JUDGMENT OF THE COURT (Grand Chamber)

23 October 2007 *

In Case C-112/05,

ACTION for failure to fulfil obligations under Article 226 EC, brought on 4 March 2005,

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

applicant,

v

Federal Republic of Germany, represented by M. Lumma and A. Dittrich, acting as Agents, assisted by H. Wissel, Rechtsanwalt,

defendant,

* Language of the case: German.

THE COURT (Grand Chamber),

composed of V. Skouris, President, P. Jann (Rapporteur), C.W.A. Timmermans, A. Rosas, K. Lenaerts and L. Bay Larsen, Presidents of Chambers, J.N. Cunha Rodrigues, R. Silva de Lapuerta, K. Schiemann, J. Makarczyk, E. Levits, A. Ó Caoimh and P. Lindh, Judges,

Advocate General: D. Ruiz-Jarabo Colomer,
Registrar: B. Fülöp, Administrator,

having regard to the written procedure and further to the hearing on 12 December 2006,

after hearing the Opinion of the Advocate General at the sitting on 13 February 2007,

gives the following

Judgment

1 By its application, the Commission of the European Communities asks the Court for a declaration that Paragraphs 2(1) and 4(1) and (3) of the Law of 21 July 1960 on the privatisation of equity in the Volkswagenwerk limited company (Gesetz über die Überführung der Anteilsrechte an der Volkswagenwerk Gesellschaft mit beschränk-

ter Haftung in private Hand, BGBl. 1960 I, p. 585, and BGBl. 1960 III, p. 641-1-1), in the version applicable to the present proceedings ('the VW Law'), infringe Articles 43 EC and 56 EC.

Legal context

The Law on public limited companies

2 Paragraph 134(1) of the Law on public limited companies (Aktiengesetz) of 6 September 1965 (BGBl. 1965 I, p. 1089; 'the Law on public limited companies'), as amended by the Law on the monitoring and transparency of companies (Gesetz zur Kontrolle und Transparenz im Unternehmensbereich) of 27 April 1998 (BGBl. 1998 I, p. 786), provides:

'Voting rights shall be exercised by reference to the par value of shares or, in the case of no par value shares ('Stückaktien'), the number of shares held. In the case of unquoted companies, where one shareholder holds a large number of shares, the articles of association may restrict its voting rights by an absolute or progressive ceiling. ...'

3 Paragraph 101(2) of the Law on public limited companies provides:

'The right to appoint representatives to the supervisory board shall be laid down in the articles of association and such rights may be granted only to specified shareholders or to the holders of specified shares. In the case of the latter, the right of representation is granted only where the shares are par value and where their

transfer is subject to approval by the company. The shares of the shareholders having this right shall not belong to a specific category. In aggregate, the rights of representation granted shall not exceed one third of the number of members of the supervisory board appointed by the shareholders in accordance with the law or the articles of association. Paragraph 4(1) of the [VW Law] shall remain unchanged.'

The VW Law

4 Paragraph 1(1) of the VW Law states that the limited liability company, Volkswagenwerk, is to be converted into a public limited company ('Volkswagen').

5 Paragraph 2(1) of the VW Law, concerning the exercise of voting rights and the limitations on that right, provides:

'The voting rights of a shareholder whose par value shares represent more than one fifth of the share capital shall be limited to the number of votes granted by the par value of shares equivalent to one fifth of the share capital.'

6 Paragraph 3(5) of the VW Law, concerning representation for the exercise of voting rights, provides:

'At the general meeting, no person may exercise a voting right which corresponds to more than one fifth of the share capital.'

7 Paragraph 4 of the VW Law, headed 'The company's articles of association', is worded as follows:

'1. The Federal Republic of Germany and the Land of Lower Saxony may each appoint two members to the supervisory board on condition that they hold shares in the company.

...

