Volume 2 | Number 2 | Autumn 2006

Competition Policy International

EU State Measures against Foreign Takeovers: "Economic Patriotism" in All But Name

Alex Nourry and Nelson Jung

Copyright © 2006
eSapience, Ltd.

Published in *Competition Policy International* (print ISSN 1554-0189, online ISSN 1554-6853), Autumn 2006, Vol. 2, No. 2.
Competition Policy International is a free publication. For additional copies, please visit cpi.esapience.org or call +1.617.844.1800.

EU State Measures against Foreign Takeovers: "Economic Patriotism" in All But Name

Alex Nourry and Nelson Jung

Protectionist tendencies of EU Member States have always been evident in sectors of industry that previously were dominated largely by state-owned companies, namely, the banking, defense, energy, postal, telecommunications, transport, and water sectors where, following privatization, Member States have sought to preserve or create so-called "national champions." However, a new wave of protectionism or economic patriotism by Member States has broken out recently, as exemplified by the long-running saga of the takeover of Endesa, the Spanish electricity group. This article examines the compatibility of special rights and other state measures with the EC's single market objectives within the framework of the EC Treaty and their impact on foreign takeovers and investments. It also examines the initiatives taken by the Commission in order to eliminate such measures and analyzes the potential remedies available to foreign investors when confronted with such measures. Such remedies include the application of the Commission's powers under Article 21 of the EC Merger Regulation that arguably could be used to even greater effect with the abolition or curtailment of the two-thirds rule.

Alex Nourry is a partner and U.K. Head of the European Competition and Regulation group at Clifford Chance LLP. Nelson Jung is an associate at Clifford Chance LLP in the same group. The authors would like to thank their colleagues Dimos Dakanalis, Christos Nifadopoulos, and Trupti Reddy for their valuable contributions to this article.

I. Introduction

Protectionist tendencies of EU Member States have always been a concern to the European Commission in the context of the EU's single-market objectives. Such tendencies have been especially evident in sectors of industry that previously were dominated largely by state-owned companies, namely, the banking, defense, energy, postal, telecommunications, transport, and water sectors where, following privatization, Member States have sought to preserve or create so-called "national champions."

This protectionism has manifested itself either through very direct and blatant means such as the grant of State aid as in the case of the French government's rescue of Alsthom, or through the exercise of other state measures, including special rights in privatized companies or the application of legislative or regulatory powers. These state measures, although now less prevalent as a result of Commission intervention, have tended to deter and, in some cases, have prevented foreign takeovers.

A new wave of protectionism or economic patriotism by Member States has broken out recently, as exemplified by the long-running saga of the takeover of Endesa, the Spanish electricity group. Endesa, having been, originally, the target of a proposed takeover by its Spanish rival, Gas Natural, in a clear attempt by the Spanish government to create a national champion in the energy sector, is also the subject of a proposed takeover by the German energy group, E.ON. While E.ON's proposed acquisition of Endesa received unconditional clearance from the Commission under the EC Merger Regulation (ECMR)[1] on the basis that the two groups do not have competing activities, the Spanish National Energy Commission (CNE) approved the merger on condition that E.ON sell up to 30 percent of Endesa's generation capacity on security grounds, thereby severely undermining the viability of the merger. The Commission reacted very swiftly and strongly to the CNE ruling, requesting that the Spanish government refrain from its protectionist obstruction of E.ON's takeover of Endesa.[2] Meanwhile, Iberdrola, another Spanish utility, also joined the fray by appealing against the Commission's clearance of the E.ON-Endesa deal, motivated by its agreement

1 Council Regulation 139/2004 of 20 January 2004 on the control of concentrations between undertakings, 2004 O.J. (L 24) 1.

2 On the same day of its challenge to the Spanish government's obstruction of E.ON's takeover of Endesa, the Commission also called on the Italian government to explain its move to block the planned merger between Italian highway operator, Autostrade and Spain's Abertis. The Italian government had argued that the merger would be in breach of an Italian law that prohibits construction companies from holding shares in a concessionary. However, the Commission cleared the merger between Albertis and Autostrade on 22 September, 2006, and Italy's Infrastructure Minister Antonio di Pietro has, in the meantime, acknowledged that the Commission's clearance decision overrules the Italian law. *See* European Commission, Press Release No. 1244 (2006).

with Gas Natural to buy up to EUR 9 billion of excess assets following a merger with Endesa.[3]

The takeover battle for Endesa also highlights the inherent limitations of the Commission's exclusive jurisdiction under the ECMR to examine mergers between largely domestic players, even when such mergers may have a substantial impact on the single market. The Commission was unable to assert its jurisdiction over Gas Natural's proposed takeover of Endesa because of the ECMR's so-called "two-thirds rule," as both parties derived over two-thirds of their respective turnover from activities within Spain. As a result, it fell to the Spanish authorities to review the proposed merger, which they ultimately approved subject to certain conditions.

At the time, in a paper to her fellow Commissioners, European Commissioner Neelie Kroes was reported to have called for wide-ranging reform of the EC's merger regime and, in particular, the abolition of the two-thirds rule on the grounds that it no longer reflected "an optimal allocation of competence between the national and the Community level, and even constitutes in some instances, an obstacle to a consistent treatment of cases."[4] The paper also pointed to the merger of E.ON and Ruhrgas, the German energy group, as another merger that the Commission, rather than the national competition authority, should have examined. Although that merger was blocked by the Bundeskartellamt, the German competition authority's decision was overruled by the German government.

The Commissioner's paper also raised the issue of other sectors, in particular, the financial services sector, where some of the largest mergers also fell outside the Commission's competence due to the application of the two-thirds rule, citing the takeover of Credit Lyonnais by Credit Agricole and of Paribas by BNP as examples in the French banking sector.

This article examines the compatibility of special rights and other state measures (other than State aid) with the EC's single market objectives within the framework of the EC Treaty and their impact on foreign takeovers and investments. It also examines the initiatives taken by the Commission in order to eliminate such measures and analyzes the potential remedies available to foreign investors when confronted with such measures. Such remedies include the application of the Commission's powers under Article 21 of the ECMR that arguably could be used to even greater effect with the abolition or curtailment of the two-thirds rule.

3 This issue of *Competition Policy International* went to print on October 2, 2006. The authors, therefore, were not able to discuss new developments after that date.

4 Tobias Buck, *Kroes calls for more powers over mergers*, FIN. TIMES, Nov. 16, 2005.

II. The EU Legal Framework

A. FUNDAMENTAL PRINCIPLES OF EU LAW

The single or internal market freedoms of free movement of goods (Article 28 of the EC Treaty), services (Article 49 EC), capital (Article 56 EC), and right of establishment (Article 43 EC) enshrined in the Treaty constitute fundamental principles of EU law. Over the past decade, the principles governing the application of the Treaty freedoms have converged to a considerable extent. Essentially, any measure by a Member State that is liable to hinder or make less attractive the exercise of any of the freedoms is likely to be in breach of the Treaty unless it can be justified. The range of grounds on which Member States can validly rely to justify such a measure depends on whether the measure constituting a hindrance to the single market discriminates on the grounds of nationality (either directly or indirectly) or if it is indistinctly applicable. Discriminatory measures can be justified only by the limited and narrowly construed grounds set down explicitly in the Treaty, such as public policy, public security, or public health.[5] Non-discriminatory measures, however, are justifiable by overriding requirements in the general interest (a non-exhaustive list of such requirements having been developed by the EC Courts) provided that they comply with the principle of proportionality. Restrictions on the Treaty freedoms can never be justified by purely financial or economic reasons.

State measures restricting foreign takeovers generally come within the ambit of the free movement of capital as they are liable to deter or dissuade cross-border capital transactions. Article 56 EC gives effect to the free movement of capital between Member States, and between Member States and third countries. To that end, it provides that all restrictions on the movement of capital between Member States as well as between Member States and third countries are prohibited as a matter of principle. According to settled case law,[6] Directive 88/361, together with the nomenclature annexed to it, may be used for the purposes of defining a capital movement.[7] By way of example, direct investment in the form of participation in an undertaking by means of shareholding or the acquisition of securities on the capital market constitute capital movements within the meaning of Article 56 EC.[8]

---

5 In this respect, *see, e.g.*, Articles 30, 46, 55, and 58(1)(b) of the EC Treaty.

6 Case C-222/97, Trummer and Mayer, 1999 E.C.R. I-1661, at paragraphs 20 & 21.

7 1988 O.J. (L 178) 5; *see also*, Communication of the Commission on certain legal aspects concerning intra-EU investment, 1997 O.J. (C 220) 15.

