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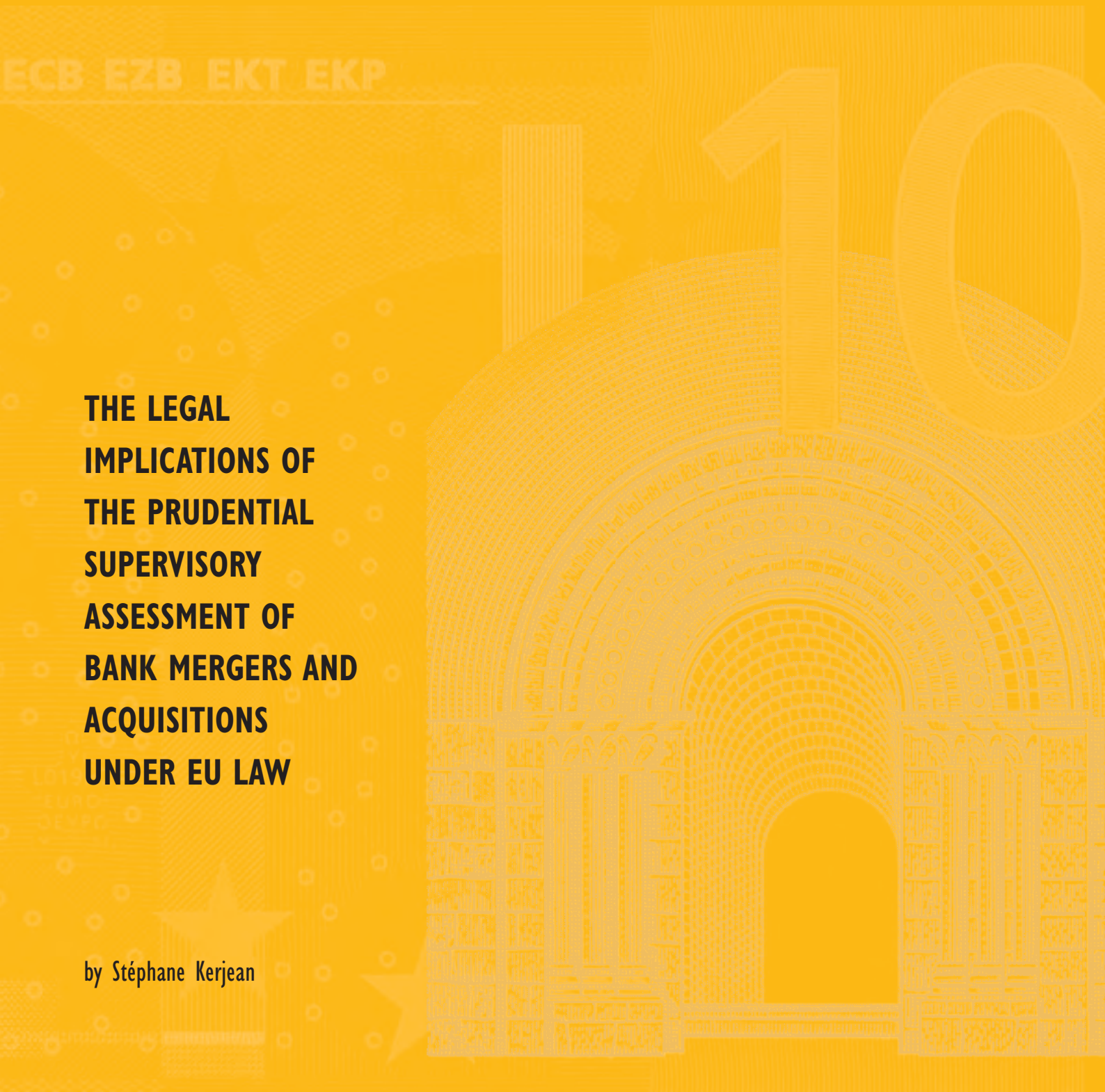

THE LEGAL IMPLICATIONS OF THE PRUDENTIAL SUPERVISORY ASSESSMENT OF BANK MERGERS AND ACQUISITIONS UNDER EU LAW

by Stéphane Kerjean

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Abstract

In September 2004, the Scheveningen ECOFIN Council invited the European Commission to identify the various obstacles to cross-border consolidation in the EU financial sector, including obstacles resulting from the application of prudential rules by supervisory authorities. Although this consolidation has increased in recent years, the number of cross-border mergers and acquisitions in the banking sector continues to lag behind other (non-financial) sectors. Moreover, the difficulties experienced by EU banks in attempting to acquire stakes in financial undertakings in other EU Member States (e.g. in Italy in 2005 or in Poland in 2006) have highlighted the need to ensure a high level of transparency and legal certainty in the rules applied by supervisory authorities when assessing proposed increases in and acquisitions of qualifying holdings, and the need for the Commission to closely monitor the application of these rules. This has led to the adoption of Directive 2007/44/EC of the European Parliament and of the Council of 5 September 2007 ('the Qualifying Holdings Directive') which introduces harmonised procedural rules and evaluation criteria for the prudential assessment of acquisitions and increases of holdings in the financial sector. These new EU rules must be implemented by 21 March 2009. This paper provides an overview of the main characteristics of the new rules applicable at Community level to acquisitions and increases of holdings in the financial sector, with a particular focus on the amendments introduced to the Banking Directive (2006/48/EC).

Before looking at the new EU legal framework for qualifying holdings, this paper puts these rules into perspective against the European Court of Justice's application of the Treaty principles on the free movement of capital and freedom of establishment, and their consequences for cross-border banking consolidation in the EU. This paper provides an analysis of the exceptions to these Treaty freedoms, especially the prudential carve-outs, the impact of these principles on third country investors and authorities, and an assessment of the lessons to be drawn from the infringement proceedings initiated by the Commission in recent years in the banking sector. Lastly, this paper studies the relationship between the prudential rules and the competition law rules in cases of cross-border banking mergers.

INTRODUCTION

Despite the increase of European cross-border banking consolidation in recent years, domestic institutions continue to account for the majority of the banking sector in the EU Member States, with an average market share of approximately 73 %[1]. Moreover, in the euro area, while interbank market and capital market related activities show clear signs of increasing integration, retail banking markets continue to be fragmented[2]. Although the recent growing importance of cross-border M&A transactions in the banking sector also points to further progress in banking integration[3], concerns have been expressed about the lack of cross-border banking consolidation. In 2004, the informal meeting of the Economic and Financial Affairs Council (ECOFIN) in Scheveningen noted that the incidence of cross-border mergers and acquisitions in the banking sector lagged behind other (non-financial) sectors and invited the European Commission to study possible obstacles to cross-border mergers and acquisitions in the wholesale and retail banking sectors[4]. Against this background, the Commission expressed its intention to review those parts of Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions ('the Banking Directive')[5] that allow Member States to oppose acquisitions or increases of qualifying holdings in a credit institution on prudential grounds. This has resulted in a review being carried out of the existing EU rules pertaining to supervisory assessments of holdings in the Banking Directive and other financial sector directives with a view to maintaining and enhancing further cross-sectoral consistency with the securities and insurance sectors[6], and to the adoption of Directive 2007/44/EC as regards harmonised procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase of holdings in the financial sector ('the Qualifying Holdings Directive')[7].

1 In 2006 banks from other Member States and from third countries accounted for 19 % and 8.2 % respectively of total bank assets in the EU (ECB Report entitled 'EU banking structures', October 2007, pp. 13-14).

2 ECB report on Financial Integration in Europe, April 2008, p.17. See also Bini Smaghi (2007).

3 See ECB/Eurosystem contribution on the review of the Lamfalussy framework, November 2007, pp.3-5.

4 See 'Cross-border consolidation in the EU financial sector', Commission staff working document, 26.10.2005, SEC(2005) 1398 (www.europa.eu).

5 OJ L 177, 30.6.2006, p. 1. The Banking Directive lays down rules on the taking up and pursuit of the business of credit institutions and their prudential supervision, and it incorporates the new capital requirement provisions derived from the framework agreement on the international convergence of capital measurement and capital requirements adopted by the Basel Committee on Banking Supervision on 26 June 2004.

6 ECOFIN agreed in November 2005 that the review of the banking legislation applicable to supervisory assessments of qualifying holdings should be extended to cover the corresponding provisions regulating the securities and insurance sectors.

7 Directive 2007/44/EC of the European Parliament and of the Council of 5 September 2007 amending Council Directive 92/49/EEC and Directives 2002/83/EC, 2004/39/EC, 2005/68/EC and 2006/48/EC as regards procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase of holdings in the financial sector (OJ L 247, 21.9.2007, p. 1).

Structure of the Legal Working Paper

Chapter 1 of this paper provides an overview of the case law of the European Court of Justice ('the Court') applicable to the right of establishment and the free movement of capital, and assesses the distinction between these two freedoms. Chapter 1 is also devoted to the interpretation by the Court of the 'prudential carve-out' contained in the provisions of the Treaty establishing the European Community ('the Treaty') relating to the free movement of capital. Against this background, chapter 1 of the paper examines the proceedings initiated by the European Commission in the banking sector in recent years as a result of infringements of these two freedoms. Furthermore, it reviews the application of the prudential interests exception in the context of Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings ('the EC Merger Regulation') (OJ L 24, 29.1.2004, p. 1). Chapter 2 of this paper presents the new substantive EU rules applicable to the prior authorisation of qualifying holdings in the banking sector contained in the Qualifying Holdings Directive. The rationale for the recent reform is addressed, together with its material scope and the level of harmonisation adopted. This part examines in particular aspects relating to the notification of qualifying holdings to supervisory authorities by proposed acquirers, and the harmonised criteria to be used for supervisory assessment. Chapter 3 provides a general overview of the procedural rules applicable to the supervisory assessment of qualifying holdings, aspects relating to the transparency of the notification process, cooperation between supervisory authorities and the treatment of third country acquirers. Lastly, chapter 4 of this paper addresses the issue of the Commission's right to request prudential information from supervisory authorities.

Executive summary

(1) Cross-border banking consolidation in the EU and the Treaty-based right of establishment and free movement of capital

There are two main sets of rules in the Treaty which affect cross-border consolidation in the EU banking sector and more generally intra-EU investment in the financial sector: the prohibition of restrictions on freedom of establishment on the one hand, and the free movement of capital on the other hand. It is the settled case law of the European Court of Justice that all measures which prohibit, impede or render less attractive the exercise of the freedom of establishment must be regarded as constituting such a restriction. The case law of the Court indicates that a restriction on freedom of establishment can only be allowed if it pursues a legitimate aim which is compatible with the Treaty and which is justified by overriding reasons of public interest. As regards the free movement of capital, the Court has stated that national measures must be regarded as restrictions if they are likely to prevent or limit the acquisition of shares in an undertaking or to deter investors from other Member States from investing in their capital, and such measures are therefore liable to render the free movement of capital illusory. This freedom may be restricted by national rules which are justified on the grounds set out in Article 58 EC or by overriding reasons in the general interest[8].

In relation to both freedoms, for restrictive measures to be justified they must meet the conditions established by the Court. As a rule, a measure which is liable to hinder or make less attractive the exercise of fundamental Treaty freedoms must be applied in a non-discriminatory manner. Moreover, it must comply with the principle of proportionality, in that it must be appropriate for the attainment of the objective it pursues, and it must not go beyond what is necessary to attain that objective, i.e. it must comply with the usual necessity and proportionality tests. The Court has also clarified that the free movement of capital may be restricted by national rules which are justified on the grounds set out in Article 58 EC or by overriding reasons in the general interest to the extent that there are no Community harmonising measures to ensure the protection of those interests[9].

The dividing line between the right of establishment and the free movement of capital under the Treaty is difficult to draw. On the one hand, the concept of movement of capital covers both 'direct investment' and 'portfolio investment', and the term 'direct investment' involves the concept of control which is in principle connected with the exercise of the right of establishment. On the other hand, the Court considers that the decisive criterion for determining whether national laws fall under one or the other of these two Treaty freedoms is whether the provisions give holders a definite influence on the decisions of a company and allow them to determine its activities, which is also

8 See pp. 14 -18 of the paper.

9 Ibid.

connected to the idea of controlling influence. In view of the overlap between the concept of 'definite influence' and the criteria pertaining to 'direct investment', this weakens the distinction for applying the 'definite influence' test. However, the Court will examine the purpose of the law at issue. Since only the fundamental freedom which is the main focus as regards the substance of the matter should be applied, the Court will decide which of the two freedoms is primarily affected. While, in some cases, the Court has considered that the law at issue has primarily affected freedom of establishment and that restrictions on the free movement of capital have been an unavoidable consequence of the restriction on the freedom of establishment, in the 'golden shares' cases the Court has taken the view that the free movement of capital was primarily affected, and that restrictions on freedom of establishment have been a direct consequence of the obstacles to the free movement of capital. In other cases, the Court has considered that national legislation, for instance in the field of taxation, may fall within the scope of both Article 43 EC on freedom of establishment and Article 56 EC on free movement of capital[10].

Except perhaps in the case of situations involving third countries, for which the scopes of the two freedoms under the Treaty differ, the lack of a precise classification of the restrictive measures relating to one or the other of these two freedoms does not have major consequences, since the Court subjects both Community freedoms to similar scrutiny[11]. Unlike in the case of freedom of establishment or free movement of services, the Treaty provisions on free movement of capital provide for a prohibition of all restrictions between Member States as well as of restrictions between Member States and third countries. In the *Skatteverket* case, the Court clarified that the concept of a restriction on movement of capital should be interpreted in the same way in relations between a Member State and a third country as it is in relations between one Member State and another, and that the application of certain national restrictive measures to the movement of capital must take account of the different legal contexts in which the movement of capital to or from third countries takes place. Against this background, certain restrictions might be justified which would not be justified between Member States. For instance, where the law of a Member State makes the grant of a tax advantage dependent on satisfying certain requirements, compliance with which can only be verified by obtaining information from the competent authorities of a third country, the Member State may be justified in refusing to grant that advantage if that third country is not under any obligation to provide information and it proves impossible to obtain the information from that country. The Court has also clarified that third country nationals, who cannot rely on freedom of establishment, cannot circumvent restrictions on their establishment in a Member State which are permitted under Community law by invoking the provisions on free movement of capital[12].

10 See pp. 18 - 25 of the paper.

11 See p. 24 of the paper.

12 See pp. 25 - 28 of the paper.

(2) Prudential supervision and prudential carve-out

The Treaty provides for a specific prudential carve-out in the case of free movement of capital, with the right of Member States to take measures to prevent infringements of national laws and regulations in the field of the prudential supervision of financial institutions. This carve-out does not expressly exist in the Treaty in the context of freedom of establishment. The purpose of supervisory measures is to ensure that credit institutions meet their obligations, and supervisory authorities have an obligation to protect a plurality of interests, including the stability and the functioning of the financial system[13]. With the exception of the Opinion of Advocate General Stix-Hackl in the *Fidium Finanz* case, the application of the free movement of capital carve-out to prudential supervision has not yet been fully explored by the Court[14]. However, both in respect of free movement of capital and the right of establishment, the Court has acknowledged that there can be overriding reasons relating to the public interest, such as the protection of the good reputation of the national financial system, which may justify exceptions to the prohibition of restrictions. Although the Court may support the view that prudential considerations and other exceptions should be circumscribed by the same strict qualifications as apply to other restrictions, it is possible that similar reasons relating to the integrity and stability of the financial/banking system and the effective supervision of financial institutions could be invoked successfully before the Court. The Court considers the possible application of these exceptions in situations where the interest concerned is not already protected by Community harmonisation measures. It is also possible that national measures which affect certain types of credit institutions and which might be considered as prohibiting, impeding or rendering less attractive the exercise of freedom of establishment, or preventing or limiting the acquisition of shares or deterring investors from investing in the capital of companies and thus rendering free movement of capital illusory, may increasingly be challenged before the Court[15].

(3) The EC Merger Regulation prudential carve-out

The Commission has sole jurisdiction to take the decisions provided for in the EC Merger Regulation, including those in the financial sector. This means that a Member State cannot apply its national merger control legislation to a transaction which falls within the scope of the EC Merger Regulation[16]. However, under specific conditions Member States may derogate from the exclusive power of the Commission. In particular, legitimate interests concerning prudential rules ('the prudential carve-out') may in principle allow a Member State to invoke these interests to oppose a concentration with a Community dimension in the financial sector. This carve-out has not yet been successfully invoked by a Member State. Moreover, the level of harmonisation of EU prudential rules has changed

13 See pp. 28 - 30 of the paper.

14 See pp. 30 - 31 of the paper.

15 See pp. 30 – 34 of the paper.

16 See pp. 31 - 41 of the paper.

considerably in the nearly twenty years since the adoption of the first EC Merger Regulation in 1989, implying that the prudential carve-out has much more limited relevance than it had, especially following the adoption in the Qualifying Holdings Directive of harmonised evaluation criteria and procedural rules for the prudential assessment of acquisitions and increase of shareholdings in the financial sector. However, not all possible recourse by a Member State to the EC Merger Regulation prudential carve-out in the context of cross-border banking mergers may be exhausted. For example, it is possible that this provision may be applied to merger operations in the banking sector which involve financial or non-financial institutions from third countries[17].

The concepts used in the context of the merger control rules or in the application of the prudential rules have developed separately and currently coexist without convergence, as, for instance, in the case of the concept of control. To avoid any risk of conflict between the rules derived from the EC Merger Regulation and those derived from the Banking Directive, as amended by the Qualifying Holdings Directive, and other prudential requirements contained in EU directives, this paper recommends considering a more systematic procedure of notification to the Commission of legitimate interests related to prudential rules in the context of banking mergers with a Community dimension[18].

(4) Infringement proceedings initiated in the banking sector

Attempts in recent years by some European banks to acquire credit institutions in other Member States have sometimes been frustrated by national supervisory authorities blocking cross-border mergers on allegedly prudential grounds. This was the case in Portugal with the *Champalimaud* case in 1999, in Italy with the *BBVA/BNL* and *ABN AMRO/Antonveneta* cases in 2005 and in Poland with the *Unicredito/BPH* case in 2006. These cases triggered two distinct types of infringement proceedings: on the one hand proceedings for breach of the rules on the free movement of capital, and of the right of establishment and/or, on the other hand for breach of certain provisions of the EC Merger Regulation. However, these cases present a number of similarities, since they all concerned a credit institution from one Member State wishing to acquire direct control of a credit institution or a financial group in another Member State, for which clearance from the supervisory authority of the target institution was required. These cases related to the exercise of their discretionary powers by national (banking or insurance) supervisory authorities in the prudential assessment of cross-border mergers and acquisitions in the financial sector, and in all cases the Commission rejected the prudential grounds invoked by the national authorities to oppose the cross-border investments. Although, in accordance with its usual practice, in these cases the Commission invoked breaches of both freedoms, it was the right of establishment that was primarily affected, for instance in cases of manifest

[17] See pp. 41 - 46 of the paper.

[18] Ibid.

discrimination between foreign banks and domestic banks wishing to acquire control of a target credit institution through competing bids[19].

(5) The EU reform of the qualifying holdings rules

The reform of the EU rules on the prior authorisation of qualifying holdings in the banking sector took place against the backdrop of the lack of cross-border banking consolidation in the EU, and the unsuccessful attempts of foreign banks to acquire control over other EU banks. The Qualifying Holdings Directive, which must be implemented by Member States by 21 March 2009, is intended to ensure greater certainty and predictability with regard to the prudential criteria to be applied by the supervisory authorities for the assessment of the suitability of an acquisition. It sets out the procedural rules applied by the supervisory authorities when assessing acquisitions on prudential grounds, and introduces a transparent notification and decision-making process for supervisory authorities and proposed acquirers[20].

The Qualifying Holdings Directive reaffirms important principles, such as the prohibition of prior conditions in respect of the level of shareholding that must be acquired by investors, or the obligation of competent authorities to treat proposed acquirers in a non-discriminatory manner where there are competing bids[21]. The Qualifying Holdings Directive also provides for an enhanced legal framework ensuring cross-sectoral consistency and an increased level of cooperation between competent authorities[22], and it acknowledges a conditional right of access by the Commission to information pertaining to prudential assessments carried out by national supervisory authorities[23]. Although the notification thresholds were not amended by the reform of the qualifying holdings rules, it remains to be clarified whether the Banking Directive covers the increasing practice by certain investors, for instance hedge funds, to build up stakes in companies such as credit institutions by using swaps or other derivatives without having to comply with notification or disclosure requirements and suddenly appearing as a large shareholders at a general meeting[24]. Furthermore, apart from the Qualifying Holdings Directive, which exclusively amends the provisions of the Banking Directive relating to the qualifying holdings rules, further clarification of the interaction between the authorisation rules, the qualifying holdings rules and the prudential requirements in the Banking Directive would be beneficial[25]. The development of cross-border banking consolidation in the EU may require further consideration of the need for a more simplified procedure for acquiring or increasing shareholdings in

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19 See pp. 34 - 38 of the paper.

20 See Chapters 2 to 4 of the paper.

21 See pp. 58 - 62 of the paper.

22 See pp. 70 - 72 of the paper.

23 See Part 4 of the paper.

24 See pp. 52 - 54 of the paper.

25 See pp. 54 - 55 of the paper.

a credit institution by a regulated financial institution which is already allowed to do business with a European passport across the EU directly through the provision of services or through branches [26].

This targeted reform reflects a consensus on the core rules which should be applicable to the assessment of acquisitions and increases of qualifying holdings and which should apply uniformly in the EU financial sector. At the same time, it may be regretted that the approach chosen did not offer the possibility of developing a more comprehensive legal framework in the form of implementing measures which would have made it possible to address more adequately a number of technical aspects, for which specific procedural rules would have been warranted, and to clarify aspects for which legal certainty has not yet been fully ensured, for instance on the question of commitments made by financial institutions as a pre-condition to supervisory approvals. In this respect reference is made in this paper to the implementing measures for the European merger control rules which might have served as a useful source of inspiration in certain instances. Certain provisions of the Qualifying Holdings Directive, regarding the information required from proposed acquirers or the transparency of supervisory decisions, may not ensure that there is a truly level playing field across the Member States. More generally, the review of the EU qualifying holdings rules in the financial sector has illustrated the shortcomings of the current legislative architecture of European banking and in particular the need for a much more systematic and extensive recourse to comitology and implementing measures, as seen recently in EU securities legislation and currently in the context of Solvency II in the insurance sector[27].

Lastly, with the experience gained from the application of the new qualifying holdings rules, it will be necessary to determine whether these rules are sufficiently robust, and whether they are appropriate for the purposes of third country acquirers. The regime provided under the Qualifying Holdings Directive highlights the Community's laudable intention to keep its financial markets open to the rest of the world. Against this backdrop, proposed acquirers from third countries will be subject to the same substantive criteria as any proposed acquirer established in the EU. The supervisory authorities are however entitled to oppose a transaction for which they have not received the necessary information from the proposed acquirer and/or from the competent authorities of the third country concerned, or if the prudential criteria would not be met. The emergence of Sovereign Wealth Funds and hedge funds as new types of investors in the capital of European banks has recently reminded the public authorities of the existence of the possibility of using the exceptions to the Treaty freedoms (including prudential carve-outs) and of adopting regulatory solutions for such cases. It is too early to know whether specific requirements, for instance in terms of governance or transparency, will be needed to deal with the situation arising from the emergence of these new types of shareholders in

[26] Ibid.

[27] See pp. 47-49 of the paper.

European banks, or whether the current rules, including those in the Banking Directive, will be sufficient to address this new challenge to the banking sector[28].

[28] See Chapter 3, 3.4 of the paper.

1 Community law and prudential carve-outs

1.1 Right of establishment and free movement of capital

1.1.1 Overview of the two freedoms

There are two main sets of rules in the Treaty which affect cross-border consolidation in the EU banking sector and intra-EU investment in the financial sector more generally: these are the prohibitions of restrictions on the freedom of establishment and on the free movement of capital.

Treaty provisions on the right of establishment

As regards the right of establishment, Article 43 EC provides that: 'restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited … Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms … under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the chapter relating to capital'. Article 45 EC provides that, so far as any given Member State is concerned, the provisions of the chapter on the right of establishment do not apply to activities which in that State are connected, even occasionally, with the exercise of official authority. Article 46(1) EC provides that the provisions of the chapter on the right of establishment and measures taken in pursuance thereof must not prejudice the applicability of provisions laid down by law, regulation or administrative action providing for special treatment for foreign nationals on grounds of public policy, public security or public health[29]. Article 48 of the EC Treaty provides that '[c]ompanies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States. "Companies or firms" means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making'.

Treaty provisions on free movement of capital

The Treaty provisions governing the free movement of capital are laid down in Articles 56 to 60 EC[30]:

- Article 56(1) EC provides that 'all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited'.

- Article 57(1) EC provides that the provisions of Article 56 EC are without prejudice to the application to third countries of any restrictions which existed on 31 December 1993 under

[29] One may also add a reference to Article 294 EC which provides that: 'Member States shall accord nationals of the other Member States the same treatment as their own nationals as regards participation in the capital of companies or firms within the meaning of Article 48, without prejudice to the application of the other provisions of this Treaty'.

[30] Title III – Free movement of persons, services and capital; Chapter 4 - Capital and payments.

national or Community law adopted in respect of the movement of capital to or from third countries involving direct investment – including investment in real estate – establishment, the provision of financial services or the admission of securities to capital markets.

- Article 57(2) EC, first sentence, provides that, whilst endeavouring to achieve the objective of free movement of capital between Member States and third countries to the greatest extent possible and without prejudice to the other chapters of the Treaty, the Council may adopt measures on the movement of capital to or from third countries involving direct investment – including investment in real estate – establishment, the provision of financial services or the admission of securities to capital markets[31].
- Article 58(1)(b) EC contains a specific carve-out relating to prudential measures. It states that the provisions of Article 56 do not prejudice to the right of Member States to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions, or to take measures which are justified on grounds of public policy or public security.
- Article 58(2) EC provides that the provisions of the chapter are without prejudice to the applicability of restrictions on the right of establishment which are compatible with this Treaty.
- Article 58(3) EC nevertheless, affirms that '[t]he measures and procedures referred to in paragraphs 1 and 2 shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 56'[32].

The amendments introduced by the Lisbon Treaty to the Treaty establishing the European Community do not substantively modify the two sets of rules referred to above. The changes are essentially confined to the need to take account of new legislative procedures[33].

Prohibition of restrictions on and exceptions to the two freedoms

It is settled case law that all measures which prohibit, impede or render less attractive the exercise of freedom of establishment must be regarded as constituting a restriction[34]. Under Article 48 EC, for

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31 Article 57(2) EC, second sentence, provides that unanimity is required for measures under this paragraph which constitute a step back in Community law as regards the liberalisation of the movement of capital to or from third countries.

32 In addition to the exception provided for in Article 57(1) EC for certain restrictions which existed on 31 December 1993 under national or Community law on the movement of capital to or from third countries, where in exceptional circumstances such movements of capital cause or threaten to cause serious difficulties for the operation of economic and monetary union, Article 59 EC confers upon the Council the power to take safeguard measures. Article 60(1) EC authorises the Council to take the necessary urgent measures as regards third countries if, in the cases envisaged in Article 301 EC, action by the Community is deemed necessary. Lastly, Article 60(2) EC provides for a Member State, for serious political reasons and on grounds of urgency, to take unilateral measures against a third country with regard, among other things, to capital movements, as long as the Council has not exercised the power conferred upon it by Article 60(1) EC.

