Onderzoekcentrum Onderneming & Recht

VITALE VENNOOTSCHAPPEN IN VEILIGE HANDEN

summary

prof. dr. Claartje Bulten
prof. dr. Bas de Jong
mr. Evert-Jan Breukink
mr. Alex Jettinghoff

Kenmerk: WODC 2609/666613/15

Radboud Universiteit

VITALE VENNOOTSCHAPPEN IN VEILIGE HANDEN

Een wetenschappelijk onderzoek in opdracht van het WODC naar de wijze waarop (buitenlands) aandeelhouderschap gevolgen kan hebben voor de nationale veiligheid

KENMERK WODC: 2609/666613/15

Rapport aan het WODC uitgebracht door het Onderzoekcentrum Onderneming & Recht, Radboud Universiteit Nijmegen

'Vital companies in safe hands'

Nijmegen, februari 2017

Onderzoekscentrum Onderneming & Recht
Radboud Universiteit Nijmegen
Faculteit der Rechtsgeleerdheid
Postbus 9049
6500 KK Nijmegen

Onderzoeksteam:
Prof. mr. C.D.J. Bulten
Prof. mr. B.J. de Jong
Mr. E.J. Breukink
Mr. A. Jettinghoff

SUMMARY[1]

Introduction

Foreign investors regularly acquire or attempt to acquire significant shareholder rights in Dutch companies. Foreign investments make a material contribution to the prosperity of the Netherlands. Nevertheless, in the current geopolitical context the question arises as to whether foreign share ownership may pose a threat to Dutch (public) interests. This question was, for example, relevant with regard to the attempt by the Mexican company América Móvil to acquire a majority interest in the telecommunications company KPN (2013), the acquisition of the encryption company Fox-IT by a British party (2015), the acquisition of a division of the computer-chip manufacturer NXP by two Chinese investment firms (2016), and the attempt by the Belgian company BPost – in which the Belgian state owns a 40% stake – to take over PostNL (2016).

Commissioned by the Research and Documentation Centre (WODC), the Business & Law Research Centre of Radboud University Nijmegen has conducted research into the risks of (foreign) share ownership for national security. Prof. dr. Claartje Bulten and Prof. dr. Bas de Jong were in charge of the research. They, along with Evert-Jan Breukink and Alex Jettinghoff, made up the research team. The research looked in particular at the question of how ownership in a Dutch public limited company or private limited company may (possibly) provide access to (confidential) information and influence decision-making, and how this may impact national security.

The research contained a theoretical part and an empirical part. The legal-theoretical methodology comprised of a study of Dutch and foreign legislation, case-law and legal literature. The empirical research was carried out by conducting interviews. We spoke to various persons affiliated with companies that supply products or services relevant to national security, civil servants, and representatives of stakeholder organisations. Over thirty jurists associated with the most prominent Dutch law firms have also been interviewed.

The objective of the empirical research is to obtain a view of the perception in practice. The number of interviews is so small that no general conclusions can be drawn, nor does it support any statistically valid assumptions. This has not been our aim from the onset. The interviews served various purposes. They were conducted to, inter alia, examine the sectors and identify examples of foreign influence, and to assess the opinions of experts surrounding the different aspects examined. The interviews thus give an indication of current issues.

National Security Interests

For the purpose of answering the research question, a more detailed interpretation of the term 'national security' was first provided within the context of (foreign) share ownership. We note that national security is a more narrowly defined term than 'general interest' or 'public interest'. European law imposes conditions regarding national rules that infringe the freedom of establishment or free movement of capital. If the public security, public policy or overriding

1 See also Report ('Rapport') Chapter 7, p. 259-264.

requirements of the general interest are at stake, an infringement on the freedoms mentioned above may be allowed under certain conditions. The interviews show that there are different views on what exactly the concept of 'national security' covers. It appears that many participants also understand national security to mean the general or public interest, or believe that the government defines (or should define) national security in these terms.

The practical definition of the term 'national security' was aligned with the National Safety and Security Strategy formulated by the Dutch government. In the broader sense of the term, security interests can be grouped in three *generic* categories. These have been formulated in a report entitled *Tussen naïviteit en paranoia* (Between naivety and paranoia). In short, it involves the continuity of vital processes, the integrity and exclusivity of information, and the functioning of the democratic legal order.

