervisory board of Volkswagen constituted a derogation from general company law, as under the latter they would have been entitled to appoint a maximum of three representatives.[424]

The other two provisions were examined together and it was found that *the combination of the two* constituted a restriction on the free movement of capital. More precisely, the capping of the voting rights of every shareholder to 20 % of the company's share capital *derogated from general company law*, since Volkswagen was a listed company and for that reason a ceiling on the voting rights could not normally be inserted into its Articles of Association.[425] The fixing of the blocking minority at 20% (and thus the required majority at 80%)

419 Ibid, para 5.
420 Ibid, para 53.
421 Ibid, para 54.
422 Case C-98/01 *Commission v UK (golden shares)*, para 29.
423 Case C-112/05 *Commission v Germany (golden shares – Volkswagen I)*.
424 Ibid, para 60.
425 Ibid, para 41.

derogated form ordinary company law as the latter established a blocking minority of 25% (and thus required majority of 75%).[426] While it was true that general company law allowed the increase of the 75% percentage of required majority by the Articles of Association of a company,[427] the Court nevertheless emphasized that what was crucial was the *fact* that the Land of Lower Saxony held 20% of Volkswagen share capital.[428] In other words, the restriction came from a *combination* of *legislative provisions* granting certain privileges and the *factual situation* in which the Land of Lower Saxony was holding the required percentage of shareholding allowing it to benefit from those privileges.[429] Thus, the two provisions in question, *examined together* and *in combination with the factual situation*, enabled the Federal and State authorities to procure for themselves a blocking minority allowing them to oppose important resolutions on the basis of a reduced investment[430] and to limit the possibility for other shareholders to participate effectively in the management of the company.[431]

It is interesting to note that following the 2007 judgment, Germany repealed the provisions regarding the appointment of the representatives and the capping of voting rights, but maintained the provision on the lower blocking minority. The Commission brought again infringement proceedings against Germany for failure to comply with the 2007 judgment.[432] However, the Court dismissed the action, holding that the restriction on the free movement of capital did not result from the lower blocking minority examined in isolation, but from the *combination* of the latter with the capping of voting rights. Therefore, by repealing the provision of the Volkswagen Law relating to the appointment of representatives to the supervisory board and the provision relating to the cap on voting rights, Germany did fulfil the obligations that followed from the 2007 judgment. This way, it could be argued that the Court confirmed the validity of the *derogation from ordinary law criterion*, as from the three contested provisions, the lower blocking minority was the only one that was allowed, albeit as an exception, under general company law.

On the basis of the aforementioned considerations and taking into account the evolution of the interpretation of restrictions in the field of free movement

426 Ibid, para 44.
427 Ibid, para 45.
428 Ibid, para 48.
429 Wolf-Georg Ringe, 'Company Law and Free Movement of Capital' (2010) 69 Cambridge Law Journal 378, p. 401.
430 Case C-112/05 *Commission v Germany (golden shares – Volkswagen I)*, para 51.
431 Ibid, para 52.
432 Case C-95/12 *Commission v Germany (golden shares – Volkswagen II)*. See also the annotation Florian Mo¨slein, 'Compliance with ECJ judgments vs. compatibility with EU law – Free movement of capital issues unresolved after the second ruling on the Volkswagen law: Commission v. Germany' (2015) 52 *Common Market Law Review* 801.

of goods, it is suggested here that a twofold test could be adopted in order to delineate in a more consistent manner the scope of capital restrictions:

Discrimination on grounds of nationality: Measures that discriminate between domestic and foreign investors (distinctly applicable measures) undeniably constitute restrictions on the free movement of capital, which can be justified only by the objectives provided for in the Treaty.

Derogation from ordinary company law: Measures that do not discriminate on grounds of nationality (indistinctly applicable measures) may be divided into two sub-categories:

(a) indistinctly applicable measures that (i) *do not derogate from ordinary company law* and (ii) *respect the principle of equality between the State and private parties as market participants without granting any privilege to the State* should be regarded as 'investment arrangements', which – just like the *Keck* 'selling arrangements' in the field of free movement of goods – fall outside the scope of Article 63 TFEU. These rules merely *structure* the market and the corporate governance regime of a Member State, without hindering foreign investment.

(b) indistinctly applicable measures that (i) *derogate from ordinary company law* and (ii) *are available only to the State (to the exclusion of private investors)* constitute restrictions on the free movement of capital prohibited under Article 63 TFEU. It can then be examined whether they can be justified by the Treaty-based derogation grounds or overriding reasons in the public interest in accordance with the principle of proportionality.

