

REPORT FOR THE HEARING

(Privatisation of a public-sector undertaking – Limitation on acquisition of shares – State's Special Share)

In Case C-98/01,

Commission of the European Communities, represented by F. Benyon and M. Patakia, acting as Agents, with an address for service in Luxembourg,

applicant,

v

United Kingdom of Great Britain and Northern Ireland, represented by J. Collins, acting as Agent, J. Crow and D. Wyatt, QC, with an address for service in Luxembourg,

defendant,

APPLICATION for a declaration that the provisions limiting the possibility of acquiring shares with voting rights in the company BAA plc, as well as the procedure requiring consent to the disposal of the company's assets, control of subsidiaries and winding-up are incompatible with Articles 43 and 56 of the Treaty.

* Language of the case: English.

I – RELEVANT PROVISIONS AND FACTS OF THE CASE

1. Under the Airports Act 1986, described as ‘an Act to provide for the dissolution of the British Airports Authority and the vesting of its property, rights and liabilities in a company nominated by the Secretary of State’, the former British Airports Authority, which owned and operated seven international airports in the United Kingdom, was privatised. In 1987, the company BAA plc (hereinafter ‘BAA’) was formed. In the establishment of its share capital, a special one pound share was allocated to the Secretary of State for Transport.

2. The Articles of Association of BAA, adopted by Special Resolution on 7 July 1987, define that special share more particularly.

3. Article 10 of the Articles of Association, entitled ‘The Special Share’, provides:

‘(1) The Special Share may be transferred only to one of Her Majesty's Secretaries of State, another Minister of the Crown or any other person acting on behalf of the Crown.

(2) Notwithstanding any provision in these articles to the contrary, each of the following matters shall be deemed to be a variation of the rights attaching to the Special Share and shall accordingly be effective only with the consent in writing of the Special Shareholder:

(a) the amendment, or removal, or alteration of the effect of, all or any of the following articles:

(i) article 1, to the extent of the definitions of „holder“, „the Special Share“, „Special Shareholder“ and „Stock Exchange Nominee“;

(ii) this article;

(iii) article 39;

(iv) article 40;

(b) the Company ceasing (for whatever reason) to have the right to exercise or to control the exercise of over half the voting rights exercisable on all resolutions considered at a general meeting of any subsidiary owning a Designated Airport or any agreement being entered into with a view to the Company so ceasing;

(c) any proposal being made for the voluntary winding up or dissolution of the Company or of any subsidiary owning a Designated Airport other than a voluntary winding up or dissolution of a subsidiary which forms part of a scheme of reconstruction or amalgamation under which the said Designated

Airport is disposed of in such a manner as results in the airport operator being the Company or another subsidiary;

- (d) the Company or any subsidiary disposing or entering into an agreement with a view to its disposing of a Designated Airport or any part thereof in such a manner as would result in neither the company nor any subsidiary being the airport operator of such Airport.
- (3) For the purposes of this article:
- (a) the expression 'Designated Airport' means an airport which is for the time being designated for the purposes of section 40 of the Airports Act 1986;
 - (b) the expression 'dispose of' shall include sell, transfer, surrender, mortgage, charge, create any estate or interest in or right over, part with possession of or control over and dispose of in any other way;
 - (c) the expression „airport operator“ shall have the meaning ascribed to it by section 82(1) of the Airports Act 1986.
- (4) The directors of the Company will exercise all powers of control exercisable by the Company in relation to its subsidiaries so as to secure (so far as by such exercise they can secure) that no subsidiary shall take any action which (either alone or when taken together with any other action) would involve a variation of any of the rights attached to the Special Share.
- (5) The Special Shareholder shall be entitled to receive notice of, and to attend and speak at, any general meeting or any meeting of any class of shareholders of the Company, but the Special Share shall carry no right to vote nor any other rights at any such meeting.
- (6) In a distribution of capital in a winding up of the Company, the Special Shareholder shall be entitled to repayment of the capital paid up on the Special Share in priority to any repayment of capital to any other member. The Special Share shall confer no other right to participate in the capital or profits of the Company.
- (7) The Special Shareholder may, subject to the provisions of the Act, require the Company to redeem the Special Share at par at any time by serving written notice upon the Company and delivering the relevant share certificate.'