From 2004-2005 onwards the 'vital infrastructure' of the Netherlands has been defined from a policy perspective. It relates to vital processes which in the event of disruption or breakdown may lead to serious societal disruption. On the basis of uniform criteria and threshold values, a list was drawn up of vital processes. The first relevant question is whether foreign share ownership in certain companies may lead to 'the continuity of the vital process' (delivery, provision of services or production) being jeopardised. The second security interest 'integrity and exclusivity of information' depends on whether foreign share ownership in certain companies may lead to strategic or sensitive technological information falling unwittingly into foreign hands and/or may result in state secrets, personal data of citizens or the functioning of our security system becoming available to another country. The third generic security interest refers to 'the functioning of the democratic legal order', also formulated as 'strategic dependence': can the acquisition (by a foreign company) create a scenario where the Netherlands may at some point in the future be put under political pressure or sabotaged by a foreign country?

In addition to the generic categories of security interests, there are sector-specific security interests such as security and non-proliferation of chemical and nuclear weapons in the nuclear sector.

These subsequently concern public and private limited companies (NVs and BVs), the most frequent type of companies in the Dutch private sector. We refer to companies as 'vital companies' if they are relevant to national security. Where a company provides products or services that fall within one or more sectors of the vital infrastructure, thus contributing to one of the vital processes, then it might possibly be a vital company. In other words: if the activities of an NV or BV can jeopardise one or more of the various security interests, such as the three generic security interests (continuity of the sector, integrity and exclusivity of information, and the functioning of the democratic legal order) or sector-specific security interests, the company may be characterised as a vital company. Ultimately it is up to the public authorities to determine in a specific case and based on all the circumstances of the case whether a company may be considered as vital.

Shareholders' Rights in relation to National Security

We examined what rights shareholders in vital companies have in accordance with Book 2 of the Civil Code and how these rights may have an impact on national security. For this purpose, it is important to differentiate between the rights accrued to individual shareholders and the rights allowed to the general meeting of shareholders (the organ). As an individual, the shareholder has

the right to purchase or sell shares. A sale of shares in non-listed NVs and in BVs can be effected 'under the radar'. The change in the shareholder base is not disclosed to the outside world and is not visible. There are potential risks for national security if such a company is vital and shares are sold to an undesirable (foreign) investor.

When assessing the risks of share ownership in vital companies, it is important to take into account any possible parties behind the formal shareholders. The shareholder may, for instance, be a sovereign wealth fund in which a foreign government exercises influence. It is advisable to identify the ultimate stakeholder who has formal or effective control over the shareholder.

The right to information of the general meeting (and individual shareholders at the meeting) does not pose a real threat to national security. The board of directors may refuse to provide confidential operational information on the grounds of an 'overriding interest'.

It is possible that with a foreign share ownership in vital companies, the right to put items on the agenda may affect national security interests. The threat stems from the possibility for undesirable (foreign) investors with a sufficiently large equity interest (three per cent for the NV and one per cent for the BV) to put items on the agenda that might affect national security either directly or indirectly. This means that investors may attempt to enforce decision-making by the board of directors. By now, the scope of the right to put items on the agenda has been limited and well-defined by case law. We feel that the risk arising from the right to put items on the agenda for national security is small.

Furthermore, individual shareholders with a ten per cent or more equity interest have the right to convene a general meeting authorised by the court. The same considerations that apply to the right to put items on the agenda also apply to this right.

The right of approval, granted by company legislation or the articles of association, entails in our view a very limited risk for national security. In the first place, the board of directors itself retains in both cases its management authority and the general meeting can only withhold its approval. In that respect, the board's representative powers are not compromised by the two rights. If the board of directors does not act externally because there is no approval of the general meeting, it is conceivable that the continuity of a vital process is affected.