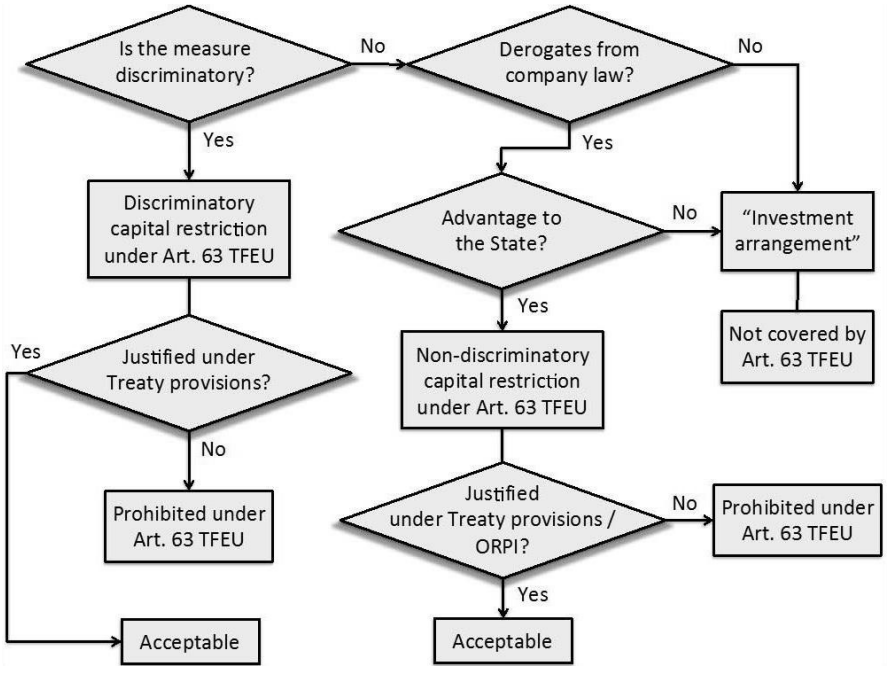

Figure 1: Schematic representation of the proposed test for 'capital restrictions'.

As stated above, the first criterion, i.e. *derogation from ordinary company law*, stems from the golden shares case law and ensures that neither the State nor private parties (if one accepts the horizontality of Article 63 TFEU) depart from the normal application of national company law in order to avail themselves of undue advantages that infringe the national legislative framework and distort the market for corporate control. This way, both the principle of legal certainty and the discretion of Member States in organising their corporate governance systems are respected. Private market operators are expected to abide by the binding rules of national company law whilst at the same time they can exercise their private autonomy under certain optional choices allowed under the national legislative framework. In the same vein, the State, in its capacity as a shareholder, is expected to act in accordance with the binding rules of national company law, while at the same time it can make use of the options available under the national corporate governance regime.

However, it should be noted that although the *non-derogation from ordinary company law* might be a necessary condition for the exclusion of a certain measure from the scope of capital restrictions, it is nevertheless not a sufficient

one. What is also needed is a guarantee that the rules of national company law from which the measure in question does not derogate, create a *level playing field* for all market participants, both public and private. In other words, it is necessary to ensure that the measure at stake respects *the principle of equality between the State and private parties as market participants* and does not grant an undue advantage to the State to the detriment of private operators.

This second criterion does not stem from the golden shares case law. To the contrary, it can be argued that the golden shares case law seems to start from the ideological premise that State participation in the market is not allowed and, therefore, golden shares are *inherently* incompatible with EU law regardless of whether they grant an undue advantage to the State. However, the view that golden shares are inherently incompatible with EU law reflects a political view which cannot be supported by the letter or the spirit of the Treaties, which merely demand the establishment and the proper functionning of a competitve internal market, without however prohibiting State participation in economic activity.

It has been argued that the political view that the State should be subject to more stringent conditions when acting as a market participant than those imposed on private operators view is supported by the legislative framework that governs EU public procurement law, whereby the State is treated with more suspicion than private market actors and is subject to more restrictive requirements when organising tenders for the purchase of goods, works or services.[433] However, the rationale underlying the strict requirements of transparency, equal treatment, open competition, and sound procedural management which bind the State in the field of public procurement is to ensure the *non-discrimination between private actors*. In other words, the purpose of EU public procurement law is to ensure that when contracting for the provision of goods or services, the State does not grant an unfair advantage to a private contractor as opposed to another private contractor. This rationale cannot be applied by analogy in the golden shares case law, as at stake is not the discrimination between private shareholders, but the participation of the *State itself as a shareholder*.

Ultimately, the analysis of the golden shares case law boils down to one fundamental question: should the State when acting as a shareholder or more broadly as a market participant be subject to more stringent conditions as the ones applicable to private market operators? This thesis answers in the negative and argues that the State should operate under equal conditions as other

433 Wolf-Georg Ringe, 'Company Law and Free Movement of Capital' (2010) 69 Cambridge Law Journal 378, p. 397.

private market operators. Support for this position can be found in a comparative analysis of the US legal framework, which allows states to participate in economic activities under normal market conditions. In particular, in the US, when states are deemed to be engaging in economic activity rather than regulation of the market, the limitations of the American Constitution's dormant commerce clause do not apply ('market participation exception').[434] The private activities of states are governed by private law and they are not subject to special limitations.[435] Thus, states can acquire shareholding in corporations and pursue their interests to the extent that these interests can be pursued under private law.[436]

Overall, it can be argued the conceptual foundation of the suggested test is the theory of *economic supranationalism* as opposed to *economic constitutionalism*.[437] Indistinctly applicable measures should be regarded as restricting the free movement of capital only if the Member State is making use of its public regulatory powers to structure the market in its favour in derogation from ordinary company law. The mere assumption that State participation in a corporate structure hinders the market access of foreign investors – even if it is in accordance with national company law – is an overly broad interpretation of Article 63 TFEU, which oversteps the boundaries of the constitutional foundations of market integration. The European imperatives of economic and political integration do not openly demand such a dramatic retreat of the State from direct intervention in economic activity.[438] They merely demand a *level playing field*, whereby both the State and private operators abide by the rules of a competitive market.[439] The refined test on capital restrictions would allow the Court to exercise thorough and scrupulous oversight over national rules that unjustifiably grant privileges to the State, while at the same time ensuring that it does not overstep the boundaries of its judicial powers by implicitly imposing a specific corporate governance regime on the Member States. It would allow a better drawing of the dividing line between the EU and the Member States and would respect the preserved competence of the Member States to determine their corporate governance systems and protect public interest objectives, whilst at the same time remaining within the con-

434 Larry Catá Backer, 'The Private Law of Public Law: Public Authorities as Shareholders, Golden Shares, Sovereign Wealth Funds, and the Public Law Element in Private Choice of Law' (2008) 82 *Tulane Law Review* 1, p. 66-67.
435 Ibid.
436 Ibid.
437 Carsten Gerner-Beuerle, 'Shareholders Between the Market and the State. The VW Law and other Interventions in the Market Economy' (2012) 49 Common Market Law Review 97, p. 141.
438 Erika Szyszczak, 'Golden Shares and Market Governance' (2002) 29 Legal Issues of Economic Integration 255, p. 258.
439 Ibid.

tours of the Internal Market and preventing protectionist measures which derogate from ordinary company law and hinder the market access of foreign investors.