33 Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community, signed at Lisbon, 13 December 2007, (OJ C 306, 17.12.2007, p. 1) (See the amended chapters on Freedom of establishment and on Capital of the new Treaty on the Functioning of the European Union).

companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the European Community, the freedom of establishment which Article 43 EC grants to Community nationals, and which includes their right to take up and pursue activities as self-employed persons and to set up and manage undertakings, under the conditions laid down for its own nationals by the law of the Member State where such establishment is effected, entails the right to carry on their activities in the Member State concerned through a subsidiary, branch or agency. In the *Lammers & Van Cleeff* case, the Court stated that the freedom of establishment 'aims to guarantee the benefit of national treatment in the host Member State, by prohibiting any discrimination based on the place in which companies have their seat'[35]. In the *Sevic* case, the Court pointed out that 'the right of establishment covers all measures which permit or even merely facilitate access to another Member State and the pursuit of an economic activity in that State by allowing the persons concerned to participate in the economic life of the country effectively and under the same conditions as national operators'. The Court also noted in the *Sevic* case that 'cross-border merger operations, like other company transformation operations, respond to the needs for cooperation and consolidation between companies established in different Member States. They constitute particular methods of exercise of the freedom of establishment, important for the proper functioning of the internal market, and are therefore amongst those economic activities in respect of which Member States are required to comply with the freedom of establishment laid down by Article 43 EC'[36].

As regards the free movement of capital, the Court has stated that national measures must be regarded as restrictions within the meaning of Article 56(1) EC if they are likely to prevent or limit the acquisition of shares in the undertakings concerned or to deter investors from other Member States from investing in their capital[37] and that they are therefore liable to render the free movement of capital illusory[38]. Advocate General Kokott even pointed out that 'any measure that hampers or acts as a disincentive to the cross-border transfer of capital and is therefore liable to prevent investors from taking such action constitutes a restriction on the free movement of capital'[39].

The case law of the Court indicates that a restriction on freedom of establishment can be accepted only if it pursues a legitimate aim which is compatible with the Treaty and is justified by overriding reasons of public interest. But even where this is the case, it is further necessary to satisfy the proportionality test by showing that such a restriction is suitable for securing the attainment of the objective pursued

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34 Case C-298/05 *Columbus Container Services* v *Finanzamt Bielefeld-Innenstadt* [2007] ECR 0000, para. 34. See also Case C-55/94 *Gebhard* [1995] ECR I-4165, para. 37; and Case C-442/02 *CaixaBank France* [2004] ECR I-8961, para. 11.

35 Case C-105/07 *NV Lammers & Van Cleeff* v *Belgium* [2008] ECR 0000, para. 18.

36 Case C-411/03 *Sevic* [2005] ECR I-10805, paras. 18 and 19.

37 Joined Cases C-282/04 and C-283/04 *Commission* v *The Netherlands* [2006] ECR I-9141, para.20. See to similar effect Case C-174/04 *Commission* v *Italy* [2005] ECR I-4933, paras. 30-31; and Case C-265/04 *Bouanich* [2006] ECR I-923, paras. 34 and 35.

38 Case C-483/99 *Commission* v *France* [2002] ECR I-4781, para. 41; and Case C-367/98 *Commission* v *Portugal* [2002] ECR I-4731, para. 45.

39 Case C-174/04 *Commission* v *Italy* [2005] ECR I-4933, Opinion of A.G. Kokott, para. 26.

and does not go beyond what is necessary in order to attain it[40]. The Court has pointed out that 'considerations of a purely economic or administrative nature cannot in any event constitute an overriding requirement of the general interest such as to justify restricting the freedoms laid down by the Treaty'[41]. However, a number of reasons of overriding public interest have been recognised by the Court, in certain circumstances and subject to certain conditions, such as consumer protection, the prevention of fraud, the general need to preserve public order[42], the protection of workers[43], the effectiveness of fiscal supervision[44] and the prevention of abusive practices[45].

As regards the free movement of capital, this may be restricted by national rules which are justified on the grounds set out in Article 58 EC or by overriding reasons of the public interest. Various kinds of reasons have been invoked such as the guarantee of a service of general interest[46], the prevention of tax evasion[47], the protection of workers' interests[48], the protection of minority shareholders[49] or public influence over undertakings active in the provision of services of public interest or strategic services[50]. Some of these reasons have been recognised by the Court as overriding requirements of general interest capable of justifying a restriction on free movement of capital[51].

Although, under the exceptions provided for by the Treaty, Member States may impose restrictions on free movement of capital and freedom of establishment in certain circumstances where justified by the exercise of official authority, public order, public security and public health, the Court has pointed out that these exceptions are to be interpreted restrictively, and their scope cannot be determined unilaterally by a Member State[52]. Furthermore, they must pass the proportionality test, conform with the principle of legal certainty and must not be implemented for purely economic ends[53]. In the *Église de Scientologie* case concerning national legislation which 'merely requires prior authorisation for

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40 Case C-438/05 *International Transport Workers' Federation and another* v *Viking Line and another* [2007] ECR 0000, para. 75.

41 Case C-463/00 *Commission* v *Spain* [2003] ECR I-4581, para. 35.

42 Case C-260/04 *Commission* v *Italy* [2007] ECR I-7083, para. 27.

43 Case C-438/05 *International Transport Workers' Federation and another* v *Viking Line and another* [2007] ECR 0000, para. 77.

44 Case C-383/05 *Raffaele Talotta* v *Belgium* [2007] ECR I-2555, para. 35.

45 Case C-105/07 *Lammers & Van Cleeff* v *Belgium* [2008] ECR 0000, para. 28.

46 Joined Cases C-282/04 and C-283/04 *Commission* v *the Netherlands* [2006] ECR I-9141, para. 38.

47 Case C-451/05 *Elisa* v *France* [2007] ECR 0000, para. 81.

48 Case C-112/05 *Commission* v *Germany (Volkswagen)* [2007] ECR 0000, paras. 74-76.

49 Ibid. paras. 77-79.

50 Joined Cases C-463/04 and C-464/04 *Federconsumatori and others* v *Commune di Milano* [2007] ECR 0000, paras. 41-43.

51 Case C-101/05 *Skatteverket* v *A* [2007] ECR 0000, para. 55. For instance, the Court recognised that the need to guarantee the effectiveness of fiscal supervision constitutes an overriding requirement of public interest capable of justifying a restriction on the exercise of freedom of movement guaranteed by the Treaty (Case C-250/95 *Futura Participations and Singer* [1997] ECR I-2471, para. 31; Case C-315/02 *Lenz* [2004] ECR I-7063, paras. 27 and 45; and Case C-386/04 *Centro di Musicologia Walter Stauffer* [2006] ECR I-8203, para. 47).

52 With regard to European cooperative societies and European companies, the right of national financial supervisory authorities to oppose a change of registered office must be based 'only on grounds of public interest' – see Article 7(14), second subparagraph, of Council Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society (SCE), (OJ L 207, 18.8.2003, p. 7); and Article 8(14), second subparagraph, of Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE), (OJ L 294, 10.11.2001, p. 1).

53 Case C-463/00 *Commission* v *Spain* [2003] ECR I-4581, para. 34.

direct foreign investments which are such as to represent a threat to public policy or public security'[54], the Court established the conditions under which the public policy and public security exceptions may be exercised in the context of the free movement of capital. It observed that while Member States are still, in principle, free to determine the requirements of public policy and public security in the light of their national needs, in the Community context and in particular, in respect of derogations from the fundamental principle of free movement of capital, these grounds must be interpreted strictly, so that their scope cannot be determined unilaterally by the Member States without any control by the Community institutions. In particular, the Court concluded that 'public policy and public security may be relied on only if there is a genuine and sufficiently serious threat to a fundamental interest of society' and that 'like all derogations from a fundamental principle of the Treaty, the exception relating to public order must be narrowly construed'[55]. Moreover, those derogations must not be misapplied so as in fact to serve purely economic ends[56]. Further, any person affected by a restrictive measure based on such a derogation must have access to legal redress[57].

In respect of both freedoms, for these restrictive measures to be justified they must meet the conditions established by the Court. As a rule, a measure which is liable to hinder or make less attractive the exercise of fundamental Treaty freedom must be applied in a non-discriminatory manner[58]. Moreover, such measures must comply with the principle of proportionality, as they must be appropriate for securing the attainment of the objective they pursue and must not go beyond what is necessary to attain it[59], i.e. they must satisfy the usual necessity and proportionality tests. Lastly, the Court has clarified that free movement of capital may be restricted by national rules which are justified on the grounds set out in Article 58 EC or by overriding reasons of the public interest to the extent that there are no Community harmonising measures to ensure the protection of those interests[60].

1.1.2 A complex relationship between the two freedoms

The Treaty provisions regarding the right of establishment and free movement of capital reflect an awareness on the part of the drafters of the Treaty of the close links and even the overlaps[61] between

54 Case C-54/99 *Église de Scientologie* [2000] ECR I-1335, para. 16.
55 Case C-465/05 *Commission* v *Italy* [2007] ECR 0000, para. 49.
56 Case C-54/99 *Église de Scientologie* [2000] ECR I-1335, para. 17.
57 Ibid.
58 For freedom of establishment, see Case C-464/05 *Geurts and Vogten* [2007] ECR 0000, para. 20; and Case C-140/03 *Commission* v *Greece* [2005] ECR I-3177, para. 34. For free movement of capital, see Case C-213/04 *Burtscher* v *Stauderer* [2005] ECR I-10309, para. 44.
59 See, in particular, Case C-54/99 *Église de Scientologie* [2000] ECR I-1335, para. 18; Case C-334/02 *Commission* v *France* [2004] ECR I-2229, para. 28; and Case C-101/05 *Skatteverket* v *A* [2007] ECR 0000, para. 56. See also Case C-465/05 *Commission* v *Italy* [2007] ECR 0000, para. 18.
60 Case C-112/05 *Commission* v *Germany (Volkswagen)* [2007] ECR 0000, paras. 72-73; Joined Cases C-463/04 and C-464/04, *Fedeconsumatori and others* v *Commune di Milano* [2007] ECR 0000, paras. 39-40. Similar wording is used in the context of the free movement of services (see, for instance, Case C-255/04 *Commission* v *France* [2006] ECR I-5251, paras. 43 and 44). This wording does not appear in the context of freedom of establishment. However in taxation cases, for example, the Court has stated that, in the absence of any unifying or harmonising Community measures, Member States retain the power to define the criteria for allocating their powers of taxation (Case C-231/05 *Oy AA* [2007] ECR I-6373, para. 52).
61 Case C-265/04 *Bouanich* [2006] ECR I-923, Opinion of A.G. Kokott, para. 71.

these two freedoms. The approach of the Court to this relationship, which has evolved over time, highlights its complexity[62].

Cumulative or alternative application

With regard to the issue of the cumulative or alternative application of these two freedoms, it has been pointed out by Advocate General Kokott that there have been some cases where the Court has considered both freedoms to be applicable. Other cases could be interpreted as indicating that there is a *lex specialis* relationship between the two freedoms. In yet other cases it appears that reasons of procedural economy explain why only one of the two freedoms has been examined[63]. The Court recently indicated that 'in order to ascertain whether national legislation falls within one or the other of the freedoms of movement, the purpose of the legislation at issue must be taken into consideration'[64]. Furthermore, Advocate General Kokott has argued that in such cases 'only the fundamental freedom which is the main focus as regards the substance of the matter should be applied'[65]. However, in the same opinion Advocate General Kokott also criticised this test, considering that 'the freedom of establishment and the free movement of capital can in principle be applied side-by-side'[66].

In some cases, the Court has applied the 'main focus' test to conclude that freedom of establishment was primarily affected. For instance, in the *Geurts and Vogten* case[67], the Court concluded that the legislation at issue in the main proceedings primarily affected freedom of establishment[68] and only fell within the scope of the provisions of the EC Treaty concerning that freedom. The Court considered that, if it were accepted that such a national measure had restrictive effects on the free movement of capital, these effects would have to be seen as an unavoidable consequence of any restriction on the freedom of establishment, and this would not justify an independent examination of that measure in the light of Articles 56 to 58 EC[69].

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62 Case C-251/98 *Baars* [2000] ECR I-2787, Opinion of A.G. Albert.

63 Case C-265/04 *Bouanich* [2006] ECR I-923, Opinion of A.G. Kokott, para. 71, footnote 57.

64 Case C-157/05 *Holböck* [2007] ECR I-4051, para. 22. See also Case C-492/04 *Lasertec* [2007] ECR 3775, para. 19; Case C-196/04 *Cadbury Schweppes and another* [2006] ECR I-7995, paras. 31-33; Case C-452/04 *Fidium Finanz* [2006] ECR I-9521, paras. 34 and 44-49; Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR I-11673, paras. 37-38; Case C-446/04 *Test Claimants in the FII Group Litigation* [2006] ECR I-11753, para. 36; and Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107, paras. 26-34.

65 Case C-464/05 *Geurts and Vogten*, [2007] ECR 0000, Opinion of A.G. Kokott, para. 24.

66 Case C-464/05 *Geurts and Vogten*, [2007] ECR 0000, Opinion of A.G. Kokott, paras. 22 and 23. Moreover, according to Advocate General Kokott, the wording of Article 58(2) EC and the expression 'subject to the provisions of the chapter relating to capital' in the second paragraph of Article 43 EC appear to indicate that in such cases neither the one nor the other fundamental freedom is ousted, but that both fundamental freedoms can be applied in parallel (Case C-265/04 *Bouanich* [2006] ECR I-923, Opinion of A.G. Kokott, para. 71, footnote 58).

67 Case C-464/05 *Geurts and Vogten* [2007] ECR 0000, para. 16.

68 In other words, the situation of a Community national who, since the transfer of his residence, had been living in one Member State and holding the majority of the shares in companies established in another Member State, fell within the scope of Article 43 EC since that transfer (para. 14).

69 Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107, paras. 33-34; Case C-102/05 *Skatteverket* v *A and B* [2007] ECR I-3871, paras. 26-27; Case C-231/05 *Oy AA* [2007] ECR I-6373, paras. 23-24; and Case C-492/04 *Lasertec* [2007] ECR I-3775.

The opposite situation applies in cases relating to 'golden shares' which grant a government authority certain prerogatives to intervene in the share structure and management of privatised undertakings in strategically important areas of the economy. These special powers take various forms (procedures for administrative authorisations, shares to which special privileges are attached, the right to appoint members of company bodies) and are exercised in various ways (through the right to object to the acquisition of capital, or to intervene in dealings affecting assets)[70]. In most of the cases, they are the result of legislation, rather than being created by the company itself[71]. The Court has taken the position that the free movement of capital has primarily been affected in cases concerning golden shares 'in so far as the special shares at issue entail restrictions on freedom of establishment, such restrictions are a direct consequence of the obstacles to the free movement of capital considered above, to which they are inextricably linked'[72]. Consequently, the Court has concluded that, where an infringement of Article 56(1) EC is established, there is no need for a separate examination of the measures at issue in the light of the Treaty rules concerning freedom of establishment.

Lastly, in some cases, the Court has considered that national legislation, for example in the field of taxation, may fall within the scope of both Article 43 EC on freedom of establishment and Article 56 EC on free movement of capital[73].

The distinction between direct investments and portfolio investments

Article 56(1) EC prohibits restrictions on movements of capital between Member States in general[74]. In the absence of a Treaty definition of movement of capital within the meaning of Article 56(1) EC, the Court has recognised that the Nomenclature in Council Directive 88/361/EEC implementing the old Treaty provisions on the free movement of capital[75] ('the 1988 Directive') has indicative value[76]. In line with the 1988 Directive, the Court has indicated that the concept of movement of capital includes in particular (i) direct investments in the form of participation in an undertaking through a holding of shares which confers the possibility of effectively participating in its management and

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70 Joined Cases C-367/98, C-483/99 and C-503/99 *Commission* v *Portugal, France and Belgium*, [2002] ECR 4731, Opinion of A.G. Ruiz-Jarabo Colomer, para.1. They can also be special rights to approve certain decisions of the competent organs of such companies (Joined Cases C-282/04 and C-283/04 *Commission* v *the Netherlands* [2006] ECR I-9141, para. 1).

71 For cases concerning golden shares, see Case C-367/98 *Commission* v *Portugal* [2002] ECR I-4731; Case C-483/99 *Commission* v *France* [2002] ECR I-4781; Case C-503/99 *Commission* v *Belgium* [2002] I-4809; Case C-463/00 *Commission* v *Spain* [2003] ECR I-4581; Case C-98/01 *Commission* v *United Kingdom* [2003] ECR I-4641; and Joined Cases C-282/04 and C-283/04 *Commission* v *the Netherlands* [2006] ECR I-9141.

72 Joined Cases C-282/04 and C-283/04 *Commission* v *the Netherlands* [2006] ECR I-9141, para. 43. The Court also referred in particular to Case C-463/00 *Commission* v *Spain* [2003] ECR I-4581, para. 86.

73 Case C-157/05 *Holböck* [2007] ECR I-4051, with reference to Case C-374/04 *Test Claimants in Class IV of the ACT Group Litigation* [2006] ECR 11673; and Case C-446/04 *Test Claimants in the FII Group Litigation* [2006] ECR 11753.

74 See, among other things, Joined Cases C-282/04 and C-283/04 *Commission* v *the Netherlands* [2006] ECR I-9141, para. 18 and the case law cited; and more recently, Case C-112/05 *Commission* v *Germany (Volkswagen)* [2007] ECR 0000, paras. 17-19.

75 Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [the article was repealed by the Treaty of Amsterdam] (OJ L 178, 8.7.1988, p. 5).

76 See Annex I to the 1988 Directive.

control (direct investments[77]) and (ii) the acquisition of shares on the capital market solely with the intention of making a financial investment without any intention to influence the management and control of the undertaking (portfolio investments)[78]. The Court generally defines direct investments as 'investments of any kind undertaken by natural or legal persons and which serve to establish or maintain lasting and direct links between the persons providing the capital and the undertakings to which that capital is made available in order to carry out an economic activity', which corresponds to the definition contained in the 1988 Directive. The 1988 Directive stresses that this concept must be understood in its widest sense and covers: (1) the establishment and extension of branches or new undertakings belonging solely to the person providing the capital, and the full acquisition of existing undertakings; (2) the participation in new or existing undertaking with a view to establishing or maintaining lasting economic links and (3) long-term loans with a view to establishing or maintaining lasting economic links. As regards undertakings mentioned under (2) which have the status of companies limited by shares, there is participation in the nature of direct investment 'where the block of shares held by a natural person of another undertaking or any other holder enables the shareholder, either pursuant to the provisions of national laws relating to companies limited by shares or otherwise, to participate effectively in the management of the company or in its control'[79].

In the golden shares cases, although the Court concluded that the restrictive measures in question should be assessed in accordance with the principles of free movement of capital, often it did not assess at all, or at least not in detail, whether the restrictions related to direct and/or portfolio investments. In Joined Cases C-282/04 and C-283/04 *Commission* v *the Netherlands*, the Court considered that the special shares at issue 'may have a negative influence on direct investments', 'may have a deterrent effect on portfolio investments' and that the exercise of these special rights 'might discourage direct or portfolio investments in that company'[80]. In the *Volkswagen* case, the restrictions on the free movement of capital which were at issue in the proceedings related only to direct investments in the capital of Volkswagen, and not to portfolio investments made solely with the intention of making a financial investment, since the latter were not relevant to the action[81]. The Court considered that the disputed law diminished interest in acquiring a stake in the capital of Volkswagen, since it would create 'an instrument liable to limit the ability of direct investors to participate in a company with a view to establishing or maintaining lasting and direct economic links with it which would make possible effective participation in the management of that company or in its control'[82].

77 Case C-446/04 *Test Claimants in the FII Group Litigation* [2006] ECR I-11753, paras. 179 -181; and Case C-157/05 *Holböck* [2007] ECR I-4051, paras. 33 and 34.
78 Joined Cases C-282/04 and C-283/04 *Commission* v *the Netherlands* [2006] ECR I-9141, para. 19.
79 Annex I, title I explanatory notes of the 1988 Directive.
80 Joined Cases C-282/04 and C-283/04 *Commission* v *the Netherlands* [2006] ECR I-9141, paras. 23 to 30.
81 Case C-112/05 *Commission* v *Germany (Volkswagen)* [2007] ECR 0000, para. 54.
82 Ibid.

The criterion of definite influence

One may support the view of Leo Flynn that, 'when distinguishing between the internal market freedoms, the line dividing establishment and capital is the hardest of all to draw'[83]. An assessment of the Court's decisions indicates that the criterion of 'definite influence' is decisive for the Court in ascertaining whether national legislation falls within the scope of one or the other of the above freedoms. In the *Überseering* case, in the context of an acquisition of shares, the Court clarified that 'as a general rule the acquisition by one or more natural persons residing in a Member State of shares in a company incorporated and established in another Member State is covered by the Treaty provisions on the free movement of capital, provided that the shareholding does not confer on those natural persons definite influence over the company's decisions and does not allow them to determine its activities. By contrast, where the acquisition involves all the shares in a company having its registered office in another Member State and the shareholding confers a definite influence over the company's decisions and allows the shareholders to determine its activities, it is the Treaty provisions on freedom of establishment which apply'[84]. For instance, in the *Lasertec* case, the Court stated that national provisions relating to holdings which give the holders a definite influence on the decisions of a company and allow them to determine its activities fall 'within the material scope solely of the Treaty provisions relating to freedom of establishment'[85]. By contrast, in the *Holböck* case[86], since the national taxation legislation in question 'was not intended to apply only to those shareholdings which enable the holder to have a definite influence on a company's decisions and to determine its activities', the Court concluded that the legislation 'irrespective of the extent of the holding which the shareholder has in the company … may fall within the scope of both Article 43 of the EC Treaty on freedom of establishment and Article 56 EC on free movement of capital'.

In the *Volkswagen* case[87], the Court examined whether the national law in question breached Article 56 EC. As regards possible simultaneous breaches of Article 43 and Article 56, the Court referred to the *Überseering* case, under which national provisions which apply to holdings by nationals of one Member State in the capital of a company established in another Member State, which give them definite influence on the company's decisions and allow them to determine its activities, fall within the substantive scope of the Treaty provisions on freedom of establishment. Interestingly, as regards the choice of the applicable freedom, the Court noted in the *Volkswagen* case that the provisions of the law in dispute addressed, at least in part, 'the situation of a possible takeover of Volkswagen by a shareholder seeking to exercise a controlling influence over the undertaking'. However, although the Commission asked the Court to declare that the German law in question infringed both Articles 43 and 56 EC, the Court dismissed the action in so far as it was based on a breach of Article 43 EC since the applicant in this case did not advance any specific argument in support of the claim that there was a

83 Flynn, p. 788.
84 Case C-208/00 *Überseering* [2002] ECR I-9919.
85 Case C-492/04 *Lasertec* [2007] ECR I-3775.
86 Case C-157/05 *Holböck* [2007] ECR I-4051, paras. 23-24.
87 Case C-112/05 *Commission* v *Germany (Volkswagen)* [2007] ECR 0000.

restriction on freedom of establishment[88]. In the *Federconsumatori* case, the questions referred for a preliminary ruling by an Italian court only related to Article 56 EC and the Court did not discuss a possible breach of Article 43 EC[89]. However, it would be possible to challenge the choice of the applicable freedom in this latter case, since the judgment also described situations which could be considered as affecting freedom of establishment[90].

The frontier between free movement of capital and freedom of establishment is not always simple to define on the basis of the criteria used by the Court since the concept of 'definite influence' and the criteria pertaining to 'direct investment' overlap to a certain extent. On the one hand, since the *Baars* judgment, the 'definite influence' test has been used to determine which type of free movement is at stake (either free movement of capital or freedom of establishment) and consists in examining whether 'the shareholding confers a definite influence over the company's decisions and allows the shareholders to determine its activities'. As acknowledged by the Court in the *Baars* case, 'control or management of the company' are factors connected with the exercise of the right of establishment[91]. On the other hand, as explained above with regard to restrictions on the free movement of capital, the Court defines a 'direct investment' as participation in a new or existing undertaking with a view to 'establishing or maintaining lasting economic links' which enables the shareholder 'to participate effectively in the management of the company or in its control'. Since the concept of direct investment also includes control, this weakens the distinction for applying the 'definite influence' test. It is usually understood that, in the absence of harmonisation of company law concepts of control and of a definite influence at EU level, this determination requires national courts to examine the company law rules in the Member State in which the undertaking is established[92]. Moreover, the definition of direct investment in the 1988 Directive refers to 'the provisions of national laws relating to companies limited by shares or otherwise'. However, especially in the context of golden shares cases, Advocate General Ruiz-Jarabo Colomer deplored the 'incorrect legal classification of the alleged infringement' made by the Court since, in his view, the restrictions concerned should have been assessed in the light of the rules on freedom of establishment rather than free movement of capital, since the Member States were in a position to control the decisions of the privatised company (either by intervening in the composition of the membership of the board of directors or by influencing specific management decisions)[93]. These cases illustrate the legal uncertainty resulting from the overlap of the two

88 Case C-112/05 *Commission* v *Germany (Volkswagen)* [2007] ECR 0000, paras. 14-16.

89 Joined Cases C-463/04 and C-464/04 *Federconsumatori* v *Comune di Milano* [2007] ECR 0000. According to settled case law and in order to provide a useful reply to the court which had referred to it a question for a preliminary ruling, the Court may be required to take into consideration rules of Community law to which the national court has not referred in its question (Case C-513/03 *van Hilten-van der Heijden* [2006] ECR I-1957, para. 26)

90 Joined Cases C-463/04 and C-464/04 *Federconsumatori* v *Comune di Milano* [2007] ECR 0000 (see paras. 34 and 36)

91 Case C-251/98 *Baars* [2000] ECR I-2787, para. 20.

92 Case C-251/98, *Baars* [1999] ECR I-2787, Opinion of A.G. Albert, para. 33. See Case C-446/04 *Test Claimants in the FII Group Litigation* v *Commissioners of Inland Revenue*, [2006] ECR I-11753, Opinion of A.G. Geelhoed, paras. 118 to 120.

93 Case C-463/00 *Commission* v *Spain* [2003] ECR 4581; and Case C-98/01 *Commission* v *Spain* [2003] ECR I-4641, Opinion of A.G. Ruiz-Jarabo Colomer, para. 36. For developments on the same topic, see Case C-112/05, *Commission* v *Germany (Volkswagen)* [2007] ECR 0000, Opinion of A.G. Ruiz-Jarabo Colomer, paras. 58 and 59).

concepts[94]. Although one may sympathise with Advocate General Ruiz-Jarabo Colomer's view that the above classification 'is of no great consequence, since the Court of Justice subjects both Community freedoms to similar scrutiny', this issue may be of relevance in situations involving third countries, in view of the different scopes of Article 43 and Article 56 EC[95].

A few cases involving the free movement of capital rules deal with the issue of the proportionality between the level of investment and the influence exercised over the company[96]. They relate, for instance, to (i) restrictions on the rights of shareholders arising from privileged access granted to certain public entities, with some similarities to the golden shares cases[97] or to (ii) restrictions on the conditions under which voting rights attached to shares can be exercised by shareholders. As regards the first type of restrictions, the Court has pointed out in the *Volkswagen* case that the national measures in question constituted a restriction on the movement of capital in particular, since public shareholders had 'an instrument which gives them the possibility of exercising influence which exceeds their levels of investment' and 'as a corollary, the influence of other shareholders may be reduced below a level commensurate with their own levels of investment'[98]. At issue was a requirement, derogating from general law and imposed by specific legislation, which gave any shareholder holding 20 % of the share capital a blocking minority. Moreover, the Volkswagen law allowed two public entities each to appoint two representatives to the supervisory board of Volkswagen, provided they were shareholders in the company, irrespective of the extent of their holdings. This rule derogated from general company law, and the right of appointment conferred on the two public entities enabled them to participate more significantly in the activities of the supervisory board than their status as shareholders would normally allow. In the *Federconsumatori* case, the Court confirmed this decision and considered that the Italian legislation in question was such as to enable the State or a public body to obtain control which was disproportionate to its shareholding in the company and was liable to deter direct investors from other Member States from investing in the company[99]. In the *Commission* v *Spain* case, which related to a Spanish law limiting the voting rights attached to shares held by foreign public entities in Spanish companies operating in the energy sector, the Court was confronted with restrictions on the exercise of voting rights attached to shares, which constituted one of the main means by which shareholders could participate effectively in the

94 This overlap of concepts is illustrated in Joined Cases C-282/04 and C-283/04 *Commission* v *The Netherlands* [2006] ECR I-9141, paras. 42 and 43.