8 The explanatory notes in Council Directive 88/361 of 24 June 1988 for the implementation of Article 67 of the Treaty, Annex I, 1988 O.J. (L 178) 5, state that direct investment is characterized by the possibility of participating effectively in the management of a company or in its control.

Restrictions on acquisitions of controlling stakes in a domestic company by EU investors are also caught by the freedom of establishment as guaranteed in Article 43 EC. In fact, restrictions on the free movement of capital in the context of state measures preventing takeovers by EU investors are usually inextricably linked to the right of establishment.[9]

It should be noted that Article 295 EC, which lays down the Treaty's neutrality between public and private ownership, does not have the effect of exempting the Member States' system of property ownership from the ambit of the Treaty freedoms. Thus, while Member States are not obliged to privatize state-owned companies, once a company is privatized, there is only limited scope for intervention. Member states can also not easily escape the application of the freedoms by invoking security concerns. Article 296 EC sets out the conditions under which Member States may legitimately invoke the protection of their essential security interests, in which case the freedoms do not apply.

B. THE COMMISSION'S EXCLUSIVE JURISDICTION OVER MERGERS WITH A COMMUNITY DIMENSION

Whether a transaction falls within the ambit of the ECMR and, as a consequence, is subject to the exclusive jurisdiction of the Commission, will play a crucial role in determining the powers that the Commission will have at its disposal and the effectiveness of any remedies available to a bidder when faced with state measures which restrict or seek to prevent a foreign takeover. Article 21(3) ECMR provides that no Member State shall apply its national legislation on competition to any concentration that has a Community dimension (i.e., mergers that meet the turnover thresholds set out in the ECMR).

Where the concentration significantly affects competition in a distinct market within a Member State, however, that Member State can request a referral back to its competent authorities under Article 9 ECMR. The notifying parties can also ask for a concentration with a Community dimension to be reviewed at national level by making a submission to the Commission under Article 4(4) ECMR prior to notifying.[10]

Apart from these mechanisms, whereby the whole or part of a concentration may be referred to the national competition authorities on request, Member States cannot intervene in a merger that is subject to the Commission's jurisdic-

9 SPECIAL RIGHTS IN PRIVATISED COMPANIES IN THE ENLARGED UNION - A DECADE FULL OF DEVELOPMENTS, Annex 1 (Commission Staff Working Document, Jul. 22, 2005).

10 Article 4(4) of Council Regulation 139/2004 of 20 January 2004 on the control of concentrations between undertakings (hereinafter ECMR), 2004 O.J. (L 24) 1, requires the notifying parties to make a reasoned submission to the effect that the concentration may significantly affect competition in a market within a Member State which presents all the characteristics of a distinct market and should therefore be examined, in whole or in part, by that Member State.

tion, unless they can successfully invoke the protection of their "legitimate interests" under Article 21(4) ECMR. Examples of legitimate interests include public security, plurality of the media, and prudential rules. Legitimate interests grounds are interpreted narrowly given that they constitute exceptions to the Commission's exclusive jurisdiction to vet mergers with a Community dimension.

However, there is a limitation to the Commission's exclusive jurisdiction where each of the parties to a merger achieves more than two-thirds of its turnover in the same Member State. Therefore, where the two-thirds rule is met, mergers are not subject to the Commission's scrutiny, but are reviewed instead by national competition authorities, irrespective of what impact they might have on the single market.

There is a limitation to the Commission's exclusive jurisdiction where each of the parties to a merger achieves more than two-thirds of its turnover in the same Member State. Therefore, where the two-thirds rule is met, mergers are not subject to the Commission's scrutiny, but are reviewed instead by national competition authorities, irrespective of what impact they might have on the single market.

III. The Legal and Economic Impact of Special Rights

A. WHAT ARE SPECIAL RIGHTS AND HOW ARE THEY PERCEIVED BY THE COMMISSION?

Special rights, often referred to as "golden shares," are measures used by Member States to retain control over privatized companies, usually to prevent them from being taken over or to prevent the companies' management from taking actions which are contrary to national government policy for the sector in which they operate. While the former constitutes a direct restriction on investment, the latter will only indirectly affect investment decisions by making the investment potentially less attractive.

Golden shares are one of the most commonly used types of special rights, enabling the government to veto specific events or changes in the company's structure. They are usually enshrined in the articles of association of the company and cannot be changed without the government's consent. Special rights may also be conferred on governments by legislation, either under a general framework law covering several economic sectors or specific legislation aimed at an economic sector or a company. Governments may also seek to assert special rights over companies that are awarded concession contracts to provide services of general interest (e.g., in the gambling and broadcasting sectors).

Typically, Member States justify special rights on the grounds that they are necessary to achieve certain policy objectives, usually of a public-interest nature.

However, by restricting (directly or indirectly) cross-border mergers or investments, special rights are liable to infringe the principles of free movement of capital (Article 56 EC) and right of establishment (Article 43 EC) and as such can only be compatible with EU law if they meet the strict criteria that have been laid down by the European Court of Justice (ECJ).

In the 2003 paper, *Capital Movements in the Legal Framework of the Community*,[11] the Commission was critical of the margin of appreciation that Member States had at their disposal on the basis of the Treaty, and was concerned over restrictive practices by the Member States against non-EU bidders targeting companies in the European Union. The paper described the situation as amounting to the creation of a "fortress Europe," hostile to outside investment. The Commission therefore focused its capital movements paper on international trade and the obligations of the Member States towards the Organization for Economic Co-operation and Development and other international organizations.

The Commission is responsible for monitoring the proper and timely application of Treaty rules governing the freedom of capital movements as well as other internal market freedoms. Its objective is to secure the removal of all remaining restrictions to the free movement of capital in the internal market through ongoing cooperation and dialogue with Member States. Where Member States fail to comply with their obligations under the Treaty, this responsibility will require the Commission to initiate infringement procedures against the Member States concerned.

In its staff working document, *Special rights in privatized companies in the enlarged Union—a decade full of developments*,[12] the Commission outlined three principal concerns about special rights, being that they can:

- hinder privatized companies from achieving the full benefits of privatization;
- distort market driven cross-border activity in terms of both direct and portfolio investment in privatized companies; and,
- prove one of the obstacles to achieving a level playing field in the EU market for corporate control.

The Commission also raised concerns about the strong economic implications that special rights can have for the functioning of the single market since the companies in which Member States retain special rights often play a significant

11 *Capital Movements in the Legal Framework of the Community, in* The EU Economy 2003 Review 320, 320-28 (Directorate General for Economic and Financial Affairs, 2003).

12 Special rights in privatised companies in the enlarged Union - a decade full of developments, Annex 1 (Commission Staff Working Document, Jul. 22, 2005).

role in the economy. It identified 141 companies operating in sectors ranging from telecommunications, energy, and postal services to banking and insurance in which Member States retained special rights. Of these 141 companies,[13] 14 percent were accounted for by the fifteen old Member States (EU 15) and 86 percent by the ten new Member States (EU 10).

While special rights are still widely present in the EU 10 and affect a broader range of industries, including alcoholic beverages, food processing, textiles, and pharmaceuticals, in the Commission's view, this is largely due to the timing and scale of the privatization process in these countries and, in most cases, the Member States concerned have put in place a process to deal with the issue. In other cases, the Commission believes the special rights can be justified by exceptions provided in the Treaty or are structured in a way that is compatible with EU law. Overall, the Commission's assessment is that special rights in privatized companies are being phased out and that this can be attributed to two key factors:

- the proactive approach the Commission has taken in engaging in a dialogue with Member States, and
- the impact of the rulings of the ECJ in a series of landmark cases.