4. In addition, Article 40(1) of the Articles of Association provides:

'The purpose of this article is to prevent any person (other than a Permitted Person) being, or being deemed or appearing to the directors to be, interested in shares of the Company which carry (or may in accordance with their terms in certain circumstances carry) the

right to more than 15 per cent of the votes which could be cast on any resolution at any general meeting of the Company (whether or not the votes could be cast in relation to all resolutions at all general meetings).’

II – PRE-LITIGATION PROCEDURE

5. By letter of 3 February 1999, the Commission informed the Government of the United Kingdom that it considered that the special powers of the State established by the Articles of Association of BAA might infringe the provisions of the EC Treaty on the free movement of capital and the freedom of establishment. The Commission therefore requested that Government to submit its observations to it within a period of two months.

6. The United Kingdom Government did not reply to that letter of formal notice.

7. The Commission therefore, on 6 August 1999, sent to the United Kingdom Government a reasoned opinion requesting it to comply therewith within a period of two months.

8. The United Kingdom Government replied by a letter of 5 November 1999, in which it took the position that the Member States are entitled to define, within the framework of their national company law, the essential characteristics of shares available for sale in privatised companies and that this does not deny access to the market in those shares. Furthermore, it maintained that special measures to protect the public interest may be needed in a privatisation situation.

9. The Commission, since it was not satisfied with that reply, brought the present action before the Court.

III – PROCEEDINGS BEFORE THE COURT

10. The Commission's application was lodged at the Court Registry on 27 February 2001.

11. On hearing the report of the Judge-Rapporteur, and after hearing the Advocate General, the Court decided to retain the case before the full Court and to open the oral procedure.

IV – FORMS OF ORDER SOUGHT BY THE PARTIES

12. The Commission claims that the Court should:

- (a) declare that the provisions setting a limitation on interests in voting shares in the BAA plc company (Article 40 of the Articles of Association), as well as the authorisation procedure on the disposal of assets in the company or control in subsidiaries and winding-up (Article 10 of the Articles of Association) are incompatible with Articles 43 and 56 of the EC Treaty;
- (b) order the United Kingdom to pay the costs.

13. The United Kingdom Government contends that the application should be dismissed and the Commission ordered to pay the costs.

V – PLEAS IN LAW AND ARGUMENTS OF THE PARTIES

14. The *Commission* first of all refers to its Communication 97/C 220/06 of 19 July 1997 on certain legal aspects concerning intra-EU investment (OJ 1997 C 220, p. 15). It points out that in that communication it indicated its point of view as to the interpretation of the Treaty provisions relating to the free movement of capital and the freedom of establishment within the framework of measures adopted by a Member State in the privatisation of a public undertaking.

15. According to the Commission, the provisions limiting the possibility of acquiring shares with voting rights in BAA (Article 40 of the Articles of Association), on the one hand, as well as the authorisation procedure in respect of the disposal of the company's assets, of the control of subsidiaries and of the winding-up of the company (Article 10 of the Articles of Association), on the other hand, do not comply with the conditions set out in the above-cited Communication and also infringe Articles 56 and 43 EC.

16. Those provisions of the Articles of Association, although they apply without distinction on grounds of nationality, can create obstacles to the right of establishment of nationals of other Member States as well as to the free movement of capital within the Community, since they may hinder the exercise of those freedoms or render it less attractive. In relation to the free movement of capital, it is appropriate to refer to Annex 1 to Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty (OJ 1988 L 178, p. 5), which refers, first, to portfolio investment, that is the acquisition of shares without seeking to take part in management, and, second, direct investment, which is characterised by the fact that the shareholding owned by a person enables him to participate effectively in the management of that company or in its control.