3. Resolutions of the general meeting which, under the Law on public limited companies, require the favourable vote of at least three quarters of the share capital represented at the time of their adoption, shall require the favourable vote of more than four fifths of the share capital represented at the time of that adoption.'

The pre-litigation procedure

8 After giving the Federal Republic of Germany formal notice to submit to it its observations on Paragraphs 2(1) and 4(1) and (3) of the VW Law, the Commission delivered, on 1 April 2004, a reasoned opinion stating that those provisions of national law constituted restrictions on the free movement of capital and on the freedom of establishment guaranteed by Articles 56 EC and 43 EC respectively. Since that Member State did not adopt the measures necessary to comply with that opinion within the prescribed period, the Commission brought the present action, and submits in support of that action that, by maintaining those provisions in force, the Federal Republic of Germany is in breach of Articles 56 EC and 43 EC.

The action

9 The Commission asserts, in essence, that, first, by limiting, in derogation from the general law, the voting rights of every shareholder to 20% of Volkswagen's share capital, secondly, by requiring a majority of over 80% of the shares represented for resolutions of the general assembly, which, according to the general law, require only a majority of 75%, and thirdly, by allowing, in derogation from the general law, the Federal State and the Land of Lower Saxony each to appoint two representatives to the company's supervisory board, the disputed provisions of the VW Law are liable to deter direct investment and for that reason constitute restrictions on the free movement of capital within the meaning of Article 56 EC.

10 The Commission does not advance any particular argument for the purpose of establishing a breach of Article 43 EC.

11 The Federal Republic of Germany contests the merits of the Commission's plea alleging breach of Article 56 EC.

12 Since the Commission has not set out any views whatsoever on the plea alleging breach of Article 43 EC, the Federal Republic of Germany infers from this that that plea has become devoid of purpose.

Breach of Article 43 EC

13 According to settled case-law, national provisions which apply to holdings by nationals of the Member State concerned in the capital of a company established in

another Member State, giving them definite influence on the company's decisions and allowing them to determine its activities, come within the substantive scope of the provisions of the EC Treaty on freedom of establishment (see, inter alia, Case C-251/98 *Baars* [2000] ECR I-2787, paragraph 22; Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995, paragraph 31; and Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107, paragraph 27).

14 In the present case, it is apparent from the file, in particular, from the Federal Republic of Germany's arguments in defence, that the provisions of the VW Law in dispute in the present proceedings address, at least in part, the situation of a possible takeover of Volkswagen by a shareholder seeking to exercise a controlling influence over the undertaking.

15 It must be stated, however, that the Commission did not advance any specific line of argument in support of any restriction on the freedom of establishment, either in its application or in its reply, or even at the hearing.

16 Accordingly, the Court must dismiss the action in so far as it is based on a breach of Article 43 EC.

Breach of Article 56 EC

17 According to consistent case-law, Article 56(1) EC generally prohibits restrictions on movements of capital between Member States (see, inter alia, Joined Cases C-282/04 and C-283/04 *Commission* v *Netherlands* [2006] ECR I-9141, paragraph 18 and the case-law cited).

18 In the absence of a Treaty definition of 'movement of capital' within the meaning of Article 56(1) EC, the Court has previously recognised the nomenclature set out in Annex I to Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [article repealed by the Treaty of Amsterdam] (OJ 1988 L 178, p. 5) as having indicative value. Movements of capital within the meaning of Article 56(1) EC therefore include direct investments, that is to say, as that nomenclature and the related explanatory notes show, 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 (see, to that effect, Case C-446/04 *Test Claimants in the FII Group Litigation* [2006] ECR I-11753, paragraphs 179 to 181, and Case C-157/05 *Holböck* [2007] ECR I-4051, paragraphs 33 and 34). As regards shareholdings in new or existing undertakings, as those explanatory notes confirm, the objective of establishing or maintaining lasting economic links presupposes that the shares held by the shareholder enable him, either pursuant to the provisions of the national laws relating to companies limited by shares or in some other way, to participate effectively in the management of that company or in its control (see *Test Claimants in the FII Group Litigation*, paragraph 182, and *Holböck*, paragraph 35; see also C-367/98 *Commission* v *Portugal* [2002] ECR I-4731, paragraph 38; Case C-483/99 *Commission* v *France* [2002] ECR I-4781, paragraph 37; Case C-503/99 *Commission* v *Belgium* [2002] ECR I-4809, paragraph 38; Case C-463/00 *Commission* v *Spain* [2003] ECR I-4581, paragraph 53; Case C-98/01 *Commission* v *United Kingdom* [2003] ECR I-4641, paragraph 40; Case C-174/04 *Commission* v *Italy* [2005] ECR I-4933, paragraph 28; and *Commission* v *Netherlands*, paragraph 19).