The Commission also identified the development of a more robust regulatory environment in specific sectors (e.g., telecommunications and energy) as another relevant factor both at the EU and national level, which has allowed Member States to protect the services of general interest in a relatively less restrictive manner. However, where special rights still persist, whether in the EU 15 or EU 10, that are not compatible with EU law, the Commission will not hesitate to proceed with infringement proceedings against the Member States concerned.

The latest report published by the Commission in November 2005,[14] assesses the microeconomic impact of special rights in privatized EU companies on company performance, investment in the companies, and share values. The report, however, does not address the broader impacts of special rights on economic performance in the industry sectors concerned, or on consumers, or on the European Union as a whole.

In its conclusions, the report found that:

- special rights held by public authorities tend to have a negative impact on the longer-term economic performance of EU privatized companies;

13 This number includes a number of regional companies, including 29 regional waterworks in the Czech Republic and 21 energy companies in Hungary.

14 OXERA, SPECIAL RIGHTS OF PUBLIC AUTHORITIES IN PRIVATISED EU COMPANIES: THE MICROECONOMIC IMPACT (2005) (report prepared for the European Commission).

- both existing and new empirical research provide strong evidence that special rights can constitute important barriers to direct investment;
- special rights have an adverse impact not only on the market for corporate control, by restricting takeover activity and distorting the level playing field in the market, but also on portfolio investors, who would otherwise benefit from increases in the value of their shares during a takeover;
- to the extent that special rights restrict the free movement of capital across EU borders, they impede further financial market integration; and
- regulation may be seen as a potentially less restrictive and more transparent means of achieving public policy objectives, especially if carried out by an arm's-length regulatory authority.

On the basis of this report, it is likely that the Commission will continue and possibly intensify its efforts against special rights and may try to steer national governments more proactively towards entrusting independent regulatory bodies with the protection of public interest concerns rather than resort to special rights or other similar state measures.

B. CONDITIONS FOR COMPATIBILITY OF SPECIAL RIGHTS WITH EU LAW

In its July 2005 document, the Commission regarded the rulings delivered by the ECJ in a series of seven infringement cases initiated by the Commission pursuant to Article 226 EC, as the most significant development in the field of special rights. In these cases, the Court set down very strict criteria for the use of special rights and their compatibility with EU law.

The ECJ's rulings[15] essentially confirm that special rights can be compatible with EU law even when they may be at odds with the principles of free movement of capital (Article 56 EC) and right of establishment (Article 43 EC) provided they are:

- justifiable, based on the exceptions explicitly listed in the Treaty or by reference to requirements in the general interest (where this constitutes a genuine and serious threat);
- necessary to protect the interests concerned and this protection cannot be obtained by less restrictive measures (i.e., proportionate);

15 Case C-58/99, Commission v. Italy, 2000 E.C.R. I-3811; Case C-367/98, Commission v. Portugal, 2002 E.C.R. I-4731; Case C-483/99, Commission v. France, 2002 E.C.R. I-4781; Case C-503/99, Commission v. Belgium, 2002 E.C.R. I-4809; Case C-98/01, Commission v. United Kingdom, 2003 E.C.R. I-04641; Case C-463/00, Commission v. Spain, 2003 E.C.R. I-4581; Case C-174/04, Commission v. Italy, 2005 E.C.R. I-4933.

- objective, non-discriminatory, and transparent; and
- subject to a legal remedy.

The ECJ also confirmed that the Treaty provisions on the free movement of capital do not draw a distinction between private undertakings and public undertakings.[16]

The cases concerned proceedings against Belgium, France, Portugal, Spain, the United Kingdom, and two cases against Italy. They all essentially concerned veto rights in favor of the state relating to the ownership of shares or capital of privatized companies. In all of the cases, with the exception of the case against Belgium, the ECJ ruled in favor of the Commission. While the Commission considers the ECJ's decisions in all seven cases as landmark rulings, those in the cases against Belgium, France, and Portugal delivered in 2002 stand out in particular. However, the cases against Italy, Spain, and the United Kingdom are also briefly examined, as well as the current status of pending cases and ongoing Commission intervention.

1. Portugal

The case against Portugal[17] concerned a general framework law relating to the privatization of undertakings in the banking, insurance, energy, and transport sectors that specified maximum levels of foreign participation (ranging between 5 and 40 percent) in the privatized companies. The ECJ found the law to constitute a restriction on the free movement of capital within the meaning of Article 56 EC. The Portuguese government sought to justify the law on the grounds that it was necessary for the pursuit of national economic policy objectives, for choosing a strategic partner, for strengthening the competitive structure of the market concerned, or modernizing and increasing the efficiency of means of production. However, none of these objectives were found by the ECJ to constitute a valid justification for restrictions on the fundamental Treaty freedoms.

2. France

The case against France[18] concerned legislation that vested in the state a golden share in Société Nationale Elf-Aquitaine, and gave the Minister of Economic Affairs the right to:

- approve any direct or indirect shareholding by a natural or legal person, acting alone or in conjunction with others, in excess of one-fifth, one-tenth or one-third of the capital of, or voting rights in, the company, and

16 Case C-174/04, Commission v. Italy, 2005 E.C.R. I-4933.

17 Case C-367/98, Commission v. Portugal, 2002 E.C.R. I-4731.

18 Case C-483/99, Commission v. France, 2002 E.C.R. I-4781.

- oppose any decision to transfer or use as security the majority of the capital of four subsidiaries of that company.

In addition, the law provided for the appointment of two state representatives on the board of directors of the company, without entitlement to vote.

The ECJ ruled that the French law was incompatible with the free movement of capital, despite the fact that it applied without distinction to French nationals and to nationals of other Member States. It held that:

> "even though the rules in issue may not give rise to unequal treatment, they are liable to impede the acquisition of shares in the undertakings concerned and to dissuade investors in other Member States from investing in the capital of those undertakings. They are therefore liable, as a result, to render the free movement of capital illusory."[19]

The French government's justification for adopting the law was the safeguarding of supplies of petroleum products in the event of a crisis. The ECJ accepted that, in principle, this objective could be a valid public interest justification for the French law. However, the provisions of the law were too wide and "investors concerned were given no indication whatsoever as to the specific, objective circumstances in which prior authorization would be granted or refused."[20] Therefore, the legislation went beyond what was necessary in order to attain the objective indicated and constituted an unjustifiable restriction of the free movement of capital.

3. Belgium

The Belgium case[21] also involved legislation whose objective was to secure energy supplies at a time of crisis. Belgium had passed laws vesting in the state a golden share in, inter alia, Distrigaz. The law provided that:

- advance notice of any transfer, use as security or change in the intended destination of the company's system of lines and conduits that are used, or are capable of being used, as major infrastructures for the domestic conveyance of energy products must be given to the Minister

19 *Id.* at paragraph 41.

20 *Id.* at paragraph 50.

21 Case C-503/99, Commission v. Belgium, 2002 E.C.R. I-4809.

responsible, who can oppose such operations if he considers that they adversely affect the national interest in the energy sector, and

- the Minister may appoint two state representatives to the board of directors of the company who can propose to the Minister the annulment of any decision of the board of directors which they regard as contrary to the guidelines for the country's energy policy, including the government's objectives concerning the country's energy supply.

The ECJ found that the measures were restrictive but allowed them on the basis that they were justified, as being necessary to attain the stated objective (to maintain minimum supplies of gas in the event of a real and serious threat) and because there were no less restrictive measures to attain the general interest objective. In particular, the ECJ found that the measures were acceptable because:

- the law established a system of opposition not prior approval (see the France case discussed above) and the public authorities were obliged to adhere to strict time limits when exercising the right to oppose an acquisition;
- the right was limited to certain decisions in relation to certain strategic assets of Distrigaz (lines and conduits); and,
- any intervention by the Minister had to be supported by a formal statement of reasons and was subject to judicial review by the courts.

Cumulatively, these three factors meant that the law did not grant a wide discretion to the state to intervene and established objective criteria on which the state could do so.