95 O'Brien, p. 1498.

96 On these aspects, see the Commission's Impact assessment on the proportionality between capital and control in listed companies, of 12 December 1007, p. 10 (SEC(2007)1705). The Commission reports, for instance, that some institutional arrangements (e.g. decisions taken by companies themselves) can create a discrepancy between financial ownership and voting power with the result that a shareholder can increase his control without holding a proportional stake of equity.

97 In Joined Cases C-282/04 and C-283/04 *Commission* v *the Netherlands* [2006] ECR I 9141, the Court noted that the special shares conferred on the State an influence over the management of the companies 'which is not justified by the size of its investment and is significantly greater than that which its ordinary shareholding in those companies would normally allow it to obtain'. Moreover, those shares limited the influence of other shareholders in relation to the size of their holding in the two entities (para. 24).

98 Case C-112/05 *Commission* v *Germany (Volkswagen)* [2007] ECR 0000, para. 64.

99 Joined Cases C-463/04 and C-464/04 *Federconsumatori* v *Comune di Milano* [2007] ECR 0000, para. 29. In that case, national rules gave a public body that retained a shareholding of 33.4 % in a privatised company the power to appoint an absolute majority of the members of the board of directors.

management of a company or in its control. In this regard the Court stressed that any measure aimed at preventing the exercise of these rights or subjecting them to conditions may deter investors from other Member States from acquiring shareholdings in the companies concerned, and would constitute a restriction on free movement of capital. Investors may be deterred from acquiring shares if there is a risk that they may be deprived of the corresponding voting rights attached to the shares held.[100]

1.1.3 Free movement of capital and third countries

Unlike for the case with freedom of establishment or free movement of services[101], the Treaty provisions on free movement of capital provide for a prohibition of all restrictions between Member States as well as of restrictions between Member States and third countries. Furthermore, Article 57(1) EC provides that the provisions of Article 56 EC are without prejudice to the application to third countries of any restrictions which existed on 31 December 1993 under national or Community law adopted in respect of the movement of capital to or from third countries involving direct investment – including investment in real estate – establishment, the provision of financial services or the admission of securities to capital markets.

Among the ongoing infringement proceedings initiated by the Commission, there is one relating to the French decree of 2005 which creates an authorisation procedure for foreign investments in certain sectors that could affect public policy, public security or national defence[102]. The Commission is concerned that some of the provisions of this decree could discourage investment from other Member States, contrary to Treaty rules on the free movement of capital and the right of establishment. The scope of the authorisation procedure under the French decree is more extensive for investments from third countries, but this is authorised by Article 57 EC, as this measure existed prior to 31 December 1993. However, because 'indirect investments'[103] are also subject to authorisation, the Commission considers that the procedure provided for third-country investments could create a restriction on investments by companies that are legally established in the EU, but which have shareholders established in third countries. The Commission considers that such a restriction on investment is

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[100] The English version of the judgment is not yet available. The French version of the Court judgment reads as follows: '*toute mesure visant à empêcher l'exercice de ces droits ou à les subordonner à des conditions peut dissuader les investisseurs d'autres États membres d'acquérir des participations dans les entreprises concernées et constitue une restriction à la libre circulation des capitaux…les investisseurs peuvent être dissuadés d'acquérir des actions s'il existe un risque qu'ils soient privés des droits de vote afférents aux actions détenues*'. See also Case C-274/06 *Commission* v *Spain* [2008] ECR 0000, paras. 24 and 25.

[101] The chapter of the Treaty relating to freedom of establishment does not include any provision which extends the scope of its provisions to situations involving nationals of non-member countries who are established outside the EU. The objective of that chapter is to secure freedom of establishment for nationals of Member States. Therefore, Article 43 EC et seq. cannot be relied on in a situation where a company in a non-member country has a shareholding which confers on it a controlling influence on the decisions and activities of a company in a Member State (see Case C-492/04 *Lasertec* [2007] ECR I-3775, para. 27). On the free movement of services, see Case C-452/04, *Fidium Finanz* [2006] ECR I-9521, para. 25.

[102] The Commission has formally asked France to modify Decree 2005-1739 of 30 December 2005 in order to remove its incompatibility with the provisions of the Treaty (IP/06/1353, 12.10.2006).

[103] 'Indirect investment', which is not defined in the Commission's press release, would require a specific assessment.

incompatible with the free movement of capital and freedom of establishment[104]. According to the Commission, this requirement, imposed on European companies owned by third country investors, would also breach the principle of Article 48 EC, which establishes that companies established in Member States should be treated like nationals of the host Member State.

In the *Skatteverket* case the Court provided some useful clarification of the scope of the prohibition of restrictions between Member States and third countries[105]. The Court referred to the fact that Article 56(1) EC, which entered into force on 1 January 1994, gave effect to the liberalisation of the movement of capital between Member States and between Member States and non-Member States[106]. As regards the direct effect of Article 56(1) EC in relations between Member and non-Member States, Article 56(1) EC lays down a clear and unconditional prohibition for which no implementing measure is needed and which confers rights on individuals which they can rely on before the courts. Therefore, as regards the movement of capital between Member States and non-Member States, the Treaty provisions[107] may be relied on before national courts and may render national rules that are inconsistent with the Treaty inapplicable, irrespective of the category of capital movement in question[108].

During the Court proceedings on the *Skatteverket* case some concerns were expressed by certain Member States that the above interpretation of these articles might 'lead to unilateral liberalisation on the part of the European Community without the Community securing a guarantee of equivalent liberalisation on the part of the third countries concerned and, in the relations with those countries, without measures for the harmonisation of national provisions', and to the risk of the EU being deprived of 'the means of negotiating liberalisation with those countries, since such liberalisation would have already automatically and unilaterally opened up the Community market to those countries'[109]. In reply to these objections the Court said that 'even if the liberalisation of the movement of capital with third countries may pursue objectives other than that of establishing the internal market such as, in particular, that of ensuring the credibility of the single Community currency on world financial markets and maintaining financial centres with a world-wide dimension within the Member States' [110], the concept of restrictions on movement of capital should be interpreted in the same way in

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104 The Court has pointed out that a provision of national law which makes a direct foreign investment subject to prior authorisation constitutes a restriction on the movement of capital. Measures taken by a Member State which are liable to dissuade its residents from obtaining loans or making investments in other Member States constitute restrictions on movements of capital, as do measures which make a foreign direct investment subject to prior authorisation (Case C-54/99 *Église de Scientologie* [2000] ECR I-1335, paras. 14 and 18).

105 Case C-101/05 *Skatteverket* v *A* [2007] ECR 0000.

106 Ibid. para. 20. See Joined Cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera and Others* [1995] ECR I-4821, para. 19; and Case C-513/03 *van Hilten-van der Heijden* [2006] ECR I-1957, para. 37.

107 Article 56(1) EC, in conjunction with Articles 57 EC and 58 EC.

108 Case C-101/05 *Skatteverket* v *A* [2007] ECR 0000, para. 21. See also Joined Cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera and Others* [1995] ECR I-4821, paras. 41 and 47. In this respect the Court has clarified that the direct effect of this provision applies without distinction between those categories of capital movement which are covered by Article 57(1) EC and those which are not covered (para. 26).

109 Case C-101/05 *Skatteverket* v *A* [2007] ECR 0000, paras. 29 and 30.

110 Ibid, para. 31.

relations between Member States and third countries as in relations between Member States[111]. At the same time the Court acknowledged that the application of certain national restrictive measures to the movement of capital must take account of the different legal contexts in which movements of capital to or from third countries take place[112]. Moreover, certain restrictions might be justified in this context which would not be allowed between Member States[113]. In the *Skatteverket* case, the Court considered that the restriction in question could be justified by the need to guarantee the effectiveness of fiscal supervision[114] and that it was legitimate for a Member State to refuse to grant a tax advantage when it proved impossible to obtain the requested information from a third country[115]. The Court found that, within the Community, a Member State cannot rely on the fact that it may be impossible to obtain cooperation from another Member State in conducting inquiries or collecting information in order to justify a refusal to grant a tax advantage. However, in view of the fact that the movement of capital between Member States and third countries takes place in a different context, this approach cannot be transposed in its entirety to the movement of capital to or from third countries. The Court found that, where the legislation of a Member State makes the grant of a tax advantage dependent on satisfying certain requirements, and compliance with those requirements can only be verified by obtaining information from the competent authorities of a third country, that Member State may be justified in principle in refusing to grant that advantage if that third country is not under any legal obligation to provide information and if it proves impossible to obtain such information from that country[116].

The *Skatteverket* case also raises the issue, in cases involving third countries, of the possibility of circumventing freedom of establishment rules by applying free movement of capital rules. This issue was not examined by the Court in its preliminary ruling since the Court only examined the provisions of Swedish law at issue in the light of the provisions of the Treaty on free movement of capital. However, Advocate General Bot considered the circumstances under which Article 56(1) EC could have the effect of allowing a natural or legal person who does not satisfy the requirements for relying on the Treaty provisions on freedom of establishment to circumvent those requirements. The Advocate General rejected this possibility where the national legislation concerns situations in which a shareholder's holding enables him to have a 'definite influence' on a company's decisions and to determine its activities since, in this context, 'the legislation must be examined in the light of the

[111] In this respect the Court noted that the extension of the principle of free movement of capital to movement of capital between third countries and Member States was enshrined in Article 56 EC, and the same terms are used for movements of capital within the Community as for movements involving third countries (para. 31). Moreover, the Treaty contains safeguard clauses and derogations which apply specifically to the movement of capital to or from third countries (see para. 32).

[112] Taking into account the degree of legal integration that exists between EU Member States and the existence of Community legislation (para. 36).

[113] Case C-101/05 *Skatteverket* v *A* [2007] ECR 0000, para. 37.

[114] Ibid, para. 63.

[115] Ibid, para. 67.

[116] Advocate General Geelhoed does not exclude the possibility that a Member State may be able to prove that a restriction of capital movements with third countries is justified on a given ground, in circumstances where this ground would not justify a restriction on purely intra-Community capital movements (Case C-446/04 *Test Claimants in the FII Group Litigation* v *Commissioners of Inland Revenue* [2006] ECR I-11753, Opinion of A.G. Geelhoed, para. 121).

articles of the Treaty relating to freedom of establishment and those articles alone'[117]. Advocate General Bot noted, however, that for legislation on free movement of capital, the criterion of 'decisive influence' might not necessarily constitute a sufficient justification to exclude the application of Article 56(1) EC, in the light of Article 57(1) EC relating to restrictions which existed on 31 December 1993, since the definition of movement of capital under the latter provision may also involve 'establishment'. In the *Holböck* case, however, as mentioned above, the Court considered that national legislation, that is not intended to apply only to shareholdings which enable the holder to have a definite influence on a company's decisions, may fall within the scope of provisions on both freedom of establishment and free movement of capital[118]. In this case the Court concluded that Article 43 EC could not apply since this article did not cover movements of capital between Member States and third countries and the legislation at issue was not incompatible with the prohibition set out in Article 56(1) EC in the light of the Article 57(1) EC exception. This case indicates that the 'main focus' test may be inapplicable where, under the legislation at issue, it is not clear whether a specific freedom is primarily affected[119]. However, in the *Skatteverket* case, Advocate General Bot considered that the risk that the Treaty rules on freedom of establishment might be circumvented may also be avoided by virtue of Article 58(2) EC which provides that the provisions of the chapter on free movement of capital are 'without prejudice to the applicability of restrictions on the right of establishment which are compatible with this Treaty'[120]. In the *Bouanich* case, Advocate General Kokott further clarified that Article 58(2) EC is intended to ensure in particular that third country nationals who cannot rely on freedom of establishment cannot circumvent certain restrictions permitted by Community law on their establishment in a Member State by invoking the provisions on free movement of capital[121].

1.2 Free movement of capital, right of establishment in the banking sector and prudential supervision

1.2.1 Free movement of capital and prudential supervision

The meaning of prudential supervision

Article 58(1)(b) EC contains a specific carve-out referring to prudential measures. This Article provides that the provisions of Article 56 are without prejudice to the right of Member States to take

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[117] In such cases, the restrictive effects which such legislation might have on free movement of capital constitute an unavoidable consequence of any restriction on freedom of establishment. They do not therefore justify a separate examination in the light of the free movement of capital provisions. As a consequence, Advocate General Bot considered that the Treaty provisions on free movement of capital do not apply and cannot be relied upon in order to circumvent the fact that it is impossible for a national of a third country established outside the Union to rely on the articles of the Treaty on freedom of establishment (Case C-101/05 *Skatteverket* v *A* [2007] ECR 0000, Opinion of A.G. Bot, para. 93).

[118] See Case C-157/05 *Holböck* [2007] ECR I-4051, paras. 23 and 24.

[119] O'Brien, p. 1497.

[120] Case C-101/05 *Skatteverket* v *A* [2007] ECR 0000, Opinion of A.G. Bot, paras. 93 to 96.

[121] Case C-265/04 *Bouanich* [2006] ECR I-923, Opinion of A.G. Kokott, para. 71, footnote 58. Conversely, on the basis of the proviso 'subject to the provisions of the chapter relating to capital' in the second paragraph of Article 43 EC, lawful restrictions on capital movements also have implications for the freedom of establishment.

all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and of the prudential supervision of financial institutions, or to take measures which are justified on grounds of public policy or public security. As mentioned above, this carve-out was originally contained in the 1988 Directive[122] and there is not a similar carve-out in the Treaty provisions on freedom of establishment. Although the list of areas in which 'requisite measures' can be taken is in principle not exhaustive[123], under Article 58(1)(b) EC the Court has mainly dealt with cases involving taxation[124].

The application of Article 58(1)(b) to prudential supervision has not yet been fully explored by the Court. Although both the Treaty[125] and the Banking Directive[126] refer to this concept in various instances, the concept of the prudential supervision of financial institutions is not defined by Community legislation. The Basel Committee on Banking Supervision considers that 'the task of supervision is to ensure that banks operate in a safe and sound manner and that they hold capital and reserves sufficient to support the risks that arise in their business' and that 'strong and effective banking supervision provides a public good that may not be fully provided in the marketplace and, along with effective macroeconomic policy, is critical to financial stability in any country'[127]. On these aspects, the Court pointed out in the *Panagis Pafitis* case[128] that 'considerations concerning the need to protect the interests of savers and, more generally, the equilibrium of the savings system, require strict supervisory rules in order to ensure the continuing stability of the banking system'. In the *Peter Paul* case, which related to the liability of supervisory authorities for losses resulting from defective supervision[129], the Court noted that 'it is not possible in a number of Member States for the national authorities responsible for supervising credit institutions to be liable in respect of individuals in the event of defective supervision'. The Court stated in particular that 'those rules are based on considerations related to the complexity of banking supervision, in the context of which the authorities

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122 See Article 4, first paragraph, of the 1988 Directive.

123 Article 58(1)(b) EC states that the provisions of Article 56 shall be without prejudice to the right of Member States to take all requisite measures to prevent infringements of national law and regulations, *in particular* in the field of taxation and of the prudential supervision of financial institutions.

124 For instance, in the *Bordessa* case, the Court considered that requiring a prior declaration may be one of the measures which Member States are permitted to take since, unlike prior authorisation, it does not entail suspension of the transaction in question but still allows the national authorities to exercise effective supervision in order to prevent infringements of their laws and regulations (Joined Cases C-358/93 and C-416/93 *Bordessa* [1995] ECR I-361, para. 17). In Case C-478/98 *Commission* v *Belgium* [2000] ECR I-7587, paras. 37-40, the Court pointed out that 'the requisite measures to prevent certain infringements in the field of taxation referred to in Article 73d(1)(b) of the Treaty include measures intended to ensure effective fiscal supervision and to combat illegal activities such as tax evasion'.

125 See Article 58(1)(b) EC, Article 105(5) EC and Article 105(6) EC. Article 105(5) EC provides that the ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system. Article 105(6) EC provides that the Council may confer upon the ECB specific tasks concerning policies relating to the prudential supervision of credit institutions and other financial institutions with the exception of insurance undertakings.

126 See in particular recitals 7, 8, 34 and 57 of Directive 2006/48/EC.

127 Basel Committee on Banking Supervision, *Core principles for effective banking supervision* (1997). See also ECB, 'The role of central banks in prudential supervision' (March 2001).

128 Case C-441/93 *Panagis Pafitis and others* v *Trapeza Kentrikis Ellados* [1996] ECR I-1347, para. 49.

129 On this issue, see Tison, pp. 639-675.

are under an obligation to protect a plurality of interests, including more specifically the stability of the financial system'[130]. In the same case, the Advocate General emphasised that 'supervisory measures in general …do not serve solely the interests of depositors, let alone the interests of the depositors of the credit institution involved. The purpose of supervisory measures is to ensure that credit institutions meet their obligations. Before supervisory measures are taken, a comprehensive weighing of many interests must take place, in which the interests of particular depositors may from time to time conflict with those of other depositors or particular public interests. The protection of interests other than those of depositors, such as the interest in a functioning banking system, even precludes, as a matter of principle, the taking into consideration of the interests of depositors alone'[131].

The lessons of the *Fidium Finanz* case

Although there is not abundant case law on the limits of the prudential supervision carve-out in the context of the principle of the free of movement of capital, the Opinion of Advocate General Stix-Hackl in the *Fidium Finanz* case[132] has given rise to developments on the interpretation of this carve-out. In its communication – Intra-EU investment in the financial services sector the Commission pointed out that prudential considerations 'along with other exceptions, should be circumscribed by the same qualifications that condition other restrictions'[133]. However, this interpretation has not been assessed by the Court since, in that case, the Court rejected the applicability of the Treaty provisions on free movement of capital. The rules in dispute formed part of the German law on the supervision of undertakings which carry out banking transactions and offer financial services[134]. The German court referred to the Court a request for a preliminary ruling on whether granting credit on a commercial basis constituted a provision of services which is covered by Article 49 of the EC Treaty and/or whether it falls within the scope of the rules governing the free movement of capital[135]. In this case, the Court concluded that: (i) the German rules which make 'the granting of credit on a commercial basis, on national territory, by a company established in a non-member country subject to prior authorisation, and which provide that such authorisation must be refused, in particular, if that company does not have its central administration or a branch in that territory', affect primarily the exercise of the freedom to provide services[136] and (ii) that 'the restrictive effects of those rules on the free movement of capital are merely an inevitable consequence of the restriction imposed on the provision

130 Case C-222/02 *Peter Paul and others* v *Germany* [2004] ECR I-9425, para. 44.

131 Case C-222/02 *Peter Paul and others* v *Germany* [2004] ECR I-9425, Opinion of A.G. Stix-Hackl, para. 76.

132 Case C-452/04 *Fidium Finanz AG* [2006] ECR I-9521.

133 Commission communication – Intra-EU investments in the financial services sector, (OJ C 293, 25.11.2005, p. 2).

134 The purpose of this law 'is to supervise the provision of such services and to authorise such provision only for undertakings which guarantee to conduct such transactions properly' (paragraph 45 of the judgment).

135 Case C-452/04 *Fidium Finanz AG* [2006] ECR I-9521, para. 22. Since the national measure in question related to the freedom to provide services and the free movement of capital at the same time, the Court considered to what extent the exercise of those fundamental freedoms was affected, and whether one prevailed over the other. In such cases, the Court examines the measure in dispute 'in relation to only one of those two freedoms if it appears, in the circumstances of the case, that one of them is entirely secondary in relation to the other and may be considered together with it' (para. 34).

136 Case C-452/04 *Fidium Finanz AG* [2006] ECR I-9521, para. 50.

of services'[137]. In this context, the Court concluded that a company such as Fidium Finanz established in a non-member country cannot rely on the provisions on the free provision of services[138].

Advocate General Stix-Hackl had taken a different approach in this case. Having rejected the applicability of the rules on the freedom to provide services[139], the Advocate General assessed the matter in the light of the rules on free movement of capital. The Advocate General examined (i) whether the grant of loans from a third State to a borrower in the EU could fall under the rules on the free movement of capital and, more particularly, (ii) whether the requirement of authorisation for the grant of credit by an undertaking having its registered office in a third country to residents of an EU Member State constituted a restriction on the free movement of capital, and (iii) whether this could be justified under Article 58(1)(b) EC. Since the objectives of the rules on the supervision of financial institutions are the protection of borrowers and the protection of capital markets[140], the Advocate General considered that an authorisation requirement could be classified as both suitable and necessary for the purposes of attaining such objectives[141] and could be regarded as a 'requisite measure' to prevent infringements of national law and regulations in the field of the prudential supervision of financial institutions within the meaning of Article 58(1)(b) EC[142] .

The prudential exception and the *Commission* v *Austria* case

As described above, the Court has given a strict interpretation of possible exceptions to the prohibition of restrictions on Treaty freedoms, including in relation to the financial sector. In the context of the freedom to provide services, the Court has considered that the maintenance of the good reputation of the national financial sector may constitute an imperative public interest capable of justifying restrictions on the freedom to provide financial services[143]. Advocate General Jacobs pointed out that, in the absence of harmonisation rules, Member States enjoyed some discretion in determining the level of investor protection in their territories[144], a situation which has evolved in recent years with the adoption of several harmonisation directives in the financial sector. In the *Commission* v *Austria* case (recently closed by the Commission[145]) the action brought before the Court by the Commission may

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[137] Ibid. para. 49.

[138] See O'Brien, pp. 1483-1499; and Vigneron and Steinfeld, pp. 239-254.

[139] Since the 'scope *ratione personae* of the freedom to provide services does not extend to persons resident outside the Community', Case C-452/04 *Fidium Finanz AG* [2006] ECR I-9521, Opinion of A.G. Stix-Hackl, para. 42.

[140] Ibid. paras. 130 ff.

[141] Ibid. para. 152. Advocate General Stix-Hackl indicates (para. 139) that the authorisation requirement and the possibility of supervision which it provides are a suitable means of attaining the objectives of protecting customers and protecting the capital market, and that this is illustrated by the relevant provisions of Directive 2000/12/EC. Reference is made to recital 65 and Article 4 of Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions (OJ L 126, 26.5.2000, p. 1) (i.e. recital 57 and Article 6 of the Banking Directive).

[142] Para. 129 of the Opinion of A.G. Stix-Hackl.

[143] Case C-384/93 *Alpine Investments* [1995] ECR I-1141, para. 44.

[144] Case C-384/93 *Alpine Investments* [1995] ECR I-1141, Opinion of A.G. Jacobs, para. 90. In another case, Advocate General Sharpston also confirmed that overriding reasons of public interest may justify a restriction being imposed on the freedom to provide services by a national measure where that interest is not already protected by Community harmonisation measures or safeguarded by provisions to which the provider of services is subject in the Member State of its establishment (Joined Cases C-393/05 *Commission* v *Austria* [2007] ECR 0000; and Case C-404/05 *Commission* v *Germany* [2007] ECR 0000, Opinion of A.G. Sharpston, para. 68).

[145] See below pp. 33-34.

have provided clarification of the definition and scope of restrictions on movements of capital as well as on the limits to the exceptions to the Treaty prohibition[146] in the banking context. The Commission considered that a provision of the Austrian federal banking law requiring certain credit institutions which are affiliated to a central institution to hold liquid reserves corresponding to a certain percentage of their deposit funds with their central institution (in accordance with conditions laid down by the central institution), and preventing them from investing their liquid assets with other European financial institutions, constitutes a restriction on the free movement of capital which is prohibited under Article 56(1) EC. According to the Commission, this legal obligation prevented primary banks from investing a significant part of their liquid assets with other European credit institutions and from obtaining, by cross-border transfers to other Member States, higher rates of return than those provided by the central institution.

Before turning to the assessment of the possible exceptions to the prohibition, it is worth examining in greater depth the nature of the restrictions in this case. According to legal doctrine[147], the Court looks to 'actual or potential effects to establish the existence of a restriction on the free movement of capital and does not incorporate a *de minimis* principle'. Taken together with a broad definition of the scope of free movement of capital, the definition of a restriction might include a very wide range of situations including restrictions of a potential nature. For instance, in the *Grønfeldt* case, the Court considered that 'a difference in treatment on the basis of the place of investment of the capital has the effect of discouraging a shareholder from investing his capital in a company established in another State and also has a restrictive effect on companies established in other States in that it constitutes an obstacle to their raising capital in [the home Member State of the shareholder]'[148]. In the *Skatteverket* case, the Court concluded that 'the measures prohibited by Article 56(1) EC, as restrictions on the movement of capital, include those which are likely to discourage non-residents from making investments in a Member State or to discourage that Member State's residents from doing so in other States'[149]. In the *Meilicke* case, the Court has considered that the tax legislation at issue could deter 'persons who are fully taxable in Germany for income tax purposes from investing their capital in companies established in other Member States. Conversely, that legislation is liable to have a restrictive effect as regards those companies, in that it constitutes an obstacle to their raising capital in Germany, the shares of companies established in other Member States [being] less attractive to investors residing in Germany than shares in companies which have their seat in that Member State'[150].

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146 Case C-270/06 *Commission* v *Austria*, action brought on 20 June 2006 (OJ C 212, 2.9.2006, p. 17).

147 Flynn, p. 783.

148 Case C-436/06 *Grønfeldt* v *Finanzamt Hamburg – Am Tierpark* [2007] ECR 0000, para. 14.

149 Case C-101/05 *Skatteverket* v *A* [2007] ECR 0000, para. 40. See also Case C-513/03 *van Hilten-van der Heijden* [2006] ECR I-1957, para. 44; and Case C-370/05 *Festersen* [2007] ECR I-1129, para. 24. Similarly, as regards freedom of establishment, the Court has pointed out that 'even though Article 43 EC is, according to its terms, aimed particularly at ensuring that foreign nationals are treated in the host Member State in the same way as nationals of that State, it also prohibits the Member State of origin from hindering the establishment in another Member State of one of its own nationals as well as of nationals of other Member States residing in its territory' (Case C-464/05, *Geurts and Vogten* v *Belgium* [2007] ECR 0000, para. 15).

150 Case C-292/04 *Meilicke* v *Finanzamt Bonn-Innenstadt* [2007] ECR I-1835, paras. 23 and 24.

In the *Commission* v *Austria* case, the alleged restriction may have justified examining whether it corresponds to a 'purely internal situation' according to the Court's terminology. A purely internal situation requires that all the facts in the main proceedings are confined to a single Member State. Moreover, the national legislation at issue, which applies without distinction to nationals and to nationals of other Member States, may in general only fall within the scope of the provisions on the fundamental freedoms established by the Treaty to the extent that it applies to situations related to intra-Community trade[151]. Case law indicates that in such circumstances the Court may agree to give a ruling on the interpretation of Community law[152]. In its pleadings in this case, the Commission rejected justifications of the restrictions based on the grounds explicitly referred to in Article 58 EC, on the grounds of consumer protection[153] or on the grounds of overriding reasons relating to the public interest and in particular 'the protection of the integrity and the good reputation of the Austrian financial sector' and 'the achievement of effective supervision of financial institutions'.