19 Concerning this form of investment, the Court has stated that national measures must be regarded as 'restrictions' within the meaning of Article 56(1) EC if they are liable to prevent or limit the acquisition of shares in the undertakings concerned or to deter investors of other Member States from investing in their capital (see *Commission* v *Portugal*, paragraph 45; *Commission* v *France*, paragraph 41; *Commission* v *Spain*, paragraph 61; *Commission* v *United Kingdom*, paragraph 47; *Commission* v *Italy*, paragraphs 30 and 31; and *Commission* v *Netherlands*, paragraph 20).

20 In the present case, the Federal Republic of Germany submits, in essence, that the VW Law is not a national measure within the meaning of the case-law referred to in the preceding three paragraphs. It also states that the disputed provisions of that Law, taken separately or as a whole, are not restrictions within the meaning of that case-law either.

21 The arguments put forward by the Commission in support of its plea alleging breach of Article 56 EC must be examined in the light of the above considerations.

The existence of a national measure

Arguments of the parties

22 The Federal Republic of Germany observes that the VW Law is based on an agreement which was entered into in 1959 between individuals and groups which, during the 1950s, had claimed rights in respect of the limited company Volkswagenwerk. At that time, the trade unions and the workers, on the one hand, and the Federal State and the Land of Lower Saxony, on the other, claimed rights in respect of that company. Under that agreement, the workers and the trade unions, in return for relinquishing their claim to a right of ownership over the company, secured the assurance of protection against any large shareholder which might gain control of the company.

23 The Federal Republic of Germany explains that the agreement was first expressed by the conclusion of a contract ('Staatsvertrag'), on 12 November 1959, between the

Federal State and the Land of Lower Saxony, and subsequently by the adoption, on the basis of that contract, of the Law of 9 May 1960 on the regulation of the legal situation of the Volkswagenwerk limited company (Gesetz über die Regelung der Rechtsverhältnisse bei der Volkswagenwerk Gesellschaft mit beschränkter Haftung, BGBl. 1960 I, p. 301), followed by the adoption, on 6 July 1960, of Volkswagen's articles of association, and finally, of the VW Law, which reproduced the rules already contained in those articles of association.

24 According to the Federal Republic of Germany, when it created and privatised the public limited company Volkswagen, the VW Law was merely expressing the will of the shareholders and all the other persons and all other groups which had laid claim to private rights over that undertaking. In relation to the free movement of capital, the Law in question should therefore be treated in the same way as an agreement between unit-holders. In accordance with the maxim *pacta sunt servanda*, this agreement, it submits, continues to be of the same value today.

25 The Commission takes the view that those historical considerations are irrelevant. Its criticism of the Federal Republic of Germany does not concern the reasons behind that Member State's legislative activity in 1960, but rather its current failure to legislate, inasmuch as the VW Law has for a long time fallen foul of the requirements of the free movement of capital.

Findings of the Court

26 Even if, as the Federal Republic of Germany submits, the VW Law does no more than reproduce an agreement which should be classified as a private law contract, it must be stated that the fact that this agreement has become the subject of a Law suffices for it to be considered as a national measure for the purposes of the free movement of capital.

