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THE GOLDEN SHARE OF PRIVATIZED COMPANIES

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Over the last ten years, various European, Asian and South American countries have conducted privatization programs. This general trend furthers the global application of privatization techniques, not least because of the weight of foreign investors.

Having learned from the British experience in the 1980s, France adopted certain British and American concepts, including the golden share. Used during the privatization of British Aerospace and British Telecom, this special share, reserved for the government, provides a legal instrument for fighting off takeovers of strategically important privatized companies.

The golden share was introduced in French law by Act 86-912 of August 6, 1986, Section 10, on the privatization conditions for the sixty-five national enterprises listed in Act 86-793 of July 2, 1986, authorizing the government to take various economic and social measures. Section 7 of Act 99-923 of July 19, 1993, preserves and refines this legal instrument, originally adopted for a five-year term.

The recent refinements have turned this copy of the British golden share into a real French golden share.

I. CREATION OF THE GOLDEN SHARE

Transfer of ownership from the public to the private sector is a delicate operation. The government does not merely sell property or know-how. During privatization transactions, it is charged with protecting national interests and preserving national independence.

A. Protecting National Interests

Section 10 of the Act of August 6, 1986 (modified), stipulates that an ordinary share must be converted into a golden

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share when necessary to protect national interests. However, national interests are defined in neither the Act of July 19, 1993, nor in the Conseil d'État Decree No 93-1296 on the application of Section 10 of the Act of August 6, 1986. Moreover, it isn't easy to distinguish between this concept and the concept of national independence.

While the definition is not entirely clear, national interests are apparently juxtaposed with foreign interests. This notion is confirmed by Senate Advisory No. 345, presented on behalf of the Commission of Constitutional laws (second ordinary session of 1992-1993), which refers to securities sold to individuals or legal entities who are not members of the European Union or who are under non-EU control. Such individuals or legal entities may not own more than 20% of the capital of a privatized company. This threshold may be lowered by the Minister of the Economy "when necessary to protect national interests." The Senate Advisory also warns against the acquisition by foreign nationals of over five percent of enterprises whose core business contributes "to the exercise of public authority," whose special status is justified "by reasons of State, national security and national health," or activities "producing or trading arms, munitions and defense equipment," pursuant to Sections 55, 56 and 223 of the Treaty of Rome.

There are however, signs that some parties within the government would like to limit the protection of national interests from foreign ownership. Report No. 326 (1992-1993), prepared for the Senate Finance Committee, proposed to abolish the 20% ceiling on interests held by foreign nationals. Although limiting protection of national interests, this report also extended the scope of the golden share based on the principle of national independence.

B. Preserving National Independence

Constitutional Council ruling No 86-207 of June 25-26, 1986, on the Act authorizing government to take various economic and social measures, states that national independence must be preserved. National independence is not a strictly defined legal concept. More restrictive than the concept of national interests, national independence is invoked to preserve the golden share when the activities of a company concerned are tied to strategies which are vital to national sover-

eignty.

For the moment, the Constitutional Council has made neither an effort to define the concept of national independence, nor was this aspect taken up in the Conseil d'État decision of February 7, 1987, on the 1986 partial privatization of Elf-Aquitaine. The concept of national independence is, however, covered by Section 16 of the French Constitution, which lays down the exceptional powers of the President of the Republic.

The concept appears to cover activities linked to national defense (armament industry), economic protection (oil supplies, *cf.*, the declaration of the President of the Republic of July 14, 1993, on the privatization of Elf-Aquitaine) and possibly national transportation and infrastructures (airlines, railroads, etc.). The government may also base its stance on other applicable texts. For instance, several texts permit close government control of the armament industry. Moreover, the decree of October 30, 1935, provides for permanent or temporary control by a government representative over any enterprise having won a defense equipment contract.

The Statutory Orders of April 18, 1939 (modified), on the reform of the defense equipment, arms, and munitions industries, require defense equipment makers or traders to be authorized by the Minister of Defense. Such authorization is granted solely to enterprises owned by French partners and managed by individuals who are French nationals. Section 238 of the Public Contract Code stipulates that government contractors for defense equipment are governed by the strict rules of the Public Contract Code and to the inspections stipulated by the laws and regulations governing defense equipment, arms and munitions. Lastly, decree No 90-58 of January 15, 1990, on the regulation of direct foreign investments, stipulates that all investments in production of or trading in defense equipment activities require authorizations by the Ministry of the Economy. In accordance with Community Principles, the regulations on direct foreign investments lay down general restrictions, notably in case of capital market upheavals.