As regards the argument that the obligatory deposit at issue laid down in the law is necessary for the purposes of consumer protection, the Commission explained first, that statutory rules to safeguard liquidity, which apply to all banks, already exist in Austria and secondly, that there are less restrictive means for ensuring sufficient liquidity which do not impede the free movement of capital or which impede it less. According to the Commission, the rule which was applied could even be counter-productive in terms of consumer protection, since it prevents primary banks from investing their liquid reserves abroad, possibly more profitably, in the interests of their customers. Furthermore, the Commission maintained that there was no evidence to indicate that the insolvency of individual primary banks would necessarily trigger a chain reaction and provoke a run on the savings deposits of other primary banks in the sector. The Commission exposed the view that this catastrophic scenario was not convincing, as comparable systems in other Member States are managed without compulsory statutory deposits, and have operated with stability for many decades without this having led to a series of bank collapses.

On 1 January 2008, the Austrian Banking law was amended[154] and the Commission decided to close the infringement procedure[155]. After this modification, banks are still required to join a system of joint

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[151] See Joined Cases C-515/99, C-519/99 to C-524/99 and C-526/99 to C-540/99 *Reisch and others* [2002] ECR I-2157, para. 24; or Case C-300/01 *Salzmann* [2003] ECR I-4899, para. 32. In the pending Case C-270/06 *Commission* v *Austria* case (OJ C 212, 2.9.2006, p. 17) the cross-border element is of a potential nature and corresponds to the frustration of potential investments by primary institutions in other European credit institutions. The rules on freedom of establishment could also have been potentially applicable in this case.

[152] The Court considers that it might be useful to the referring court if 'its national law were to require that a national of a Member State must be allowed to enjoy the same rights as those which a national of another Member State would derive from Community law in the same situation' (Joined Cases C-515/99, C-519/99 to C-524/99 and C-526/99 to C-540/99 *Reisch and others* [2002] ECR I-2157, para. 26). The absence of a transnational element does not affect 'the Court's obligation to reply to the national court by interpreting the provisions of Community law which set the framework for the scope of the national provisions at issue in the main proceedings. It is only in the exceptional case, where it is quite obvious that the interpretation of Community law sought bears no relation to the facts or the purpose of the main action, that the Court refrains from giving a ruling' (Case C-300/01 *Salzmann* [2003] ECR I-4899, para. 32).

[153] Case C-270/06 *Commission* v *Austria*, action brought on 20 June 2006 (OJ C 212, 2.9.2006, p. 17).

[154] Article 25 (13) of the Austrian Banking Law, as amended (Federal Gazette I N° 108/2007).

[155] See IP/08/871 of 5.6.2008.

liquidity compensation and keep a particular liquidity reserve, but this reseve may also be kept with another bank in the EU, provided this bank assumes the obligation to provide liquidity to the local banks in case of need. It is possible that the freedom of establishment rules, or more likely the free movement of capital rules, would increasingly provide a basis for challenging provisions relating directly to some national peculiarities of certain types of credit institutions[156].

1.2.2 Infringement proceedings initiated by the Commission in the banking sector

In recent years, attempts by some European banks to acquire credit institutions in other Member States have sometimes been frustrated by national supervisory authorities invoking allegedly prudential reasons for blocking cross-border mergers at Community level. In certain instances these cases have triggered two distinct types of infringement proceedings: (i) for breach of the rules on the free movement of capital and on the right of establishment (Articles 56 and 43 EC respectively); and/or (ii) for breach of certain provisions of the EC Merger Regulation[157].

The *Champalimaud* case

The *Champalimaud/ Banco Santander Central Hispano* (*BSCH)* case is of interest since it constitutes the first important attempt by national authorities over the last years to oppose a cross-border acquisition in the EU financial sector[158]. On 30 June 1999, BSCH and Mr António Champalimaud notified the European Commission under the EC Merger Regulation of a transaction whereby BSCH acquired 40 % of the share capital of the two holding companies of the AC Group, and Mr Champalimaud acquired 1.6 % of the capital of BSCH. These holding companies owned the majority of the capital of the insurance company Mundial Confiança, which owned several Portuguese banks (including Banco Pinto and Sotto Mayor). The agreements in question led to joint control of this group of financial institutions being exercised by BSCH and Mr Champalimaud. The measures taken by the Portuguese authorities in 1999 (essentially an administrative decision by the Portuguese Minister of Finance) to veto the acquisition of a controlling interest in companies of the Champalimaud group by the Spanish bank BSCH, and subsequently to suspend certain voting rights of shares held in the Champalimaud group and shares owned by Antonio Champalimaud himself[159], prompted the Commission to initiate infringement proceedings for breach of the insurance directives[160] and of the

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156 See European Banking Federation (June 2005 and December 2007), p. 37.

157 The aspects related to the European merger control rules are addressed in Chapter 1, 1.3 below.

158 Commission decision of 20 July 1999 relating to a proceeding pursuant to Article 21 of Council Regulation 4064/89 of 21 December 1989 on the control of concentrations between undertakings (BSCH/Champalimaud, Case IV/M.1616).

159 The agreements were notified to the Portuguese authorities in June 1999. The Portuguese Finance Minister decided to oppose the transaction in an administrative decision ('despacho') on 18 June 1999 and in particular suspended the voting rights of BSCH and of Mr Champalimaud in Mundial Confiança.

160 As with the Banking Directive, the EU Insurance Directives, especially Council Directive 92/49/EEC of 18 June 1992 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and amending Directives 73/239/EEC and 88/357/EEC (third non-life insurance Directive) (OJ L 228, 11.8.1992, p. 1), and Council Directive 92/96/EEC of 10 November 1992 on the coordination of laws, regulations and administrative provisions relating to direct life assurance and amending Directives 79/267/EEC and 90/619/EEC (third life assurance Directive) (OJ L 360, 9.12.1992, p. 1), require interventions by supervisory authorities to be based on prudential principles ('the need to ensure sound and prudent management').

Treaty rules on freedom of establishment and the free movement of capital[161]. In this case, the Portuguese authorities invoked the infringement of procedural rules and, in particular, the fact that BSCH would have acquired a qualifying holding in Mundial Confiança S.A. without previously notifying the Minister of Finance and that the notification would not have satisfied the requirements of Portuguese law[162]. On the substance, the Portuguese authorities analysed 'whether the specific conditions of the operation and the situation that it will create guarantee a sound and prudent management of the insurance undertaking Mundial Confiança S.A. and its appropriate supervision'[163]. They concluded that the 'lack of clarity and transparency of the group resulting from the operation and the process of decision established could have negative repercussions on the immediate and long term stability of the insurance undertaking in question and the financial group which depends from it, as well as on the possibility of the existence of an appropriate supervision'[164].

The Commission considered that the Portuguese measures were not justified on prudential grounds and were disproportionate[165]. Furthermore, in the Commission's view, the Portuguese authorities were in breach of Community law because (i) the administrative decision to veto the deal was adopted just 24 hours after the last of the agreements was notified to the Portuguese Minister; (ii) the parties concerned had no opportunity to provide supplementary information, to discuss the operation with supervisory authorities or to amend the operation to meet possible prudential concerns, (iii) the full prudential reasons for vetoing the deal were not notified to the parties concerned; (iv) the Portuguese authorities' intervention was based on defence of national economic interests; and (v) the suspension of voting rights was a disproportionate measure and could not be subject to judicial review[166].

The *BBVA/BNL* and *ABN AMRO/Antonveneta* cases

In 2005, two failed bids for Italian banks by other EU banks also triggered infringement proceedings by the Commission; these were the *BBVA/BNL* and *ABN AMRO/Antonveneta* cases[167]. In these cases the Commission considered that the provisions applied by the Italian supervisory authority to the acquisition of shareholdings in domestic banks by other EU banks could have acted as a disincentive to investment from other Member States in the Italian banking industry, and could thus be

[161] On 20 October 1999, the European Commission decided to send Portugal a reasoned opinion, i.e. the second stage of infringement procedures under Article 226 of the EC Treaty, following the letter of formal notice (IP/99/773).

[162] Commission decision of 20 July 1999 relating to a proceeding pursuant to Article 21 of Council Regulation 4064/89 of 21 December 1989 on the control of concentrations between undertakings (BSCH/Champalimaud, Case IV/M.1616), para. 17.

[163] Ibid. para. 16.

[164] Ibid. para. 39. The Portuguese authorities also gave the Commission three examples of situations derived from the agreements which, according to them, would on their own justify the objections of the supervisory authorities as far as the verification of sound and prudent management were concerned (paras. 42 to 45).

[165] As regards prudential aspects, the Commission noted in particular that BSCH is a well known financial entity, which controlled already two banking subsidiaries in Portugal, duly authorised by the Portuguese authorities, and which performs banking and insurance activities in Spain, being there also duly authorised by the Spanish authorities and that concentration operations in the financial sector with similar structures have been notified to the Commission in several occasions (BSCH/Champalimaud, Case IV/M.1616, paras 56 and 57).

[166] See IP/99/551.

[167] The first transaction concerned the proposed acquisition by the Spanish bank Banco Bilbao Vizcaya Argentaria (BBVA) of the Italian bank Banca Nazionale del Lavoro (BNL). The second transaction concerned the proposed acquisition by the Dutch bank ABN AMRO of the Italian bank Banca Antonveneta.

incompatible with the free movement of capital and the right of establishment of foreign EU investors trying to acquire domestic banks[168]. From a European merger control viewpoint, neither transaction raised any competition concerns, and both had been authorised by the European Commission[169]. At the time of the authorisation Competition Commissioner Neelie Kroes even considered that the proposed operations were 'a positive sign of movement towards a more integrated internal market for financial services'[170]. However, the two bids were notified to Banca d'Italia which, under Italian law, has to authorise takeover bids, and increases of shareholdings in Italian banks above certain thresholds, after verifying their compatibility with prudential rules[171].

In the *ABN AMRO/Antonveneta* case, the Italian Administrative Court examined the role of Banca d'Italia with regard to its authorisations for the purchase of significant holdings in Italian banks[172]. ABN AMRO's petition was based in part on allegations that there were unjustifiable differences in the treatment accorded by Banca d'Italia to ABN AMRO and to the other bidder, an Italian bank Banca Popolare Italiana (BPI). In particular, ABN AMRO alleged that Banca d'Italia showed preference to BPI by, among other things, (i) consistently reviewing BPI's requests for approval significantly more quickly than ABN AMRO's requests, and (ii) initially refusing approval for ABN AMRO to increase its stake without giving sound reasons. Although the Italian Court rejected ABN AMRO's petition[173], Curran and Turitto noted that 'the battle fought by ABN and BPI has most importantly brought into focus the room which Community law in this area continues to leave for an exercise of discretion by national regulators in a manner which may be inconsistent with the principles of freedom of establishment and equality of treatment'[174].

As regards the infringement of the Treaty provisions, the Commission was concerned that the existing Italian regulatory framework allowed the exercise of supervisory authority lacking in procedural transparency and creating legal uncertainty, in view of the lack of 'specified criteria used for the appreciation of prudential acceptability' or with regard to the conditions imposed for the exercise of 'control'[175]. The Commission indicated, for instance, that this framework could lead to a situation in which the supervisory authority could refuse authorisation based on 'opaque concerns', such as 'stability of governance'[176]. In January 2007, following amendments to the Italian national regulatory

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168 Against this background, on 14 December 2005 the European Commission decided to send Italy a formal request to submit its observations on provisions in its national regulatory framework that applied to supervisory decisions on the acquisition of stakes in domestic Italian banks by other EU banks (IP/05/1595, 14.12.2005).

169 See the Commission's simplified decisions of 27 April 2005, BBVA/BNL, COMP/M3768 and ABN AMRO/Banca Antonveneta, COMP/M3780, both taken in accordance with the EC Merger Regulation.

170 IP/05/498, 28.4.2005.

171 Cuadrado, p. 95.

172 Curran and Turitto, pp. 79-82. In this case ABN AMRO filed a claim against the decisions of Banca d'Italia on the increase of its shareholding in Antonveneta initially up to 14.9 % and subsequently up to 29.9 %.

173 Ibid, p. 80.

174 Ibid, p. 82. The same authors also deplored that the court's rejection of the ABN AMRO petition on the 'partiality' issue 'fails to provide a precedent which would encourage a more substantive approach to the supervisory review function in the context of cross-border acquisitions and leaves what has been perceived to be a regulatory vacuum in this area'.

175 IP/05/1595, 14.12.2005. See Chapter 1, 1.2.2.

176 The provisions in question are the 1993 Italian Banking Law (Legislative Decree No 385/1993 of 1 September 1993), the 'Istruzioni di vigilanza per le banche', which refers to Article 2359 of the Italian Civil Code (re 'controlled companies'), and a decision by the Interministerial Committee for Credit and Savings of 19 July 2005 (Official Journal No 188 of 13 August 2005).

framework[177], the European Commission decided to terminate the infringement proceedings against Italy[178].

The *UniCredito/BPH* case

Another case of proceedings for breach of the Treaty provisions in the banking sector, the *UniCredito/BPH* case, relates to the assessment by the Polish banking supervisory authority of the application by the Italian bank UniCredito for authorisation to exercise voting rights in respect of its shares in the third-largest bank in Poland, BPH, which had been acquired by UniCredito as a result of UniCredito's merger with the HVB group[179]. The Polish banking supervisory authority requested UniCredito to complete the documentation necessary for it to take a decision, thereby prolonging the proceeding in respect of UniCredito's application[180]. Despite the clearance of the merger between UniCredito and HVB by the Commission under the EC Merger Regulation[181], the Polish Government requested UniCredito to sell its BPH shares on the ground that UniCredito had infringed a non-compete clause contained in the privatisation contract previously concluded between the Polish Treasury and UniCredito under which UniCredito had acquired a majority shareholding in the privatised Polish bank Pekao SA (Pekao)[182]. Under this non-compete clause, UniCredito was prevented from investing in other Polish entities that could be competitors with Pekao in the Polish market. The Polish Government wanted the banking supervisory authority to refuse Unicredito the authority to exercise its voting rights based on BPH shares because of its alleged infringement of the non-compete clause, and thereby to block the merger of Pekao and BPH.

In the Commission's view, the non-compete clause was an unjustified restriction on movements of capital as well as, with regard to direct investment, on freedom of establishment[183]. After several months of investigation and intense political pressure from the Polish Government and Parliament, the Polish banking supervisory authority finally adopted a decision authorising Unicredito to exercise the

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177 During the proceeding initiated by the Commission some amendments to the relevant Italian national legal provisions were adopted: (a) the 'vigilanza' document issued on 28 August 2006 by the Governor of the Banca d'Italia, which amended part of the 'Istruzioni di vigilanza per le banche' by abolishing the obligation for prior communication to the Banca d'Italia of an intended acquisition of holdings – leading to the control of a bank or a financial holding company – before such intention is communicated to the competent decision-making bodies of the company for approval, was published in the Italian Official Journal No 215 of 15.9.2006, and (b) Law No 303 of 29 December 2006 was issued, providing, among other things, for a transfer of powers from the Banca d'Italia to the 'Autoritá garante della concorrenza e del mercato' (i.e. the Italian competition authority) in the area of competition, namely for the assessment of operations of concentrations in the field of banking. The author is indebted to Laura Fabiani and to Nicola de Giorgi for this information and the information contained in the previous footnote.

178 See the Commission's press release, IP/07/83, 24.1.2007.

179 On 8 March 2006, the European Commission announced that it had sent a formal letter to the Polish authorities (IP/06/276, 8.3.2006). At the same time the Commission announced that it had reached the preliminary conclusion that the Polish Government had infringed Article 21(2) of the EC Merger Regulation (IP/06/277). These proceedings are still being pursued by the Commission.

180 See the Resolution No 20/KNB/06 of 5.4.2006 of the Polish Banking Supervisory Authority on the granting of authorisation to exercise voting rights at a general meeting of a bank's shareholders.

181 See the Commission decision of 18 October 2005, COMP/M.3894, authorising the proposed concentration by which Unicredito acquired control of HVB by a public bid. The decision indicates that HVB already held approximately 71 % of the shares of BPH.

182 According to statements by the Polish Government, the non-compete clause was included in the Privatisation Agreement 'to safeguard the competitiveness of the Polish market in banking services'.

183 See IP/06/276.

voting rights attached to its shareholding in BPH[184]. Meanwhile, in the course of 2006 a formal agreement was reached between Unicredito and the Polish Ministry of the Treasury which, according to the Polish authorities, was aimed at ensuring that BPH remained an independent bank on the Polish market. The completion of the transaction was intended to remove any dispute between the Polish State Treasury and UniCredito or HVB with respect to the privatisation agreement.

While, in the *Champalimaud/BSCH* and *UniCredito/BPH* cases, the Commission has initiated proceedings both for the infringement of merger control rules and of Treaty freedoms (free movement of capital and right of establishment), in the *BBVA/BNL* and ABN *AMRO/Antonveneta* cases the Commission has initiated proceedings only on the basis of the free movement rules. Of the above infringement proceedings, only the *UniCredito/BPH* case has resulted in an action before the Court (and so far only on those aspects relating to the merger control rules[185]). In the *Champalimaud/BSCH* case a compromise was reached between the undertakings, the Commission and the Portuguese authorities which led to the withdrawal of their respective actions before the Court. In the *BBVA/BNL* and ABN *AMRO/Antonveneta* cases, following amendments to the Italian national regulatory framework, the Commission terminated the infringement proceedings against Italy. However, these cases have a number of similarities, since they all concern investors from EU Member States wishing to acquire direct control of a credit or financial institution in another Member State, for which clearance from the supervisory authority in the host Member State was required. These cases, with only an intra-Community dimension, concern alleged infringements of the rules on free movement of capital and the right of establishment. All these cases relate to the exercise of discretionary powers by national supervisory authorities in the context of the prudential assessment of cross-border mergers and acquisitions in the financial sector, and in all cases the Commission rejected the prudential grounds invoked by national authorities to oppose the cross-border investments by non-domestic banks.

If the Court had applied the 'main focus' test described above, it is likely that the freedom of establishment would have been considered as 'primarily affected' although, in line with the *Holböck* case, the Court may also have agreed to examine whether both freedoms were affected. It has already been pointed out that restrictions on the freedom of establishment by way of the exceptions provided for by the Treaty in circumstances linked to the exercise of official authority, to public order, public security and public health, are to be interpreted restrictively, and their scope cannot be determined unilaterally by the Member States. Therefore, these exceptions would not have been available in the above cases. Moreover, it seems unlikely that overriding reasons relating to the public interest such as the functioning or stability of the banking/financial system, the protection of the integrity and the good reputation of the domestic financial sector, effective supervision of financial institutions, or even the

[184] See the Resolution No 20/KNB/06 of 5.4.2006 of the Polish Banking Supervisory Authority.
[185] Case T-41/06 *Poland* v *Commission* (Action brought on 6 February 2006) (OJ C 96, 22.4.2006, p. 17). However, the proceedings initiated by the Commission against Poland with regard to the infringement of the free movement rules and of the EC Merger Regulation are still pending (see also I.C.2 below).

protection of depositors or minority shareholders would have justified the restrictions on the freedom of establishment in these cases, especially where there is manifest discrimination between foreign and domestic banks (as appeared to be the case in Italy)[186].

1.3 Prudential interests and European merger control rules

1.3.1 The European merger control rules in the banking sector

The European merger control rules also contain a prudential carve-out which was introduced in 1989 with the adoption of the first EC Merger Regulation. Under the EC Merger Regulation rules, the European Commission has the exclusive power to examine concentrations with a Community dimension, including those affecting the banking and financial sectors. A concentration is deemed to arise where a lasting change of control results from: (a) the merger of two or more previously independent undertakings or parts of undertakings, or (b) the acquisition, by one or more persons already controlling at least one undertaking, or by one or more undertakings, whether by purchase of securities or assets, by contract or by any other means, of direct or indirect control of the whole or parts of one or more other undertakings[187].

The EC Merger Regulation provides that control is 'constituted by rights, contracts or any other means which, either separately or in combination and having regard to the considerations of fact or law involved, confer the possibility of exercising decisive influence on an undertaking, in particular by: (a) ownership or the right to use all or part of the assets of an undertaking; (b) rights or contracts which confer decisive influence on the composition, voting or decisions of the organs of an undertaking'[188].

As regards the applicable thresholds, a concentration is considered to be of a Community dimension where: (a) the combined aggregate worldwide turnover of all the undertakings concerned is more than EUR 5,000 million; and (b) the aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than EUR 250 million, unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State[189]. These rules apply in full to the financial sector together with some specific provisions taking account of the special characteristics of financial institutions[190]. Since 1989, most concentrations with a Community dimension in the banking sector have not given rise to any

[186] The aspects related to non-discrimination under the Treaty are addressed in Chapter 2 of this paper in the context of the principle in the Qualifying Holdings Directive on non-discrimination between competing bids.
[187] Article 3 (1) of the EC Merger Regulation ('Definition of concentration').
[188] Article 3(2) of the EC Merger Regulation. The EC Merger Regulation further provides that: 'Control is acquired by persons or undertakings which: (a) are holders of the rights or entitled to rights under the contracts concerned; or (b) while not being holders of such rights or entitled to rights under such contracts, have the power to exercise the rights deriving therefrom'.
[189] See Article 1(1) and (2) of the EC Merger Regulation. Article 1(3) of the EC Merger Regulation contains a second series of thresholds covering other types of concentrations of Community dimension.
[190] See Article 5(3) of the EC Merger Regulation on the calculation of turnover thresholds for credit institutions and other financial institutions and for insurance undertakings. As regards the application of the EC Merger Regulation in the banking sector, see Kerjean (2000), pp. 14-26.

competitive concerns, due in particular to the absence of substantial competitive overlaps in the different markets or segments in the countries where the parties to the concentrations were active[191].

In the banking sector the Commission has considered transactions corresponding to an increase of a minority shareholding in a credit institution, where it decided under the EC Merger Regulation provisions on a move from an absence of control to a position of sole control, taking account of the level of votes cast at the previous three annual general meetings. This was the case in the *Société Générale de Belgique/Générale de Banque* decision, where an increase in shareholding from 20.94 % to 25.96 % was held to be sufficient to amount to the acquisition of sole control[192]. Under the EC Merger Regulation, sole control may exist where specific rights attach to a minority shareholding[193]. As regards *de jure* sole control, there will typically be a situation of negative sole control where one shareholder holds 50 % in an undertaking while the remaining 50 % is held by several other shareholders (assuming this does not lead to *de facto* positive sole control), or where a supermajority is required for strategic decisions which in fact confers a veto right on a single shareholder, irrespective of whether it is a majority or a minority shareholder[194]. This was the case in the context of the *BBVA/BNL* transaction[195]. As regards *de facto* sole control, a minority shareholder may also be deemed to have sole control on a *de facto* basis. This is particularly the case where the shareholder is highly likely to achieve a majority at shareholders' meetings, given the level of their shareholding and evidence of attendance at shareholders' meetings in previous years[196].

Interestingly, in the *Société Générale de Belgique/Générale de Banque* decision the Commission pointed out that the above qualification did not prejudge the conditions which could be applied to the transaction in respect of the different applicable national laws, and in particular banking laws and that the concept of control under the EC Merger Regulation may differ from that applied in specific areas of Community and national law concerning, for example, taxation or prudential rules[197]. The

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191 Therefore, these concentrations were authorised during the normal examination stage of one month and did not give rise to an in-depth investigation of four additional months. A few of these transactions gave rise to commitments on the part of the parties to the concentration (see the Bank Austria/Creditanstalt case, COMP/M.2125, Commission's merger control decision of 14.11.2000; the Nordbanken/Postgirot case, COMP/M.2567, decision of 8.11.2001; or Fortis's acquisition of the remaining ABN AMRO assets (decision of 3 October 2007 subject to full compliance with the commitments submitted by the notifying party, COMP//M.4843). See also the Skandinaviska Enskilda Banken (SEB)/FöreningsSparbanken (FSB) case, IP/01/1290, 19.9.2001 which might have led to a prohibition of the transaction. In this case, the parties withdrew notification to the Commission of their proposed transaction in the course of its investigation.

192 Case IV/M.343, *Société Générale de Belgique/Générale de Banque*, Commission decision of 3 August 1993.

193 Bellamy & Child, (Chapter 8 on Merger Control) pp. 643-644.

194 Commission Consolidated Jurisdictional Notice under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings ('the Notice'), 10.7.2007, para. 58.

195 See the consecutive Commission merger control decisions COMP/M.3537 *BBVA/BNL* of 20 August 2004 and M.3768 *BBVA/BNL* of 27 April 2005.

196 The Notice, para. 59 and Case COMP/M.343, *Société Générale de Belgique/Générale de Banque*, Commission decision of 3 August 1993; and COMP/M.159 *Mediobanca/Generali*, Commission decision of 19 December 1991. Based on past voting patterns, the Commission will carry out a prospective analysis and take into account foreseeable changes of the shareholders' attendances following the transaction. The Commission will also analyse the positions of other shareholders and assess their roles.

197 Regarding the issues raised, in the context of prudential rules by the application of the concept of 'control' to the acquisition of minority shareholdings in credit institutions, see, for instance, p. 36, p. 43 and pp. 59 - 61.

Commission considers that the interpretation of this concept in other areas is therefore not necessarily decisive for the concept of control under the EC Merger Regulation[198].

If the acquisition of a minority shareholding would not confer joint or even sole control within the meaning of the EC Merger Regulation, the transaction will not constitute a concentration of a Community dimension. If a transaction involves a minority investment or other links between independent undertakings which are insufficient to establish sole or joint control, then Articles 81 and 82 EC may be applicable to such arrangements[199]. In the *Banco Santander/Abbey National* case[200], the strategic cooperation between Banco Santander and a third party, the Royal Bank of Scotland (RBS), a competitor of Abbey National on the UK market raised some concerns. Prior to the notification of the transaction, the parties to the cooperation therefore agreed to amend their cooperation arrangements by terminating the representation on each others' boards of directors, their commercial cooperation, as well as any cooperation in joint venture operations. The only link remaining between the two banks was a limited cross-shareholding. At the time of notification, Banco Santander held 5.06 % of the ordinary shares in RBS, and RBS held 2.83 % of the shares in Banco Santander. Banco Santander reduced its shareholding in RBS to 2.54 % of RBS's issued ordinary share capital. The Commission considered that 'these shareholdings would not entitle either RBS or Banco Santander to exercise any substantial influence over the other's commercial activities'[201].

1.3.2 The merger control prudential carve-out

The EC Merger Regulation alone applies to concentrations as defined in the EC Merger Regulation[202] and the Commission has sole jurisdiction to take the decisions provided for in the EC Merger Regulation[203], which means that a Member State cannot apply its national merger control legislation to a transaction falling within the scope of the EC Merger Regulation[204]. However, Member States may take 'appropriate measures to protect legitimate interests other than those taken into consideration by [the EC Merger Regulation] and compatible with the general principles and other provisions of Community law'[205] and may therefore, under specific conditions, derogate from the exclusive powers of the European Commission. Among the above legitimate interests, the EC Merger Regulation expressly mentions 'public security, plurality of the media and prudential rules[206]. In practice, this

198 The Notice, para. 23.
199 It is settled case law that, although the acquisition by one company of an equity interest in a competitor does not in itself constitute conduct restricting competition, such an acquisition may nevertheless serve as an instrument for influencing the commercial conduct of the company in question so as to restrict or distort competition on the market on which they carry on business (Cases 142/84 and 156/84 *BAT and Reynolds* v *Commission* [1987] ECR 4487).
200 Commission merger control decision, COMP/M.3547 *Banco Santander/Abbey National*, 15.9.2004.
201 Para. 13 of the Commission decision *Banco Santander/Abbey National.*
202 Article 21(1) of the EC Merger Regulation.
203 Article 21(2) of the EC Merger Regulation.
204 Article 21(3) of the EC Merger Regulation.
205 Article 21(4) of the EC Merger Regulation, first subparagraph.
206 For an application of the prudential carve-out in the insurance sector, see the Commission decision IV/M.759 *Sun Alliance/Royal Insurance*, 18.6.1996.

means that legitimate interests relating to prudential rules ('the prudential carve-out') may in principle allow a Member State to invoke these interests with a view to opposing a concentration in the financial sector with a Community dimension.