4. Italy

The first decision against Italy, in 2000, concerned investment restrictions contained in a 1992 general framework law on privatization that, although amended by the Italian government in 2001, the Commission still considered to unduly restrict the freedoms of capital movements and establishment, and therefore referred it to the ECJ.

The second decision against Italy, in 2005, concerned a law of 2001 aimed at avoiding anticompetitive attacks on Italian companies operating in the electricity and gas sectors by public entities operating in the same sectors in other Member States, and enjoying a dominant position in their domestic markets. The law was also designed to safeguard energy supplies. In rejecting the Italian government's justifications for the law, the ECJ said that Italy had failed to show how energy supplies would be threatened by the acquisition of an Italian energy company specifically by a buyer dominant in another Member State as opposed to any other type of buyer. The ECJ also ruled that "an interest in generally strengthening the competitive structure of the market in question cannot con-

stitute valid justification for restrictions on the free movement of capital"[22] and, in any case, that objective could be served by the ECMR. Following the judgment, the Commission called on Italy to comply with the ECJ's ruling as it was not convinced that the amendments subsequently made to the law fully implemented the ruling of the Court.[23]

5. Spain

The decision against Spain in 2003 concerned a law of 1995 relating to the privatizations of Repsol SA, Telefónica de España SA, Telefónica Servicios Móviles SA, Argentaria, Tabacalera SA, and Endesa SA., that gave the Spanish government a right of prior approval of certain management decisions.[24] In rejecting the measures, the ECJ ruled that the fact that the legislation concerned introduced regimes that would last only ten years did not make the measures proportionate since an "infringement of Treaty obligations does not cease to be an infringement merely because it is limited in time."[25] Following the ECJ's ruling in 2003, it was not until May 2006 that the Spanish government fully eliminated the restrictions concerned, after the Commission had called on Spain to comply with the ECJ's judgment, and had sent Spain a reasoned opinion as part of infringement proceedings under Article 228 EC.

6. United Kingdom

The decision against the United Kingdom, concerned a golden share held by the U.K. government in British Airports Authority plc (BAA), that limited all interests in the company to 15 percent of voting shares and provided the U.K. government with a veto right over the disposal of shares. Following the ECJ's ruling in 2003, the U.K. government relinquished its golden share, that otherwise might have prevented the recent takeover of BAA by Spain's Ferrovial.[26]

7. Pending Cases

Infringement cases concerning golden shares are also pending before the ECJ against Germany and the Netherlands. The case against Germany concerns the 1960 law privatizing Volkswagen (VW) that to date still prevents any sharehold-

22 Case C-174/04, Commission v. Italy, 2005 E.C.R. I-4933, at paragraph 37.

23 European Commission, Press Release No. 439, Free movement of capital: Commission calls on Italy to apply Court of Justice ruling on the law on investment in energy companies (2006); Eur. Commission, Press Release No. 1270, Free movement of capital: Commission calls on Italy to modify law on privatised companies and to apply Court ruling on investment in energy companies (2005).

24 Case C-463/00, Commission v. Spain, 2003 E.C.R. I-4581.

25 *Id.* at paragraph 81.

26 Case COMP/M.4164, Ferrovial/Quebec/GIC/BAA, 2006 O.J. (C 182) 11.

er from acquiring more than 20 percent of voting rights, and confers a special blocking minority right on any shareholder who has 20 percent of voting rights. Traditionally, both the German government and the Land of Lower Saxony (the Land) held 20 percent voting rights in VW, although the Land is now the only shareholder with 20 percent voting rights and two mandatory members of the board. The Commission brought the case before the ECJ in 2004[27] claiming that these provisions of the VW Act make it substantially less attractive for other EU investors to acquire the company's shares with a view to participating effectively in management decisions or controlling it, and so are contrary to the Treaty provisions on free movement of capital and the right of establishment.

The two cases against the Netherlands, initiated by the Commission pursuant to Article 226 EC, concern golden shares held by the Dutch government in Koninklijke KPN N.V. (KPN) and TNT Post Groep N.V. (TPG). Conferring a major influence over KPN's and TPG's financial decision-making and the management of the two companies, the Commission took the view that the golden shares may deter EU investors from investing in the capital of the two companies and, consequently, were contrary to the Treaty rules on free movement of capital and the right of establishment.[28] On April 6, 2006, Advocate General Poiares Maduro came to the conclusion that the Netherlands has indeed failed to fulfill its obligations under Article 56 EC by retaining its golden shares in KPN and TPG and this view was endorsed by the ECJ in its judgment of September 28, 2006.[29]

The Commission continues to monitor compliance with the Treaty provisions governing free movement of capital; and in this context is actively considering infringement procedures against a number of Member States (some of which have already been mentioned), including Denmark (possible obstacles to investment from other Member States in Copenhagen Airports); France (authorization procedure for foreign investments in certain sectors and ban on stock market listing for football clubs);[30] Hungary (privatization framework law); Luxembourg (veto rights over shareholdings in the satellite companies SES Astra and SES Global); and Spain (law amending functions of Spanish energy regulator).

27 European Commission, Press Release No. 1209, Free movement of capital: Commission takes Germany to the Court of Justice on Volkswagen law (2004).

28 European Commission, Press Release No. 1753, Free movement of capital: Commission takes the Netherlands to Court of Justice on special powers in KPN and TNT (2003).

29 Cases C-282/04 & C-283/04, Commission v. Netherlands (not yet reported).

30 France recently lifted its ban on the listing of sports clubs. *See* Adam Jones, *Olympique Lyonnais Leads Listing Field,* Fin. Times, Sept. 25, 2006.

IV. The New Wave of Interventionism

A. "ECONOMIC PATRIOTISM" IN ALL BUT NAME

Based on the Commission's own assessment special rights, or golden shares, are being phased out by Member States, including among the EU 10. This probably also coincides with the fact that privatization programs in a number of Member States have now largely run their course.

The Commission appears disposed to encouraging Member States to entrust independent regulatory bodies with the protection of public interest concerns rather than resort to special rights or other interventionist measures. While Member States may be receptive to such an approach, possibly with the exception of certain sectors, such as defense,[31] this does not necessarily guarantee that Member States will refrain from interventionism in the pursuit of national interests.

Recently, a new wave of interventionism by Member States has emerged. This has manifested itself in the adoption or exercise of legislative and regulatory measures, or the blatant promotion of national champions in preference to a foreign takeover.

Indeed, recently, a new wave of interventionism by Member States has emerged. This has manifested itself in the adoption or exercise of legislative and regulatory measures, or the blatant promotion of national champions in preference to a foreign takeover. Such interventionism is well illustrated, for example, by the Spanish government's actions in relation to the contested takeover of Endesa or by the French government's defense of Danone following rumors that PepsiCo was preparing a takeover bid in a sector that few would credit as being strategic or in the general interest, but nevertheless Danone was deemed by the government "a French icon and off-limits to foreign ownership."[32]

While such government interventions may be perceived to be in the national interest, in the long run they are unlikely to be in the best interests of domestic consumers since they are prone to result in higher prices and lower innovation. They are also undesirable from an internal market perspective as they create an unlevel playing field for business and ultimately are more likely to undermine rather than enhance the competitiveness of EU industry.

31 For example, it is unlikely that the U.K. government would relinquish its golden shares in BAE Systems and Rolls-Royce or France its golden shares in Thales and EADS.

32 Arturo Bris, *Global Growing Pains,* Fin. Times, April 6, 2006.

B. LEGISLATIVE AND REGULATORY MEASURES

Controversially, in December 2005, France adopted a law[33] creating an authorization procedure for foreign investments in certain sectors that could affect public policy, public security, or national defense. The protected sectors include gambling (e.g., casinos); private security services; research, development, or production of chemical or biological antidotes; activities concerning equipment for intercepting communications or eavesdropping; services for evaluation of security of computer systems; dual-use (civil and military) technologies; cryptology; activities of firms that are repositories of defense secrets; research, production, or trade in arms, munitions, explosives, or other military equipment; or any other industry supplying the defense ministry any of the aforementioned goods or services.[34]

On April 4, 2006, the Commission sent a formal request to France, after informal dialogue that led the Commission to believe that the French law could potentially lead to restrictions in the freedom of movement of capital (Article 56 EC) and the right of establishment (Article 43 EC).[35] Although the French law appeared to make wider use of an independent regulator for the purposes of protecting the public interest (along the lines of the proposals contained in the Commission's report of November 2005),[36] the Commission was concerned that the ambit of the powers conferred on the French regulator was considerably wider than appeared necessary for achieving the stated objectives of public policy, public security, and national defense and consequently not proportionate.