3.4.5 The 'positive effect' criterion

In an earlier version of this section published as a journal article,[440] it has been argued that a quantitative dimension could be added in order to enable the Court to take into account some factual evidence in borderline cases in which there is a strong likelihood that the special shareholding in question has actually promoted and encouraged cross-border capital flows rather than discouraged it. It has been suggested that, as a third step of the refined test, the Court could examine the 'positive effect on capital movements', i.e. it could allow Member States to rebut the presumption that golden shares derogating from ordinary company law hinder foreign investors by providing convincing evidence proving that the existence of the golden shares in the undertaking concerned has actually encouraged capital movements instead of restricting them.

So far, the Court has found that special shareholding in privatised companies amounts to a restriction on capital movements, even when there is factual evidence that this shareholding has no negative impact on the acquisition of shares by foreign investors. Member States have tried to invoke the 'substantial hindrance' criterion, as developed in the free movement of goods, in the area of free movement of capital, but the Court has not accepted it.

In particular, in *Commission v Portugal (Energias de Portugal)*,[441] the Portuguese Republic contended that the provisions of national law at issue did not establish any *direct* or *substantial* obstacle to the access of direct investors or portfolio investors to the share capital of EDP. To the contrary, EDP's shares were among the most sought-after on the Lisbon Stock Exchange and a large number of those shares were in the hands of foreign investors.[442] This could probably be explained by the fact that the existence of public ownership in a national

440 Ilektra Antonaki, 'Keck in Capital? Redefining "Restrictions" in the "Golden Shares" Case Law' (2016) Erasmus Law Review 177.

441 Case C-543/08 *Commission v Portugal (golden shares – EDP)*. The national legislation at issue granted to the Portuguese State and to other public shareholders 'golden shares' in the company EDP – Energias de Portugal, the principal licensed distributor of electricity in Portugal and the undertaking acting as the last resort supplier. The special rights at stake included (a) the right of veto in respect of certain resolutions of the general meeting of the company's shareholders; (b) the right to appoint a director, where the State has voted against the nominees successfully elected as directors; and (c) the exemption of the State from the voting ceiling of 5% laid down in relation to the casting of votes.

442 Ibid, para 69.

industry can sometimes be regarded as guaranteeing the financial stability and solvency of a company (as the State can always raise money from taxation), and can thus act as an incentive for foreign public and private investors to buy shares in that company. However, the Court refused to engage in a factual examination of the actual impact of the special rights in question on cross-border investment and ruled that foreign investors, whether actual or potential, might have been deterred from acquiring stake in the capital of EDP.[443] This echoes the *Consten and Grundig* ruling in competition law, where the Court held that there was no need to take account of the concrete effects of an agreement once it appeared that it had as its object the prevention, restriction or distrortion of competition.[444] Similarly, in *Commission v Germany (I) (Volkswagen)*, the Court did not take into account Germany's argument that Volkswagen's shares were among the most highly-traded in Europe and that a large number of them were in the hands of investors from other Member States.[445]

The rationale underlying the 'substantial hindrance' criterion, as developed in the free movement of goods, could be transposed into the area of free movement of capital in order to give Member States the possibility to refute the premise of the Court's reasoning that golden shares are *by definition* a restriction on capital movements. This could take the form of a criterion based on a possible 'positive impact' of golden shares on capital movements, which would allow the Member States to prove that the contested golden shares have actually incentivised cross-border investment and have increased the number of foreign shareholders, rather than restricting it.

However, despite its appeal, the criterion of 'positive impact' is loosely framed and it is difficult to be reconciled with the principle of legal certainty. Furthermore, it is questionable whether the Court has the necessary expertise and the competence to evaluate highly technical evidence relating to the financial situation of the companies concerned.[446] Therefore, upon careful consideration, it was decided that the 'positive effect' criterion should not form part of the suggested legal test for the delineation of the scope of capital restrictions. Nevertheless, if used carefully and on a case-by-case basis, it could help redress some shortcomings arising from the erroneous premise that all golden shares *inherently* and *by their very nature* restrict capital movements.

443 Ibid, para 71.

444 Joined cases 56 and 58-64 *Consten and Grundig*, p. 342.

445 Case C-112/05 *Commission v Germany (golden shares – Volkswagen I)*, para 53.

446 The Court has never conducted an economic analysis in its golden shares case law (and understandably so) and yet it has accepted as axiomatic that golden shares prevent the acquisition of shares and deter foreign investors from investing in the undertakings concerned. See Jérémie Houet, *Les Golden Shares en droit de l'Union Européenne* (Larcier 2015), p. 169.