The issue of the application of the EC Merger Regulation prudential carve-out in the banking sector arose for the first time in 1999 in the context of the *Champalimaud/BSCH* case[207] discussed above in the context of the free movement of capital. The Commission required the Portuguese Government to suspend the supervisory measures adopted at national level[208] in relation to a transaction notified under the EC Merger Regulation and authorised by the Commission[209], and in view of the Portuguese authorities' failure to respect its decision, the Commission decided to initiate proceedings against Portugal for breach of Community law[210] and then to refer the case to the Court[211]. Although a compromise subsequently reached between the various parties led the Commission and the Portuguese Government withdrawing their actions[212], in this case the Commission considered that the legitimate interests invoked (officially or not) by the Portuguese Government, that is to say (i) prudential interests under Community law, (ii) strategic and national interests[213] and (iii) procedural rules, could not constitute legitimate interests within the meaning of the EC Merger Regulation and they could not justify the opposition to the transaction[214]. Since the transaction mainly concerned the acquisition of an insurance company, the Commission's assessment was based on the concept of prudential interests covered by the relevant EU directives in the insurance sector[215]. The Commission concluded that the structure proposed did not raise any concern from a prudential point of view, in particular because doubts had not been raised that the persons who were to acquire a qualifying holding in Mundial Confiança were of good repute and had the appropriate professional qualifications[216]. Moreover, the Commission considered that preventing a breach of procedural rules is not one of the interests

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207 See Chapter 1, pp. 34-35 of the paper.

208 Decision of 18 June 1999 of the Portuguese Finance Minister.

209 See Commission decisions of 20 July 1999 based on Article 21(3) of the EC Merger Regulation (confirmed by a subsequent decision of 20 October 1999) and of 3 August 1999, Antonio de Sommer Champalimaud/BSCH, Case No IV/M.1616.

210 See IP/99/749, 13.10.1999; IP/99/773, 20.10.1999.

211 These proceedings led to the Commission bringing an action before the Court in November 1999 (IP/99/818 of 3 November 1999). An agreement was reached at the end of November only after the Commission, the Portuguese Government and the parties concerned had held negotiations, under which BSCH agreed to hand over part of the banking assets in the Champalimaud group to the leading Portuguese financial institution, Caixa Geral de Depositos. The Commission authorised this new agreement on 11 January 2000 (Case IV/M.1799 - BSCH/Banco Totta y CPP/A. Champalimaud). As a consequence of this agreement, and once the Portuguese Government had explicitly revoked the decision it had adopted on 18 June 1999 (IP/00/21, 12.1.2000), the Commission and Portugal announced the withdrawal of their respective actions before the Court (IP/00/296, 27.3.2000).

212 Commission decision of 11 January 2000, Case IV/M.1799 - BSCH/Banco Totta y CPP/A. Champalimaud and IP/00/296, 27.3.2000.

213 According to the Portuguese Government, strategic sectors such as the banking sector must be maintained within the national fold and Portugal was obliged, while respecting the law, to firmly defend national interests and the State's 'dignity'. The Commission obviously rejected the arguments relating to the protection of national interests and strategic sectors for the national economy. These measures, even if notified, could not in fact be invoked as 'legitimate interests' because of the infringement of the principle of non-discrimination on the basis of nationality laid down in Article 12 EC, and because of failure to respect the principles of freedom of establishment and free movement of capital (paras. 63 to 66 of the Commission decision of 20 October 1999).

214 Commission decision of 20 October 1999, Case No IV/M.1616, BSCH/Champalimaud, Article 1.

215 Ibid, para. 40.

216 Ibid, para. 48.

explicitly provided for in the EC Merger Regulation [217] and that a failure to notify a qualifying holding to a national supervisory authority does not constitute 'a legitimate motive' that justifies a decision opposing a transaction with a Community dimension[218]. Therefore, a decision of a Member State to oppose a concentration in order to ensure that a transaction is notified to the national supervisory authorities would be clearly in breach of the principle of proportionality[219].

In the *BBVA/BNL* and *ABN AMRO/Banca Antonveneta* cases, the two bids had been notified under the EC Merger Regulation and authorised by the Commission. At the national level, Banca d'Italia had to authorise takeover bids and increases of shareholdings in an Italian bank above certain thresholds, after verifying their compatibility with prudential rules[220]. After the clearance decisions by the Commission under the EC Merger Regulation, BBVA and ABN AMRO claimed that Banca d'Italia created obstacles to their bids which, among other things, constituted an infringement of the EC Merger Regulation prudential carve-out. In particular, ABN AMRO claimed that Banca d'Italia, by favouring a counter-bid by Banca Popolare Italiana, had used discriminatory treatment against ABN AMRO that created a serious obstacle to its bid and could not be justified under prudential rules[221]. The Commission finally decided not to intervene formally on this basis, among other things 'because a direct link could not be established between the alleged discriminatory treatment and the failure of ABN AMRO's bid'[222]. In the other case, BBVA also claimed that Banca d'Italia had contravened the EC Merger Regulation prudential carve-out provisions since the approval of its bid was conditional upon the acquisition of a shareholding of more than 50 % in BNL. According to BBVA this condition was not justified under prudential rules and could constitute an obstacle to the acquisition of control (i.e. control over BNL could have been acquired with a shareholding of less than 50 %). The Commission indicated to Banca d'Italia that such a conditional approval could, indeed, constitute a breach of the EC Merger Regulation provisions on legitimate interests. Following the Commission's intervention, Banca d'Italia stated that 'it did not condition its authorisation but it indicated that in case BBVA acquired a shareholding below 50 % in BNL it would need to verify if, after the bidding process, BBVA would be able to exercise effective control over BNL'[223].

In the *UniCredito/HVB* case[224], the Commission considered that the Polish Government had infringed the EC Merger Regulation [225] by encroaching on its exclusive competence by requiring Unicredito to divest its shares in BPH, despite the fact that Unicredito's acquisition of BPH had already been

[217] Ibid, para. 67.
[218] Ibid, para. 68.
[219] Ibid, para. 70.
[220] Cuadrado, p. 95.
[221] Ibid.
[222] Ibid. See however Curran and Turitto, pp. 79-82.
[223] Cuadrado, p. 95.
[224] See the Commission merger control decision of 18 October 2005, COMP/M.3894 authorising the proposed concentration by which Unicredito acquired control of HVB by a public bid.
[225] Article 21(2) of the EC Merger Regulation provides that, subject to review by the Court, the Commission has sole jurisdiction to take the decisions provided for in the EC Merger Regulation.

authorised by the Commission as part of its takeover of HVB.[226] The Polish authorities decided to challenge the Commission's merger control decision before the Court, on the grounds, among other things, that the Commission was in breach of its duty to cooperate under Article 10 EC, by reason of its failure to take into consideration the legitimate interests of Poland before the decision was adopted, the protection of which is provided for in the EC Merger Regulation. The Polish authorities did not refer to the prudential carve-out under the EC Merger Regulation, but instead invoked 'a legitimate public interest on the part of the Polish Government in guaranteeing the application and implementation of the strategies of de-monopolisation and privatisation'.

In 1989, when adopting the initial EC Merger Regulation, in connection with the prudential carve-out the Council specified that 'legitimate invocation may be made of the prudential rules in Member States which relate in particular to financial services'. The Council noted that the application of these rules is normally confined to national bodies for the surveillance of banks, stockbroking firms and insurance companies and that they concern, for example, the good repute of individuals, the honesty of transactions and the rules of solvency[227]. The Council also pointed out on this occasion that 'these specific prudential criteria are the subject of efforts aimed at a minimum degree of harmonisation being made in order to ensure uniform "rules of play" in the Community as a whole'. The level of harmonisation of EU prudential rules attained has changed considerably in the almost twenty years since the adoption of the first EC Merger Regulation, implying that the prudential carve-out has much more limited relevance, especially following the adoption, in the Qualifying Holdings Directive (Directive 2007/44/EC), of harmonised evaluation criteria and procedural rules for the prudential assessment of acquisitions and increases of shareholdings in the financial sector. A number of points can be made in this respect.

First, the EC Merger Regulation establishes a distinction between 'legitimate interests' such as prudential rules and 'other public interests' under the EC Merger Regulation [228] which are required to be notified[229]. According to legal doctrine and due to the unfortunate drafting of Article 21(4) of the

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[226] These proceedings are still being pursued by the Commission (see IP/06/276 and IP/06/277, 8.3.2006). As explained above, in March 2006 the Commission initiated parallel proceedings against Poland for infringement of the Treaty provisions on free movement of capital and freedom of establishment. In February 2006, the Polish authorities decided to seek the annulment of the Commission merger control decision of 18 October 2005 before the Court (Case T-41/06 *Poland* v *Commission* (OJ C 96, 22.4.2006, p. 17)).

[227] Notes on Council Regulation (EEC) 4064/89. http://ec.europa.eu/comm/competition/mergers/legislation/regulation/notes.html. Similar Notes were not issued by the Commission when the EC Merger Regulation was last reviewed in 2004. In the *Sampo/Storebrand* case, the Commission took the view that, 'as regards the legitimate interests expressly listed, such as prudential rules, these should be subject to a uniform interpretation, guided, where possible, by Community law in the field' (COMP/M2491, Commission decision of 27 July 2001, EEA case, para. 39, fourth sentence).

[228] Article 21(4) of the EC Merger Regulation, first subparagraph, provides that Member States may take 'appropriate measures to protect legitimate interests other than those taken into consideration by the [EC Merger Regulation] and compatible with the general principles and other provisions of Community law'. Article 21(4), second subparagraph, provides that 'public security, plurality of the media and prudential rules shall be regarded as legitimate interests'. Article 21(4), third subparagraph, of the EC Merger Regulation provides that '[a]ny other public interest must be communicated to the Commission by the Member State concerned and shall be recognised by the Commission after an assessment of its compatibility with the general principles and other provisions of Community law before the measures… may be taken'.

[229] On these aspects, see Case C-42/01 *Portugal* v *Commission* [2004] ECR I-6079.

EC Merger Regulation when applied to 'intrinsically legitimate interests', there is doubt about whether the Commission has competence to assess the compatibility of such interests without recourse to the proceedings before the Court under Article 226 EC[230]. In the *Champalimaud/BSCH* case, there were interests other than prudential interests at stake which needed to be assessed by the Commission. However, in its decision the Commission pointed out that national authorities, 'confronted with a situation which raises such substantial doubts as to the consideration of the interests protected as legitimate interests, should have communicated to the Commission the interests they attempted to protect, pursuant to Article 21(3) of [the EC Merger Regulation]', before adopting the national measures. The Commission considers that where there are 'strong doubts as to whether a measure is in fact based on prudential rules, not notifying it to the Commission before any measure is adopted would be contrary to principle of exclusive jurisdiction laid down by the Merger Regulation'[231].

Second, 'prudential rules' is not defined in the EC Merger Regulation. The Council's explanatory notes and the Commission's decision in the *Champalimaud/BSCH* case tend to indicate that this expression should be interpreted relatively widely. The Commission noted that, on the one hand 'not every interest that a Member State would consider as being prudential should be considered as such by Community law and therefore covered by the prudential carve-out', and on the other hand 'the harmonising provisions of Community legislation should be taken into account in order to determine the Community notion of prudential interest which should include those interests protected by the harmonisation directives'[232]. In practice, when there is a concentration with a Community dimension, the national supervisory authority of the target undertaking is solely entitled to adopt prudential decisions relating to the authorisation of an acquisition or an increase of shareholdings. When assessing a qualifying holding under the new rules, the national authority will examine whether the harmonised prudential assessment criteria are met and will assess in particular the financial soundness of the proposed acquirer or the compliance of the target credit institution with the prudential requirements of the Banking Directive and compliance with other applicable Community directives. Although the authority can examine all the necessary components of a prudential assessment[233], this assessment will have to be carried out in accordance with the above criteria and the Community directives. Furthermore, a number of factors now constrain the discretion of the national authorities in cases of cross-border banking mergers with a Community dimension. These include, on the prudential side: the maximum harmonisation approach of the Qualifying Holdings Directive and the involvement of the supervisory authority of the proposed acquirer in the assessment of qualifying holdings; and, on

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230 For an assessment of the Court's judgment C-42/01 *Portugal* v *Commission* [2004] ECR I-6079, see Rodger, pp. 1519-1532.

231 Commission decision of 20 July 1999 relating to a proceeding pursuant to Article 21 of Council Regulation 4064/89 of 21 December 1989 on the control of concentrations between undertakings (Case No IV/M.1616 - BSCH/Champalimaud), paras. 65 and 66.

232 Commission decision of 20 July 1999 relating to a proceeding pursuant to Article 21 of Council Regulation 4064/89 of 21 December 1989 on the control of concentrations between undertakings, (Case No IV/M.1616, BSCH/Champalimaud).

233 For an assessment of the harmonised assessment criteria of the Qualifying Holdings Directive, see Chapter 2 of this paper.

the merger control side, the unsuccessful attempts of supervisory authorities referred to above to encroach on the Commission's exclusive jurisdiction over banking mergers authorised under the EC Merger Regulation, the publicity given to these major transactions and the increased vigilance and sensitivity of the Commission on the matter of cross-border banking consolidation in the EU. These constraints, together with measures such as the Commission's right of access to information pertaining to prudential assessments carried out by national authorities, limit therefore the scope for a unilateral and disproportionate interpretation of prudential rules and/or prudential exceptions.

Third, in all likelihood the above elements should exhaust the possibilities of recourse by a Member State to the EC Merger Regulation prudential carve-out in the context of cross-border banking mergers. However, one should not exclude the possibility that this provision may gain importance for merger transactions in the banking sector which involve financial or non-financial institutions from third countries and which would require a national supervisory authority to take account of specific prudential and/or procedural considerations[234].

Against this backdrop, consideration might be given to whether a more systematic procedure for notification to the Commission of these legitimate interests relating to prudential rules[235] might not, in the context of banking mergers with a Community dimension, remove any possible risk of conflict between the rules derived from the EC Merger Regulation on the one hand and those derived from the Banking Directive and other prudential requirements contained in EU directives on the other hand.

[234] On the aspects relating to the prudential assessment of qualifying holdings of third country acquirers, see Chapter 3, pp. 72 - 75 of this paper.

[235] Rodger, p. 1526.

2 The substantive EU rules applicable to the prior authorisation of qualifying holdings in the banking sector

2.1 Introduction

The reform of the EU rules applicable to the prior authorisation of qualifying holdings in the banking sector took place against the backdrop of the lack of cross-border banking consolidation in the EU financial sector[236], and of the unsuccessful attempts of foreign banks to acquire control over certain Italian banks in the course of 2005[237]. The aim of the reform is to ensure that supervisory authorities are as specific and transparent as possible if they have doubts about the sound and prudent management of the credit institution concerned, and to minimise the scope for public authorities to invoke prudential rules in order to hinder cross-border mergers and acquisitions for nationalistic reasons. Against this backdrop, the Qualifying Holdings Directive is intended to ensure greater certainty and predictability in the application of the prudential criteria by the competent authorities for the supervisory assessment of an acquisition[238] and it sets out the procedural rules to be applied by the competent authorities for such assessment with the introduction of a transparent notification and decision-making process for supervisory authorities and proposed acquirers.

The procedure for the adoption of Qualifying Holdings Directive was completed relatively quickly, since the Commission presented its formal proposal on 12 September 2006 ('the Commission's proposal') and agreement was reached with the European Parliament and the Council, following a single reading under the co-decision procedure. Following the Report of MEP Wolf Klinz on 5 February 2007 for the Committee on Economic and Monetary Affairs of the European Parliament ('the MEP Wolf Klinz Report'), the resolution of the European Parliament was adopted on 13 March 2007. Political agreement on the Qualifying Holdings Directive was reached by ECOFIN on 27 March 2007. As part of the legislative process the European Central Bank (ECB) was consulted and gave its opinion on the Commission's proposal in ECB Opinion CON/2006/60[239]. The Qualifying Holdings Directive modifies selected provisions of the Banking Directive[240] and, in order to ensure

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236 See the report of the informal meeting of ECOFIN, 13.9.2004 and the Commission staff working document, 'Cross-border consolidation in the EU financial sector', 26.10. 2005, (SEC(2005) 1398, Part III, p. 28).

237 See above Chapter I.

238 Proposal for a Directive of the European Parliament and of the Council amending Council Directive 92/49/EEC and Directives 2002/83/EC, 2004/39/EC, 2005/68/EC and 2006/48/EC as regards procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase of shareholdings in the financial sector, COM(2006) 507 final (Explanatory memorandum to the Commission's proposal, para. 1.4, p. 2).

239 ECB Opinion CON/2006/60 of 18 December 2006 on a proposal for a Directive amending certain Community directives as regards procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase of shareholdings in the financial sector (OJ C 27, 7.2.2007, p. 1). For further information regarding the advisory role of the ECB under Article 105(4) EC, see Würtz (2005), pp. 283-328 on draft Community legislation and Kerjean (2005), pp. 3-14 on draft national laws.

240 This is essentially Article 19 of the Banking Directive and subsidiarily Article 12(1), Article 20, Article 21(3) and Article 150(2) on comitology.

cross-sectoral consistency, the corresponding provisions of four other financial sector directives[241], which regulate the notification and prior authorisation process for the acquisition or increase a qualifying holding in an assurance, insurance or re-insurance undertaking or an investment firm[242].

The Qualifying Holdings Directive must be implemented by the Member States before 21 March 2009. Notifications of qualifying holdings submitted to the competent authorities prior to the entry into force of national rules implementing the Qualifying Holdings Directive will have to comply with rules in force at the time of notification[243]. When a reference is made in this paper to the national laws of a Member State, this is based on the current laws and it does not prejudge the content of laws to implement the Qualifying Holdings Directive.

In substance, the amendments to the Banking Directive apply *mutatis mutandis* to the other financial sector Directives with some adjustments to take account of the special characteristics of each sectoral directive. The analysis in this paper is essentially based on the provisions of the Banking Directive[244].

The approach taken in the Qualifying Holdings Directive is one of maximum harmonisation as regards both the procedure and the prudential assessments, without the Member States being entitled to lay down stricter rules[245]. This essentially covers the thresholds for notifying a proposed acquisition or disposal of a qualifying holding, the assessment procedure and the list of assessment criteria[246]. In particular, Member States may not impose requirements for notification to and approval by the competent authorities of direct or indirect acquisitions of voting rights or capital that are more stringent than those set out in the Banking Directive[247]. However, there are certain exceptions to this maximum harmonisation rule (for instance, for aspects relating to thresholds). This choice of

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241 Council Directive 92/49/EEC of 18 June 1992 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and amending Directives 73/239/EEC and 88/357/EEC (third non-life insurance Directive) (OJ L 228, 11.8.1992, p. 1); Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance (OJ L 345, 19.12.2002, p. 1); Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L 145, 30.4.2004. p. 1); and Directive 2005/68/EC of the European Parliament and of the Council of 16 November 2005 on reinsurance and amending Council Directives 73/239/EEC, 92/49/EEC as well as Directives 98/78/EC and 2002/83/EC (OJ L 323, 9.12.2005, p. 1).

242 The reform does not affect the rules for the authorisation of these regulated entities or the rules on qualifying holdings outside the financial sector (see, e.g., Articles 120 ff. of the Banking Directive).

243 Article 8(2) of the Qualifying Holdings Directive.

244 As regards the insurance sector, the Qualifying Holdings Directive amends Directive 92/49/EEC, Directive 2002/83/EC and Directive 2005/68/EC. These three directives form part of the group of directives which have been recast in the Amended Proposal for a Directive of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), COM(2008) 119 final of 26.2.2008. The new Solvency II regime is intended to ensure the financial soundness of insurance undertakings, the protection of policyholders (consumers and businesses) and the stability of the financial system as a whole. The rules will replace the old requirements and establish more harmonised requirements across the EU. As regards Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ L 145, 30.4.2004, p. 1) (the MiFID), the Qualifying Holdings Directive only modifies the qualifying holdings rules applicable to investment undertakings and not the specific and parallel requirements applicable to regulated markets.

245 Recital 6 of the Qualifying Holdings Directive.

246 Ibid, third sentence.

247 Article 19(8) of the Banking Directive, as amended.

maximum harmonisation contrasts with the other provisions of the Banking Directive which are still based on the principle of the minimum harmonisation of rules and the mutual recognition of prudential supervision between the Member States (home State control). Member States are entitled to establish stricter rules than those laid down in several provisions of the Banking Directive for credit institutions authorised by their competent authorities[248]. In 2005, in its communication entitled 'Intra-EU investments in the financial services sector, the Commission noted that there are risks of incompatibility with primary Community law if national rules are more restrictive than EU secondary legislation, for instance with regard to the determination of the soundness of financial institutions, approval thresholds and administrative procedures, or if the discretionary powers of supervisory authorities in connection with the authorisation and supervision of financial intermediaries are not used exclusively to protect the interests for which they are intended[249]. By analogy with the judgment in the *De Castro Freitas and Escallier* case[250], the Commission pointed out that 'when legislating or creating or enforcing administrative practices, Member States must respect both the basic freedoms guaranteed by the Treaty in addition to ensuring compliance with the directive'. The Commission also noted that, although EU secondary legislation has established a number of core principles to ensure the probity and soundness of financial institutions, including compliance with the 'fit and proper' requirement and solvency requirements, Community legislation has not gone beyond a certain degree of harmonisation of specific provisions, which thus enables Member States to apply supplementary rules and administrative practices to the common rules laid down in EU directives[251]. This choice of maximum harmonisation rules for notification of the acquisition and disposal of qualifying holdings may help reduce substantially the risk of conflicts between national law and the Treaty freedoms.

2.2 Notification of qualifying holdings

2.2.1 Prior authorisation of qualifying holdings

Under the Banking Directive, credit institutions must obtain authorisation from the competent supervisory authorities before commencing their activities[252]. The application for authorisation must be accompanied by a programme of operations setting out, among other things, the types of business envisaged and the structural organisation of the credit institution. Competent authorities may only grant authorisation to the credit institution if there are at least two persons who effectively direct the business of the credit institution[253] and if these persons are of sufficiently good repute and have sufficient

248 Recital 15 of the Banking Directive. Under the previous rules of the Banking Directive this concerns the provisions on minimum capital/initial capital, authorisation for the taking-up of the business of credit institutions, *qualifying holdings*, exchange of information and confidentiality, the minimum level of own funds and qualifying holdings outside the financial sector.

249 See Chapter 4, 'Secondary legislation on prudential supervision', third paragraph, of Commission communication – Intra-EU investments in the financial services sector (OJ C 293, 25.11.2005, p. 2).

250 Joined Cases C-193/97 and 194/97 *de Castro Freitas & Escallier* v *Ministre des Classes moyennes et du Tourisme* [1998] ECR I-6747; or more recently, Case C-330/03 *Colegio de Ingenieros de Caminos* [2006] ECR I-801, para. 29.

251 See Chapter 4, second paragraph of Commission communication – Intra-EU investments in the financial services sector.

252 Article 6 of the Banking Directive.

253 Article 11(1) of the Banking Directive.

experience to perform such duties[254]. Taking into account the need to ensure the sound and prudent management of a credit institution, the competent authorities must be satisfied as to the suitability of the shareholders or members[255]. The competent authorities must be informed of the identities of the shareholders or members, whether direct or indirect, natural or legal persons, that have qualifying holdings, and of the amounts of those holdings[256].

Under the Banking Directive, prior authorisation is also required for acquisitions and/or increases of qualifying holdings. In this respect the Banking Directive previously provided that:
'The Member States shall require any natural or legal person who proposes to hold, directly or indirectly, a qualifying holding in a credit institution first to inform the competent authorities, telling them of the size of the intended holding. Such a person shall likewise inform the competent authorities if he proposes to increase his qualifying holding so that the proportion of the voting rights or of the capital held by him would reach or exceed 20 %, 33 % or 50 % or so that the credit institution would become his subsidiary.
…the competent authorities shall have a maximum of three months from the date of the notification … to oppose such a plan if, in view of the need to ensure sound and prudent management of the credit institution, they are not satisfied as to the suitability of the person concerned'[257].

The above provision was modified by the Qualifying Holdings Directive as follows:
'Member States shall require any natural or legal person or such persons acting in concert (hereinafter referred to as the proposed acquirer), who have taken a decision either to acquire, directly or indirectly, a qualifying holding in a credit institution or to further increase, directly or indirectly, such a qualifying holding in a credit institution as a result of which the proportion of the voting rights or of the capital held would reach or exceed 20 %, 30 % or 50 % or so that the credit institution would become its subsidiary (hereinafter referred to as the proposed acquisition), first to notify in writing the competent authorities of the credit institution in which they are seeking to acquire or increase a qualifying holding, indicating the size of the intended holding and relevant information'[258].

The Banking Directive therefore requires prior notification to and authorisation from competent authorities when a natural or legal person proposes to acquire, directly or indirectly, or increase a qualifying holding in a credit institution. This requirement is maintained under the new qualifying holdings rules[259]. The Qualifying Holdings Directive simply clarifies that the proposed acquirer must notify *in writing* the competent authority of the credit institution in which it is seeking to acquire a qualifying holding with a view to obtaining clearance from that authority. A similar obligation to

254 Article 11(1), second subparagraph, of the Banking Directive.
255 Article 12(1) of the Banking Directive.
256 Ibid.
257 Article 19(1) of the Banking Directive.
258 Article 4(2) of the Qualifying Holdings Directive.
259 Article 19(5) and (6) of the Banking Directive, as amended.

notify applies when a natural or legal person decides to dispose of or reduce a qualifying holding in a credit institution[260]. The precise moment when the proposed acquirer decides to acquire is not defined – probably intentionally – though the wording of the Qualifying Holdings Directive is more precise in this respect than the expression used in the Banking Directive ('proposes to hold') and refers to a more formal commitment on the part of the proposed acquirer than a simple intention. National laws usually refrain from defining a specific moment when the notification obligation arises[261]. In Italy, the requirement for prior communication to the Banca d'Italia of an intention to acquire holdings leading to the control of a bank or a financial holding company, before such intention is communicated to the decision-making bodies of the company for approval, has been repealed[262]. By comparison, in the context of the EC Merger Regulation, concentrations with a Community dimension must be notified to the Commission 'prior to their implementation and following the conclusion of the agreement, the announcement of the public bid, or the acquisition of a controlling interest'[263]. Notification may also be made 'where the undertakings concerned demonstrate to the Commission a good faith intention to conclude an agreement or, in the case of a public bid, where they have publicly announced an intention to make such a bid, provided that the intended agreement or bid would result in a concentration with a Community dimension'[264].

The Court has provided guidance on the rights and obligations of investors and the duties of public authorities in prior authorisation procedures, such as the notification of qualifying holdings. In the context of prudential supervision, in the *Fidium Finanz* case Advocate General Stix-Hackl pointed out that 'a notification system is essentially preferable to a system of prior authorisation because it is a means which has a less adverse effect on the free movement of capital. However, the requirement of authorisation for the grant of credit goes beyond a mere need for information on the part of the national authorities. It is intended to enable those authorities, if necessary, to adopt and enforce effective measures against the undertaking, which, in extremis, may even include the refusal or withdrawal of authorisation'[265]. Nevertheless, Member States must exercise their supervisory prerogatives in keeping with fundamental Treaty principles, and procedures for prior administrative

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260 Article 20 of the Banking Directive, as amended. In these cases, the natural or legal person does not have to supplement the notification with any specific information, as in the case of acquisitions or increases of shareholdings.

