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Europe's Highest Court Strikes Down Takeover Protections in German Company

Earlier this week, the European Union's highest court, the European Court of Justice, concluded that Germany's 47-year-old "Volkswagen law" restricts the free movement of capital in the European Community and is, therefore, not permissible. *Commission v. Germany*, Case No. C-112/05 (Oct. 23, 2007). Germany had argued that the law is not a national measure that limits the acquisition of shares in undertakings or deters investors of other Member States from investing their capital. The European Commission disagreed and, following repeated unsuccessful initiatives seeking to have Germany revoke the law, the EC initiated suit against Germany in March 2005.

Specifically, the Court struck down each of the following "golden share" type provisions that had the cumulative effect of insulating Volkswagen AG from purchase by an acquirer not acceptable to the Federal Republic of Germany and the northern German state of Lower Saxony (where Volkswagen is headquartered):

- First, the Court found impermissible a provision that prevented any single shareholder in Volkswagen from casting more than 20% of the votes (even if the shareholder held more than 20%). This provision had the practical effect of limiting Porsche, with a 31% stake in Volkswagen, from exercising its voting rights in full or pursuing a takeover.

- Second, the Court struck down a law that required a supermajority vote of over 80% of the shares to approve any resolution presented to shareholders, which effectively provided Germany and Saxony with blocking rights over any such resolution since each held 20% of Volkswagen's capital at the time the supermajority vote requirement was adopted.

- Third, the Court found that the right granted to each of Germany and Saxony to appoint two representatives to the Volkswagen supervisory board improperly deterred investors from other Member States from investing in Volkswagen's capital. The Court specifically rejected Germany's assertions that such a law was needed to protect workers' interests.

The immediate impact of the Court decision is that it could allow Porsche to attempt to acquire Volkswagen. However, the decision has greater implications since it sends a strong message to Member States that the free movement of capital within the European Community will take precedence over a Member State's individual industrial policy. The Court has ruled consistently in favor of the EC against attempts by Member States to protect companies or industries, including the fostering of "National Champions" and the provision of state aid. The decision follows other recent EU rulings prohibiting golden share structures and comparable arrangements. While the Volkswagen law technically did not involve a golden share, many of the same principles were inherent in its construct.

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