27 The exercise of legislative power by the national authorities duly authorised to that end is a manifestation *par excellence* of State power.

28 The Court must point out, in addition, that the provisions of the Law at issue can no longer be amended solely at the will of the parties to the initial agreement, since any modification requires that a new Law be voted in in accordance with the constitutional law procedures of the Federal Republic of Germany.

29 That being so, the Court must reject the argument of the Federal Republic of Germany that the VW Law is not a national measure for the purposes of the free movement of capital.

The existence of restrictions

30 Having regard to the parties' arguments in relation to the first two complaints, and the cumulative effects of the two provisions of the VW Law which those complaints call in question, it is appropriate for the Court to examine the latter together.

The first and second complaints, based on the fact that the voting rights are capped at 20% and the blocking minority is fixed at 20%

— Arguments of the parties

31 As regards, first, the capping of the voting rights of every shareholder at 20% of Volkswagen's share capital, as laid down in Paragraph 2(1) of the VW Law, the

Commission maintains that this rule is at variance with the requirement that there be a correlation between shareholding and the related voting rights. Even if the capping of voting rights is a common instrument of company law, also used in other Member States, there is a considerable difference between the State making it possible to insert such an instrument into a company's articles of association, as is the case in German law for non-quoted public companies, and the State adopting, in its capacity of legislator, a provision to this end for one undertaking alone, and ultimately, for its own benefit, as is the case with Paragraph 2(1) of the VW Law.

32 The Federal Republic of Germany observes that, when Volkswagen was established, voting rights were capped at 0.01% for all shareholders, with the exception of the Federal State and the Land of Lower Saxony, which were entitled to exercise their rights in proportion to the 20% interest which each held. However, in 1970, this exceptional status in favour of the Federal State and the Land of Lower Saxony was abolished and the ceiling on voting rights was raised to 20%, to be applied without distinction to all shareholders. The Federal Republic of Germany goes on to state that, since then, the disputed provision of the VW Law has been applicable without distinction to all shareholders in Volkswagen. This legal framework can be distinguished, in this regard, from those which were at issue in the case-law to which the Commission refers for the purpose of establishing the existence of restrictions on the free movement of capital in the present case (*Commission* v *Portugal*, paragraph 36 and 44; *Commission* v *France*, paragraph 35 and 40; *Commission* v *Belgium*, paragraph 36; *Commission* v *Spain*, paragraphs 51 and 56; *Commission* v *United Kingdom*, paragraphs 38 and 43; and *Commission* v *Italy*, paragraph 26). This case-law, it is argued, concerned special rights established for the benefit of the State. According to the Federal Republic of Germany, any extension of the protection of the free movement of capital beyond the special rights of the State would stretch the scope of that freedom to infinity.

33 Disputing the view that there should be a correlation between the holding in a company's share capital and the voting rights of that company's shareholders, the Federal Republic of Germany submits that the national legislature is free to legislate

in the field of national company law and to lay down rules applicable to certain groups of companies, or indeed to one company alone, provided that such legislation does not give rise to any impediment.

34 As regards, secondly, fixing the blocking minority at 20%, the Commission maintains that, by requiring a majority of more than 80% of the capital represented for decisions of the general assembly which, according to general company law, require only a majority of at least 75%, Paragraph 4(3) of the VW Law enables the Land of Lower Saxony to block such decisions on the basis of the interest of approximately 20% which it has held since Volkswagen was privatised. According to the Commission, the requirement of a threshold in excess of 80%, while formally not appearing to be discriminatory, was created for the exclusive benefit of the public authorities.

35 The Commission accepts that the Law on public limited companies allows the percentages required to pass the resolutions referred to to be fixed at over 75%, but submits that this is a freedom which is left to shareholders, who can decide whether or not to avail themselves of it. By contrast, the threshold of 80% required under Paragraph 4(3) of the VW Law was imposed on Volkswagen's shareholders by the legislature in order to procure for itself, as the principal shareholder at the time, a blocking minority.