261 In France, Article 2(1) of the French regulation 96-16 of 20 December 1996, relating to changes in the situation of credit institutions and of investment firms other than portfolio management companies, provides that any person or group of persons acting together must obtain the authorisation of the CECEI 'prior to carrying out any operation relating to the acquisition, increase or disposal or a direct or indirect equity interest in an undertaking' (available at www.banque-france.fr).

262 This requirements differs from the requirement in French law, under which any natural or legal person wishing to notify a public bid to the French Financial Markets Authority with a view to acquiring a quantity of the equity of a credit institution authorised in France, must inform the Governor of the Banque de France, Chairman of CECEI, eight working days before the submission of the proposed takeover bid or its public announcement if prior to the submission (Article L.511-10 of the Code). The requirement in question is only of a declarative nature and part of the transparent dialogue with financial sector authorities, unless it is shown that the oral advice of the Governor not to apply for approval for a cross-border acquisition or increase of shareholding is used as a substitute for a documented refusal of authorisation.

263 On the meaning of the 'implementation' of a concentration, see Order of the Court of First Instance, 18.3.2008, Case T-411/07 R, *Aer Lingus* v *Commission* (relating to an acquisition of minority shareholding).

264 Article 4(1) and Article 7 of the EC Merger Regulation (regarding the suspension of concentrations in case of public bids).

265 Case C-452/04 *Fidium Finanz* [2006] ECR I-9521, Opinion of A.G. Stix-Hackl paras. 143 and 147.

approval must be suitable and proportionate, provide legal certainty and be transparent (for instance, in terms of deadlines and delays applicable, the quantity and quality of information required, as well as nature of documents to be provided[266]). In this regard the Court has pointed out that 'a scheme of prior administrative authorisation cannot legitimise discretionary decisions taken by the national authorities, which are liable to negate the effectiveness of provisions of Community law, in particular those relating to a fundamental freedom'[267]. The Court has also stressed that 'in order for a prior administrative authorisation scheme to be justified even though it derogates from such a fundamental freedom, it must, in any event, be based on objective, non-discriminatory criteria which are known in advance, in such a way as to circumscribe the exercise of the national authorities' discretion, so that it is not used arbitrarily… Such a prior administrative authorisation scheme must likewise be based on a procedural system which is easily accessible and capable of ensuring that a request for authorisation will be dealt with objectively and impartially within a reasonable time and refusals to grant authorisation must also be capable of being challenged in judicial or quasi-judicial proceedings'[268]. Similarly, the Court has emphasised that systems of prior authorisation must allow all persons affected by a restrictive measure to have a legal remedy. According to the Court, investors must be given a clear 'indication of the specific, objective circumstances in which prior approval will be granted or withheld' since 'such lack of precision does not enable individuals to be apprised of the extent of their rights and obligations deriving from Article 56 EC, with the result that such rules must be regarded as contrary to the principle of legal certainty'[269].

2.2.2 Qualifying holdings and thresholds for notification

The Banking Directive defines a qualifying holding as 'a direct or indirect holding in an undertaking which represents 10 % or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of that undertaking'[270]. This definition has not been modified by the reform. Moreover, the series of thresholds in the Banking Directive for qualifying holdings[271] remains unchanged, with the exception of the threshold of 33 % which is replaced by a threshold of 30 %[272]. As regards the applicable thresholds, the amended Banking Directive continues to apply to an acquisition of a qualifying holding or an increase of a qualifying holding 'as a result of which the proportion of the voting rights or of the capital held would reach or

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266 Commission communication – Intra-EU investments in the financial services sector (OJ C 293, 25.11.2005, p. 2), para. 3.

267 Case C-385/99 *Müller-Fauré* [2003] ECR I-4509, para. 84; and Case C-452/01 *Ospelt* [2003] ECR I-9743, para. 34. In certain circumstances, a prior declaration system, when coupled with appropriate legal instruments, may in fact constitute a measure proportionate to the public interest objective pursued. Such a system may make it possible to eliminate the requirement for prior authorisation, generally more restrictive on the free movement of capital, without undermining the effective pursuit of the aims of the public authority (Case C-213/04 *Burtscher* v *Stauderer* [2005] ECR I-10309, para. 52). However, a procedure simply involving a declaration does not in itself enable the aim pursued to be achieved in the context of a procedure for prior authorisation (Case C-302/97 *Konle* [1999] ECR I-3099, para. 46).

268 Case C-157/99 *Smits and Peerbooms* [2001] ECR I-5473, para. 90.

269 Case C-463/00 *Commission* v *Spain* [2003] ECR I-4581, paras. 74 and 75; and Case C-54/99 *Église de Scientologie* [2000] ECR I-1335, paras. 21 and 22.

270 Article 4(11) of the Banking Directive.

271 Article 19(1), first subparagraph, of the Banking Directive.

272 Article 19(1) and Article 20 of the Banking Directive, as amended.

exceed 20 %, 30 % or 50 % or so that the credit institution would become its subsidiary'[273]. The thresholds for notifying a proposed acquisition or disposal of a qualifying holding are among the provisions which are subject to maximum harmonisation[274]. Therefore, unlike the current situation where some Member States have established additional or lower thresholds for notification than those in the Banking Directive, it is not possible for Member States to introduce stricter rules, i.e. additional thresholds. However, Member States may still require that the competent authorities merely be informed about acquisitions of holdings below the thresholds laid down in the Banking Directive, 'so long as a Member State imposes no more than one additional threshold below 10 % for this purpose'[275]. In the latter case, it is understood that the obligation to inform is simply declarative and does not require authorisation from the competent authority. Lastly, competent authorities are entitled to provide 'general guidance as to when such holdings would be deemed to result in significant influence'[276], which, in order to ensure a level playing field throughout the EU, should preferably be provided in the form of common guidelines from the Committee of European Banking Supervisors (CEBS).

Another issue relates to the increasing practice for investors (hedge funds in particular) to build up a stake by stealth, by using swaps or other derivatives whereby they do not obtain voting rights until, upon unwinding the swap, they suddenly appear as a major voter at a shareholders' meeting[277]. The derivatives revolution in finance, especially the growth in equity swaps and other privately negotiated OTC equity derivatives, has made it easier and cheaper to decouple economic ownership from voting power[278]. The rapid growth of hedge funds has coincided with an increase in this kind of decoupling, and these funds sometimes hold more votes than shares, a pattern called 'empty voting' since the votes have been emptied of their accompanying economic rights[279]. Against this background, it has become possible to obtain control over more votes than the corresponding economic interests in the related voting shares, or vice versa, and some concern has been expressed that hedge funds, for instance, may not provide adequate disclosure about the extent of their voting power and economic interests in the companies involved[280]. The concerns raised by 'empty voting' practices[281] trigger increasing attention from national supervisory authorities in the EU[282], namely – but not exclusively – in the context of the transposition of the Transparency Directive[283] and the application of disclosure rules to certain types of

[273] Article 19(1) of the Banking Directive, as amended.
[274] Recital 6, third sentence, of the Qualifying Holdings Directive.
[275] Recital 6, fourth sentence, of the Qualifying Holdings Directive.
[276] Recital 6, last sentence, of the Qualifying Holdings Directive.
[277] OECD (2007), p. 42 and p. 46 and in particular the description of the equity swap arrangement in the Perry Corp/Rubicon case.
[278] Hu and Black, p. 1014.
[279] Ibid.
[280] OECD (2007), p. 42 and p. 46.
[281] See the Commission's Impact assessment on the proportionality between capital and control in listed companies, of 12 December 1007, p. 24 (SEC(2007)1705).
[282] See, for instance, the public consultation launched by the UK Financial Services Authority on Disclosure of Contracts for Difference (07/20, November 2007: http://www.fsa.gov.uk/pubs/cp/cp07_20.pdf).
[283] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated

financial instruments such as derivatives. The effectiveness of EU legislation in protecting corporate democracy, the stability of the financial system and its freedom from unsuitable outside influence, as well as protecting the creditors of financial institutions, may be impaired if it does not deal with these kinds of transactions which effectively undermine the presumed intentions of the legislator[284]. It is not ascertained yet whether the definition of 'qualifying holding' and more generally, the provisions of the Banking Directive are capable of dealing with such practices effectively[285], also given the possibilities for investors to act in concert[286].

2.2.3 Consistency between authorisation and qualifying holdings rules

Historically, the Banking Directive has developed with parallels between the rules applicable to authorisation requirements for credit institutions and the rules applicable to the prudential assessment of acquisitions and increases of shareholdings. This is to a large extent maintained under the Qualifying Holdings Directive, one particular concern being to avoid regulatory arbitrage allowing individuals and institutions wishing to conduct banking business to circumvent the initial conditions for authorisation by acquiring a qualifying holding in a target entity[287]. By contrast, other aspects of the reform might have the consequence of reducing, at least formally, the parallelism of the above provisions of the Banking Directive. As regards authorisation procedures, the competent authorities must be satisfied as to the suitability of the shareholders or members[288], taking into account the need to ensure the sound and prudent management of credit institutions. As for the qualifying holdings rules and as described below, the competent authorities must assess the suitability of a proposed acquirer and the financial soundness of the proposed acquisition against an exhaustive set of criteria[289], and may only oppose a proposed acquisition if there are reasonable grounds for doing so on the basis of the criteria set out in the Qualifying Holdings Directive or if the information provided by the proposed acquirer is incomplete[290].

More fundamentally, this raises the question of whether this parallelism is justified, assuming that the rules applicable to an acquisition or an increase of a shareholding do not necessarily need to follow the same pattern as the authorisation rules, and that this type of transaction could legitimately be subject to less onerous constraints than the conditions for the authorisation of a credit institution. In particular, it could reasonably be argued that the mere fact of being an authorised credit institution (or even, under certain conditions, a financial sector entity regulated under Community law) should suffice for an entity to be entitled to pursue the acquisition of a credit institution, since the acquirer is already

market and amending Directive 2001/34/EC (OJ L 390, 31.12.2004, p. 38) and Commission Directive 2007/14/EC of 8 March 2007 laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC (OJ L 69, 9.3.2007, p. 27). See, on these aspects, for instance, Clerc (2008) or Grillier and Segrain (2007).

284 This terminology is borrowed to Professor René Smits.

285 Despite the reference to the Transparency Directive for the definition of voting rights and the conditions regarding aggregation (Article 12(1), second subparagraph, of the Banking Directive, as amended).

286 See below Chapter 3, 3.2 of the paper.

287 Recital 3 of the Qualifying Holdings Directive, third sentence.

288 Article 12(2) of the Banking Directive.

289 Article 19a(1) of the Banking Directive, as amended.

290 Article 19a(2) of the Banking Directive, as amended.

allowed to do business with a European passport across Europe directly through the provision of services or through branches. The Qualifying Holdings Directive points in that direction when it suggests, for instance, that the assessment of the reputation should be facilitated if the acquirer is authorised and supervised within the EU[291]. Supervisory authorities consider that this approach overlooks the fact that, in addition to the supervisory assessment of the suitability of the proposed acquirer in the narrow sense, there is a need to examine the wider suitability of the qualifying shareholder in relation to the new group and the position of the target institution following the acquisition, including the situation where the proposed acquirer is from a different regulated sector than the target institution. This approach was not pursued further in the Qualifying Holdings Directive and no distinction was introduced between regulated financial sector institutions with a European passport and non-regulated proposed acquirers.

2.3 Prudential assessment

2.3.1 The harmonised prudential assessment criteria

The Qualifying Holdings Directive contains an exhaustive list of prudential assessment criteria[292] which is an improvement on the previous wording of the Banking Directive which merely provided that the competent authority could oppose the plan of the proposed acquirer 'if, in view of the need to ensure sound and prudent management of the credit institution', it is not 'satisfied as to the suitability of the person concerned'. The assessment of the suitability of the proposed acquirer and the financial soundness of the proposed acquisition must now be carried out against an exhaustive set of five specific criteria. Two of the criteria relate to the proposed acquirer and require an assessment to be made of its reputation (including its integrity and professional competence, and an examination of past business conduct[293]) and its financial soundness (including its adequacy for carrying on the type of business of the target credit institution)[294].

Two of the prudential assessment criteria relate more specifically to the target institution. These are the reputation and experience of the persons who will direct the credit institution as a result of the proposed acquisition[295] and the continuing compliance by the institution with the prudential requirements[296]. The supervisory authorities often refer to the 'fit and proper' criteria as an essential component of the assessment of the suitability of shareholders or qualifying shareholders. Although this wording does not appear as such in the Banking Directive, this concept is generally understood as meaning that the persons who effectively direct the business of the credit institution must be of sufficiently good repute and have sufficient experience to perform such duties.[297] The latter criterion

[291] Recital 8 of the Qualifying Holdings Directive. See also below on the aspects relating to cooperation between supervisory authorities.
[292] Article 19a(1) of the Banking Directive, as amended.
[293] Article 19a(1)(a) of the Banking Directive, as amended.
[294] Article 19a(1)(c) of the Banking Directive, as amended.
[295] Article 19a(1)(b) of the Banking Directive, as amended.
[296] Article 19a(1)(d) of the Banking Directive, as amended.
[297] See, in the context of the authorisation criteria, Article 11 (1) of the Banking Directive.

of compliance with prudential requirements is intended to cover all applicable directives in the financial sector[298], notably the directives on electronic money, financial conglomerates and capital requirements[299]. It is specified in this respect that the prudential assessment of a proposed acquisition should not in any way suspend or supersede the requirements of ongoing prudential supervision and other relevant provisions to which the target entity has been subject since its own initial authorisation[300].

As described above, in the context of the proceedings against Italy and Portugal for infringements of the Treaty in relation to the banking sector, the Commission expressed some reservations about the invocation by national authorities of concerns such as the lack of clarity and transparency of the group structure resulting from the transaction[301], or concerns regarding the stability of the governance of the target institution[302], as possible justifications for refusing the acquisition of qualifying holdings, since these criteria may allow too much discretion to the supervisory authority. These criteria were not incorporated in the Qualifying Holdings Directive. However, the criterion requiring compliance by the credit institution with prudential requirements[303] is complemented by a more subjective reference to the need to ensure that 'the group of which the credit institution will become a part has a structure that makes it possible to exercise effective supervision, effectively exchange information between the competent authorities and determine the allocation of responsibilities among the competent authorities'[304]. One may regret this reference to the exchange of information and the allocation of responsibilities between the competent authorities in the context of this criterion in view of the other provisions of the Qualifying Holdings Directive on cooperation between the national supervisory authorities in the EU Member States. A separate criterion on these aspects applicable to third country acquirers might have been more appropriate[305].

Lastly, the fifth criterion relates to whether there are reasonable grounds to suspect the existence of money laundering or terrorist financing activities[306] in connection with the proposed acquisition[307].

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[298] The Commission's proposal suggested a different wording for this criterion and stressed the need for a credit institution 'to meet and continue to meet its obligations under this Directive and any applicable sectoral rules'. In this context the term 'sectoral rules' refers to the Community legislation relating to the prudential supervision of regulated entities.

[299] Directive 2000/46/EC of the European Parliament and of the Council of 18 September 2000 on the taking up, pursuit of and prudential supervision of the business of electronic money institutions (OJ L 275, 27.10.2000, p. 39); Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (OJ L 35, 11.2.2003, p. 1); and Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast) (OL L 177, 30.6.2006, p. 201).

[300] Recital 4 of the Qualifying Holdings Directive.

[301] See I.B.2 above.

[302] See I.B.2 above.

[303] Article 19a(1)(d) of the Banking Directive, as amended.

[304] Ibid.

[305] See Chapter 3 of this paper.

[306] Within the meaning of Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (OJ L 309, 25.11.2005, p. 15).

[307] Article 19a(1)(e) of the Banking Directive.

For comparison, in the USA the criteria for the assessment of acquisition of control of any depository (i.e. credit) institution whose deposits are insured by the United States Federal Deposit Insurance Corporation pertain both to prudential and antitrust considerations[308]. In particular, the appropriate Federal banking agency may deny approval of any proposed acquisition if: (a) the proposed acquisition of control would result in a monopoly or would be in furtherance of any combination or conspiracy to monopolise or attempt to monopolise the business of banking in any part of the United States; (b) the effect of the proposed acquisition of control in any section of the country may be substantially to lessen competition or tend to create a monopoly, or the proposed acquisition of control would in any other manner be in restraint of trade, and the anticompetitive effects of the proposed acquisition of control are not clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served; (c) either the financial condition of any acquiring person or the future prospect of the institution is such as might jeopardise the financial stability of the bank or prejudice the interests of the depositors of the bank [depository institution]; (d) the competence, experience, or integrity of any acquiring person or of any of the proposed management personnel indicates that it would not be in the interest of the depositors of the bank, or in the interest of the public to permit such person to control the bank; (e) any acquiring person neglects, fails, or refuses to furnish the appropriate Federal banking agency with all the information required by the appropriate Federal banking agency; or (f) the appropriate Federal banking agency determines that the proposed transaction would result in an adverse effect on the Deposit Insurance Fund[309]. As another example of the applicable rules in the USA, specific criteria apply to the acquisition of a credit institution by a Bank Holding Company or a company becoming a Bank Holding Company[310] which combine both competitive, financial, managerial, and supervisory conditions (including compliance with applicable banking law, including anti-money laundering laws)[311].

In the EU Member States there is a tendency for a clear distinction to be made between the merger control authorisation criteria and the prudential criteria, together with specific procedures and mechanisms for cooperation between competition authorities and prudential supervision authorities, with banking mergers being subject to the ordinary merger control regime. For instance, in France, following the *Crédit Agricole/Crédit Lyonnais* case[312] in 2003 which revealed a gap in the French legislation[313], specific rules have been introduced in order to define the powers of the competition authority and of the Banque de France respectively in cases of mergers in the banking sector. Under

[308] See Blache (2006) for a detailed analysis of US banking laws and, more specifically on these aspects, pp.113-118 and pp.134-136.

[309] See 12 U.S.C. §1817(j)(7) (http://uscode.house.gov/uscode-cgi/).

[310] See 12 U.S.C . §1842.

[311] These criteria also include an assessment of the effects of the proposed acquisition on the convenience and needs of the communities to be served. For a recent example of the application of these criteria, see the Federal Reserve System Order approving the acquisition of control of a Bank (JPMorgan Chase & Co acquiring indirect control of Bear Stearns Bank & Trust), 1 April 2008.

[312] Decision of the CECEI of 14 March 2003 authorising the acquisition by Crédit Agricole SA of control of 50.01 % of the voting rights of Crédit Lyonnais and the resulting acquisition of minority shareholdings, and judgment of the French Council of State of 16 May 2003 annulling the decision of the CECEI.

[313] On this issue, see : Krimmer (2003), p. 3 ; Toboul (2003), II 10126; Bourdeaux and Degoffe (2003), p. 1007; Vilmart (2003), p. 176.

the French Monetary and Financial Code, in transactions involving concentrations relating, whether directly or not, to a credit institution or an investment firm[314], the CECEI may, if it considers it appropriate in the light of all the information it has, decide on prudential grounds following a decision of the French Ministry of Economy as competition authority[315]. In Italy, a draft law currently under discussion provides that, in the event of a banking merger, Banca d'Italia must issue a non-binding opinion within thirty days of receiving the relevant documentation. In the event of non-compliance with this obligation, the Italian competition authority may adopt its decision without it[316].

2.3.2 Prohibition of restrictions on the level of shareholding

Member States must not impose any prior conditions in respect of the level of shareholding that must be acquired nor allow their competent authorities to examine a proposed acquisition in terms of the economic needs of the market[317]. These two limitations, which were introduced in the Qualifying Holdings Directive, make it clear that the competent authorities should not interfere in business decisions or strategies and should not attempt to restrict the conditions under which investors decide to acquire shareholdings[318]. The second of these limitations imposed on competent authorities in the exercise of their prerogatives mirrors a prohibition which is already applicable to authorisation[319]. Furthermore, these provisions reflect the Court's consistent case law described above, according to which national measures must be considered as restrictions on the free movement of capital if they are likely to prevent or limit the acquisition of shares in the undertakings concerned or to deter investors of other Member States from investing in their capital[320]. In particular, in the *Commission* v *Portugal* case the Court concluded that a breach of the prohibition of restrictions on the movement of capital was established when there were rules 'precluding investors from other Member States from acquiring more than a given number of shares in certain domestic undertakings'[321].

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314 Article L.511-12-1 of the French Monetary and Financial Code.

315 In accordance with Articles L.430-1 and following of the French Code of Commerce or the decision of the European Commission taken in accordance with the EC Merger Regulation.

316 See the draft Italian law on the regulation and supervision of markets and the functioning of the competent independent authorities and ECB Opinion CON/2007/17 of 18 June 2007 at the request of the Italian Ministry of Economic Affairs and Finance on a draft law on the regulation and supervision of markets and the functioning of the competent independent authorities, para. 4. For the aspects related to competition and banking supervision in the Italian context, see also ECB Opinion CON/2005/58 of 23 December 2005 at the request of the Italian Ministry of Economy and Finance on an amendment to the draft law on the protection of savings concerning the Banca d'Italia, paras. 7 and 8; ECB Opinion CON/2006/51 of 3 November 2006 at the request of the Italian Ministry of Economic Affairs and Finance on a draft legislative decree exercising powers delegated under the Law on the protection of savings, para. 3; and ECB Opinion CON/2004/16 of 11 May 2004 at the request of the Italian Ministry of Economic Affairs and Finance on a draft law on the protection of savings, para. 14.

317 Article 19a(3) of the Banking Directive, as amended.

318 An example of such a restriction is the conditional approval of a bid upon the acquisition of a shareholding above 50 % (see Chapter I of the paper).

319 See Article 8 of the Banking Directive.

320 See Chapter 1 of the paper.

321 Case C-367/98 *Commission* v *Portugal* [2002] ECR I-4731, para. 42; Case C-463/00 *Commission* v *Spain*, [2003] ECR I-4581, para. 57; Case C-483/99 *Commission* v *France* [2002] ECR I-4781, para. 41; Case C-98/01 *Commission* v *United Kingdom* [2003] ECR I-4641, para. 44; Case C-478/98 *Commission* v *Belgium* [2000] ECR I-7587, para. 18; and Case C-54/99 *Église de Scientologie* [2000] ECR I-1335, paras. 14 and 18.

One concern relating to the prudential assessment of shareholdings relates to situations which may contribute to the existence of 'precarious ownership structures', i.e. where the proper functioning of the target credit institution may be put at risk by a conflict between large shareholders, each of whose shareholdings may be large enough to block decisions but insufficient to control the institution[322]. Such an ownership structure may impair the management of the target credit institution, with possible negative implications for its effective supervision and, from a prudential perspective, it is important to retain adequate safeguards to ensure that the target institution's corporate governance is sufficiently robust to prevent a potential deadlock in its decision-making following the proposed acquisition[323]. These situations may also occur when the share ownership structure of a target credit institution is not sufficiently stable, and where there is an acquisition of a minority shareholding in the target institution by an important competitor of the credit institution.

The attempt by the French bank BNP in 1999 to acquire Société Générale, another French bank, following a hostile bid and the subsequent negative decision of the French competent authority, the CECEI, is an illustration of this situation[324]. In this case, following a hostile bid by BNP, the CECEI refused the acquisition by BNP of a minority 37.15 % shareholding in Société Générale, representing 31.8 % of the voting rights[325]. Although the decision was not published, the CECEI analysis was that, when a single contributor of capital does not exercise effective control of a credit institution, it must ensure that the share ownership structure is nevertheless sufficiently stable. In particular, when a takeover bid has not been approved by the target institution's decision-making bodies, the CECEI considered that a clear, pre-arranged solution should be encouraged. In this case, given the size of the new group resulting from the proposed acquisition, the aim was to ensure that any difficulties that might arise during or after the transaction should not adversely affect the smooth functioning of the banking system and the security of customers[326]. Since the threshold for the launch of a takeover bid was not reached[327], in the absence of an agreement between the parties (*une solution claire et concertée*[328]) or of a clear power of control over the new group (*la détention manifeste du pouvoir effectif de contrôle* [329]) on completion of the transaction, the CECEI refused to authorise the planned disposals of securities.

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322 See Opinion CON/2006/60, para. 2(6).
323 Opinion CON/2006/60, para. 2(6).
324 However, the CECEI authorised the parallel acquisition of control of Paribas by BNP (BNP had obtained 65.06 % of the capital of Paribas and 65.2 % of the voting rights).
325 Daigre, para. 1, third sub-paragraph, p.1.
326 Article L.511-10 of the French Financial and Monetary Code provides that, before commencing their activities, credit institutions must obtain authorisation from the CECEI. Among other requirements, the CECEI must also assess the applicant company's ability to realise its development plans in conditions which are compatible with the proper functioning of the banking system and which afford sufficient security for customers (Article L.511-10, third subparagraph).
327 See the successive versions of the CECEI Annual Report since 1999 on these aspects (for instance, the CECEI 2006 Annual Report, '4.5.2. Large-scale restructurings', p. 106).
328 Ibid.
329 Ibid.

The decision of the CECEI in 1999 was perceived as the expression of an aversion on the part of public authorities to hostile takeovers in the French banking sector[330] and gave rise to legal criticism for a number of reasons[331]. *First*, the CECEI which is responsible for supervising compliance with prudential rules, was criticised for having acted *ultra vires*, for instance by having imposed the requirement for an agreement between the parties[332]. *Second*, the need for the proposed acquirer to exercise effective control over the target is not a requirement imposed either under the qualifying holdings rules of the Banking Directive or under the French rules. Under Community law, a 'qualifying holding' refers to the direct or indirect holding of 10 % or more of the capital or voting rights, or to the possibility of exercising 'a significant influence over the management of the undertaking', and notification must be given of a decision to acquire, directly or indirectly, a qualifying holding in a credit institution or to further increase such qualifying holding as a result of which the proportion of voting rights or of the capital would reach or exceed 20 %, 30 % or 50 %, or so that the credit institution would become its subsidiary[333]. Under the French rules[334], reference is made to the notion of 'effective control', but only as one of the notification thresholds[335] and not as a material condition for the authorisation of the transaction. In this context, the concept of control (which had to be in addition exercised *de façon manifeste*), to which the CECEI referred in the above case, went beyond the French rules which do not subject the authorisation of an acquisition of a minority shareholding to this condition of effective control or any similar condition. The *BNP/Société Générale* case illustrates to a certain extent the insufficient demarcation between rules relating to qualifying holdings and those relating to the authorisation of credit institutions. The Qualifying Holdings Directive is intended to prevent any circumvention of the initial conditions for authorisation by acquiring a qualifying holding in the target entity[336], and the prudential assessment should not in any way suspend or supersede the requirements for ongoing prudential supervision and other relevant provisions to which the target entity has been subject since its initial authorisation[337]. As mentioned above, one of the authorisation criteria under French law concerns the assessment of the applicant company's ability to realise its development plans in conditions which are compatible with the proper functioning of the banking system and the security of customers[338], and this criterion was invoked by

330 Daigre, para. 19, p.5.

331 See in particular Daigre (2000) and Toboul (2001).

332 Prof. Daigre considered for instance that the CECEI '*a reçu une mission limitée…de contrôle de légalité. Certes, à cette occasion, il exerce un certain pouvoir d'appréciation, mais on considérait jusque-là que celui-ci ne portait pas sur une 'véritable condition subjective d'opportunité économique. A l'évidence, à l'occasion de l'affaire BNP-Société Générale-Paribas, le CECEI a nettement élargi son rôle et s'est donné un véritable pouvoir d'appréciation de l'opportunité économique des opérations, dont on peut se demander s'il est conforme à sa vocation légale*' (Daigre, p. 7).