In other areas, such as oil supplies, the government has legal instruments with which to preserve national independence. Forfeiture of voting rights for shareholders who violate these mechanisms remain in effect.

II. CREATION OF THE GOLDEN SHARE

A. *Creation by Decree*

Under Section 10, paragraph 2 of the Act of August 6, 1986, the Minister of the Economy was charged with ruling whether the protection of national interests required the creation of the golden share. The procedure enacted by the Act of July 19, 1993, calls for the adoption of an ordinary decree for every enterprise concerned. This is a more strict condition, reflecting the legislators' intention to involve the ministers concerned, notably the supervisory ministers, more closely in privatizations.

B. *Adoption of Decree Before Referral to Privatization Commission*

Already enacted by Section 10, paragraph 2 of the Act of August 6, 1986, and reiterated in Section 7 of the Act in July 19, 1993, the use of the golden share is rooted in the very mechanism underlying privatization. However, the Privatization Commission is not entitled to suggest whether it is appropriate to create such a golden share.

During the privatizations in 1986 and 1987, ordinary shares were converted into golden shares. Golden shares were in fact fully used in the case of MATRA and HAVAS, but only partly in the case of Elf-Aquitaine and Bull, since these two enterprises were not privatized but allowed to sell off secondary subsidiaries without authorizations from Parliament (so-called "respiration"). In 1993, the government refrained from creating a golden share for the Banque National de Paris and Rhône-Poulenc. Banque Hervet will probably be exempt as well. On the other hand, Elf-Aquitaine's oil and chemical activities have prompted the government to convert its ordinary share into a golden share.

III. THE SCOPE OF THE GOLDEN SHARE

Section 7 of the Act of July 19, 1993, strengthens the effect of the golden share stated in Section 10 of the Act of August 6, 1986. The Senate, National Assembly and the Government have taken a unanimous position. The golden share offers three types of rights, sometimes tied to penalties. Section 10.1 lists the conditions under which a golden share may be creat-

ed. Specifically, section 10.1 requires a determination as to whether the protection of national interests requires the conversion of an ordinary share held by the government into a golden share tied to all or part of the rights defined below. If so, the decree also orders the conversion.

Section 10.1 also creates the following additional rules for the creation and dissolution of the golden share:

Prior approval is required from the Minister of the Economy before a person, acting alone or jointly, may cross one or more of the thresholds laid down by the decree mentioned in the first paragraph above and calculated as a percentage of the share capital or voting rights;

Appointment of one or two government representatives to the Board of Directors or the Supervisory Board, as applicable, is required; such representatives are appointed by decree and have no voting rights;

The right to veto, on conditions stipulated by Conseil d'État decree, decisions to dispose of or pledge assets, if such would prejudice national interests. The effects of this share are indelibly tied to its creation.

Except where national independence is concerned, the golden share may at all times be irrevocably converted by decree into an ordinary share.

The Minister of the Economy must also approve the acquisition of interests exceeding five percent by foreign individuals or foreign or foreign-controlled legal entities, in the meaning of Section 355-1 of Company Act No 66-537 of July 24, 1966, acting alone or jointly, in those enterprises or subsidiaries covered by this Chapter whose core business comes under the Sections 55, 56, and 223 of the Treaty instituting the European Economic Community.

When interests have been acquired in violation of I.1 or II of this Section, the holder(s) of the irregularly acquired interests may not exercise the corresponding voting rights and must sell such shares within three months. Upon expiration of the three month deadline, the shares are automatically sold by court order on conditions laid down by decree. The Minister of the Economy brings such acquisitions to the attention of the Chairman of the company's Board of Directors or Directorate, as applicable, who in his turn alerts the next general shareholder meeting.

The provisions of points I and II are also available to the

privatization of the public sector enterprises mentioned in paragraph 1 of Section 20.

A. Ownership Thresholds

1. The Application of Thresholds

The Act of July 19, 1993, is more flexible than the Act of August 6, 1986, which stipulated a threshold of 10% on interests in the meaning of the Act of July 24, 1966. The decree creating the golden share grants the government a free hand in setting thresholds. The concept of acquisition of interests is defined in Section 10.III of the Act.

While British privatizations never applied thresholds below 15% for most of its future privatizations, the French government will probably opt for a threshold below 10%, corresponding to a significant financial investment and control. It is expected to base itself on the legal thresholds provided for by general law, i.e. minimum five percent. Such a threshold is determined by decree for the entire duration of the golden share. Whenever an individual or legal entity wishes to cross this threshold, approval is required.