36 As a preliminary point, the Federal Republic of Germany argues that, as with the provision on the capping of voting rights at 20%, the provision of the VW Law at issue applies without distinction to all shareholders in Volkswagen. It considers therefore that, as the provision at issue does not confer any special rights on the State, it does not amount to a restriction on the free movement of capital.

37 The Federal Republic of Germany adds that neither the Law on public limited companies nor the relevant Community rules provide for a limit on the fixing of a blocking minority. The situation of the Land of Lower Saxony, as regards its ability to form a blocking minority, reflects the normal situation of a shareholder of its size. The Federal Republic of Germany states in this regard that, although the Land of Lower Saxony currently holds an interest of around 20% in Volkswagen's capital, that interest is the result of investments made on the market as a private investor.

— Findings of the Court

38 As the Federal Republic of Germany has observed, the capping of voting rights is a recognised instrument of company law.

39 It is common ground, moreover, that, while the first sentence of Paragraph 134(1) of the Law on public limited companies lays down the principle that voting rights must be proportionate to the share of capital, the second sentence thereof allows a limitation on the voting rights in certain cases.

40 However, as the Commission has correctly noted, there is a difference between a power made available to shareholders, who are free to decide whether or not they wish to use it, and a specific obligation imposed on shareholders by way of legislation, without giving them the possibility to derogate from it.

41 In addition, the parties are in agreement that the first sentence of Paragraph 134(1) of the Law on public limited companies, as amended by the Law on the control and transparency of companies, removed the possibility of inserting a limitation on

voting rights in the articles of association of listed companies. As the Commission has submitted, without being contradicted on this point by the German Government, since Volkswagen is a listed company, a ceiling on the voting rights cannot for that reason normally be inserted into its articles of association.

42 The Federal Republic of Germany submits that the limitation laid down in Paragraph 2(1) of the VW Law, since it applies without distinction to all shareholders, may be seen both as an advantage and as a disadvantage. While on the one hand there is the restriction on voting rights to which a shareholder holding more than 20% of the share capital is subject, on the other there is a corresponding protection against the influence of other possible shareholders having significant holdings, and thus, the guarantee of effective participation in the company's management.

43 Prior to assessing this argument, it is appropriate to examine the effects of the cap on voting rights alongside the requirement contained in Paragraph 4(3) of the VW Law of a majority of over 80% of the share capital in order to pass certain resolutions of the general assembly of Volkswagen's shareholders.

44 As the Commission has argued, without being contradicted by the Federal Republic of Germany, such resolutions include amendment of the company's articles of association, capital or financial structures, for which the Law on public limited companies fixes the required majority at a minimum of 75% of the share capital.

45 As the Federal Republic of Germany has observed, the percentage of 75% of the share capital provided for in the Law on public limited companies may be increased and fixed at a higher level by the particular company's articles of association. However, as the Commission has correctly noted, it is open to shareholders to

decide whether or not to make use of that power. Conversely, the fact that the threshold of the required majority has been fixed by Paragraph 4(3) of the VW Law at more than 80% of the capital results, not from the will of the shareholders, but, as was held in Paragraph 29 of the present judgment, from a national measure.

46 This requirement, derogating from general law, and imposed by way of specific legislation, thus affords any shareholder holding 20% of the share capital a blocking minority.

47 Admittedly, as the Federal Republic of Germany has stated, this power applies without distinction. In the same way as the cap on voting rights, it may operate both to the benefit and to the detriment of any shareholder in the company.

48 However, it is apparent from the file that, when the VW Law was adopted in 1960, the Federal State and the Land of Lower Saxony were the two main shareholders in Volkswagen, a recently privatised company, and each held 20% of its capital.

49 According to the information provided to the Court, while the Federal State has chosen to part with its interest in the capital of Volkswagen, the Land of Lower Saxony, for its part, still retains an interest in the region of 20%.