The Commission also challenged the inclusion of casinos in the category of companies for which there is public policy concern, especially as the transposition of the Money Laundering Directive could provide adequate public protection. The Commission is therefore likely to require France to amend its legislation, failing which it will be forced to pursue infringement proceedings against France under Article 226 EC.

In February 2006, Spain adopted new legislation extending the powers of the CNE, Spain's National Energy Commission, requiring the authorization of the CNE for the acquisition of over 10 percent of the share capital, or any other percentage resulting in significant influence, in companies engaged directly or indirectly in regulated activities in the energy sector. In exercising such powers, the CNE is able to take into consideration a variety of factors, including any risks in relation to the regulated activities, the inability to perform such activities, and the protection of the general interest and reasons of public security. In the

33 Decree 2005-1739 of 30 December 2005, O.J., December 31, 2005, No. 45.

34 *See id.*

35 European Commission, Press Release No. 438, Free movement of capital: Commission scrutinises French law establishing authorisation procedure for foreign investments in certain sectors (2006).

36 *See* Oxera, *supra* note 14.

Commission's view, these factors are vague and indeterminate and as a result give the CNE wide discretionary powers. In May 2006, the Commission announced that it had opened infringement proceedings under Article 226 EC by requesting in a formal letter that Spain provide more information concerning the new legislation, having already warned the Spanish government that the law was likely to violate EU law, insofar as it hindered or rendered less attractive the free movement of capital and the right of establishment.[37]

The Spanish legislation is particularly sensitive given that it was adopted in the context of competing takeover bids for the Spanish electricity operator, Endesa. On February 21, 2006, the German energy company E.ON announced its intention to launch a public bid for Endesa, countering the bid that Spain's Gas Natural had made for the company in September 2005. Just three days after E.ON's announcement (on February 24, 2006), Spain adopted the law[38] extending the CNE's powers to allow it to block foreign takeovers. This move was widely criticized as a blatant attempt by the Spanish government to deter E.ON from pursuing its bid. Nevertheless, E.ON notified its proposed takeover of Endesa to the Commission on March 16, 2006, and this was cleared unconditionally on April 25, 2006. The CNE subsequently also approved E.ON's proposed takeover of Endesa, on July 28, 2006, but subject to substantial conditions, including, most significantly, the sale of 30 percent of Endesa's domestic generation capacity. In light of the CNE's decision, the Commission announced that it would take the appropriate measures to ensure that its clearance decision in *E.ON/Endesa*[39] was respected and, accordingly, on August 3, 2006, sent the Spanish government a letter based on Article 21 ECMR, requesting "clarifications" regarding the CNE's decision.[40] In its reply of August 10, 2006, the Spanish government accused the Commission of exceeding its authority and countered that the conditions imposed on E.ON do not prevent it from acquiring Endesa. According to the Commission's preliminary conclusions, however, most of these conditions raise serious doubts as to their compatibility with EC law. Competition Commissioner Neelie Kroes vowed to remain vigilant in this case and to continue to take a firm stance in similar cases.[41] Not surprisingly, therefore, on September 26, 2006, the Commission announced that it had

37 European Commission, Press Release No. 569, Free movement of capital: Commission opens infringement proceedings against Spain regarding law amending functions of Spanish electricity and gas regulator (2006).

38 Act of 24 February by which the Functions of the National Commission of Energy are Modified (B.O.E., 2006, 3436).

39 Case COMP/M.4110, E.ON/Endesa, 2006 O.J. (C 68) 09.

40 European Commission, Press Release No. 1096, Statement by Commission Spokesperson: Receipt of letter from Spanish authorities on Eon/Endesa merger (2006).

41 See Competition Commissioner Neelie Kroes' speech on "Cross-border mergers and energy markets" given at the Villa d'Este Forum in Cernobbia, Italy, on 2 September 2006, Speech/06/480.

adopted a decision finding that Spain has breached Article 21 ECMR by virtue of the conditions imposed by the CNE on E.ON's bid for Endesa.[42] The Commission also announced that it had sent Spain a reasoned opinion alleging that the legislation that extended the power of the CNE to authorize mergers in the energy sector infringes Articles 43 and 56 EC. In addition, both E.ON and Endesa have appealed the CNE's decision.[43]

C. PROMOTING MERGERS TO CREATE NATIONAL CHAMPIONS

Member States are not averse to resorting to even more blatant industrial engineering when they cannot rely on legislative or regulatory measures in order to create national champions.

When Italy's Enel expressed interest in the French energy company Suez, the French government orchestrated a defensive merger between Suez and Gaz de France in February 2006. President Jacques Chirac summarized his opposition to Enel's bid for Suez by declaring: "France doesn't want to surrender to a purely financial operation."[44] Although France was cleared in May 2006 of breaching EU internal market rules by promoting the defensive merger, it was criticized by the Commission for considering maintaining a golden share in the merged entity.[45] The Commission decided on June 19, 2006, that it would investigate the merger on the basis of competition concerns raised in the Belgian gas and electricity supply market.[46] It outlined its main concerns in a Statement of Objections issued on August 19, 2006,[47] and is expected to adopt a decision on the compatibility of the merger between Suez and Gaz de France with the common market on November 17, 2006.[48]

A national champion was created in the German *E.ON/Ruhrgas* case. The German Federal Cartel Office prohibited the acquisition of a majority stake in

42 European Commission, Press Release No. 1265, Mergers: Commission Rules Against Spanish Energy Regulator's Measures Concerning E.ON's Bid for Endesa (2006).

43 European Commission, Press Release No. 1264, Free Movement of Capital: Commission Calls on Spain to Modify the Law Amending the Functions of the Spanish Electricity and Gas Regulator (2006).

44 Bris, *supra* note 32.

45 *France to keep control over GdF/Suez assets*, Reuters, May 23, 2006.

46 European Commission, Press Release No. 802, Mergers: Commission opens in-depth investigation into merger between Gaz de France and Suez group (2006).

47 European Commission, Press Release No. 1109, Mergers: The European Commission Adopts a "Statement of Objections" Regarding the Merger Project Between Suez and Gaz de France (2006).

48 In view of remedies proposed by Suez and Gaz de France on September 20, 2006, the deadline for the Commission's decision was extended by 15 working days; MEMO/06/340.

Ruhrgas by E.ON in 2002 on the basis of competition concerns.[49] However, in spite of the merger being blocked by the Bundeskartellamt, the Federal Minister of Economics ultimately granted a special ministerial authorization and cleared the merger. This special authorization could, of course, not have been granted had the transaction triggered the Commission's exclusive jurisdiction under the ECMR. However, the Commission had reached the decision that it was not competent to review the case given that E.ON and Ruhrgas achieved more than two-thirds of their EU-wide turnover within Germany. The U.K.'s energy regulator, Ofgem, argued at the time that the merger should have been reviewed at EU level, claiming that E.ON's subsequent acquisition of U.K. energy company Powergen took it above the two-thirds limit. In Ofgem's view, E.ON had effectively side-stepped the Commission's exclusive jurisdiction over the merger. At the time, the E.ON/Ruhrgas merger attracted widespread criticism that it was incompatible with the spirit of competition and undermined the liberalization of the EU energy market.

D. STATE INTERVENTION IN THE CONTEXT OF ARTICLE 21 ECMR

The ability of Member States to successfully resort to interventionist measures is far more limited when it comes to takeovers with a Community dimension falling within the exclusive jurisdiction of the Commission under the ECMR. Member States do not have the power to intervene in mergers that have a Community dimension unless they can justifiably invoke legitimate interests (e.g., public security, media plurality, or prudential rules) within the meaning of Article 21(4) ECMR. To the extent that this provision constitutes an exception to the Commission's exclusive competence to vet mergers falling within the ECMR, the provision is to be narrowly construed, so that any measures invoked by Member States pursuant to Article 21(4) ECMR must be proportionate and compatible with EU law.

