Could the CJEU smooth Brexit?

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ABSTRACT - In Europe free movement of capital is enshrined in Article 63 TFEU. However, this freedom had a very slow start; it was recognised direct effect only after the CJEU Bordessa judgement (Joined Cases C-358/93 and C-416/93). Yet, its erga omnes effect, i.e. it can be horizontally claimed also by non-EU nationals, makes it potentially the more far-reaching of all EU freedoms. Thus, in the current context the construction of its scope and content by the CJEU enjoys special importance, because free movement of capital will continue to apply to companies established in the United Kingdom also after Brexit.

1. Introduction

In Europe free movement of capital is enshrined in Article 63 TFEU. However, this freedom had a very slow start (Schön, 2005) [1]; it was recognised as having direct effect only after the CJEU Bordessa judgment[2]. Yet, its erga omnes effect, ie the fact that it can be horizontally claimed also by non-EU nationals, makes it potentially the most far-reaching of all EU freedoms. Thus, in the current context of Brexit, the construction of its scope and content by the CJEU enjoys special importance, because free movement of capital will continue to apply to companies established in the UK after Brexit. To be true, European openness to capital movements is not unconditional. The Treaty allows restrictions under specific conditions, for example in the field of taxation and prudential supervision of financial institutions and on grounds of public security or of public policy, as well as for 'overriding reasons in the general interest'. Restrictions to non-EU capital movements can be adopted by EU co-legislators by qualified majority under Article 64(2) TFEU. Yet, in the past the CJEU has been prepared to expand the scope of the freedom, and interpret the exceptions restrictively (e.g. when assessing golden shares).

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[1] Compare W. Schön, '*Der Kapitalverkehr mit Drittstaaten und das Internationale Steuerrecht*', *Festschrift für Franz Wassermeyer* (2005), p. 491 (describing this freedom, at the time, as the "poor cousin" of other fundamental freedoms).
[2] CJEU, Judgment of 23 February 1995, joined Cases C-358/93 and C-416/93.

2. Freedom of capital in a post-Brexit scenario: a) the current approach of the CJEU based on the "center of gravity"

In a post-Brexit scenario, the TFEU freedom of establishment and freedom to provide services will cease to be legitimate entitlements of UK companies. Thus, a fundamental question will be which activities and transactions crossing the Channel will enjoy freedom of capital, and what kind of freedom they will enjoy. This, in turn, will depend (i) on the degree of capital movement that those activities and transactions entail, and (ii) on which of the competing forces underpinning the case law of the CJEU prevails. The last point is important. Although the CJEU has adopted a decisive and expansive approach towards free movement of capital, it has so far taken a restrictive stance on the relationship between free movement of capital on the one hand, and freedom of establishment or freedom to provide services, on the other. Pursuant to this approach, free movement of capital does not apply to (equity) investments or to the provision of (financial) services when they are primarily the expression of freedom of establishment and/or freedom to provide services. Thus, a 'centre of gravity' test is required, meaning that if the activity or transaction is deemed to be an exercise of other freedoms, it will be 'attracted' by them, and be subject to analysis only by those freedoms. In practice this means that any restriction of activities considered primarily an exercise of freedom of establishment or services, and only incidentally of free movement of capital, will be considered compatible with the Treaties on the sole ground that those freedoms do not apply to non-EU nationals. The fact that the measure incidentally restricts free movement of capital will not result in an additional evaluation of the restriction. In such case, investors from outside the EU who are concerned, for example, by a restriction to acquire control of an EU company, cannot claim protection under primary EU law. This position was originally stated by the CJEU in a series of fiscal cases – starting from Bachmann3 (point 34) – and eventually extended to the financial sector in Fidium Finanz.4 There the Court discussed the scope of free movement of capital with regard to the provision of banking services to a German citizen from Switzerland. In a departure from the Opinion of AG Stix Hackl (Opinion 16 March 2006, in particular points 62-63) the Court concluded (at point 49) that:

'[i]t is apparent that, in the circumstances of the main case, the predominant consideration is freedom to provide services rather than the free movement of capital. Since the rules in dispute impede access to the German financial market for companies established in non-member countries,

[3] CJUE, Judgment of 28 January 1992, Case C-204/90, in particular point 34.

[4] CJEU, Judgment of 3 October 2006, Case C-452/04, departing however from the Opinion of Advocate General Stix Hackl (Conclusions 16 March 2006), in particular points 62 and 63).

they affect primarily the freedom to provide services. Given the restrictive effects of those rules on the free movement of capital are merely an inevitable consequence of the restriction imposed on the provision of services, it is not necessary to consider whether the rules are compatible with Article 56 EC et seq'.

3. (b) "Centre of gravity" and its calibration as to foreign direct investment

The CJEU eventually applied the same principle to foreign direct investment, and held, in particular, that equity investment must be classified either as (i) portfolio investments; (ii) investments that institute a 'lasting and direct link' but do not grant control; or (iii) investments implying control. Only the first two enjoy protection under free movement of capital. This was not always so. The Court in Konle[5] admitted a parallel and cumulative application of the two freedoms as to cross-border real estate investments. On this basis, AG Alber argued in Baars[6], at points 49-50 of his Opinion, in favour of a cumulative application of both freedoms.[7] Yet, here the Court began its drift towards the distinction between different degrees of protection for different types of investment by holding that, in the instant case, the acquisition of control was protected by freedom to establish, without more. Then, in Cadbury Schweppes[8], the Court expressly rejected the cumulative application of both freedoms to the acquisition of control (points 32-33). This principle has been routinely repeated by the Court ever since[9], unless there remains an ambiguity on the kind of influence (control or less than control) attached to the investment[10]. Only in such ambiguous circumstances has the Court held – first in Holböck[11] - that a national measure restricting foreign direct investment can fall within the scope of both freedoms.