50 Paragraph 4(3) of the VW Law thus creates an instrument enabling the Federal and State authorities to procure for themselves a blocking minority allowing them to oppose important resolutions, on the basis of a lower level of investment than would be required under general company law.

51 By capping voting rights at the same level of 20%, Paragraph 2(1) of the VW Law supplements a legal framework which enables the Federal and State authorities to exercise considerable influence on the basis of such a reduced investment.

52 By limiting the possibility for other shareholders to participate in the 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, this situation is liable to deter direct investors from other Member States.

53 This finding cannot be undermined by the argument advanced by the Federal Republic of Germany to the effect that Volkswagen's shares are among the most highly-traded in Europe and that a large number of them are in the hands of investors from other Member States.

54 As the Commission has argued, the restrictions on the free movement of capital which form the subject-matter of these proceedings relate to direct investments in the capital of Volkswagen, rather than portfolio investments made solely with the intention of making a financial investment (see *Commission* v *Netherlands*, paragraph 19) and which are not relevant to the present action. As regards direct investors, it must be pointed out that, by creating an instrument liable to limit the ability of such 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, Paragraphs 2(1) and 4(3) of the VW Law diminish the interest in acquiring a stake in the capital of Volkswagen.

55 This finding is not affected by the presence, among Volkswagen's shareholders, of a number of direct investors, which, according to the Federal Republic of Germany, is

similar to such a presence among the shareholders of other large undertakings. This circumstance is not such as to cast doubt on the fact that, because of the disputed provisions of the VW Law, direct investors from other Member States, whether actual or potential, may have been deterred from acquiring a stake in the capital of that company in order to participate in it 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, even though they were entitled to benefit from the principle of the free movement of capital and the protection which that principle affords them.

56 It must therefore be held that the combination of Paragraphs 2(1) and 4(3) of the VW Law constitutes a restriction on the movement of capital within the meaning of Article 56(1) EC.

The third complaint, based on the right to appoint two representatives to Volkswagen's supervisory board

— Arguments of the parties

57 The Commission submits that Paragraph 4(1) of the VW Law, allowing the Federal State and the Land of Lower Saxony each to appoint two representatives to the supervisory board of Volkswagen, on condition that they are shareholders in the company, derogates from the rule laid down in Paragraph 101(2) of the Law on public limited companies, to the effect that such a right may be inserted only into the articles of association and may concern only one third of the members of the supervisory board appointed by the shareholders, that is, three representatives in the case of Volkswagen. According to the Commission, by limiting the ability of the other shareholders to participate effectively in the management and control of that company, Paragraph 4(1) constitutes a restriction on the free movement of capital.

58 The Federal Republic of Germany submits that the supervisory board is merely a monitoring body and not a decision-making body. It goes on to state that the number of representatives on the supervisory board of Volkswagen is in proportion to the Federal Republic's holding in Volkswagen's capital, and that, in that respect, the Land of Lower Saxony's level of representation is lower than its holding in the capital. It claims that Paragraph 4(1) of the VW Law is also of no practical relevance to investment-related decisions.

— Findings of the Court

59 Under Paragraph 4(1) of the VW Law, the Federal State and the Land of Lower Saxony are each entitled, on condition that they are shareholders in the company, to appoint two representatives as members of the supervisory board of Volkswagen, that is, a total of four persons.

60 Such an entitlement constitutes a derogation from general company law, which restricts the rights of representation conferred on certain shareholders to one third of the number of the shareholders' representatives on the supervisory board. As the Commission has argued without being contradicted on this point, in the case of Volkswagen, the supervisory board of which comprises 20 members, 10 of whom are appointed by the shareholders, the number of representatives who may be appointed by the Federal State and the Land of Lower Saxony may not exceed a maximum of three according to general company law.