17. Although it is true that the Member States may lay down certain restrictions on those Treaty freedoms in certain circumstances linked to the exercise of official authority, to public policy, to public safety and to public health, such restrictions must be interpreted strictly and their scope cannot be determined unilaterally by each Member State. Furthermore, they must also pass the proportionality test, must not be misapplied so as to

serve purely economic ends and must be in conformity with the principle of legal certainty (see Case C-19/92 *Kraus* [1993] ECR I-1663 and Case C-55/94 *Gebhard* [1995] ECR I-4165).

18. Article 40 of BAA's Articles of Association, which prevents any person from controlling more than 15% of the company, is clearly incompatible with the provisions of the Treaty, since the United Kingdom Government has not invoked any public interest in that regard or any particular circumstances.

19. Similarly, Article 10(7) of the Articles of Association, which requires the consent of the Special Shareholder for a number of important decisions concerning the business of BAA, amounts to a totally discretionary power, the contours of which are undetermined in the hands of the State. That discretionary power restricts the possibilities for other shareholders to participate in the management of the company, possibilities which are an integral part of direct investment. Consequently, they hinder the exercise of the abovementioned freedoms or render it less attractive.

20. The Commission emphasises that the United Kingdom has not invoked, in the course of the pre-litigation procedure, any imperative requirements in the general interest to justify those restrictions.

21. Moreover, it appears, according to the British press, that the United Kingdom Government intends to give up the rights attaching to the Special Shares in issue. From that the Commission infers that they are probably unnecessary.

22. In relation to the argument put forward by the United Kingdom Government in its reply to the reasoned opinion, namely that the mechanisms of private (company) law are not affected by the restrictions in issue, the Commission claims that, although the special measures are effectively permitted by United Kingdom company law, they are not the result of the normal play of that law but are measures taken by the State by virtue of an Act of Parliament. If it is in its capacity as a public authority that a Member State introduces restrictions by mechanisms of company law, those mechanisms of private law can in no way avoid examination of the compatibility of such restrictions with the Treaty (see Cases C-478/98 *Commission v Belgium* [2000] ECR I-7587; C-16/94 *Dubois* [1995] ECR I-2421, paragraph 20; and Joined Cases C-51/96 and C-191/97 *Deliège* [2000] ECR I-2549).

23. The *United Kingdom Government* contends that the rights conferred on the Special Shareholder by Articles 10 and 40 of BAA's Articles of Association do not constitute restrictions on the Treaty freedoms. The Commission's action is therefore unjustified and should be dismissed.

24. As a preliminary point, the United Kingdom Government emphasises that the Commission's Communication has no legal effect, but is only an expression of its opinion.

25. It explains also that, under the national company law in force in the United Kingdom, different classes of shares can exist and that the rights attached to them may also be different, both in relation to sharing in the company's profits and to its management. The Special Share concerned comes within that range; in particular, shares without voting rights are entirely normal in certain companies.

26. As for the accusation made against it by the Commission of interfering with the free market, the United Kingdom Government contends that the measures in issue are, contrary to the Commission's view, in accordance with Community law. They apply to all nationals of the Member States without discrimination on grounds of nationality and do not restrict access to the market. No justification for those measures is therefore necessary.

27. What is concerned is not a power of veto over the acquisition of property and assets owned by the company, but only the question whether assets and shares should be put on the market at all, and the right to participate in the decisions of the company.

28. The legal flaw in the Commission's case is that it treats the formulation, in *Kraus and Gebhard*, cited above, to the effect that every measure which hinders the exercise of the fundamental freedoms or renders it less attractive must be justified by proportionate recourse to overriding requirements, as being of universal application. That however is not correct. In the context of the free movement of goods, the over-extensive application of the previous case-law had to be corrected by the judgment in *Joined Cases C-267/91 and C-268/91 Keck and Mithouard* [1993] ECR I-6097. The Commission's argument in this case would lead to a repeat, in the context of the freedom of establishment and the free movement of capital, of all the difficulties which led to that judgment.