3.5 National responses

Zooming out from the doctrinal context of this study, one might actually wonder whether the legal issues analysed here pose real concerns to the Member States and whether they have a practical impact on their economic policies. In particular, in order to assess the actual consequences of the European case law within the domestic jurisdiction of the Member States, it is necessary to examine how this case law has been in practice enforced at the national level. In the field of golden shares, Benjamin Werner conducted an interesting survey of the reactions of national governments to the golden shares case law.[447] The main finding of his study was that most governments did abolish their golden shares after the respective rulings of the Court. However, they did so only because they had already adopted institutionalised fall-back solutions ('protective equivalents') to safeguard the interests originally protected by the golden shares.[448] This means that although in the majority of the cases the golden shares were abolished, their practical effect remained intact through the adoption of other measures with an equivalent effect. In cases where the practical effect of the golden shares could not have been maintained if the golden shares were abolished completely, the Member States opted to revise them in a way that would ensure compliance with the judgments of the Court whilst at the same time protecting the crucial prerogatives of the public authorities.

Examples of Member States which abolished their golden shares while adopting other 'protective equivalents' include the UK and the Netherlands. In particular, in the aftermath of the *BAA* ruling, although the British government abolished the golden shares, the Department of Transport commented that despite the repealing of the special rights, all crucial issues regarding the operation of BAA could still be regulated by the adoption of subsequent legislation.[449] In the same vein, although the Dutch government complied with the *KPN/TPG* judgment by abolishing the golden shares in the privatised post company TPG, it did so only because the universal service obligation was guaranteed by law. In this respect, a spokesman of the Dutch Finance Ministry declared that

447 Benjamin Werner, 'National responses to the European Court of Justice case law on Golden Shares: the role of protective equivalents' (2016) 24 Journal of European Public Policy 989.

448 Ibid, at p. 990. Notable exceptions are Greece and Portugal, which from 2010 until 2012 abolished their golden shares without reported 'protective equivalents' as a result of the implementation of the Troika's rescue package, see p. 996.

449 Ibid, pp. 997-998.

> 'We should not overestimate the importance of the golden share. The original intention was to protect the universal nature of postal services in the Netherlands. This is already protected by law'.[450]

The most prominent example of a Member State that revised the contested legislation in order to protect its special powers is Germany. More precisely, in the aftermath of *Volkswagen I*, the German government decided to revise the Volkswagen law instead of abolishing it completely, as this was the only way to reach a compromise between the obligation to comply with the ruling of the Court and the pressure from domestic political actors and trade unions to retain the veto power for certain decisions of the company.[451] Thus, the German government repealed the provisions regarding the appointment of the representatives and the capping of voting rights, but maintained the provision on the lower blocking minority. This way, the most important legal effect of the legislation, i.e. the veto power of the State and the workers, was kept in place.[452] Interestingly, in *Volkswagen II*, the Court held that by revising the legislation, Germany did fulfil the obligations that followed from the *Volkswagen I* judgment.

The aforementioned national reactions to the golden shares case law show that although the Member States ostensibly complied with the rulings of the Court, they nevertheless maintained in practice a certain degree of influence over the privatised undertakings concerned, either by adopting 'protective equivalents' or by revising the contested legislation and keeping the most crucial powers. Therefore, the liberalisation of the market for corporate control was somehow frustrated by the way in which the rulings were actually enforced at the national level.

4 Conclusion of Chapter 4

This chapter has attempted to investigate whether the interpretation of Article 63 TFEU in the golden shares case law allows room for State participation in the Market for the purposes of protecting public interest objectives and respects the division of competences between the EU and the Member States in the field of corporate governance, whilst at the same time ensuring that Member States do not impose protectionist measures liable to hinder the market access of foreign investors.

450 Ibid, p. 998.
451 Ibid, p. 999.
452 Ibid, p. 1000.

The use of golden shares in strategically sensitive privatised undertakings (in the energy sector, telecommunications, postal services, airports, car industries etc.) is a widespread phenomenon in Europe, which has given rise to a long-running litigation between the Commission and the Member States before the Court of Justice. The privatisation of State-owned companies has stimulated the growth and development of capital markets in Europe by creating an equity culture.[453] However, the State's involvement in the competitive market through golden shares is perceived as a threat or a hindrance to the emergence of a fully competitive market for corporate control.[454] The establishment of special shareholding in national privatised champions is regarded by the Commission as an expression of economic protectionism and therefore incompatible with the free movement of capital.

In most of the cases, the Member States contend that this special shareholding does not derogate from ordinary company law and is in any case necessary in order to pursue public interest objectives, such as safeguarding security of energy supplies or guaranteeing a service of general interest. The Court has so far adopted a rigorous application of the free movement of capital, ruling in all but one case that the special shareholding that Member States retain in privatised undertakings constitutes a restriction on the free movement of capital because of its *deterrent* effect on foreign investment. It has thus created a normative framework for regulating the relationship between the State and the competitive market.[455]

The adjudicative model of the Court is based on the ideological premise that golden shares are inherently incompatible with the fundamental freedoms and is characterised by a strikingly broad interpretation of the notion of 'capital restrictions'. This broad interpretation carries the risk that it might turn into a 'quality control' of domestic company law, whereby the Court will be called upon to review not only questions of cross-border discrimination or market access, but also *any type* of company law arrangements.[456] This may lead to a situation where *all* company law rules (ranging from various anti-takeover mechanisms to the German co-determination rule)[457] will be liable to deter foreing investors and therefore hinder capital movements.[458] The rigorous

453 Erika Szyszczak, 'Golden Shares and Market Governance' (2002) 29 Legal Issues of Economic Integration 255, p. 260.
454 Ibid, p. 261.
455 Ibid, p. 256.
456 Wolf-Georg Ringe, 'Company Law and Free Movement of Capital' (2010) 69 Cambridge Law Journal 378, p. 400.
457 Ibid, p. 400.
458 Ibid, p. 400. See also Mads Andenas, Tilmann Gütt and Matthias Pannier, ''Free Movement of Capital and National Company Law' (2005) 16 European Business Law Review 757; Stefan Grundmann and Florian Mo¨slein, 'The Golden Share – State Control in Privatised Com-

application of the free movement of capital in the golden shares case law implicitly favours the constitutional foundations of *liberal market economies* (as opposed to *coordinated market economies*) and promotes through negative integration a corporate governance system, which endorses the *principle of proportionality between ownership and control* and the *principle of shareholders' primacy*. This in turn might lead to an erosion of the *varieties of capitalism* that exist in Europe and to a judicially driven convergence into a specific model of market economy, which might give rise to concerns regarding the respect of the division of competences between the EU and the Member States.