2. The Authorization of Thresholds

The authorization date is settled by Section 7 of the Act of August 6 (modified): authorization must be granted before a threshold is crossed. On the other hand, this law does not cover the reasons which may cause a shareholder to cross a threshold, and there are cases in which a larger stake is not acquired by active investment (*e.g.*, when double voting rights are granted). In this case, it will be necessary to anticipate conversion of a single voting right into a double voting right. However, this should seldom occur, as core shareholder groups are organized during privatization. Moreover, authorization is required only for the privatized company itself, unless the company engages in defense Activities, in which case it is required for the subsidiaries as well as the parent company.

The Minister of the Economy is charged with granting or refusing the authorization to cross a threshold. In practice, he needs to decide quickly and clearly in light of the potential impact of such information on the stock market, notably in case of an accumulation strategy.

B. The Power to Appoint One or Two Government Representatives to the Board of Directors or the Supervisory Board

Government representatives appointed pursuant to the golden share are appointed by decree, and are not entitled to vote. They serve principally as watchdogs over corporate management, acting on behalf of the government. In this way, they are similar to government officials (commissaires du gouvernement) who serve a watchdog function in industries and enterprises legally required to have a government representative on the board (these are organizations such as SOFICAS, or Sociétés Financières d'Innovations, Sociétés de Développement Régionales, Organes Centraux de Réseaux de Crédit, etc.). This innovative mechanism gives full effect to the golden share by allowing the government to be in contact with company managers without interfering in company management, and by limiting the government to the protection of national interests (e.g., by the power to veto asset disposal, without allowing the government to meddle inordinately in the business operations of the company).

C. The Power to Veto Asset Disposal

Although not true directors in the traditional sense of the term, the government representatives appointed pursuant to the golden share have significant powers. One of the most significant is the power to veto asset disposal. The conditions on which this new right is exercised are governed by Conseil d'État Implementation Decree No. 33-1296. The Conseil d'État mechanism reserves to the government the to confirm by order its opposition to undesirable disposal of assets deemed strategic. A decree instituting a golden share includes a list of strategic assets whose disposal may be vetoed by the government. Plans for the disposal of assets included on this list are declared to the Minister of the Economy. Such a declaration must be accompanied by all data needed to investigate the case.

A disposal is authorized when the Minister of the Economy has not vetoed it by order published in *Journal Officiel de la République Française*, the French government gazette, within one month from the date of receipt of the complete file, as attested by the administration. This period may be extended for fifteen days by order of the Minister of the Economy. Before

expiration of the period, the Minister of the Economy may waive his veto right.

Section 3 of the Implementation Decree provides that any disposal or pledging of listed assets in violation of the decree is automatically null and void.

The requirement that a list of strategic assets be adopted has been questioned on several grounds, including whether such a list is appropriate and whether it is the best form of protection for the assets in question. These questions come from the fact that inventory prepared at the time of privatization will reflect a fixed image of national interests, whereas the enterprise operates in an economic system whose time factor implies and requires constant adaptation to remain competitive. For example, given the certainty of obsolescence by technical progress, what value will a company's patents have in ten years? What value should be placed on gas and oil reserves, as well as other consumables? Further complicating the situation is the fact that assets acquired by the company after privatization cannot be vetoed even if serving national interests, as such veto would affect ownership rights of new shareholders.

Thus, the decision as to which assets will be placed on the list is a critical to foreign investors. In the future, practice should show whether a restrictive definition of the assets concerned (*i.e.*, a short list), can overcome likely reservations. If not, the reaction of French and foreign investors toward this privatization is an open question, especially because they may view the privatization as "limited." Whether their attitude will be cautious, reserved or indifferent, investors will be paying close attention to the concept of national interest.

IV. PENALTIES

The penalty mechanism provided for in the Act of July 19, 1993 is close to the mechanism enacted in 1986, in regard to both the behavior punished and the penalties applied.

A. *Punished Cases*

Section 7 of the Act of 1993 created a penalty mechanism applicable in two cases:

- Where a person, acting alone or jointly, and without prior approval from the Minister of the Economy, acquires and inter-

est giving a percentage in the capital or voting rights exceeding the thresholds fixed by decree for each transaction;

- Where a foreign or foreign-controlled entity, acting alone or jointly, without prior approval from the Minister of the Economy, acquires a 5% interest in the capital of an enterprise whose core business comes under the Sections 55, 56 and 223 of the Treaty of Rome.