29. In this case, neither the rules of private law which determine the characteristics of shares available on the market, nor those which allow special shareholders to participate in the decisions of the company, or which require the consent of the special shareholders before certain decisions can be taken, constitute restrictions on access to the market.

30. The decision whether or not to dispose of a company's assets [see Article 10(2)(b) of BAA's Articles of Association relating to the company giving up control of a subsidiary which owns a designated airport and Article 10(2)(a) relating to the disposal of a Designated Airport] does not interfere with either the right of establishment, or the free movement of capital, since companies are not obliged to put assets on the market. It can only be an obstacle in cases where a particular person has to be authorised to buy the assets when they are disposed of, which is, however, not the case here.

31. Since neither Article 10 nor Article 40 of BAA's Articles of Association gives rise to any discrimination on grounds of nationality, those articles are in conformity with Community law and require no justification.

32. The United Kingdom Government explains in detail that the rights of the Special Shareholder under Article 10, which require prior written consent to the taking of certain

decisions by the company, are completely in accordance with the normal rules of company law in force in the United Kingdom, which allow the issue of different classes of shares whether those rules are 'usual' or not. BAA's Articles of Association do not constitute national legislation and cannot be equated to it. The Member States are entitled to engage in economic activities on the same basis as private market operators, within the framework of contracts governed by private law between each shareholder and the company. In the absence of harmonisation of the rules of national company law, Community law cannot impose on a company which issues shares the obligation to put on the market the mechanisms for acquiring control of it, or to attach to its shares all the range of rights which all actual and potential investors might wish to see attached to them. If the position were otherwise, the whole national system would be subverted. In other words, it is not the aim of the Treaty freedoms to achieve complete *laissez-faire* in the corporate constitution of companies established under the laws of the Member States.

33. The same analysis is valid for Article 40 of the Articles of Association which, according to the Commission, 'prevents any person from controlling more than 15% of the company'. Here again, it is only a matter of defining the characteristics of the shares put on the market, under the applicable company law, and not of approving acquisition by a particular investor, thereby restricting access to the market in those shares. The Commission's contention amounts to a claim that it is obligatory for the constitution of BAA to provide for a sufficient number of shares of the appropriate class or classes to be put on the market as would allow a shareholder to acquire sole overall control of BAA. Community law places no such obligation on those setting up companies, whether public authorities are involved in the process or not.

34. According to the Commission's contention, it would be perfectly acceptable for a Member State which takes the decision to privatise a public undertaking to retain shares representing not less than 51% of the voting rights. Consequently, the fact of putting on the market all the equity capital of a company which controls virtually the entire airport infrastructure of the country, and relinquishing governmental control of its business strategy, is regarded as more restrictive of the Treaty freedoms than placing less than half of the equity capital of the same company on the market, and retaining the right to influence or to determine the entire business strategy of the company. That example demonstrates the full error of the Commission's contention.

35. Finally, the United Kingdom Government accepts that the rights of the Special Shareholder were designed to protect the public interest. However, all activities of the State are so designed, whether the State pursues that aim by intervention on, or participation in, the market. In this case, the compatibility of the rights conferred on the State by the Special Share with the requirements of Community law are to be judged not by the objectives pursued by the State, but by the effects of the rights in question on those exercising fundamental freedoms.

36 In its reply, the *Commission* notes, first of all, that the United Kingdom Government has not advanced any argument to justify the conduct in issue for imperative

reasons in the general interest. It goes on to reject the argument to the effect that the Treaty freedoms are not applicable in this case. According to the Commission, there can be no doubting the fact that the measures in issue restrict access to the market for investors of other Member States and render the exercise of the freedoms concerned less attractive.

37 As for Article 40 of BAA's Articles, the title of which 'Limitations on Shareholdings' is significant, its effect is that a shareholder who already owns 15% of the voting rights cannot acquire an additional share.