4. (c) Beyond the "centre of gravity" approach.

[5] CJEU, Judgment of 1 June 1999, Case C-302/97.
[6] CJEU, Judgment of 13 April 2000, Case C-251/98.
[7] On freedom to establish in the CJEU case law, compare G. J. Vossestein, *Modernization of European Company Law and Corporate Governance* (Alphen aan den Rijn: Wolters Kluwer, 2010), p. 77.
[8] CJEU, Judgment of 12 September 2006, Case C-196/04, in particular points 32-33.
[9] Compare, for instance, CJEU, Judgment of 23 October 2007, Case C-112/05 *Commission v. Germany* (*Volkswagen I:* on this G. J. Vossnstein, *Volkswagen:* 'The State of Affairs of Golden Shares, General Company Law and European Free Movement of Capital', in *ECFR*, No. 1 (2008), p. 115); CJEU, Judgment of 26 March 2009 Case C-327/07 *Commission v. Italy;* Judgment of 21 October 2010, Case C-81/09, *Idryma Typou*, point 48; Judgment of 28 September 2006, joined Cases C-282/04 and C-283/04, *Commission v. The Netherlands*, points 42- 43.
[10] More recently CJEU, Grand Chamber, Judgment of 22 October 2013, joined Cases C-105/12 – C-107/12, *Essent*, (in particular point 40); see also CJEU, Judgment of 28 September 2006, joined Cases C-282/04 and C-283/04, *Commission v. The Netherlands*, point 19; CJEU, Judgment of 8 July 2010, Case C-171/08, *Commission v. Portugal*, point 49.
[11] CJEU, Judgment of 24 May 2007, Case C-157/05.

The centre of gravity approach adopted so far by the CJEU has been criticised in the literature, noting that it could have fatal consequences for foreign direct investment from outside the EU.[12] In the current, extraordinary, circumstances determined by Brexit, a reconsideration by the Court of this approach could serve Europe and Britain well, by smoothing out at least some of the otherwise harshest consequences of Brexit. Consider just the case of share acquisitions. If viewed from a company law perspective, the tripartite distinction made by the Court, which rests on the degree of intensity of investors' influence over the company, is brittle in theory and intractable in practice. How should one classify joint-control? And significant influence or co-influence? Is there a common, uniform, threshold that triggers freedom of establishment? One for all or one to be determined for each specific company depending on its national company law and ownership structure? There are countless scenarios where this slippery distinction could become a breeding ground for litigation and undesired national discretion[13], which could easily disguise discrimination against non-EU investments, and discourage EU-inbound investment, which still constitutes a core European policy and, in today's landscape of global capital flows, a real necessity. Moreover, if the Court rightly considers that a minority investment implies a capital movement, this is even more so with majority investments, which imply a proportionally larger use of capital. Finally, in company law terms, equity investments, especially those aiming to take control, have both organizational and financial implications. Freedom of establishment naturally relates to the former whilst free movement of capital relates to the latter. Both are inextricably intertwined.

Although the above reasoning applies to freedom of establishment, a similar argument can also be made in relation to freedom to provide services. Although a case-by-case approach is recommended in many cases, which entail at the same time service provision and capital movements severing the 'service component' from the 'capital' could prove artificial and even arbitrary.

5. Conclusions

In the Court experience, a change in jurisprudence, albeit rare, is still possible and has been adopted on quite substantial matters in the past: Keck and Mithouard[14] (point 16) and Metock[15] (point 58) are very illustrative examples. Thus, if the CJEU could reconsider its case law on the 'center of gravity', this, to our mind, would help to make the post-Brexit scenario for financial activities from London to the Continent less black and white; it could nicely accommodate the transitional period.

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[12] S. Hindelang, *The Free Movement of Capital and Foreign Direct Investment*, p. 108, where additional references.
[13] As to Italy, Tar Lazio, Judgment of 18 May 2010 and Consiglio di Stato, Judgment of 2 November 2011, *Delta*.

[14] CJEU, Judgement of 24 November 1993, Joined Cases C-267/91 and C-268/91.
[15] CJEU, Judgement of 25 July 2008, Case C-127/08.

This pragmatic approach would preserve the right for London-based investors to acquire control of EU-based companies, facilitating group strategies that try to address the new scenario through a mixture of London and continental presence. This would at the same time grant the protection of freedom of capital to (some) cross-border financial transactions or activities that also implicate capital movements. The greatest merit of a reconsidered approach, however, would be to reverse the burden of action on many cross-border financial activities currently performed from London. Even if freedom of capital were made fully applicable by the Court, the EU would still retain the right to limit capital movements from Britain, but this would require a positive action, and a regulation adopted by appropriate majorities. This could offer some leeway for a more sensible and proportionate regime than any of the three other available options (Norway-like, Swiss-like and Canada-like) currently discussed as the most likely alternatives for the post-Brexit landscape. Britain's exit may be the biggest revolution in the EU's history. There is no need to accompany the revolution with a guillotine that drastically severs financial arteries, to the detriment of both Britain and Europe.