The general meeting's rights to issue instructions entail little risk for national security. Although under current law, instructions may, at least for BVs, be of a concrete nature, the board of directors may refuse to act pursuant to an instruction if it represents a conflict with the company's interests. Based on the principle that for vital companies the public interest is incorporated in the company's interest, the board of directors can disregard an instruction when such instruction, if acted upon, has a deleterious impact on national security. Directors must, however, remain firm in the face of opposition. Threatening with dismissal (one of the meeting's other powers) is not inconceivable.

The general meeting's power to amend the articles of association may (indirectly) jeopardise the different security interests. Once an investor can change the articles of association by virtue of a sufficiently large interest, he may seek to include provisions that would give him more or almost all influence in the company. He may then exert his influence to frustrate the continuity of vital processes, releasing confidential information and jeopardising the functioning of the democratic legal order. Also the general meeting's power to restructure (dissolution, merger, demerger, conversion, transfer of the seat) in case of vital companies may have implications for

the national security interests to be protected. The most extreme example is the dissolution of a vital company. The continuity of the sector concerned is then directly affected. The law already establishes onerous requirements for the required resolutions, which requirements are also often being tightened up in the articles of association with high thresholds for decision-making. If a shareholder has the required voting rights to effect changes to the articles of association or undertake restructurings, then he will already be able to exercise other powers as well, such as the right to appoint or dismiss directors.

The power to appoint combined with the power to dismiss directors may, in case of foreign share ownership in vital companies, jeopardise national security interests. The power of appointment is the most significant risk to national security. This is also the perception in practice. Undesirable (foreign) investors with sufficient control in the general meeting can nominate and appoint directors affiliated with them. This also takes place in practice; consider the insurance company Vivat NV – incidentally, probably not a vital company. Directors can subsequently exert influence on the company's strategy and therefore affect the continuity of a vital process. Moreover, directors have in principle access to the operational level and (confidential) information within the company, which can then be passed on. It is also conceivable that the functioning of the democratic legal order is affected because foreign investors can put directors who are in sympathy with them at the helm of Dutch companies. This may have a negative impact on trust in the functioning of "the system" in general and the sector in which the company is active in particular. All of this applies also to the power to appoint and dismiss members of the supervisory board, but to a (much) lesser extent. The supervisory directors have more distance to the company, with less straightforward access to information, and are not engaged in operational activities.

The extent of influence that a shareholder has depends on the size of his equity interest. An undesirable (foreign) shareholder that has decisive influence at the general meeting of a vital company may entail risks for national security. This is the case if the shareholder has a majority of the voting rights in a meeting. Such majority may arise through providing more than 50% of the capital, but also with a smaller interest. When few shareholders attend the meeting ('shareholder absenteeism'), a minority interest (thus smaller than 50%) can be sufficient to pass resolutions.

Companies may endeavour to protect themselves from the (security) risks associated with share ownership. Corporate law offers various possibilities to do this, which are discussed in this report. Consider, for example, the possibility of imposing quality requirements or applying the full large company regime ('structuurregime'), which would restrict the general meeting's power of appointment. Another option is the use of protective measures, such as the issuance of preference shares to a protective foundation. This instrument was used for the publicly-traded company KPN, when a Mexican company intended to take over KPN. Case law, however, emphasises that this should generally involve a temporary measure. We would like to point out that protection under corporate law is of a private-law nature and is dependent on, inter alia, the organisation and structure of the vital company. Accordingly, the fate of a vital company with a protective foundation is in the hands of the foundation's board, which decides whether or not it will exercise the option to take preference shares. In light of this, it is relevant to assess how

effective corporate-law protection still is once an undesirable (foreign) shareholder has influence over the composition of the company's board of directors.

Analyses of Vital Sectors

For an answer to the question as to what influence an undesirable (foreign) shareholder may have, it is necessary to consider which laws and regulations currently exist. We made an analysis of existing laws and regulations; however, our research is no replacement for the ex ante analyses recommended by the Working Party on Economic Security (*de Werkgroep Economische Veiligheid*). The following vital sectors are discussed: energy, ICT/Telecom, drinking water and water, transport, the chemical industry, the nuclear sector, the financial sector, digital government and Defence. We examined private share ownership in the vital infrastructure and the way in which the government reduces the risks to national security within this context by deploying public and private law instruments.