1. The *Champalimaud* Case

In *BSCH/Champalimaud*,[50] the acquisition by Banco Santander Central Hispanico (BSCH), a Spanish bank, of the Champalimaud group of Portuguese banks and insurance companies fell within the ECMR and was therefore notified to the Commission. However, the Portuguese Minister of Finance adopted a decision freezing Champalimaud's shares on the basis that the transaction failed to comply with Portuguese financial rules. While the Portuguese authorities claimed that their decision was based on prudential grounds, the Commission doubted that this was in fact the case and suspected the decision to be driven by protectionist considerations. Moreover, the Portuguese authorities had not communicated the interests they wanted to protect to the Commission in accordance with Article

49 *See* the Bundeskartellamt's press release relating to its decision to prohibit the acquisition *available at* http://www.bundeskartellamt.de/wEnglisch/News/Archiv/ArchivNews2002/2002_02_28.shtml.

50 Case IV/M.1616, BSCH/A.Champalimaud*,* 1999 O.J. (C 197) 5.

21(4) ECMR. As a consequence, the Commission initiated infringement proceedings and adopted an interim measures decision suspending the application of the Portuguese authorities' decision pending further investigation.

The Commission was not only concerned with an apparent attempt to undermine its exclusive jurisdiction under the ECMR, but also raised the issue whether the Portuguese decision violated the principles of free movement of capital and freedom of establishment. However, the Portuguese authorities refused to suspend their decision and instead suspended certain voting rights in the Champalimaud group. The Commission cleared the concentration in August 1999 and initiated further infringement proceedings against Portugal in September 1999 for not complying with the interim measures decision. On October 20, 1999, the Commission adopted a final decision declaring that Portugal had infringed Article 21 ECMR. Following the withdrawal of the Portuguese measures, BSCH went on to acquire control of Banco Totta & Açores, SA. and Banco de Crédito Prédial Português, both subsidiaries of the Champalimaud group.

2. The *Cimpor* Case

This case involved a proposed bid for the Portuguese cement company Cimpor, in which the Portuguese state held golden shares. In 2000, Holderbel, a Belgian subsidiary of Holderbank of Switzerland and Portuguese cement company, Secil, launched a public bid to acquire Cimpor. Given that the transaction had a Community dimension it was notified to the Commission under the ECMR. However, the Portuguese Minister of Finance prohibited the transaction. The Commission issued a decision finding that Portugal did not protect any legitimate interests under Article 21 ECMR, and that Portugal was acting in breach of the Commission's exclusive jurisdiction to review the concentration.[51] The Commission decided that Portugal should withdraw its prohibition measures in order to comply with Community law.

Portugal challenged the Commission's decision claiming that the Commission had no legal basis for it. Portugal had not made a request for the protection of legitimate interests under Article 21 ECMR and argued that non-compliance with the procedure in Article 21 was not sufficient for the Commission to reach its infringement decision. Furthermore, Portugal claimed that, if anything, the Commission should have opened an infringement procedure against Portugal under Article 226 EC rather than relying on Article 21 ECMR to reach its decision. However, in its ruling of June 22, 2004, the ECJ dismissed Portugal's appeal on the basis that the Commission acted legitimately in making a decision under Article 21 ECMR.[52]

51 Case COMP/M.2054, Secil/Holderbank/Cimpor, 2000 O.J. (C 198) 5. The parties subsequently withdrew their notification.

52 Case C-42/01, Portugal v. Commission, 2004 E.C.R. I-6079; for an analysis of the implications of the decision in terms of remedies, *see infra*, Section V.

3. The Polish Banking Case

In March 2006, the Commission began infringement proceedings against Poland under Article 21 ECMR. The Commission considered that Poland had breached the Commission's exclusive jurisdiction to review mergers with a Community dimension by requiring the bank UniCredit to divest its shares in the Polish bank BPH, the acquisition of which had already been approved by the Commission as part of UniCredit's takeover of German bank HVB.[53] The Polish Treasury instructed UniCredit to sell its shares in BPH on the basis that UniCredit was bound by a non-compete clause in a privatization agreement it had entered into when it acquired the Polish bank Pekao in 1999 from the Polish state. Poland insisted that this non-compete clause continued to prevent UniCredit, for a period of ten years, from opening subsidiaries and/or branches in Poland, acquiring control of banks active in Poland, or making any capital investment in any company active in the Polish banking sector. The Commission reminded Poland that Member States can neither apply their national competition law to concentrations with a Community dimension, nor can they adopt measures which could prohibit or prejudice (de jure or de facto) such concentrations unless they can rely on legitimate interests under Article 21(4) ECMR, and the specific measure is proportionate and compatible with EU law.

The Commission considered the Polish government's decision to invoke the non-compete clause to constitute a measure that can de facto prevent, or seriously prejudice, the *UniCredit/HVB* concentration. In addition, the Commission noted that Poland had not communicated to it any other hypothetical legitimate interests under Article 21(4) ECMR, and that, in any event, the non-compete clause itself appeared to be incompatible with the free movement of capital and the freedom of establishment.[54] The Commission emphasized that it could adopt a decision under Article 21 ECMR requiring the Polish government to refrain from invoking the non-compete clause. Moreover, the Commission stressed that such a decision would be directly applicable, meaning that it could be invoked directly before a national court or public authority in Poland by aggrieved third parties.

In April 2006, Poland entered into an agreement with UniCredit according to which UniCredit agreed to sell 200 of the 483 branches of Poland's BPH bank. The Commission, however, announced that this agreement did not necessarily mean an end to proceedings against Poland for violating Article 21 ECMR.

---

53 Case COMP/M.3894, Unicredito/HVB, 2005 O.J. (C 235) 4.

54 Note that the Commission started infringement proceedings under Article 226 EC with regard to a possible violation of Articles 43 and 56 EC. *See* Eur. Commission, Press Release No. 276, Free movement of capital: Commission opens infringement procedure against Poland in context of UniCredit/HBV merger (2006).

4. The Italian Banking Cases

The Italian central bank's handling of foreign takeover bids has also given rise to concerns recently. In one case the Commission cleared the public takeover bid by the Dutch banking group ABN Amro for Italian bank Antonveneta. However, the governor of Italy's central bank, who holds a personal veto over banking mergers, appeared to have favored a rival bid from the Italian bank BPI, and reportedly overruled a number of senior Italian regulators who expressed concerns about the viability of BPI's bid. After a long takeover battle, ABN Amro ultimately succeeded, becoming the first foreign bank to acquire an Italian financial institution, and the governor of the Italian central bank, Antonio Fazio, was forced to step down amid a criminal investigation into allegations of insider trading and abuse of office.

The Italian banking cases have sparked a wider drive by the Commission to combat protectionism in Europe's fragmented financial services sector. The Commission appears particularly keen to clarify the role of central banks and other financial regulators, that are tasked, among other things, with ensuring that cross-border mergers do not undermine the stability of domestic financial markets. The Commission argued that the present regime gives national institutions too much scope to obstruct foreign takeovers. To this end, on March 16, 2006, the Commission announced that it may look to overhaul rules for the policing of mergers in the banking, insurance, and securities sectors with the aim of reducing protectionism and harmonizing supervisory practices.[55] More recently, the Commission said it was going to table a proposal to change the banking directive to the effect that national supervisors will only be able to oppose a merger in this sector if one of the objective and non-discriminatory criteria set out in the directive is met.[56]

V. Remedies against State Measures Available to Foreign Investors

A. OVERRIDING POLITICAL AND COMMERCIAL CONSIDERATIONS

State measures that restrict foreign takeovers or investments and do not meet the conditions for compatibility with EU law laid down by the ECJ will render

55 Charlie McCreevy, EU Commissioner for Internal Market and Services, has commented that "the tendency by national regulators to encourage national champions" is one reason for the currently limited cross-border banking consolidation. Charlie McCreevy, *European Banking - challenges and changes ahead*, Address to Institut International de'Etudes Bancaires (May 20, 2005).