333 Article 19(1) of the Banking Directive.

334 See Article 2(1) of the French Regulation No 96-16 of 20 December 1996 which provides that 'any person or group of persons acting together shall obtain the authorisation of the CECEI prior to carrying out any operation relating to the acquisition, increase or disposal or a direct or indirect equity interest in an undertaking subject to this Regulation, when the effect of the transaction is to enable said person or persons: to acquire or relinquish effective control over the management of the undertaking; to acquire or relinquish one third, one fifth or one tenth of the voting rights'.

335 This approach may be compared with the approach adopted by Banca d'Italia in the BBVA/BNL case (see Part I.C.2, third paragraph of the paper).

336 Recital 3 of the Qualifying Holdings Directive.

337 Recital 4 of the Qualifying Holdings Directive.

338 See the above Article L.511-10, third subparagraph, of the French Monetary and Financial Code.

the CECEI to refuse clearance for the above acquisition of a minority shareholding[339]. Under the new EU qualifying holdings rules, one may doubt that the decision in this case would be considered compatible with Community law in view of the harmonised prudential assessment criteria laid down in the Qualifying Holdings Directive and the consequent reduction of discretion left to national supervisory authorities.

2.3.3 Non-discrimination and competing bids

In the context of the ABN AMRO attempt in 2005 to acquire the Italian bank Antonveneta by a public bid, ABN AMRO claimed that, 'by favouring a counter-bid by Banca Popolare d'Italiana, [Banca d'Italia] had applied a discriminatory treatment to ABN AMRO that created serious obstacles to its bid' and could not be justified under prudential rules[340]. Recent transactions indicate that competent authorities (both prudential and competition authorities) pay particular attention to emphasising their neutrality vis-à-vis competing bidders[341]. In this regard, the Qualifying Holdings Directive introduces a specific obligation for competent authorities to treat proposed acquirers in a non-discriminatory manner in cases where there are competing bids, i.e. 'when two or more proposals to acquire or increase qualifying shareholdings in the same credit institution have been notified to the competent authority'[342]. The general prohibition of all discrimination on grounds of nationality laid down by Article 12 EC only applies independently to situations governed by Community law for which the EC Treaty does not lay down specific rules of non-discrimination. In relation to freedom of establishment and the free movement of capital, the Treaty already lays down such specific rules in Articles 43 EC and 56 EC in particular[343]. Against this backdrop, the above provision of the Qualifying Holdings Directive on competing bids was therefore not strictly necessary, although it constitutes a useful clarification in the specific context of competing bids on which notifying parties can rely. More specifically, regarding freedom of establishment[344], the Court further pointed out that this freedom 'is

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339 See Article L.511-10 of the French Financial and Monetary Code (for authorisation) extended by the CECEI to clearance of qualifying holdings (see, for instance, the CECEI Annual Report (2006), p.106).

340 Cuadrado, p. 95. See also Curran and Turitto, pp. 79-82.

341 For example, in its merger control decision of 6 August 2007 in the Barclays/ABN AMRO case (COMP/M4692), the Commission points out that the decision is without prejudice to the outcome of the possible competing bids (IP/07/1216). Clearance of the proposed transaction by the Commission does not imply that it considers that the bid will be successful. On 17 September 2007, in relation to the consortium's proposed takeover of ABN AMRO, the Dutch Finance Minister stressed that the declaration of no objection did not imply a preference for a certain scenario or party. See also White, Konevsky and Angelette (2008), pp.171-175.

342 Article 19a(5) of the Banking Directive, as amended.

343 Case C-105/07, *NV Lammers & Van Cleeff v Belgium* [2008] ECR 0000, para. 14. In Article 56 EC, in particular, the Treaty lays down a specific rule of non-discrimination in relation to the free movement of capital (Case C-443/06 *E. Hollmann* [2007] ECR 0000, para. 29), which is a prohibition which goes beyond the mere elimination of unequal treatment on grounds of nationality, as between operators on the financial markets (Case C-367/98 *Commission* v *Portugal* [2002] ECR I-4731, para. 44). Moreover, in relation to the right of establishment, the principle of non-discrimination is specifically laid down by Article 43 EC (Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Hoechst* [2001] ECR I-1727, para. 39).

344 Freedom of establishment which Article 43 EC grants to Community nationals and which includes the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, under the conditions laid down for its own nationals by the law of the Member State where such establishment is effected, entails, in accordance with Article 48 EC, for companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the European Community, the right to carry on their activities in the Member State concerned through a subsidiary, branch or agency.

intended to guarantee the benefit of national treatment in the host Member State, by prohibiting any discrimination based on the place in which companies are registered' and that, 'in the case of companies, their registered office for the purposes of Article 48 EC serves, in the same way as nationality in the case of individuals, as the connecting factor with the legal system of a State'[345].

2.3.4 The practice of commitments

A recital of the Qualifying Holdings Directive allows competent authorities to take into account commitments made by a proposed acquirer to meet prudential requirements under the assessment criteria laid down in the Directive, provided that the rights of the proposed acquirer under the Directive are not affected[346].

The idea of commitments is well-known in the context of merger control rules[347] and enables the parties to a concentration to offer commitments with a view to rendering a concentration compatible with the common market and eliminating competition problems[348]. This enables the Commission to attach conditions and obligations to its decision in order to ensure that undertakings comply with their commitments, and the Commission may revoke a decision if the undertaking concerned commits a breach of an obligation attached to a decision[349]. This concept is not defined in the Banking Directive, and its application is not harmonised at Community level. The question therefore arises as to whether such practices initiated in the context of conditional authorisations can be developed without conflicting with the harmonised prudential assessment criteria, assuming that commitments made by a proposed acquirer are legally binding obligations, precisely defined, and formally attached to the conditional decision of the supervisory authority. In the context of the authorisation of credit institutions, and since the Banking Directive provides for minimum harmonisation in this field[350], this practice seems to be relatively widespread among supervisory authorities[351]. This practice also exists in certain Member States in connection with qualifying holdings[352] and despite the risk of excessive discretion left to these authorities that it entails, it is often justified by the scope offered to supervisory authorities to approve transactions which they would be otherwise obliged to reject in the absence of such commitments[353].

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345 Case C-105/07, *NV Lammers & Van Cleeff v Belgium* [2008] ECR 0000, para. 19.

346 Recital 3, last sentence, of the Qualifying Holdings Directive.

347 d'Ormesson and Kerjean, pp. 479-514.

348 Recital 30 of the EC Merger Regulation.

349 See recitals 30 and 31 and Articles 6 and 8 of the EC Merger Regulation.

350 See recital 15 of the Banking Directive. Moreover, some provisions of the Banking Directive refer to specific conditions under which authorisation may be granted (See, e.g., Article 12(3) or Article 17(1)(c) of the Banking Directive).

351 For an example of supervisory practices relating to commitments, see the Annual Report of the CECEI, 2005 Exercise, pp. 88-92.

352 See, for instance, Section 3:104(1) of the Dutch Financial Supervision Act, which provides that De Nederlandsche Bank may attach restrictions or regulations to a declaration of no-objection. In France, the CECEI in its 2006 Annual Report (Exercise, p. 92) notes that the proposal for a directive specifies that the acquirer may always agree to take on supplementary commitments with a view to complying with the prudential assessment criteria.

353 Opinion CON/2006/60, para. 2(8).

For example, in the case of the acquisition of ABN AMRO by a consortium of banks, in September 2007 the Dutch Minister of Finance issued a declaration of no objection, on the advice of De Nederlandsche Bank (DNB) on prudential aspects. DNB's advice assessed a number of risks connected with the planned takeover and split-up of ABN AMRO. For that reason, DNB indicated that strict agreements should be made with the consortium to mitigate these risks as much as possible[354]. The Dutch Minister of Finance expressed the view that if, and only if, the conditions and limitations of DNB were observed, the risks would not justify withholding the declaration of no objection[355]. The Dutch Minister also concluded that a takeover by the consortium would not lead to an undesirable development in the financial sector as a whole, as defined in the Dutch Financial Supervision Act if, and only if, the requirements and conditions of the declaration of no-objection, such as the implementation of a transition plan, which were intended to ensure a smooth process in the break-up of ABN AMRO and sufficient continuity in the management of the bank, were observed[356].

This practice of making commitments gave rise to legal objections since it converts an ex-ante control into an ex-post control not provided for expressly by the Banking Directive[357]. Under the Qualifying Holdings Directive however, this practice of making commitments is restricted at least by two criteria: (i) they must be aimed at meeting prudential requirements under the harmonised prudential assessment criteria, and (ii) they must not affect the rights of the proposed acquirer. In practice this means that any commitments imposed by a national supervisory authority on any proposed acquirer should not be used by the supervisory authority as a means to recover the margin of discretion lost in the new context of maximum harmonisation[358]. These commitments must not constitute disguised restrictions or allow arbitrary discrimination, and they must meet the proportionality and necessity tests. Against this backdrop, the absence of a clear common EU legal framework setting out the types of commitments which are acceptable, and the conditions under which these commitments can be accepted from proposed acquirers, can create undesirable legal uncertainty with regard to the scope for competent authorities to take them into account.

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354 DNB Recommendation to the Dutch Minister of Finance on the applications by the 'Consortium' and Fortis for a declaration of no-objection regarding ABN AMRO Bank, 17.9.2007. The application by the Consortium was subject to restrictions in relation to governance and to specific requirements regarding, for instance, the maintenance of the status quo before the applicant for the declaration has obtained sufficient control, the transition plan and capital and liquidity planning.

355 See the news release from the Dutch Minister of Finance, 'No objection against take-over ABN AMRO by consortium', 17.9.2007.

356 See the Commission's merger control decision of 3.10.2007, Case No COMP/M.4844, *Fortis/ABN AMRO assets*, paras. 209 and 231-232, which reports on the details of this transition plan in its part on the assessment of the commitments proposed by the parties to the concentration.

357 See, for instance, Toboul (2001), p.79.

358 Recital 3 of the Qualifying Holdings Directive, last sentence.

3 The procedural rules applicable to the supervisory assessment of qualifying holdings

3.1 General overview of the reform

An essential aspect of the reform of the supervisory assessment of qualifying holdings is the adoption of harmonised procedural rules which benefit legal certainty and the predictability of the assessment procedure. This contrasts with the former provisions of the Banking Directive, which are almost silent on these aspects. While, under the old rules, the competent authorities have a maximum of three months from the date of the notification to oppose the plan of the proposed acquirer[359], under the new rules the competent authorities will have a maximum of sixty working days to carry out the prudential assessment[360]. This represents a compromise between three months and the Commission's initial proposal of a maximum of thirty working days, a proposal which raised a number of concerns from supervisory authorities and from the ECB. The competent authorities can request any further information necessary to complete the assessment no later than the 50th working day of the assessment period[361]. This assessment period may only be interrupted once (for the period between the request for information and the receipt of the response by the proposed acquirer) and the interruption must not exceed 20 working days[362]. Any further requests by the competent authorities for completion or clarification of the information will be at their discretion, but may not result in an interruption of the assessment period[363]. The interruption period may be extended to 30 working days in the case of a proposed acquirer from a third country or a natural or legal person which is not subject to supervision.

These procedural rules have been introduced into the Banking Directive as an extension of the current provisions on qualifying holdings. One may regret that the reform of the qualifying holdings rules was not seized upon as an opportunity to develop an approach based on implementing measures which would have further contributed to the clarity and transparency of the process. 'Implementing measures' refers to the authority given to the Commission to enact more specific regulations in a particular area on the basis of a delegation of power[364]. In the context of financial services legislation,

359 Article 19(1), second paragraph, of the Directive 2006/48/EC.
360 Article 19(2) of the Banking Directive, as amended.
361 Article 19(3), first subparagraph, of the Banking Directive, as amended.
362 Article 19(3), second subparagraph, of the Banking Directive, as amended.
363 Article 19(3), second subparagraph, last sentence of the Banking Directive, as amended.
364 Article 202 EC, third indent, provides that the Council may confer on the Commission, in the acts which the Council adopts, powers for the implementation of the rules which the Council lays down.

the legal framework for this delegation of power is based on the Lamfalussy approach[365]. While the securities sector is now regulated by a comprehensive package of framework legislation and implementing measures[366], in the banking area the Banking Directive is characterised by having very limited recourse to comitology and by the adoption of very few implementing measures[367]. Much still remains to be done in the banking field in order to reap the full benefits of the Lamfalussy regulatory approach, with the Level 1 provisions covering framework principles and Level 2 acts constituting the main body of technical rules applicable to EU financial institutions[368].

Although they apply to an area of exclusive competence of the European Commission, the rules adopted in the context of the EC Merger Regulation [369] could have served as a useful model for the elaboration of implementing rules applicable to notifications of qualifying holdings. Under the EC Merger Regulation, the Commission has the power to lay down implementing provisions concerning: (i) the form, content and other details of notifications and submissions, (ii) certain time limits, (iii) the procedure and time limits for the submission and implementation of commitments, and (iv) hearings[370]. In particular, Commission Regulation (EC) No 802/2004 implementing the EC Merger Regulation defines the persons entitled to submit notifications and the rules applicable to the submission of notifications, clarifies the effective date of notification, specifies time limits, suspension

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365 For an overview of the Lamfalussy framework, see in particular: Directive 2005/1/EC of the European Parliament and of the Council of 9 March 2005 amending Council Directives 73/239/EEC, 85/611/EEC, 91/675/EEC, 92/49/EEC and 93/6/EEC and Directives 94/19/EC, 98/78/EC, 2000/12/EC, 2001/34/EC, 2002/83/EC and 2002/87/EC in order to establish a new organisational structure for financial services committees (OJ L 79, 24.3.2005, p. 9); and Directive 2008/24/EC of the European Parliament and of the Council of 11 March 2008 amending Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions, as regards the implementing powers conferred on the Commission (OJ L 81, 20.3.2008, p. 38) (amending the Banking Directive); the resolution of the Stockholm European Council on more effective securities market regulation in the European Union, http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ec/00100-r1.%20ann-r1.en1.html, 23 March 2001; and the Final report of the Committee of Wise Men on the regulation of European securities markets ('the Lamfalussy Committee'), 15 February 2001, http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf.

366 Framework legislation adopted under the co-decision procedure (Level 1 of the Lamfalussy proecedure) sets out the core principles and defines implementing powers. Technical details are formally adopted by the Commission as implementing measures at Level 2, after a vote of the competent regulatory Committee (for instance, the European Banking Committee). For the technical preparation of implementing measures the Commission is advised by Committees made up of representatives of national supervisory bodies, referred to as the Level 3 Committees (for instance, the Committee of European Banking Supervisors – CEBS).

367 The scope for comitology in the Banking Directive is very circumscribed and rarely used; see, e.g., Commission Directive 2007/18/EC of 27 March 2007 amending the Banking Directive as regards the exclusion or inclusion of certain institutions from its scope of application and the treatment of exposures to multilateral development banks (OJ L 87, 28.3.2007, p. 9). The corollary of the limited comitology in banking legislation is the absence of substantial and structured Level 2 implementing measures.

368 See, on these aspects, paras. 6 to 10 of ECB Opinion CON/2005/4 of 17 February 2005 at the request of the Council of the European Union on a proposal for directives of the European Parliament and of the Council recasting Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions and Council Directive 93/6/EEC of 15 March 1993 on the capital adequacy of investment firms and credit institutions (OJ C 52, 2.3.2005, p. 37); and para. 6 of ECB Opinion CON/2004/7 at the request of the Council of the European Union on a proposal for a Directive of the European Parliament and of the Council amending Council Directives 73/239/EEC, 85/611/EEC, 91/675/EEC, 93/6/EEC and 94/19/EC and Directives 2000/12/EC, 2002/83/EC and 2002/87/EC of the European Parliament and of the Council, in order to establish a new financial services committee organisational structure, COM(2003) 659 final, (OJ C 58, 6.3.2004, p. 23), on a proposal to extend the Lamfalussy process to all financial sectors.

369 See the EC Merger Regulation and Commission Regulation (EC) No 802/2004 of 7 April 2004 implementing Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings, (OJ L 133, 30.4.2004, p. 1).

370 Article 23 of the EC Merger Regulation.

periods, access to the file and the treatment of confidential information. Furthermore, the Regulation (EC) No 802/2004 includes annexes containing the standard forms for the notification of concentrations. As explained below, a similar approach to the reform of the rules on qualifying holdings, with the development of a harmonised list specifying the information necessary for supervisory assessment, and perhaps with a simplified procedure for proposed acquirers which are already regulated financial sector entities, would have contributed considerably to the transparency and harmonisation of supervisory practice in this area[371].

A number of technical issues could not be easily addressed in the framework of the Banking Directive. This refers in particular to implementing measures which would have been effective to cover certain aspects of the procedural rules that need to be further refined to ensure sufficient legal certainty and transparency[372]. The Qualifying Holdings Directive only mentions that the Commission may adopt implementing measures for 'adjustments' of the evaluation criteria for the prudential assessment of acquisitions and increases of shareholdings in the financial sector, in order to take account of future developments and to ensure the uniform application of the Directive[373]. However, a number of aspects related to the procedure for the notification of qualifying holdings could have been further clarified, such as the rules applicable to notifications submitted by proposed acquirers, the procedure for the assessment of qualifying holdings (time limits, suspensions) or in relation to transparency. In addition, as described above, the situations involving 'persons acting in concert', or the legal nature and scope of 'commitments' that proposed acquirers may give to competent authorities, would have benefited from further deliberation which could have been translated into implementing measures.

A typical example of procedural rules which would have benefited from more adequate treatment in the form of implementing measures, and for which the example of the EC Merger Regulation implementing rules could have been helpful, is the issue of the 'completeness' of the notification[374]. The EC Merger Regulation provides that notifications become effective on the date on which they are received by the Commission[375]. Where the information, including documents contained in the notification, is incomplete in any material respect, the Commission informs the notifying parties in writing without delay[376]. In such cases, the notification becomes effective on the date on which the complete information is received by the Commission[377]. Incorrect or misleading information is considered to be incomplete information[378].

371 See Annexes I to III of Regulation (EC) No 802/2004.
372 See para. 3(5) of Opinion CON/2006/60.
373 Article 150(2)(f) of the Banking Directive, as amended.
374 Article 5 of Regulation (EC) No 802/2004.
375 Article 5(1) of Regulation (EC) No 802/2004.
376 Article 5(2), first sentence, of Regulation (EC) No 802/2004.
377 Article 5(2), last sentence, of Regulation (EC) No 802/2004.
378 Article 5(4) of Regulation (EC) No 802/2004.

Following the qualifying holdings reform, the supervisory authorities must acknowledge receipt in writing to the proposed acquirer. This should be given within two working days following receipt of the notification, as well as following any subsequent receipt of the information related to requests by competent authorities for 'further information'[379]. The assessment period of sixty working days begins from the date of the written acknowledgement of receipt by competent authorities of the notification and all documents required by the Member State to be attached to the notification[380]. This is relevant, since the date of the written acknowledgement of receipt of the notification constitutes the starting point for the assessment procedure and it triggers various other steps of the procedure, such as the date of expiry of the assessment period, the deadline for requesting further information, etc. The wording of the Qualifying Holdings Directive suggests that supervisory authorities must acknowledge receipt within two working days 'following receipt of the notification'. However, it could be understood that the acknowledgement of receipt should only be sent by the supervisory authority when the authority is satisfied that the notification is 'complete', i.e. when it has received the notification and 'all documents required'. Ambiguity remains on this issue of the completeness of the notification, since the Qualifying Holdings Directive only refers to the 'notification' and not to the 'notification and all documents required by the Member State'[381]. Moreover, the supervisory authorities must acknowledge receipt of the notification, as well as following 'the possible subsequent receipt of the information' resulting from requests for further information by competent authorities[382]. This wording indicates that supervisory authorities may have to acknowledge receipt not only (i) following receipt of the (complete) notification, but also (ii) when the 'additional information needed' is provided. It is understood that this second type of acknowledgement of receipt is justified by the need to give information about the end of the interruption period to a proposed acquirer who gives the supervisory authority the additional information. Where a proposed acquirer notifies the supervisory authority but provides an incomplete set of documents or information, this should not automatically trigger an acknowledgement of receipt from the supervisory authority and the immediate start of the assessment period. For the sake of clarity one may regret that, in contrast to the European merger control rules, the Banking Directive does not: (i) expressly refer to the meaning of 'complete' notification and of the 'effective date of the notification', and (ii) distinguish more clearly between the receipt of complete notification[383] and the possibility for the competent authority to request further information. Lastly, the assessment of the completeness of the notification may continue to allow some discretion to competent authorities since, as described above, the list specifying the information necessary to carry out the prudential assessment is not harmonised at EU level.

379 Article 19(2), first subparagraph, of the Banking Directive, as amended.
380 Article 19(2), second subparagraph, of the Banking Directive, as amended.
381 Compare the first and second subparagraphs of Article 19(2) of the Banking Directive, as amended.
382 Article 19(2), second subparagraph, of the Banking Directive, as amended.
383 In the provisions of the Banking Directive on consolidated supervision (Article 129(2), fourth subparagraph), the period of six months for the assessment of applications begins on the date of receipt of the complete application by the competent authority.

3.2 Aspects related to the transparency of the notification process

3.2.1 The notion of proposed acquirer

'Proposed acquirer' is defined in the Qualifying Holdings Directive as a 'natural or legal person or such persons acting in concert'[384]. The term 'persons acting in concert' which is not used elsewhere in the Banking Directive is introduced for the first time in the qualifying holdings rules reform.

This term is defined in Directive 2004/25/EC on takeover bids as 'natural or legal persons who cooperate with the offeror or the offeree company on the basis of an agreement, either express or tacit, either oral or written, aimed either at acquiring control of the offeree company or at frustrating the successful outcome of a bid'[385]. As regards the acquisition or disposal of major proportions of voting rights under the Transparency Directive, the notification requirements apply, among other things, to a natural person or legal entity to the extent it is entitled to acquire, to dispose of, or to exercise voting rights for instance, when 'voting rights held by a third party with whom that person or entity has concluded an agreement, which obliges them to adopt, by concerted exercise of the voting rights they hold, a lasting common policy towards the management of the issuer in question'[386]. While the provision of the Transparency Directive aims to provide transparency as to who has the power to exercise voting rights when the holders of voting rights agree to pool their votes, the provision of Directive 2004/25/EC on takeover bids is aimed at protecting minority shareholders by requiring the launch of mandatory bids at equitable prices when shareholders act in concert to acquire control[387].

In the context of the Banking Directive, the purpose of the above amendment is to prevent any avoidance of the approval requirement where there is joint shareholding or joint exercise of control over the target institution. While the Qualifying Holdings Directive fails to further specify the situations covered, or the implications for the (legal or natural) persons concerned, for instance with respect to the obligation to notify[388], national laws which implement the current Banking Directive have sometimes defined 'persons acting in concert'[389]. Guidance from the Committee of European Banking Supervisors (CEBS) would be useful in developing a harmonised approach to this concept.

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384 Article 19(1), first sentence, of the Banking Directive, as amended.

385 Article 2(d) of Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids (OJ L 142, 30.4.2004, p. 12).

386 Article 10(a) of the Transparency Directive.

387 Article 5(1) of Directive 2004/25/EC.

388 See Opinion CON/2006/60, para. 6(3).

389 See, for instance, Article 4 of the French Regulation 96-16 of 20 December 1996 relating to changes in the situation of credit institutions and of investment firms other than portfolio management companies, available at http://www.banque-france.fr/gb/supervi/telechar/regle_bafi/Regulation_96_16.pdf. Among other things, the French Regulation takes into account voting rights held by a third party with whom the party in question acts in concert and provides that 'persons who have reached an agreement with a view to acquiring or disposing of voting rights, or with a view to exercising rights in order to implement a common policy with regard to the reporting institution, shall be deemed to be acting in concert'.

3.2.2 The nature of the information to be provided by proposed acquirers

The Banking Directive does not currently specify what type of information should be given to the competent authorities together with the notification[390]. This is a lacuna which is corrected in the Qualifying Holdings Directive, which provides that Member States must make publicly available a list specifying the information that is necessary for carrying out the assessment and which must be provided to the competent authorities at the time of notification[391]. While the recitals to the Qualifying Holdings Directive acknowledge that different information might be needed if, for instance, the potential acquirer is an 'unregulated entity' or 'established in a third country' and that '[p]rovision should also be made for the possibility to request less extensive information in justified cases'[392], it leaves it up to the Member States to define what documents a potential acquirer must submit. This might be a convenient approach, in line with the principle of proportionality[393], and the Member States cannot require information that is not relevant for a prudential assessment[394]. From an internal market perspective, however, one may regret that the Qualifying Holdings Directive did not provide for a harmonised approach to the information to be provided by proposed acquirers at EU level. Although the list specifying the information necessary for supervisory assessment may have given rise to specific implementing measures[395], the rapporteur of the European Parliament on the Commission's original proposal for a directive supported the practical approach which leaves to the Member States the responsibility for defining the list of documents that a potential acquirer has to submit. Nevertheless, the rapporteur stressed that further coordination within Lamfalussy committees and the development of a common approach in this area would be highly desirable. The rapporteur also suggested that a review by the Commission two years after the transposition of the Qualifying Holdings Directive would allow comparison to be made of the national lists. Should the progress be insufficient, action at the Community level would be necessary to define EU requirements in order to ensure a level playing field[396]. Although a report on the implementation of the Qualifying Holdings Directive, together with any appropriate proposals, will have to be prepared by the Commission by March 2011, this suggestion was not retained[397].

390 Under Article 19(1) of the Banking Directive.
391 Article 19a(4) of the Banking Directive, as amended.
392 Recital 9 of the Qualifying Holdings Directive.
393 Article 19a(4) of the Banking Directive, as amended, points out that the information required must be proportionate and adapted to the nature of the proposed acquirer and the proposed acquisition.
394 Article 19a(4) of the Banking Directive, as amended.
395 Para. 3(5) of Opinion CON/2006/60.
396 Report of Wolf Klinz, Member of the European Parliament for the Committee on Economy and Monetary Affairs on the proposal for a directive of the European Parliament and of the Council amending Council Directive 92/49/EEC and Directives 2002/83/EC, 2004/39/EC, 2005/68/EC and 2006/48/EC as regards procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase of shareholdings in the financial sector A6-0027/2007, 5.2.2007 (the MEP Wolf Klinz Report), para. 4.
397 Article 6 of the Qualifying Holdings Directive.

3.2.3 Notification and publicity of decisions

In the absence of opposition in writing by the competent authorities within the assessment period, a proposed acquisition is deemed to be approved[398]. Furthermore, in accordance with good administrative practice, the competent authorities should complete their assessment without delay and inform the proposed acquirer of a positive assessment, if requested to do so by the proposed acquirer[399]. The competent authorities may only oppose the proposed acquisition 'if there are reasonable grounds for doing so on the basis of the [prudential assessment criteria] or if the information provided by the proposed acquirer is incomplete'[400]. As with the authorisation process[401], the supervisory authority must inform proposed acquirers in writing and provide the reasons for a negative decision[402]. However, the Banking Directive does not provide for the decisions of supervisory authorities in relation to qualifying holdings (positive or negative) to be made public. While the Commission's proposal was silent on this issue, the CEBS objected to the idea that publishing a negative decision was an appropriate way to achieve transparency, considering that: (i) the reasons behind a negative assessment could be complex, and they could prove misleading and damaging for some of the interested parties, and (ii) the decision might not be well understood and could even have an unwarranted negative repercussion on the proposed acquirer's reputation[403]. The Qualifying Holdings Directive offers an unsatisfactory compromise solution under which, subject to national law, an appropriate statement of the reasons for the decision may be made available to the public at the request of the proposed acquirer[404], although a Member State may also decide to allow the competent authority to make such disclosure in the absence of a request by the proposed acquirer[405]. Since this approach may still leave much to the discretion of the supervisory authorities, it is unlikely that it will contribute to ensuring sufficient transparency in this area. Where decisions are not published, this deprives third parties of the possibility of challenging decisions the content of which they are not aware of[406].