B. Penalties

Holders of interests acquired without approval by the Minister of the Economy, may not exercise the corresponding voting rights. Moreover, under Section 10-III of the Act of 1986 (modified), such persons must sell their shares within three months. Past the deadline of three months, the shares are automatically sold by court order on conditions laid down by decree. In addition, the Minister of the Economy is responsible for alerting the Chairman of the Board of Directors or the Directorate of such irregular acquisitions. The Chairman must notify the next general shareholders meeting to ensure that negligent shareholders cannot exercise their voting rights.

V. LIMITS ON THE GOLDEN SHARE

A. Limits Imposed by the Constitutional Council "Freedom of Enterprise" Decision of July 4, 1989

The ruling handed down by the Constitutional Council on the Act of July 10, 1989, clearly stated that the control exercised by the public authorities over the ownership of privatized enterprises does not affect the freedom of enterprise. The deputies who had drafted the application for the ruling held that the golden share reserved for the government and enabling the government to veto acquisitions capable of harming national interests violated "the freedom to acquire interests in an enterprise and therefore the freedom to take control of such enterprise." Responding to these arguments, the Constitutional Judge reiterated the principle according to which the "freedom of enterprise is neither general nor absolute" and that the law maker is entitled to subject it to "limitations required in the general interest, provided they do not alter its scope." Holding that government control over the acquisition of shares in privatized companies is designed to protect the national interest

and is governed by temporary application rules of limited scope, the Constitutional Council ruled that this procedure does not violate the freedom of enterprise.

B. Compliance with European Union Law

In adopting a mechanism to control the acquisition of shares in privatized companies, the law maker must comply with two basic principles of Union law, free circulation of capital and nondiscrimination.

1. Free Circulation of Capital

The Court of Justice of the European Union has identified the free circulation of capital as one of the fundamental freedoms under the Treaty. Its application calls for the adoption of Union Acts under derived law. Thus, Directive No 88-361 of June 24, 1988, was designed to organize the liberalization of capital movements, i.e. financial transactions intended mainly to place or invest a given amount of money.

The freedom of nationals of EU Member States to acquire shares in privatized companies aligns with the application of the principle of free movement of capital. Thus, compliance of the French privatization act with Union law not only means that the nationals of an EU Member State must have access to offerings on the same terms as French individuals, but also that the golden share created in favor of the government may not be used to block EU shareholders for other reasons than protection of national interests.

2. Non-Discrimination

By calling for prior approval by the Minister of the Economy of foreign acquisitions exceeding five percent of the capital in enterprises tied to national security, national defense or national health, the legislature aimed to protect national independence. This stipulation could, however, violate the principle of nondiscrimination in that it specifies stricter control for foreigners than for French nationals. However, Section 10-II of the Act of 1986 (modified) refers explicitly to the sectors granted exemptions under the Sections 55, 56 and 223 of the Treaty of Rome (security, defense, health). Thus, this rule complies with Union law.

VI. THE TEMPORARY NATURE A GOLDEN SHARE

Section 10, paragraph 5 of the Act of August 6, 1986, states that "the golden share may at all times be irrevocably converted into an ordinary share by order of the Minister of the Economy. It is automatically so converted after five years."

In ruling No. 89-254 of July 4, 1989, the Constitutional Council held that "government control of the acquisition of shares in privatized companies . . . is intended to protect national interests and is subject to the temporary application of procedures of limited scope which do not violate the freedom of enterprise."

Hence, the special treatment of privatized companies, compared with the general provisions of corporate law, may not be extended beyond a certain period whose term was not specified by the Constitutional Council. Section 10-I-3, paragraph 3 (modified), is worded as follows: "Except where national independence is concerned, the golden share may at all times be irrevocably converted into an ordinary share by decree."

Comparison of the 1986 and 1993 versions shows the withdrawal of a predetermined period, although not without a bitter fight in parliament. In light of constitutional jurisprudence, the government may not hold indefinitely its golden share in enterprises not involved with national independence. Even in the case of such enterprises it must waive its prerogatives in due time.

The ultimate lesson is that the French golden share is not a threat to the financial markets. The golden share is an instrument in the service of a liberal state disposing of property which cannot be of use for its sovereign functions, while maintaining a degree of control in order to watch over national independence. Another purpose of the golden share is to preserve the ownership structure chosen at the time of privatization. Moreover, a mixed commission with equal representation extended its use to selling off secondary subsidiaries by public-sector enterprises with sales of over one billion French francs and a staff of over one thousand employees.