38 As for the right of veto conferred on the Special Shareholder by Article 10 of the Articles of Association, it results in

- a shareholder being unable to benefit from, or improve, his investment by voting, for example, for the sale of an airport to a purchaser at a very significant price,
- if the share price falls, a shareholder's vote to liquidate a particular subsidiary etc. and realise its significant assets can be overruled,
- the repatriation of the investment, that is the liquidation or assignment of assets built up, would be restricted,
- a particularly favourable take-over bid can be blocked, since the Special Shareholder can at any moment demand redemption of the share.

39 That right of veto may be exercised, for an indefinite period, over any transaction, at the entire discretion of the Government, without criteria or guidelines, and it may be lifted only at the initiative of the Government.

40 A Community citizen who wishes to invest or to establish himself cannot therefore, according to the Commission, take part in various management activities, some of which are directly related to the maintenance or realisation of his investment. Nor can he contribute to a decision on certain sales.

41 The Commission contends that the powers concerned are powers to be exercised by the Member State in its capacity as a State. It does not matter therefore that they are exercised by means of national company law.

42 In relation to the application of the principles laid down in the *Keck* judgment, cited above, to the facts of this case, as proposed by the United Kingdom Government, the Commission observes that that judgment concerns a particular case of national selling arrangements in the context of the free movement of goods. Even on the hypothesis of an application by analogy – excluded by the Court in several judgments such as those in Case C-415/93 *Bosman* [1995] ECR I-4921, paragraph 103, and Case C-384/93 *Alpine Investments* [1995] ECR I-1141, paragraphs 36 to 38 – what is concerned in this case is not

the manner in which shares may be acquired or dealt with, but, in the case of Article 40 of the Articles of Association, a quantitative restriction, and, in the case of Article 10, the possibility of negating a fundamental aspect of the freedoms concerned, and therefore a real restriction on the very exercise of the right in issue.

43 The Commission admits that that does not necessarily mean that the provisions are contrary to the Treaty. But the United Kingdom should have justified them with regard to the provisions of the Treaty and the Court's case-law.

44 In its rejoinder, the *United Kingdom Government* insists on the fact that the Special Share constitutes an option under the rules of national company law. If the Special Share were open to challenge, so would be every class of share with voting rights which could be described, in one way or another, as being more extensive than those of another class of shares. The Commission's argument 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.

45 The United Kingdom Government goes on to analyse once more the judgments in *Gebhard*, *Kraus*, *Bosman* and *Alpine Investments*, cited above, in order to show that in those judgments the Court put the accent on access to the labour market, or access to the activities in issue. It claims that it is therefore appropriate to apply *mutatis mutandis* the principles developed in the *Keck* judgment, cited above.

46 Neither Article 10 nor Article 40 of BAA's Articles of Association affects access to the market in BAA's shares. In particular, what the Treaty does not classify as restrictions on capital movement are national rules of private law which define the extent of the rights enjoyed under the property in question.

47 In relation to the examples of the restrictions in question, as described by the Commission, the United Kingdom Government insists on the existence of a private-law contract which the ordinary shareholders have accepted. It is a matter of the extent of the voting rights initially put on the market, and investors have invested on that basis. Therefore, they cannot later legitimately complain that they expect more than 15% of the voting rights.

48 The manner in which the Special Share may be used constitutes a defining characteristic of all the shares in BAA and therefore does not amount to a restriction on the access of investors to the market in the shares in question.

49 As for the Commission's argument on the redemption of the share in the event of a take-over bid, the United Kingdom Government does not see the Commission's problem since redemption is at par value – that is one pound – and also removes the very rights to which the Commission objects.

50 Nor does the United Kingdom Government accept the Commission's interpretation of Article 10 of BAA's Articles of Association, according to which the consent of the

Special Shareholder can be linked to the identity of a potential transferee. The right claimed by the Special Shareholder is a right to decide whether or not a Designated Airport should be disposed of, but in no case to approve potential transferees.

51 In conclusion, the United Kingdom Government confirms its position that the capital structure in question provides a model which contributes to the development of the privatisation of the single market without discrimination and without recourse to restrictions on access to the market, and that the question of justification does not therefore arise.

P. Jann

Judge-Rapporteur