56 According to FIN. TIMES, Sept. 6, 2006, the criteria set out in the draft proposal are (i) the reputation of the acquirer and its ability to meet the standards set out in the banking directive, (i) the reputation and experience of the people charged with steering the merged group, (iii) the financial soundness of the acquirer, (iv) its ability to meet all the criteria and obligations laid out in the directive and other sectoral rules, and (v) suspected links to money laundering and terrorist financing.

Member States in violation of their obligations to comply with the Treaty rules on the free movement of capital (Article 56 EC) and the right of establishment (Article 43 EC).

Violations of the Treaty will in principle give rise to a range of potential remedies for a foreign bidder or investor at both the EU and national levels. The challenge, however, is whether any of these remedies can provide effective and meaningful redress within the context of a contested cross-border merger. Even to the extent that remedies are available that would afford such redress within an acceptable timeframe, aggrieved parties will inevitably have to face up to the political and commercial realities of having to challenge the government of a Member State with which it aspires to do business not only in the immediate future but possibly also over the longer term. These overriding considerations may, in practice, prove to be the greatest obstacle to foreign investors pursuing remedies against Member States, whether at the EU or national level.

B. REMEDIES AT THE EU LEVEL

An aggrieved investor's principal remedy at the EU level will be to lodge a complaint with the Commission against the Member State concerned, with a view to the Commission initiating one or more of the enforcement procedures available to it under either Article 86 or 226 EC. Where the transaction falls within the ambit of the ECMR, the Commission also has the additional option of taking enforcement action under Article 21 ECMR.

1. Article 86 EC

An aggrieved investor could challenge a state measure that it feels confers special rights on a company by complaining to the Commission. Article 86(3) EC imposes a duty on the Commission to ensure that Member States do not keep in place measures that are contrary to Article 86(1) EC,[57] and gives the Commission power to adopt decisions or directives that are legally binding. Failure to comply with such a decision or directive can be the basis for an action before the ECJ. However, while decisions and directives of the Commission are subject to challenge by the Member State or the company that is the subject of the state measure, a failure by the Commission to issue a decision or directive following an investigation cannot be challenged by a complainant because it is does not constitute a legally binding act.[58]

57 In essence, Article 86(1) EC is designed to prevent Member States from evading the competition (and other) rules of the Treaty by maintaining public ownership of undertakings or by granting undertakings special or exclusive rights.

58 *See* Case C141/02, Commission v. Max-mobil, 2005 E.C.R. I-1283.

It has been suggested that the Commission has the power to adopt interim measures under Article 86(3) EC, although it has never done so.[59] This is on the basis that the Commission's powers arising from Article 86(3) EC may be similar to its powers in relation Articles 81 and 82 EC, that allow it to adopt interim measures in urgent cases and on the basis of a prima facie finding of infringement.

2. Article 226 EC

The Commission can (on its own initiative or following a complaint) investigate and issue a reasoned opinion under Article 226 EC in respect of a Treaty violation by a Member State. If the Member State concerned fails to comply within the time limits laid down in the reasoned opinion, the Commission may bring an action before the ECJ. Once the ECJ upholds the Commission's opinion, and if the Member State fails to comply with the finding of the ECJ, the Commission can, after giving the Member State an opportunity to submit its observations, issue a reasoned opinion specifying the points on which the Member State has not complied with the ECJ's judgment. If, following the second reasoned opinion, the Member State fails to take the necessary steps within the time limit laid down, the Commission may then bring a further action before the ECJ, requesting the imposition of a penalty payment against the Member State under Article 228 EC.

It will be readily apparent that the enforcement procedure under Article 226 EC is a long and complicated one, that is not well-suited to the commercial realities of a contested takeover, as is well illustrated by the still unresolved VW case and KPN and TPG cases. Moreover, a final decision under Article 228 EC will be of little practical use to the parties to a prospective merger since they are likely to have been driven to abandon the deal well before the ECJ has issued its decision.

3. Article 21 ECMR

Where a proposed merger falls within the ambit of the Commission's exclusive jurisdiction under the ECMR, Article 21 ECMR probably offers the most effective and timely remedy for an aggrieved investor above any other remedy available at EU or national level.

For the first time in the *Champalimaud* case, and more recently in the *Cimpor* and *UniCredit* cases, the Commission initiated proceedings on the basis of Article 21 ECMR, requiring Member States to refrain from adopting measures (ostensibly on the grounds of legitimate national interest under Article 21(3) ECMR) that would amount to an infringement of the Commission's exclusive jurisdiction under the ECMR to vet mergers with a Community dimension.

In reaching an Article 21 ECMR infringement decision, the Commission initially forms a preliminary view as to the incompatibility of the Member State

59 *See* John Temple Lang, European Union legal rules on State measures restricting competition, Paper Presented at the 2005 Summit at Como (Oct. 2005) (on file with the author).

measures with Article 21 ECMR, and sends the Member State concerned a letter asking it to justify its actions. The Member State then has fifteen working days to reply to the Commission's initial findings. If, following this consultation period, the Commission still believes that Article 21 ECMR has been infringed, it can adopt a decision requiring the Member State to withdraw the infringing national measure. This decision is addressed to the Member State, is binding on it and, crucially, is directly applicable against the Member State to which it is addressed and, as such, is enforceable in the national courts by any party affected by the decision which, in this context, would include an aggrieved foreign investor. Moreover, the Commission may also adopt interim measures in the course of Article 21 ECMR proceedings (as it did in *Champalimaud* case, where it provisionally lifted Portugal's suspension of the merger).

In its 2004 ruling in *Portugal v. Commission*,[60] the ECJ crucially confirmed that Article 21 ECMR proceedings could be initiated by the Commission regardless of whether the Member State concerned had invoked legitimate national interests under Article 21(3) ECMR. In other words, the fact that a Member State had chosen not to follow the Article 21(3) ECMR procedure did not preclude the Commission from using Article 21 to secure the withdrawal of protectionist measures that are not justified or proportionate under EU law.

In its decision, the ECJ emphasized that:

> "if the Commission were reduced, in the absence of any communication by the Member State concerned [under Article 21 ECMR] to the sole option of bringing an action for failure to fulfill obligations under Article 226 EC, it would be impossible to obtain a Community decision within the short time-limits laid down by the Merger Regulation, with a consequent increase in the risk that such a decision may be taken only after the national measures have already irretrievably prejudiced the merger with a Community dimension."[61]

Apart from the political pressure that Article 21 ECMR proceedings bring to bear on the Member State concerned, that alone may result in the withdrawal of an offending national measure, an Article 21 ECMR infringement decision may also be a powerful weapon in the hands of an aggrieved investor before the national courts.

60 *See supra* note 52.

61 *See id.* at paragraph 55.

C. REMEDIES AT A NATIONAL LEVEL

It is a well-established principle of EU law that national courts are under a general duty to disregard any national measure that is inconsistent with EU law.[62] Article 10 EC stipulates that Member States "shall abstain from any measure which could jeopardize the attainment of the objectives of the Treaty," and, as such, requires all Member States, including their courts and competition authorities, to take all necessary measures to guarantee the application and effectiveness of EU law.[63] Article 10 EC embodies the so-called "effet-utile" of EU law and the EC courts have held that it places numerous practical duties and obligations on Member States in the context of complying with both the letter and the spirit of the Treaty.