The present chapter has identified and analysed the three most controversial legal issues arising from the golden shares case law: firstly, the question of the horizontal effect of Article 63 TFEU; secondly, justification grounds invoked by the Member States and the proportionality assessment applied by the Court of Justice in the golden shares case law; and finally, and most importantly, the strikingly broad interpretation of the notion of 'capital restrictions'.

With respect to the horizontal effect of Article 63 TFEU, the chapter draws from the theory of horizontality/third-party effect (*Drittwirkung*) in national constitutional law and in international human rights law and concludes that if one accepts that the free movement of capital binds the State even when it acts as a *shareholder* ('extended vertical effect'), reasons of legal consistency and equality require that the same should apply to private action. Private parties are important market operators (in many instances much more important than the State) and their actions can have far-reaching economic and social implications. Therefore, they should be bound by the fundamental freedoms, especially when they are in a dominant position and can exercise quasi-regulatory powers over other market participants. Despite the undisputed merits of the argument that a possible horizontal effect of Article 63 TFEU will interfere with private autonomy and will turn into a 'quality control' of *all* (both public and private) company law arrangements, it is argued that this 'intrusive' function of the free movement of capital can be prevented by a more restrictive interpretation of the notion of 'capital restrictions' and by a better balancing exercise at the justifications and proportionality level.

With respect to the balancing exercise, this Chapter firstly explores the derogation grounds which have been invoked by the Member States. Secondly, it turns to the proportionality assessement and argues that in the golden shares case law the Court uses the 'procedural proportionality' test or 'good governance' model. The 'procedural proportionality' test has also been used in the

panies: Comparative Law, European Law and Policy Aspects' (2001-2002) 4 *European Banking and Financial Law Journal – Euredia* 623.

gambling case law, wherer the Court has introduced the so-called *consistency* requirement. In the field of golden shares, the Court has introduced the requirement of compliance with the *principle of legal certainty*. The *Belgian* golden shares case offers a prime example of this test and is to date the only golden shares case where the national legislation was deemed to be compatible with the free movement of capital. A proportionality assessment based on the 'good governance' model and the procedural standards of *legal certainty* can guarantee an objective judicial review that respects national regulatory diversity in a sensitive field that is not harmonized at the EU level, whilst at the same time ensuring compliance with procedural requirements that create a *transparent* legal framework protecting the *legitimate expectations* of foreign investors and providing *effective judicial remedies* against arbitrary decisions of public authorities. However, despite the fact that the Court uses the appropriate proportionality test, the fact still remains that it requires a high standard of proof and in the vast majority of the cases the Member States have failed to justify their golden shares.

For this reason, the final part of the Chapter goes a step back in the legal reasoning of the Court and argues that the Court should reconsider tthe strikingly broad interpretation of the notion of 'capital restrictions'. The analysis draws inspiration from the *Keck* concept of 'selling arrangements' as developed in the field of free movement of goods and puts forward a refined test in order to delineate in a more consistent manner the scope of 'capital restrictions'. According to this test, if the contested measure is distinctly applicable (i.e. it discriminates between domestic and foreign investors), it constitutes a discriminatory restriction on the free movement of capital, which can be justified only by the objectives provided for in the Treaty. If the contested measure is indistinctly applicable (i.e. it does not discriminate on the basis of nationality), it constitutes a capital restrictions only if it (i) *derogates from ordinary company law* and (ii) *is available only to the State (to the exclusion of private investors)*. If, however, the indistinctly applicable measure (i) *does not derogate from ordinary company law* and (ii) *respects the principle of equality between the State and private parties as market participants without granting any privilege to the State*, it should then be regarded as 'investment arrangement', which falls outside the scope of Article 63 TFEU, since it merely *structures* the market and the national corporate governance regime, without hindering foreing investment. Such a test can offer room for State participation in the market for the purposes of pursuing public interest objectives, whist at the same time ensuring that the State participates in the market under equal conditions with private market operators and that protectionist measures which derogate from ordinary company law and/or grant the State an unfair advantage are prohibited. This is particularly important since a more restrictive interpretation of the notion of 'capital restrictions' under Article 63 TFEU can ensure that the division of competences between the EU and the Member States

is respected and that the Member States are allowed sufficient room to determine their corporate governance systems and to protect public interest objectives within the contours of the Internal Market.

Overall conclusion

Capital liberalisation has undoubtedly brought significant benefits to the global economy, by improving economic efficiency, allocating efficiently global resources, promoting foreign investment and supporting the transfer of technology and innovation around the globe. However, it is often associated with increased financial instability and rising levels of unemployment and income inequality. This is why international economic organisations such as the IMF and the OECD have concluded that capital liberalisation improves economic efficiency only if it is complemented by measures of prudential supervision and regulation, sound macroeconomic policies and transparency.