61 This right of appointment is therefore a specific right, which derogates from general company law and is laid down by a national legislative measure for the sole benefit of the Federal and State authorities.

62 The right of appointment conferred on the Federal State and the Land of Lower Saxony thus enables them to participate in a more significant manner in the activity of the supervisory board than their status as shareholders would normally allow.

63 Even if, as the Federal Republic of Germany has observed, the right of representation of that Land is not disproportionate to the interest which it currently holds in the share capital of Volkswagen, the fact remains that both that Land and the Federal State have the right to appoint two representatives to the supervisory board of Volkswagen on condition that they hold shares in that company, irrespective of the extent of their holdings.

64 Paragraph 4(1) of the VW Law thus establishes an instrument which gives the Federal and State authorities the possibility of exercising influence which exceeds their levels of investment. As a corollary, the influence of the other shareholders may be reduced below a level commensurate with their own levels of investment.

65 The fact that the supervisory board, as the Federal Republic of Germany submits, is not a decision-making body, but a simple monitoring body, is not such as to undermine the position and influence of the Federal and State authorities concerned. While German company law assigns to the supervisory board the task of monitoring the company's management and of providing reports on that management to the shareholders, it confers significant powers on that body, such as the appointment and dismissal of the members of the executive board, for the purpose of performing that task. Furthermore, as the Commission has pointed out, approval by the supervisory board is necessary for a number of transactions, including, in addition to the setting-up and transfer of production facilities, the establishment of branches, the sale and purchase of land, investments and the acquisition of other undertakings.

66 By restricting the possibility for other shareholders to participate in the company with a view to establishing or maintaining lasting and direct economic links with it such as to enable them to participate effectively in the management of that company or in its control, Paragraph 4(1) of the VW Law is liable to deter direct investors from other Member States from investing in the company's capital.

67 For the same reasons as those set out in paragraphs 53 to 55 of this judgment, this finding cannot be undermined by the Federal Republic of Germany's argument that there is a keen investment interest in Volkswagen shares on the international financial markets.

68 In the light of the foregoing, it must be held that Paragraph 4(1) of the VW Law constitutes a restriction on the movement of capital within the meaning of Article 56(1) EC.

69 The question of whether or not the Federal State and the Land of Lower Saxony make use of their right under Paragraph 4(1) is entirely irrelevant. It need merely be stated in this regard that the specific right, which derogates from the general law, conferred on those Federal and State authorities, to appoint representatives to the supervisory board of Volkswagen continues to exist in the German legal system.

Possible justification for the restrictions

Arguments of the parties

70 In the alternative, the Federal Republic of Germany submits that the provisions of the VW Law criticised by the Commission are justified by overriding reasons in the

general interest. That Law, which is part of a particular historical context, established an 'equitable balance of powers' in order to take into account the interests of Volkswagen's employees and to protect its minority shareholders. The Law thus pursues a socio-political and regional objective, on the one hand, and an economic objective, on the other, which are combined with objectives of industrial policy.

71 According to the Commission, which disputes the relevance of those historic considerations, the VW Law does not address requirements of general interest, since the reasons relied on by the Federal Republic of Germany are not applicable to every undertaking carrying on an activity in that Member State, but seek to satisfy interests of economic policy which cannot constitute a valid justification for restrictions on the free movement of capital (*Commission* v *Portugal*, paragraphs 49 and 52).

Findings of the Court

72 The free movement of capital may be restricted by national measures 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 providing for measures necessary to ensure the protection of those interests (see *Commission* v *Portugal*, paragraph 49; *Commission* v *France*, paragraph 45; *Commission* v *Belgium*, paragraph 45; *Commission* v *Spain*, paragraph 68; *Commission* v *Italy*, paragraph 35; and *Commission* v *Netherlands*, paragraph 32).