National courts are under a duty to enable companies to challenge state measures that are contrary to EU law, for example, through judicial review or a declaration that the national measures are contrary to EU law. While the procedures for mounting such a challenge are governed by national law, they must not make it impossible or excessively difficult to exercise the rights granted by EU law.[64]

In *Fiammiferi*,[65] the ECJ extended the duty to set aside national provisions conflicting with Community law to non-judicial bodies such as competition authorities. According to the ECJ, since a national competition authority is responsible for ensuring, inter alia, that Article 81 EC is observed, then Article 81, in conjunction with Article 10 EC, imposes a duty on Member States to refrain from introducing (or to withdraw) measures contrary to the EC competition rules, as otherwise those rules would be rendered less effective if the competition authority were not able to disregard a national measure that is contrary to the combined provisions of Articles 10 and 81 EC.[66]

Where the proposed merger does not fall within the Commission's exclusive competence (i.e., because the parties each achieve two-thirds of their turnover in one and the same Member State), an aggrieved investor will usually be left with a claim that the protectionist measure infringes the rules on free movement of capital (Article 56 EC) and the right of establishment (Article 43 EC). In this scenario, the national court will have to determine whether the national measure at issue is in breach of the Treaty freedoms, and, if so, if it is justified under

62 *See* Case 106/77, Amministrazione delle Finanze dello Stato v. Simmenthal SpA, 1978 E.C.R. 629; Cases C-46 & 48/93, Brasserie du pecheur / Bundesrepublik Deutschland and The Queen / Secretary of State for Transport, *ex parte* Factortame and others, 1996 E.C.R. I-1029; Case 66/86, Ahmed Saeed Flugreisen and others / Zentrale zur Bek_mpfung unlauteren Wettbewerbs, 1989 E.C.R. 803.

63 *See, e.g.*, Case 68/88, Commission v. Greece, 1989 E.C.R. 2965, at paragraph 23.

64 *See, e.g.,* Case C-312/93, Peterbroeck, Van Campenhout & Cie / Belgian State, 1995 E.C.R. I-4599.

65 Case C-198/01, Consorzio Industrie Fiammiferi (CIF) v. Autorità Garante della Concorrenza e del Mercato, 2003 E.C.R. I-8055.

66 *See id.* at paragraph 50.

the criteria set down by the ECJ. If the matter is not clear-cut, it is likely to be referred by the national court to the ECJ for a preliminary ruling under Article 234 EC.[67] Even if there is no referral to the ECJ, inevitably, there will be a risk of several time-consuming appeals before the finding of an infringement of EU law becomes final. Such an action could be pursued in parallel with Article 226 EC infringement proceedings against the Member State concerned.

As already mentioned, where a proposed merger falls within the ambit of the ECMR, then Article 21 ECMR is likely to offer the most effective and timely remedy for an aggrieved investor. Ideally, an aggrieved investor bringing an action before a national court would be armed with both a Commission clearance decision under the ECMR in respect of the proposed merger, and a Commission Article 21 ECMR infringement decision condemning the infringing state measure, in which case the national court would have little choice but to set aside the state measure concerned. Furthermore, in such a scenario, it is unlikely that questions of EU law would arise that the national court would feel compelled to refer to the ECJ under Article 234 EC, and the scope for a Member State to appeal an adverse judgment of the national court is also likely to be considerably diminished. Overall, this should also result in a much speedier resolution of any claim.

On bringing an action before a national court, it would also be open to an aggrieved investor to apply for interim measures. In the *Factortame* case,[68] the ECJ held that national courts are obliged to provide interim relief against the state even if such a remedy was not available under national law. This means that a national court would have a duty to suspend the application of any state measures contrary to EU law. Insofar as a blocked bid may result in losses for a frustrated bidder, it would also be open to the bidder to bring an action for damages against the Member State concerned, as the national courts also have a duty to award compensation for breaches of EU law.[69]

D. DO THE OVERRIDING INTERESTS OF THE INTERNAL MARKET JUSTIFY THE ABOLITION OF THE TWO-THIRDS RULE?

The Commission has shown in its prohibition decision in *EDP/ENI/GDP*[70] that it will not hesitate to block the creation of a national champion where it considers

67 Under Article 234 EC, any court or tribunal of a Member State may (and in certain circumstances must) refer a case to the ECJ for a preliminary ruling concerning the interpretation of EU law. The ECJ rules on the issues referred to it and sends the case back to the national courts which then apply the EU law in question as interpreted by the ECJ to the case at hand.

68 Case 213/89, R v. Secretary of State for Transport, *ex parte* Factortame, Ltd.,1990 E.C.R. I-2433.

69 Cases C-6 & 9/90, Francovich and Bonifaci v. Italy, 1993 E.C.R. I-5357.

70 Case COMP/M.3440, EDP/ENI/GDP, 2005 O.J. (C 288) 2.

that such a merger would significantly impede effective competition in the European Union. Moreover, the Commission appears equally determined to ensure that its clearance decisions and its exclusive jurisdiction under the ECMR are not obstructed by interventionist measures, from Member States, designed to prevent foreign takeovers. European Commissioner Neelie Kroes recently stated that "the EU's single market will descend into chaos" if Member States stand in the way of mergers falling within the Commission's exclusive competence.[71] The Commission's determination to tackle protectionist measures is well illustrated by the vigorous stance it has taken against Spain's attempts to obstruct E.ON's proposed takeover of Endesa as well as its infringement decisions under Article 21 ECMR against the Portuguese government in the *Champalimaud* and *Cimpor* cases.[72]

However, the Commission is effectively powerless to prevent the creation of national champions, regardless of what impact this might have on the internal market, when it comes to mergers which fall outside its exclusive jurisdiction under the ECMR because of the application of the two-thirds rule. Much to Commissioner Kroes' frustration, this was the case with Gas Natural's proposed takeover of Endesa, that led the Commissioner to call for the abolition of the two-thirds rule.[73]

Arguably, the two-thirds rule, which was introduced as part of the EC's first merger control regime in 1989, is outdated and inconsistent with its overriding internal market objectives. However, it is worth noting that, at the time of its review of the ECMR in 2003, the Commission was of the opinion that the two-thirds rule should be retained on the grounds that it applies to less than 10 percent of filings and is a reasonable expression of the principle of subsidiarity.

Arguably, the two-thirds rule, which was introduced as part of the EC's first merger control regime in 1989, is outdated and inconsistent with its overriding internal market objectives.

Aside from the two-thirds rule, the ECMR provides for mechanisms whereby concentrations with a Community dimension, that affect competition in a distinct market within a Member State, can be reviewed at the national level. Under Article 9(2)(a) ECMR a Member State can request a referral back to its competent authorities where a concentration "threatens to affect significantly" competition in a distinct market within that Member State. Where the Commission considers that such a threat exists, it can either assert its exclusive jurisdiction and deal with the case itself, or refer the whole or part of the case to the Member State's competition authorities. In this scenario, the Commission

71 European Commission, Press Release No. 277, Mergers: Commission launches procedure against Poland for preventing Unicredit/HVB merger (2006).

72 *See supra* notes 50 & 51.

73 *See supra* note 4.

has a wide margin of discretion in deciding whether or not to refer the case to the competent national authorities.

According to Article 9(2)(b) ECMR, a request for a referral back can also be made by a Member State where a concentration "affects competition in a distinct market which does not constitute a substantial part of the common market" (i.e., in a local or regional market within that Member State). If the Commission considers such a local or regional market to be affected by the concentration, it is obliged to refer the whole case or that part of the case which relates to this market, to the Member State's competition authorities.[74]

Given that amendments to the ECMR require unanimous approval in the Council,[75] all Member States would ultimately have to agree to abolish the two-thirds rule." This may, of course, be difficult to achieve given the protectionist tendencies of Member States. Even those Member States that may be willing to give more discretion to the Commission may not be keen to make further changes to the ECMR relatively soon after its recent overhaul.

However, rather than completely abolishing the two-thirds rule, a more palatable solution for Member States might be to include the two-thirds rule as an additional ground for the referral of mergers back to Member States under Article 9(2)(a) ECMR. This would allow the Commission to assess the cross-border impact of any merger, even when it concerns essentially domestic players, in exercising its discretion to accede to a Member State request for referral back. This would effectively eliminate the possibility of Member States frustrating foreign takeovers or the objectives of the internal market by the creation of national champions from mergers falling outside the Commission's exclusive jurisdiction under the ECMR.

74 There is also a referral mechanism under Article 4(4) ECMR which can be initiated by the notifying parties. *See supra* note 10.

75 As the legal basis for the ECMR itself is Article 83 EC in conjunction with Article 308 EC, which requires unanimity, any amendments to the ECMR can only be adopted unanimously on the same legal basis.