The negative social consequences of unfettered capital flows have caused a rising backlash against globalisation, which is often accompanied by measures of economic protectionism. In the field of trade, protectionist barriers on imports and exports of goods are counter-productive and they have a negative impact on growth and employment.[1] In the field of financial integration, however, defining what constitutes a protectionist measure and assessing its impact on economic growth and employment is a more difficult exercise.

In the EU, golden shares and forms of public ownership have been are regarded as protectionist measures aiming at protecting national industries against hostile takeovers, from foreign or even domestic competitors. However, although it is true that in some cases golden shares in strategic privatised undertakings might be considered to be forms of economic protectionism, they should not always be regarded as restrictions on the fundamental freedoms. While it is straightforward that measures which prohibit the acquisition of shares by foreign investors constitute discriminatory restrictions on the free movement of capital, other measures affecting the voting rights of shareholders, the composition of the Board of Directors or the decision making process within an undertaking without discriminating between foreign and domestic investors might actually not restrict the free movement of capital.

1 Christine Lagarde, 'Fix the Roof While the Window of Opportunity is Open: Three Priorities for the Global Economy, Speech at University of Hong Kong' (*IMF*, 2018) <https://www.imf.org/en/News/Articles/2018/04/09/spring-meetings-curtain-raiser-speech> accessed 31-01-2019.

In this context, this thesis has attempted to answer the following research question:

> *How can the EU free movement of capital provisions be interpreted so as to allow room for State participation in the market for the purposes of protecting public interest objectives in the context of privatisations and golden shares?*

In order to do so, it has firstly discussed the international theoretical debate regarding the question whether capital liberalisation actually contributes to economic growth or rather exacerbates income inequality. Secondly, it has analysed the case law of the Court of Justice on privatisations and golden shares and has concluded that the judicial endorsement of a very broad interpretation of capital restrictions limits significantly the competence of the Member States to determine their corporate governance and property ownership systems and to protect vital societal values.

In particular, this broad interpretation deprives Member States of their right to prohibit the privatisation of public undertakings or to maintain golden shares in privatised companies, which are of strategic importance for the national industrial policy and often serve public interest objectives. The golden shares case law of the European Court of Justice seems to be based on the ideological premise that golden shares are inherently incompatible with the fundamental freedoms. The rigorous interpretation of the free movement of capital under Article 63 TFEU implicitly favours the constitutional foundations of liberal market economies (as opposed to coordinated market economies) and promotes through negative integration a corporate governance system, which endorses the principle of proportionality between ownership and control and the principle of shareholders' primacy.

The principle of proportionality between ownership and control implies that any shareholder should own the same fraction of cash flow rights and voting rights and the principle of shareholders' primacy refers to the protection of shareholders' interests as the ultimate objective of a corporation. According to the Court's reasoning, golden shares deviate from the principle of proportionality between ownership and control, as they grant to public authorities voting rights which do not correspond to their percentage of ownership. Furthermore, they do not adhere to shareholders' primacy, as the State's interference with the management of an undertaking for the purposes of protecting public interest objectives is allegedly capable of depressing the value of shares, thus reducing the attractiveness of investing in the undertaking concerned and thus undermining shareholders' interests. As such, they constitute restrictions on capital movements.

However, the prohibition on restrictions on capital movements under Article 63 TFEU should not be regarded as a blank cheque to abolish all national company law requirements which derogate from the principle of proportionality between ownership and control or do not adhere completely to shareholders' primacy on the assumption that they render investment less attractive. While it is true that Member States should refrain from adopting measures that obstruct the functioning of the Internal Market, the choice of the market economy model remains a national competence. Member States should in principle be able to define their market economy model, to participate in the market and to protect societal values. A judicially driven convergence into the model of liberal market economies can be barely squared with the wording and the spirit of the Treaties, let alone with the international debate about the possible contributory effect of capital liberalisation to the rising levels of income inequality. Such a convergence raises significant concerns regarding the division of competences between the EU and the Member States in the fields of corporate governance and property ownership systems and the protection of public interest objectives. In this respect, the thesis has proposed two main modifications in the judicial interpretation of the free movement provisions which could help address the aforementioned concerns regarding the division of competences and the protection of societal values: firstly, the rediscovery of the principle of neutrality under Article 345 TFEU as a legal provision which shields national decisions to maintain public ownership in undertakings from Internal Market scrutiny; and, secondly, the recalibration of the 'capital restrictions' test in the golden shares case law by reference to a Keck-inspired notion of 'investment arrangements'.

In relation to the first proposal regarding the rediscovery of Article 345 TFEU, it is suggested that the sovereign right to opt for a private or public property ownership system of undertakings should be covered by the principle of neutrality enshrined in Article 345 TFEU. EU law is neutral with respect to privatisations and nationalisations. If a prohibition of privatisation is regarded as a restriction on the free movement of capital, this is liable to render Article 345 TFEU devoid of any legal content and meaning whatsoever. Therefore, the thesis takes issue with the 'sword interpretation' adopted in Essent and embraces the 'reductionist shield' interpretation according to which measures intrinsically linked with the national property ownership system, such as a prohibition on privatisation, should be excluded from the scope of the free movement provisions by virtue of Article 345 TFEU. However, it is acknowledged that the ruling in Essent, where the Court held that the reasons underlying the choice of a public ownership system under Article 345 TFEU could be used as a justification for the capital restriction imposed by the prohibition of privatisation, should be regarded as an important compromise aiming at reconciling capital liberalisation with public interest objectives.