3.3 Cooperation and exchange of information with supervisory authorities

The competent authority responsible for the supervision of the entity in which the acquisition is proposed[407] is responsible for the final decision regarding the prudential assessment of qualifying holdings. In order to ensure the adequate involvement of the supervisory authority of the proposed acquirer, the competent authority must take full account of the opinion of the competent authority

398 Article 19(6) of the Banking Directive, as amended.
399 Recital 5 of the Qualifying Holdings Directive.
400 Article 19a(2) of the Banking Directive, as amended.
401 See Article 13 of the Banking Directive.
402 Article 19(5) of the Banking Directive, as amended.
403 CEBS Technical advice to the European Commission on a review of Article 16 of Directive 2000/12/EC, 31.5.2005, CEBS/05/76, p. 9.
404 Article 19(5), second sentence, of the Banking Directive, as amended.
405 Article 19(5), last sentence, of the Banking Directive, as amended.
406 Daigre, p. 7.
407 Recital 10, second sentence, of the Qualifying Holdings Directive. Until the reform, the Banking Directive did not clearly specify the identity of the authority responsible for authorising an increase or acquisition of qualifying holdings, and only referred to the 'competent authorities' (Article 19(1), second subparagraph, of the Banking Directive).

responsible for the supervision of the proposed acquirer, particularly as regards the assessment criteria directly related to the proposed acquirer[408]. The decision by the competent authority must indicate any views or reservations expressed by the authority responsible for the proposed acquirer[409]. The previous mechanisms in the Banking Directive for cooperation between supervisory authorities with respect to qualifying holdings provided that, where credit institutions become subsidiaries of or under the control of regulated institutions in another Member State, the assessment of the acquisition requires the prior consultation of the competent authorities of the other Member States involved[410]. The new qualifying holdings rules provide for a more extended mechanism for cooperation and for exchange of information between competent authorities in cases where the proposed acquirer is a regulated entity in the financial sector[411] authorised in another Member State or in a sector other than that in which the acquisition is proposed[412]. The competent authorities must work in close cooperation with each other when assessing the suitability of a proposed acquirer that is a regulated entity in another Member State or in another sector[413]. Thus this cooperation not only applies in a cross-border context, but also in the context of cross-sectoral transactions within a single Member State's financial sector. Although flexibility is allowed to the competent authorities for the procedural aspects of this cooperation[414], this cooperation should take account of the timelines and procedural rules for the prudential assessment, in order to make sure that the views of the authority of the proposed acquirer are also taken into account in the assessment procedure.

As mentioned above, where regulated and supervised proposed acquirers from the financial sector[415] have a European passport, this could have been considered sufficient to have made prior authorisation for the acquisition or increase of qualifying holdings superfluous, or at least subject to a less onerous procedure. This argument was not accepted. Nor was the 'mutual recognition' option accepted, i.e. the possibility of developing mutual recognition arrangements between Member States according to which, if the competent authorities of one Member State accepted a shareholder as eligible to acquire a qualifying shareholding in a bank, it ought to be possible for the competent authorities of all the other Member States to accept the decision of that Member State without resorting to a further review of the soundness of the management and shareholders of the acquiring institution[416]. Another option for cooperation between supervisory authorities was the possibility 'to work together to reach a joint determination'[417]. This solution would have risked blurring the respective functions of the competent

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408 Recital 10, last sentence, of the Qualifying Holdings Directive.
409 Article 19b(2) of the Banking Directive, as amended.
410 Article 19(2) of the Banking Directive. In the context of the conditions for the authorisation of credit institutions, Article 15 of the Banking Directive merely provides an obligation to consult the competent authorities of the other Member States involved.
411 Or the parent undertaking of the entity, or a natural or legal person controlling the entity.
412 Article 19b(1) of the Banking Directive, as amended.
413 Recital 10, first sentence, of the Qualifying Holdings Directive.
414 Article 19b(2) of the Banking Directive, as amended.
415 Article 19b(1)(a) of the Banking Directive, as amended.
416 Call for technical advice from the CEBS, 18.1.2005, p. 2.
417 For an example of a 'joint decision', see Article 129 of the Banking Directive. These arrangements provide that, in the absence of a joint decision between the competent authorities, the competent authority responsible for the exercise of supervision on a consolidated basis must make its own decision on the application.

authorities and was dropped by the Commission[418]. The original intention of the Commission[419], which was dropped in its formal proposal[420], was to confer on the competent authority of the proposed acquirer (and not of the target institution) the sole responsibility for the final decision to approve the acquisition or increase of a qualifying holding. However, the Commission finally considered that the ultimate determination of the decision should continue to rest with the target institution's supervisor[421].

3.4 The treatment of third country acquirers

Community banking law is intended to apply to credit institutions authorised by an EU Member State. This means that it is necessary to examine whether credit institutions established in a third country (a non-EU Member State) can benefit from the Community freedoms and whether these benefits should be subject to reciprocity in the third countries concerned[422]. A fundamental distinction must be made between branches and subsidiaries of third country institutions. While a branch is defined as a place of business which forms a legally dependent part of a credit institution and which carries out directly all or some of the transactions inherent in the business of credit institutions[423], a subsidiary is an undertaking governed by the national law of a Member State, mainly defined by reference to Directive 83/349/EC on consolidated accounts[424] and for which a control or similar relationship exists with a parent undertaking[425].

As regards the treatment of branches, the Banking Directive provides that the rules governing branches of credit institutions which have their head office outside the Community should be analogous in all Member States, and that Member States should not apply to these branches, when commencing or carrying on their business, provisions which result in more favourable treatment than that accorded to branches of credit institutions having their head office in the Community[426]. The Banking Directive makes clear that branches of non-EU credit institutions should not enjoy the freedom to provide services under the second paragraph of Article 49 EC or the freedom of establishment in Member States other than those in which they are established[427]. However, the Community may, through agreements concluded with one or more third countries, agree to apply

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418 The Commission mentioned the possibility of creating an independent EU supervisory institution, which would take an arbitration role between supervisory authorities and considered that while, under Article 105(6) EC, the ECB could theoretically assume this role of 'supervisor of supervisors', the objective of cross-sectoral consistency would be affected by the ECB's lack of competence in the insurance sector.

419 See, e.g., the Annual Report of the CECEI (2006), p. 92.

420 See Article 5(5) of the Commission's proposal introducing a third subparagraph in Article 129 of the Banking Directive.

421 See the Commission's Impact assessment on the proposal for a directive ('the Commission's Impact assessment'), 6.4., p. 27 and, to the support of this approach, para. 66 of the MEP Wolf Klinz Report on the Commission's proposal.

422 Carreau (1994).

423 Article 4(3) of the Banking Directive.

424 Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54(3)(g) of the Treaty on consolidated accounts (OJ L 193, 18.7.1983, p. 1), cf. Article 4(13) of the Banking Directive.

425 Article 4(10) of the Banking Directive.

426 Article 38 of the Banking Directive.

427 Recital 19 of the Banking Directive. The Banking Directive provides for notification to the Commission and the European Banking Committee of all authorisations for branches granted to credit institutions having their head office outside the Community (Article 38(2) of the Banking Directive).

identical treatment throughout the territory of the Community to branches of a credit institution which has its head office outside the Community[428].

The situation is different for subsidiaries of companies established in third countries[429]. Subsidiaries of companies established in a third country, which are formed in accordance with the law of a Member State, benefit from the right of establishment in the same way as any other Community national, provided they have 'their registered office, central administration or principal place of business within the Community'. This means that any third country company can have access to the internal market by setting up a subsidiary in a Member State. In the context of the banking sector, subsidiaries of credit institutions in third countries are legal entities distinct from the parent company and, as such, must obtain separate authorisation in the Member State where they are established, in the same as any other credit institution. As a consequence of this authorisation, these subsidiaries may benefit from the mutual recognition regime and are authorised to carry on their activities in other Member States.

A number of the provisions of the Banking Directive concerning the supervision of third country investments in the EU have been abrogated in recent years. For instance, the systematic notification to the Commission of the authorisation of 'direct or indirect subsidiaries one or more parent undertakings of which are governed by the law of a third country' and of the acquisition by a parent company of 'a holding in a Community credit institution such that the latter would become its subsidiary' has been abandoned[430]. The possibility for the Commission (i) to negotiate with third countries, on the basis of a mandate from the Council, with a view to obtaining comparable competitive opportunities for Community credit institutions and (ii) to suspend decisions by competent authorities regarding requests for authorisation and acquisition of holdings, has also been abrogated[431].

Against this backdrop, and in particular with regard to the reform of qualifying holdings rules, the regime provided under the Qualifying Holdings Directive highlights the Community's intention to keep its financial markets open to the rest of the world. In this respect, no special substantive prudential requirements are provided for proposed acquirers from third countries who are subject to the ordinary assessment criteria, both in the case of a direct acquisition in a Community credit institution and in the case of an acquisition of holdings by the subsidiary of a parent undertaking from a third country. Although concern about this was expressed by supervisory authorities[432], the

428 Recital 19, third sentence, and Article 38(3) of the Banking Directive.
429 See the analysis in Sousi, paras. 54, 215 and 252-254; and Carreau, pp. 10-15.
430 See the now abrogated provisions of Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions (OJ L 126, 26.5.2000, p. 1) (Article 23). The Banking Directive has repealed Directive 2000/12/EC.
431 Article 23(4), (5) and (6) of Directive 2000/12/EC. By comparison, equivalent provisions to some of those contained in Directive 2000/12/EC have been maintained in the MiFID (Directive 2004/39/EC). The Commission may decide, at any time and in addition to the initiation of negotiations with third countries, 'that the competent authorities of the Member States must limit or suspend their decisions regarding requests pending or future requests for authorisation and the acquisition of holdings by direct or indirect parent undertakings governed by the law of the third country in question' (See Article 15 of the MiFID).
432 See Opinion CON/2006/60, para. 2(5) and the proposed amendment 13 in the same opinion.

Commission's proposal was not amended in this respect, and only specific and limited procedural aspects need to be considered by proposed acquirers from third countries, such as the possible extension of an interruption to the assessment period[433]. The competent authorities may extend an interruption up to 30 working days, giving a possible maximum interruption of 50 working days, when the proposed acquirer is situated or regulated outside the Community[434]. The Qualifying Holdings Directive changed the possible extension of the assessment period in the Commission's proposal to a possible extension of the interruption period. Following the interruption, it is understood that the standard procedures that apply to other proposed acquirers will continue to apply.

As regards the national lists of information to be provided by proposed acquirers, reference is made in the Qualifying Holdings Directive to the need for proportionality, in particular if a potential acquirer is an unregulated entity or is established in a third country[435]. No specific mechanism is provided in the Qualifying Holdings Directive for cooperation with competent authorities of third countries at the EU level, and Member States must establish such cooperation on a bilateral basis if a proposed acquirer has its head office and is supervised outside the EU[436]. If there are difficulties with third country authorities or proposed acquirers the authorities of the target institution may apply the new substantive criteria, in line with the Court's judgment in the *Skatteverket* case, and in particular the criterion requiring that the 'group of which it will become a part has a structure that makes it possible to exercise effective supervision, effectively exchange information among the competent authorities and determine the allocation of responsibilities among the competent authorities'[437], and the authorities may oppose a proposed acquisition if this is not the case or if the information provided by the proposed acquirer is incomplete[438].

Another dimension with regard to third country acquirers is the emergence of Sovereign Wealth Funds (SWFs) and hedge funds as significant new types of investors in the banking sector[439]. In a recent communication (the 'SWFs communication') the European Commission has pointed out that SWFs may appear to be a stabilising force in financial markets, several financial institutions having recapitalised with the help of investments from SWFs[440]. In most cases, SWFs are portfolio investors and have avoided taking controlling stakes or seeking a formal role in decision-making in companies.

433 See Article 19(4) of the Banking Directive, as amended.
434 Ibid. This rule also applies to a natural or legal person not subject to supervision.
435 Recital 9 of the Qualifying Holdings Directive, second sentence.
436 For intra-Community cooperation between competent authorities, see Article 19b of the Banking Directive, as amended. Other important provisions of the Banking Directive applicable to relations with third countries relate to cooperation with third countries' competent authorities regarding supervision on a consolidated basis (Article 39 of the Banking Directive). Agreements may be reached, on the basis of reciprocity, between the Community and third countries with a view to allowing the practical exercise of consolidated supervision over the largest possible geographical area (recital 20 of the Banking Directive)
437 Article 19a(d) of the Banking Directive, as amended.
438 Ibid.
439 See, in the context of the battle for ABN Amro, White, Konevsky and Angelette (2008), p.174; see also '*La Chine s'invite dans la bataille bancaire européenne*', Les Echos, 24.7.2007; '*Sovereign funds put cash in the banks*', Financial Times, 27.11.2007; '*Qatar fund buys Crédit Suisse stake*', Financial Times, 18.2.2008.
440 Commission Communication: 'A common European approach to Sovereign Wealth Funds', COM(2008) 115. See also International Monetary Fund, pp. 4 and 10.

However, concerns have been raised about the possibility of SWFs seeking to acquire controlling stakes in companies[441]. Although investments in the EU by SWFs are subject to the same rules and controls as any other form of investment, whether foreign or domestic, and the principles of free movement of capital apply, the Commission has noted that this freedom is not absolute and may in certain respects be regulated under Article 57(2) EC[442]. Furthermore, as described above, Member States may take appropriate measures to protect legitimate interests other than those taken into consideration by the EC Merger Regulation[443]. The EU has not yet expressed a desire to exercise any of these regulatory options. Instead, the Commission has suggested promoting cooperation between recipient countries and SWFs and their sponsor countries, to establish a set of principles ensuring the transparency, predictability and accountability of the SWFs' investments, and it has noted two aspects in particular that need to be addressed: (i) it is necessary to obtain greater clarity and insight into the governance of SWFs, and (ii) it is necessary to provide greater transparency about their activities and investments[444]. As regards the banking sector[445], the experience of the application of the Qualifying Holdings Directive will provide evidence as to whether further action is needed in this area. [446]

This debate might also constitute an opportunity to reconsider more widely the rules applicable to the treatment of credit institutions from third countries and to the cooperation with their supervisory authorities with a view to ensuring fully harmonised treatment across the EU. The access of third country groups to the internal market also raises the issue of the reciprocity and of equivalent access to investments worldwide. In this respect, the Qualifying Holdings Directive provides that the Community should help improve the liberalisation of global financial markets in third countries, and that Member States should report to the Commission cases where proposed Community acquirers (supervised entities) acquiring financial institutions in third countries are 'not granted the same treatment as domestic acquirers and encounter major impediments'[447] and that the Commission may propose measures to remedy such cases or raise them in an appropriate forum[448].

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441 COM(2008) 115, para. 2.3, p. 5.

442 First, as mentioned above, the Council may, acting by a qualified majority on a proposal from the Commission, adopt measures on the movement of capital to or from third countries involving direct investment – including investment in real estate – establishment, the provision of financial services or the admission of securities to capital markets. Second, measures which constitute a step back in Community law as regards the liberalisation of the movement of capital to or from third countries may be adopted by a unanimous decision of the Council.

443 Article 21(4) of the EC Merger Regulation, first subparagraph.

444 In particular, the Commission considers that transparency measures which could be considered include, for instance, annual disclosure of investment positions (in particular for investments where there is majority ownership), the exercise of ownership rights, and disclosure of home country regulation and oversight governing SWFs (see the SWFs communication, COM(2008) 115, p. 11). In its conclusions of 13-14 March 2008, the European Council expressed its support for the objective of agreeing an international voluntary Code of Conduct for SWFs and defining principles for recipient countries.

445 Bini Smaghi (2007) pointed out that the emergence of large sovereign funds in countries where the financial system needs to be strengthened is an interesting development for the international financial system, even if it raises a number of questions in terms of transparency, objectives and stability.

446 Regarding the contribution of these funds to the international financial system, see the Report of A. Demarolle to the French Minister of Economy (2008), pp. 10 - 12.

447 Recital 14 of the Qualifying Holdings Directive.

448 Ibid.

4 The Commission's right to request information from supervisory authorities

Reflecting the Commission's role as guardian of the Treaty, Article 211 EC, first indent, provides that, in order to ensure the proper functioning and development of the common market, the Commission must ensure that the Treaty and the measures taken by the institutions pursuant thereto are applied. The Commission also has the power, where appropriate, to institute proceedings before the Court if it considers that a Member State has failed to fulfil its obligations under the Treaty. Article 226 EC provides in this respect that '[i]f the Commission considers that a Member State has failed to fulfil an obligation under this Treaty, it shall deliver a reasoned opinion on the matter after giving the State concerned the opportunity to submit its observations. If the State concerned does not comply with the opinion within the period laid down by the Commission, the latter may bring the matter before the Court of Justice'. Furthermore, Article 284 EC provides that the Commission may 'collect any information and carry out any checks required for the performance of the tasks entrusted to it'.

While the Commission has the burden of proving the allegation that an obligation has not been fulfilled (*Commission* v *United Kingdom*[449]), the Court has clearly established that Member States are required, under Article 10 EC, to facilitate the achievement of the Commission's tasks, which means in particular that they are required to cooperate in good faith with the Commission's enquiries and to provide it with all the information requested for that purpose (*Commission* v *Italy*)[450].

In recent years, however, the Commission has experienced problems in the financial sector in gaining access to the information needed to investigate alleged infringements and to assess whether infringement proceedings should be initiated against a Member State[451]. In this context, the Qualifying Holdings Directive provides in its preamble that 'the Member States should cooperate with the Commission by providing it, once the assessment procedure has been completed, with information pertaining to prudential assessments carried out by their competent authorities where such information is requested for the sole purpose of determining whether Member States have infringed their obligations under this Directive'[452]. The Qualifying Holdings Directive also points out that the Commission must monitor the application of the provisions regarding the prudential assessment of acquisitions in order to fulfil the tasks assigned to it with regard to the enforcement of Community law[453]. Although this type of provision is not unprecedented in Community legislation in other sectors, the Commission's right to request information pertaining to prudential assessments carried out by national supervisory authorities has been the focus of much attention in the discussion of the Qualifying Holdings Directive. An essential concern of the supervisory authorities relates to the extent

449 Case C-508/03 *Commission* v *United Kingdom* [2006] ECR I-3969, para. 77.
450 Case C-82/03 *Commission* v *Italy* [2004] ECR I-6635, para. 15.
451 The MEP Wolf Klinz Report on the Commission's proposal points out in this respect that the Commission may ask Member States to request prudential information from their supervisory authorities but in reality there is no obligation to provide access to such documents (para. 7).
452 Recital 11 of the Qualifying Holdings Directive.
453 Recital 11, first sentence, of the Qualifying Holdings Directive.

to which confidential information, especially information regarding individual financial institutions, can be disclosed to the Commission.

The Commission explained that the absence of provisions in the current directives 'laying out the course of action available to the Commission in exercising its responsibility under Article 211 first indent and 226 EC' contributed to 'further aggravate the current shortcomings in clarity and transparency'[454]. For these reasons, granting the Commission a clear right of access to documents would allow it to act promptly if it receives a complaint that there has been a potential misuse of supervisory powers, by requesting the competent authorities of the Member States as well as the natural or legal persons which have filed a notification as a qualifying shareholder, to provide the Commission with all the necessary information[455].

The Commission's original proposal contained an article specifically providing that it could request national supervisory authorities to provide it with the documents on which they have based their prudential assessment, as well as the reasons given to a proposed acquirer[456]. The Commission's proposal provided that the information given to the Commission should be used for the purposes of determining whether a Member State had fulfilled its obligations under the Banking Directive[457], as this would enable it 'to fulfil its role under the Treaty' and 'to be able to assess whether the criteria for the suitability assessment need further clarification'[458]. Following the consultation under the co-decision procedure, this article was converted into the recital in the Qualifying Holdings Directive referred to above[459], focusing on the need for cooperation between supervisory authorities and without any reference to the obligation of confidentiality[460]. While the Commission's proposal provided for the power to request information directly from national supervisory authorities (i.e. without the intermediation of governments[461]), the Qualifying Holdings Directive simply refers to the duty of cooperation of Member States which must provide information pertaining to prudential assessments carried out by their competent authorities. Moreover, this obligation only applies 'once the assessment procedure has been completed' and therefore not during the assessment period. Lastly, such

454 Commission's Impact assessment, para. 6.5, 'Right of access to documents', p. 27.

455 Ibid. In the same impact assessment the Commission furthers considers that, 'in the absence of an explicit reference to the Commission's rights and responsibilities under Article 211, first indent, and 226 EC, enforcement will remain unpredictable and perhaps "controversial"' (para. 2.4, p. 12).

456 Article 19c(1) of the Commission's proposal.

457 Article 19c(2), first subparagraph, of the Commission's proposal.

458 Recital 6 of the Commission's proposal, which provided that, 'in order to fulfil its role under the Treaty and to be able to assess whether the criteria for the suitability assessment need further clarification, the Commission should be entitled to request copies of the documents on which the competent authorities have based their prudential assessment'.

459 Recital 5(c) of the Qualifying Holdings Directive.

460 Unlike Article 19c(2) and (3) of the Commission's proposal. These provisions on confidentiality, which were in line with Article 287 EC, have been dropped in the Qualifying Holdings Directive, which instead introduces a single reference to Article 296 EC. This article relates to the right of Member States not to supply information 'the disclosure of which it considers contrary to the essential interests of its security' (in comparison, see recital 19 of the EC Merger Regulation).

461 See para. 7 of the MEP Wolf Klinz Report.

information is to be requested for the sole purpose of determining whether Member States have complied with their obligations under the Banking Directive[462].

In sectors other than the financial sector, there are some precedents of directives providing the Commission with an explicit right of access to information provided by national authorities, for instance, in the telecommunications sector[463]. In the *Mobistar* case[464], the Court did not challenge the right of the Commission to have access to information, although the Commission must guarantee the confidentiality of the information received. The Court also considered that this right granted to the Commission was not incompatible with the possibility of challenging decisions of national regulatory authorities before national courts. However, the Court pointed out that information could be communicated to the Commission, provided that the requests are proportionate and that, as regards information considered confidential by a national regulatory authority, it may only be exchanged with the Commission where such exchange is strictly necessary for the application of the provisions of the directives[465].

The core issue to be examined in the context of the cooperation between the Commission and the supervisory authorities with regard to the Commission's right of access to information is the extent to which supervisory information, especially information concerning individual credit institutions, may be disclosed to the Commission given the confidential nature of this information and the possible consequences for the banking system as a whole. In this respect, in *Gemeente Hillegom v Cornelis Hillenius* the Court has pointed out that 'if the monitoring of banks through supervision within a Member State and the exchanging of information by the competent authorities is to function properly, it is necessary to protect professional secrecy. The disclosure of confidential information for whatever purpose might have damaging consequences not only for the credit institution directly concerned but also for the banking system in general'[466]. The Commission has to rely on various sources of information (either from the complainant – proposed acquirer or third party – or from the competent authorities) in order to perform its tasks. At the same time, a derogation from the obligation of supervisory authorities to preserve the confidentiality of supervisory information should be clearly circumscribed. It is important to strike a balance, and to reconcile the Commission's need to have all the information necessary to decide on the merits of a particular case[467] with the need to protect the rights of proposed acquirers and the obligation of supervisory authorities to guarantee the

462 By contrast, in its Impact assessment the Commission pointed out that it should be entitled to request the relevant documents during the authorisation period or after a negative decision has been taken (see the Commission's Impact assessment, para. 6.5, 'Right of access to documents', p. 27).

463 See Article 5(2) of Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services, (OJ L 108/, 24.4.2002, p. 33) ('Provision of information').

464 Case C-438/04 *Mobistar* v *Institut belge des services postaux et des télécommunications (IBPT)* [2006] ECR I-6675.

465 Ibid. para. 42 of the judgment. In the same case, A.G. Stix-Hackl noted that the confidentiality of the information was not an obstacle to the communication of the information to the Commission, though it must however ensure adequate confidentiality (Case C-438/04, *Mobistar* [2006] ECR I-6675, Opinion of A.G. Stix-Hackl paras. 80 to 82).

466 Case 110/84 *Gemeente Hillegom* v *Cornelis Hillenius* [1985] ECR 3947, para. 27. These aspects are examined in detail in Opinion CON/2006/60 ('The Commission's right to request information from competent authorities', paras. 5.1 to 5.6).

467 Case C-438/04 *Mobistar* [2006] ECR I-6675, paras. 38 to 43.

confidentiality of information relating to financial institutions with a view to ensuring the stability of the financial system[468].

An aspect which was also raised was whether this right of access to information granted to the Commission would imply an intention to confer upon the Commission a specific role in the day-to-day supervision of regulated entities, or to enable the Commission to second-guess individual decisions of the competent authorities. The obligation imposed in the Qualifying Holdings Directive on competent authorities to disclose information only after completing their prudential assessment reflects precisely this concern to avoid any interference with actual supervisory decision-making and to respect the independence of supervisory authorities[469].

Lastly, another objection put forward by the opponents to the Commission's right of access to supervisory information was that a proposed acquirer is in any case entitled to appeal to national courts which can apply the principles of Community law to protect the proposed acquirer's rights and legitimate expectations. The Banking Directive[470] provides that Member States must ensure that decisions taken in respect of a credit institution in pursuance of laws, regulations and administrative provisions adopted in accordance with the Banking Directive are subject to review by courts[471]. It is hoped that the application of the harmonised prudential assessment criteria and the procedures contained in the new legal framework amending the Banking Directive will contribute to reducing the need for the Commission to institute proceedings for breaches of the Community laws relating to the application of supervisory rules in the banking and financial sector.

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468 Case 110/84 *Gemeente Hillegom* v *Cornelis Hillenius* [1985] ECR 3947, para. 20.

469 Opinion CON/2006/60, para. 5(6).

470 Article 55, first sentence, of the Banking Directive.

471 Article 55, second sentence, of the Banking Directive. This right of appeal is without prejudice to other available remedies under the Treaty. In this respect the Court has clearly ruled that 'the fact that proceedings have been brought before a national court to challenge the decision of a competent authority which is the subject of an action for failure to fulfil obligations and the decision of that court cannot affect the admissibility of the action for failure to fulfil obligations brought by the Commission. The existence of the remedies available through the national courts cannot prejudice the bringing of an action under Article 226 EC, since the two procedures have different objectives and effects' (Case C-508/03 *Commission* v *United Kingdom* [2006] ECR I-3969, para. 71).

CONCLUSION

Prior to their implementation large-scale cross-border banking mergers and takeover bids in the EU often give rise to a complex interplay between Community and national rules (and sometimes international rules) on takeover bids, banking and merger control. In the context of the increasing pace of banking consolidation in Europe, the Qualifying Holdings Directive, which must be implemented by Member States by March 2009, will remedy the previous weaknesses of the Community prudential legal framework regarding the authorisation of acquisitions and increases of qualifying holdings. A report on the review of the application of the Qualifying Holdings Directive will have to be prepared by the Commission by March 2011. The Commission will have to examine to what extent its declared objectives in terms of legal certainty, clarity and predictability with regard to the assessment of qualifying holdings have been met. Furthermore, the globalisation of financial markets and the emergence of new types of investors, also in the banking sector, may require consideration of whether further amendments are needed.

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