In most sectors examined, the risks of (foreign) share ownership for national security have been adequately contained. We did not find any examples where (foreign) share ownership has had specific negative effects on national security. Some sectors did, however, reveal vulnerabilities which are caused by a lack of adequate instruments to safeguard the relevant national security interests preventively. There is therefore the risk that national security may be adversely affected in the (near) future.

We conclude that the designation of positions involving confidentiality ('vertrouwensfuncties') in vital companies does not offer adequate protection from undesirable (foreign) share ownership. After all, failure to observe security clearance is only sanctioned by a fine. We also think that the appointment of security professionals does not offer sufficient protection from undesirable (foreign) shareholder influence.

We would like to draw particular attention to the fact that a vital company may be granted a suspension of payment or declared bankrupt. There are no special rules, where, for example, it must be avoided that a restructuring or sale of components in the assets to undesirable parties leads to risks for national security. This proves to be a real concern in practice. For this reason, we believe it is appropriate to have regulations in place that protect the relevant security interests at an early stage of (imminent) insolvency.

A first vulnerable sector is ICT/Telecom. The statutory provisions designed to protect the integrity and exclusivity of information for providers of telecom networks and telecom services have little effect if they are taken over by an undesirable (foreign) shareholder. Share ownership in telecom services providers to the state thus seems to be a point of concern. The communication services providers 112, C2000, the Emergency Communication Facility ('Noodcommunicatievoorziening'), the fibre-optic network for Defence, and the telecom services provided to Schiphol Airport are vulnerable to discontinuity in the event of a foreign takeover of a provider. A foreign power may also put pressure on the Netherlands by threatening to discontinue the services after a takeover. These risks do not exist – or, at least, to a much smaller extent – when another telecom provider can and may simply take over these services in case of discontinuation. We have obtained no clarity on whether this possibility exists. There is a second

vulnerability with respect to data centre managers. In particular the integrity and exclusivity of information available at these centres is at risk in the event of a foreign takeover.
The risks in the public administration sector (particularly its digital services) are fairly small but not negligible. It concerns cases where the public sector procures or outsources activities to companies that are related to the collection, processing, use, exchange, storage, or protection (including encryption) of information. At least on the market for encryption services, there is a risk of dependence of the public sector on certain companies, such as Fox-IT. If, for example, confidential information is compromised after a foreign takeover, there is possibly no alternative. With the reservation that we do not have all the information, we can conceive that the completed acquisition of Fox-IT by a British party probably involves risks from a national security perspective.

Defence employs, inter alia, contractual terms (the so-called ABDO rules) to mitigate the security risks with respect to its external suppliers, but these are insufficient to enable the government effectively to review beforehand any changes in ownership and control regarding these suppliers. In the Fox-IT case study, the acquisition of shares was only announced afterwards according to the press.

Several initiatives are meanwhile being considered in order to remove some of the vulnerabilities mentioned above, as emerges from proposals for legislation relating to the telecom sector and adaptation of the ABDO rules in the Defence sector.

Assessment of Dutch Instruments and Recommendations

This report concludes with an assessment of legal instruments through which the risks of (foreign) share ownership for national security can be reduced. We mentioned above some vulnerabilities in the vital infrastructure in the case of (foreign) share ownership. Our report contains several recommendations in order to arrive at a modern assessment framework for foreign investments, partly on the basis of an analysis of European and international law as well as foreign regulations. What these essentially amount to is that the government should have a set of public-law instruments at its disposal to counter threats to national security beforehand (and not after the fact). When drafting public-law rules, a set of sector-specific instruments in the Netherlands seems the most appropriate. In regard to the scope of a public-law regulation, it is necessary to predefine in a sufficiently concrete manner which companies will be subject to scrutiny and which investors and investments should fall within the assessment procedure. The government must have adequate powers allowing it to enforce compliance with the applicable rules and to remove threats to national security. Furthermore, we advocate that the government should monitor not only national security compliance, but also take into account public policy or overriding requirements of the general interest – as further specified in European law.

In conclusion, vital companies are not yet in safe hands with merely regulations governing (foreign) share ownership. Additional legislation on, for example, suspension of payment and bankruptcy, as well as a vital company's restructuring, activities, partnerships and financial management is equally important.