In relation to the second proposal regarding the recalibration of the 'capital restrictions' test, the analysis draws inspiration from the Keck concept of 'selling arrangements' as developed in the field of free movement of goods and and proposes the transposition of a similar concept in the field of free movement of capital. According to this test, if the contested measure is distinctly applicable (i.e. it discriminates between domestic and foreign investors), it constitutes a discriminatory restriction on the free movement of capital, which can be justified only by the objectives provided for in the Treaty. If the contested measure is indistinctly applicable (i.e. it does not discriminate on the basis of nationality), it constitutes a capital restriction only if it (i) derogates from ordinary company law and (ii) is available only to the State (to the exclusion of private investors). If, however, the indistinctly applicable measure (i) does not derogate from ordinary company law and (ii) respects the principle of equality between the State and private parties as market participants without granting any privilege to the State, it should then be regarded as 'investment arrangement', falling outside the scope of Article 63 TFEU, since it merely structures the market and the national corporate governance regime, without hindering foreing investment. Such a test can offer room for State participation in the market for the purposes of pursuing public interest objectives, whist at the same time ensuring that the State participates in the market under equal conditions with private market operators and that protectionist measures which derogate from ordinary company law and grant privileges to the State are prohibited.

Overall, the thesis argues that through this 'velvet revolution' in the context of negative integration the interpretation of the free movement of capital in the EU can respect the delicate balance of competences between the EU and the Member States and can facilitate the reconciliation of the capital freedom with public interest objectives. This way, the EU will not only follow the contemporary economic school of thought advocating a more restrictive approach regarding international capital flows in order to prevent the risks of financial instability and social inequality, but it will also reinforce the social dimension of the European integration project.

Seen from a broader perspective, the two main proposals of this thesis attempt to bridge the gap between the State and the Market and to create sufficient room for the State to engage in economic activities as a market participant. More precisely, it is argued that the State should in principle be able to participate in the market under equal conditions with other private market operators and that forms of public ownership of undertakings or special shareholding in privatised undertakings should not be regarded as inherently problematic from the perspective of EU Internal Market law. The participation of the State in the market might even be desirable in some cases in order to

pursue vital public interest objectives, such as the protection of workers, the provision of services of general interest or the protection of workers.

At the same time, beyond these social considerations, there are also economic arguments supporting certain forms of public ownership, as recent evidence shows that the State's contribution to the achievement of an innovation-led economic growth is much greater than usually thought.[2] For instance, in her recent book, Mariana Mazzucato explained how all the technological advancements that made the creation of iPhones possible were funded by the government and achieved in public universities and other public research institutes.[3] Her findings debunk the myth of a lumbering, bureaucratic State versus a dynamic, innovative private sector and emphasise the important role of the State in innovation, technology and economic growth. In view of the aforementioned social and economic considerations, it is not surprising that, despite ambitious privatisation programmes undertaken in recent decades, many governments still maintain public ownership in commercial enterprises in strategically sensitive sectors such as electricity and gas, transportation and finance in order to protect public interest objectives.[4]

In the legal terrain, almost twenty years after the first generation of golden shares cases, the saga of golden shares litigation has not come to an end yet. Notwithstanding the resistance of the Member States to give up any control over their privatised national champions, the Commission is still scrutinising national legislation granting special rights in privatised undertakings to public authorities. In fact, in July 2017, the Commission decided to refer Croatia to the Court of Justice for failing to amend the law on the privatisation of the energy company INA, which granted the State special powers to veto certain decisions of the company.[5] However, a year later, the Commission decided to suspend the referral of Croatia to the Court, since the Croatian authorities

2 Jukka Snell, 'Economic Justifications and the Role of the State' in Koutrakos, Nic Shuibhne and Syrpis (eds), *Exceptions from EU Free Movement Law: Derogation, Justification and Proportionality* (Hart Publishing 2016), p. 25.

3 Mariana Mazzucato, *The Entrepreneurial State: debunking public vs. private sector myths* (Anthem 2013).

4 OECD, *The Size and Sectoral Distribution of SOEs in OECD and Partner Countries* (OECD Publishing 2014), p. 7. See also Hans Christiansen, *The Size and Composition of the SOE Sector in OECD Countries* (2011). According to the OECD report, the largest State-owned enterprises sectors in the OECD are found in four European countries: Norway, France, Slovenia and Finland.

5 European Commission, *Press Release – Commission refers Croatia to the Court for failing to amend the law on the privatisation of the energy company INA-Industrija Nafte, d.d. (INA), Brussels, 13 July 2017* (IP/17/1949, 2017).

submitted a draft amending the INA law, which would address the Commission's main concerns subject to some further adjustments.[6]

The suspension of this referral could be regarded as an indication that the Commission might be willing to reconsider the rigorous scrutiny of golden shares and allow more discretion for Member States to regulate their corporate governance systems. Yet, the suspension of one case cannot reasonably be interpreted as a shift in the institutional view of the Commission that golden shares are inherently incompatible with the free movement of capital. Contrary to the gambling sector, where the Commission decided to close all the infringement proceedings in the area of online gambling, acknowledging explicitly the 'broader political legitimacy of the public interest objectives' and highlighting that 'it is not one of its priorities to use its infringement powers to promote an EU Single Market in the area of online gambling services',[7] no such general statement has been made in relation to golden shares. In the absence of any formal closure of pending golden shares cases, it can be inferred that legal action against Member States holding special rights in privatised undertakings still remains on the table as one of the Commission's political priorities. It is yet to be seen whether the Court of Justice will be called upon to rule on a new generation of golden shares cases and, if so, whether it will remain faithful to its well-established case law on the incompatibility of golden shares with the free movement provisions or it will be willing to reconsider some aspects of its judicial reasoning and perhaps try adopt a more restrictive approach regarding capital restrictions.