73 In the absence of such Community harmonisation, it is in principle for the Member States to decide on the degree of protection which they wish to afford to such legitimate interests and on the way in which that protection is to be achieved. They may do so, however, only within the limits set by the Treaty and must, in particular, observe the principle of proportionality, which requires that the measures adopted

be appropriate to secure the attainment of the objective which they pursue and not go beyond what is necessary in order to attain it (see *Commission* v *Portugal*, paragraph 49; *Commission* v *France*, paragraph 45; *Commission* v *Belgium*, paragraph 45; *Commission* v *Spain*, paragraph 68; *Commission* v *Italy*, paragraph 35; and *Commission* v *Netherlands*, paragraph 33).

74 As regards the protection of workers' interests, invoked by the Federal Republic of Germany to justify the disputed provisions of the VW Law, it must be held that that Member State has been unable to explain, beyond setting out general considerations as to the need for protection against a large shareholder which might by itself dominate the company, why, in order to meet the objective of protecting Volkswagen's workers, it is appropriate and necessary for the Federal and State authorities to maintain a strengthened and irremovable position in the capital of that company.

75 In addition, as regards the right to appoint representatives to the supervisory board, it must be stated that, under German legislation, workers are themselves represented within that body.

76 Consequently, the Member State's justification based on the protection of workers cannot be upheld.

77 The same applies to the justification which the Federal Republic of Germany seeks to base on the protection of minority shareholders. While the desire to provide protection for such shareholders may also constitute a legitimate interest and justify legislative intervention, in accordance with the principles referred to in paragraphs 72 and 73 above, even if it were also liable to constitute a restriction on the free movement of capital, it must be held that, in the present case, such a desire cannot justify the disputed provisions of the VW Law.

78 It should be recalled, in this regard, that those provisions form part of a legal framework giving the Federal State and the Land of Lower Saxony the ability to exercise a greater level of influence than would normally be linked to their investment. However, the Federal Republic of Germany has not shown why, in order to protect the general interests of minority shareholders, it is appropriate or necessary to maintain such a position for the benefit of the Federal and State authorities.

79 It cannot be ruled out that, in certain special circumstances, the Federal and State authorities in question may use their position in order to defend general interests which might be contrary to the economic interests of the company concerned, and therefore, contrary to the interests of its other shareholders.

80 Finally, to the extent to which the Federal Republic of Germany contends that the activity of an undertaking as large as Volkswagen may have such an impact on the general interest that it justifies the existence of statutory guarantees which go beyond the control measures provided for under general company law, it must be pointed out that, even if this argument were well founded, that Member State has failed to explain, beyond setting out general considerations as to the risk that shareholders may put their personal interests before those of the workers, why the provisions of the VW Law criticised by the Commission are appropriate and necessary to preserve the jobs generated by Volkswagen's activity.

81 In the light of all the foregoing, the complaints relied on by the Commission alleging breach of Article 56(1) EC must be upheld.

82 Consequently, it must be held that, by maintaining in force Paragraph 4(1), as well as Paragraph 2(1) in conjunction with Paragraph 4(3), of the VW Law, the Federal Republic of Germany has failed to fulfil its obligations under Article 56(1) EC.

Costs

83 Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party's pleadings. Since the Commission has applied for costs to be awarded against the Federal Republic of Germany and the latter has, in essence, been unsuccessful, the Federal Republic of Germany must be ordered to pay the costs.

On those grounds, the Court (Grand Chamber) hereby:

1. **Declares that, by maintaining in force Paragraph 4(1), as well as Paragraph 2(1) in conjunction with Paragraph 4(3), of the Law of 21 July 1960 on the privatisation of equity in the Volkswagenwerk limited company (Gesetz über die Überführung der Anteilsrechte an der Volkswagenwerk Gesellschaft mit beschränkter Haftung in private Hand), in the version applicable to the present dispute, the Federal Republic of Germany has failed to fulfil its obligations under Article 56(1) EC;**

2. **Dismisses the remainder of the action;**

3. **Orders the Federal Republic of Germany to pay the costs.**

[Signatures]