6 European Commission, *Press release – Commission suspends referral of CROATIA to the Court for failing to amend the law on the privatisation of the energy company INA-Industrija Nafte, d.d. (INA), Brussels, 19 July 2018* (IP/18/4489, 2018).

7 European Commission, *Press release – Commission closes infringement procedures and complaints in the gambling sector, Brussels, 7 December 2017* (IP/17/5109, 2017).

Samenvatting (Dutch summary)

Privatisering en gouden aandelen

Het overbruggen van de kloof tussen de Staat en de markt in het vrije verkeer van kapitaal in de EU

Het huidige proefschrift probeert de volgende onderzoeksvraag te beantwoorden: 'Hoe kan het vrije verkeer van kapitaal worden geïnterpreteerd op een manier dat het ruimte creëert voor lidstaten om deel te nemen aan de markt?' Om deze onderzoeksvraag te kunnen beantwoorden zal in dit proefschrift, ten eerste, het vrije verkeer van kapitaal in de interne markt van de Unie in de bredere context van kapitaalliberalisering op mondiaal niveau worden gesitueerd en zal het internationale theoretische debat betreffende de vraag of kapitaalliberalisering daadwerkelijk bijdraagt aan economische groei, of dat het juist inkomensongelijkheid verergert, worden onderzocht. Ten tweede, probeert het een uitgebreide en scherpe analyse te maken van de juridische kwesties die voortkomen uit de toepassing van het vrije verkeer van kapitaal op grond van artikel 63 VWEU op basis van de jurisprudentie van het Hof van Justitie. De focus ligt in het bijzonder op twee case studies: privatisering en gouden aandelen. De keuze voor deze twee case studies is gebaseerd op het feit dat ze betrekking hebben op de vormgeving van eigendomsstelsels en corporate-governance systemen van de lidstaten: twee gevoelige nationale bevoegdheden die van grote invloed zijn op het industriebeleid van de lidstaten en die de mate van overheidsinterventie op de markt bepalen.

Naast de juridische analyse van de meest controversiële kwesties uit jurisprudentie, is het proefschrift ook gebaseerd op het theoretische kader van 'varieties of capitalism' en in het bijzonder het onderscheid tussen de paradigma's van liberale markteconomieën en gecoördineerde markteconomieën, dat als terugkerend thema door het proefschrift loopt. Bezien vanuit deze theoretische invalshoek, is de belangrijkste claim van dit proefschrift dat de toepassing van het vrije verkeer van kapitaal op grond van artikel 63 VWEU in de jurisprudentie van het Hof van Justitie betreffende privatiseringen en gouden aandelen, ingrijpende implicaties heeft voor nationale corporate-governance systemen en de vormgeving van nationaal industriebeleid, alsmede dat het een potentieel deregulerend effect heeft op de sociaaleconomische stelsels van de lidstaten. Door middel van een doctrinaire, argumentatieve en normatieve juridische

analyse van de relevante jurisprudentie, stelt dit proefschrift nieuwe manieren voor om de asymmetrie tussen economische en sociale doelstellingen op het gebied van het vrije verkeer van kapitaal te bestrijden. Het argument is dat de verzoening tussen het vrije verkeer van kapitaal en sociale doelstellingen kan worden bereikt door een alternatieve interpretatie van artikel 63 VWEU. Deze interpretatie omvat, ten eerste, het gebruik van artikel 345 VWEU als een manier om bepaalde maatregelen uit te sluiten van de reikwijdte van artikel 63 VWEU, ten tweede, een meer restrictieve interpretatie van het concept van 'kapitaalbeperkingen' en ten slotte, een procedurele (in plaats van een inhoudelijke) evenredigheidstoets gebaseerd op het rechtszekerheidsbeginsel.

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Curriculum vitae

Ilektra Antonaki was born in 1990 in Heraklion (Crete), Greece. After completing her secondary school education in Heraklion in 2008, she studied law at the University of Athens, from which she graduated *cum laude* and top of her class in 2012. She was subsequently admitted to the Master 2 (Recherche) en Droit International Public at the Université Panthéon-Assas (Paris II) for which she was awarded a scholarship by the French Government. Upon successful completion of the Master 2 en Droit International Public in Paris, in 2013, she moved to Leiden in order to undertake post-graduate studies in the Advanced LLM in European and International Business Law, for which she was awarded the Leiden University Excellence Scholarship. In August 2014, she graduated *cum laude* and top of her class from the University of Leiden. Alongside the Advanced LLM, she was admitted to the Talent Programme of Leiden Law School, which allowed her to submit a PhD proposal and to receive the Meijers PhD Grant from the Graduate Institute of Legal Studies. In September 2014, she started working for the Europa Institute as a PhD candidate under the supervision of Professor Stefaan Van den Bogaert and Dr. Moritz Jesse.

In autumn 2015, she was on a two-month research visit at the European University Institute (EUI) in Florence under the supervision of Stefan Grundmann. In spring 2016, she completed the Blue Book Traineeship programme of the European Commission. In particular, she worked as a trainee within the Legal Service of the European Commission, in the SJ.A – AFFAIR Team (establishment, services, business law, movement of capital, transport, intellectual property and information society).

Ilektra specialises primarily in EU Internal Market law, but her broader research interests also touch upon EU Constitutional and Institutional law, the Charter of Fundamental Rights, EU Social law, as well as EU Trade and Investment law. In 2018, she received the Meijers Prize for the annotation on the *AGET Iraklis* case about collective redundancies in Greece, which was published in the Common Market Law Review.

In the range of books published by the Meijers Research Institute and Graduate School of Leiden Law School, Leiden University, the following titles were published in 2018 and 2019

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