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The aftermath of Inspire Art-
Applicability of the real seat
theory and grounds for
justification

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20 points

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Freedom of establishment

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Abbreviations

EC	European Community
ECJ	European Court of Justice
EU	European Union
SE	Societas Europaea (European Company)

1 Introduction

Since the Treaty of Rome entered into force in 1958, companies formed in accordance with the law of an EU Member State and having their principal place of business within the EU benefit, in principle, from the basic right of the freedom of establishment. Nevertheless, it was not entirely clear to what extent companies can rely on that freedom.¹

Recently, the ECJ specified the application of the rules on the freedom of establishment in its case law.² All these cases deal with foreign companies that conduct no business in their country of establishment, but instead operate exclusively through branch offices in other Member States. In its rulings, the Court laid down in how far EC law precludes a host state from subjecting a company formed in another EU Member State with its own domestic special company law rules. Many as a „race to the bottom“ have feared the choice of a company to establish itself in a Member State with least stringent company law rules and then subsequently operate entirely through a form of secondary establishment in another Member State. This fear is based on the fact that the described kind of acting would lead to a competition of all different national company law regimes within the Community where the most attractive for undertakings would be the one with lenient rules and low requirements when forming a company.

Especially the clash between the real seat and the incorporation theory becomes obvious in the case law of the ECJ. Countries applying the real seat theory are in particular concerned from the competition of the company law systems, since firms have to be aware that real seat theory countries will apply their own domestic law to them. This phenomenon might cause companies to choose a Member State to establish them where they are ensured to be governed by the law of the Member State of incorporation.

1.1 Purpose

This paper seeks to analyse the consequences of the recent jurisprudence in the field of the freedom of establishment. In particular, the existence of the real seat theory after the latest judgements of the ECJ will be questioned and examined. Since the real seat theory offers the Member States to take a wide range of measures and to impose their own domestic law to foreign companies, the question remains whether this doctrine can be upheld after recent ECJ decisions. If the scope of the real seat principle is limited in future, it has to be discussed, in how far Member States are still enabled to use their own domestic law regarding incoming enterprises. Consequently, this aspect needs also to be taken into consideration when dealing with the implications of the Inspire Art decision and previous cases. Therefore, the

¹ Thömmes/Rainer, EC Tax Scene, Intertax 2004, p. 118.

² See cases Segers, Daily Mail, Centros, Überseering, Inspire Art, further examination will follow below.

opportunities for Member States to justify restrictions imposed on foreign companies with a special view to the field of co-determination will be scrutinised.

1.2 Method

The method used in this paper is the traditional legal method. Legal sources that have been used are cases of the ECJ, European as well as national legislation and academic legal writing. Legal materials will be provided when answering the questions set out in the purpose. If no answer can be found in the material examined, suggestions will be made as to how the law should treat the question at issue.

The relevant case law of the ECJ will be examined in a descriptive and analytical way.

1.3 Delimitation

Due to the fact that one main aspect of this thesis is the clash between the real seat and the incorporation theory, one could scrutinise the consequences of the ECJ's judgements in all Member States favouring the real seat theory. For the purpose of this paper, the national legislation that has been focused on is German law. Since the ongoing discussion in Germany is very controversial and coming from a German law background, I found it very interesting to concentrate on this Member State and the implications of the ECJ's case law on its domestic law.

Especially in the field of workers' participation, Germany has a unique system within the EU, which cannot be found in another Member State. Although co-determination is also immanent in other jurisdictions, Germany applies a very strict standard and allows workers to participate in the company's affairs more than under the law of other Member States. Therefore Germany is one of the few countries able to arise this requirement as a possible justification for restrictions applying to the provisions on establishment.

The European Company ("Societas Europaea") will only be examined in the light of its compatibility with the real seat theory, but not under other aspects. Further EC company law will not be considered in this thesis.

The matter of tax law is reduced to a national extent, namely the effect of the ECJ's case law on German tax law in the field of companies.

1.4 Disposition

The thesis will start with an overview of the relevant Treaty Articles and theories which are important for the case law on the freedom of establishment. In the following, the cases decided by the ECJ will be presented and commented in Chapter 2. A deeper analysis under the aspect

of the real seat theory will be provided in Chapter 3. The impact of the case law on the real seat principle will be examined. Especially, the future of the real seat regime will be focused on. Furthermore, the consequences of the Court rulings in practice are discussed. Besides, the effect of the recent European cases on the real seat theory are analysed in the light of Secondary EC law. In Chapter 4, remaining possibilities for Member States to justify the imposition of national law will be scrutinised. After introducing the abuse doctrine to justify national law restricting the freedom of establishment, particular emphasis is put on national rules of co-determination. It will be analysed in how far these rules can constitute an overriding public interest to be applied to foreign companies. In the conclusion part, the main results of the assessment of the real seat theory and the impact of the ECJ's case law will be summarised.

2 Jurisprudence

2.1 Background

In several cases, the relationship of national company law rules with the Treaty principles of free establishment has been tested. Before presenting the essential case law, the relevant provisions of the Treaty on the freedom of establishment for companies will be outlined in order to have a better understanding of the legal background. Besides, the relevant theories to determine the law governing a company are represented.

2.1.1 Relevant Treaty Articles

The freedom of establishment is governed by Articles 43 to 48 EC. Article 43 EC states that

“...restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.”³

The requirement to remove all restrictions on the right to maintain a permanent or settled place of business in a Member State does not only apply to individuals, but also to companies. The equal footing of companies and individuals is guaranteed in Article 48 EC, which provides:

“Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.”⁴

Given the differences between natural and legal persons, it is not exactly possible to deal with companies in the same manner as nationals within the Treaty provisions on freedom of establishment, even though Article 48(1) EC demands the same handling. Regardless the fact that harmonisation has been achieved to a certain level by many company law directives, differences remain in the way various Member States regulate companies and their activities.⁵ One reason for the enormous differences between the Member States can be found in the individual tax law systems when it comes to corporate taxes. Another aspect is that some

³ Article 43(1) EC.

⁴ Article 48(1) EC.

⁵ Craig/de Búrca, EU Law, p. 793.

countries have more state-controlled company law regimes, while other States count more on natural market forces to regulate companies and confer more freedom upon the companies when it comes to setting up a business and operating on the market.

2.1.2 Relevant theories: incorporation vs real seat theory

Article 48 EC shows that in order to benefit from the provisions on freedom of establishment, a company must be formed in accordance with the law of a Member State and fulfil one of the three possible connection criteria with the Community. Its registered office, central administration or principal place of business must be within the Member States. The fact that there are three alternative connection criteria on an equal basis reflects that there is a disparity in what the Member States consider to be the relevant connection criteria between an undertaking and the national territory.⁶

In broad terms, there are two connection criteria in use in the Member States, the place of incorporation and the real seat of a company.

Member States following the incorporation principle, the law governing a company, its internal affairs and its general legal capacity is the law of the place of incorporation.⁷ Thus, this theory connects a company to the jurisdiction in which it has been incorporated. Consequently, it allows a company to exercise all kind of activities in other States without losing its original status in the State of incorporation. Countries applying the incorporation technique are mainly the Netherlands, Denmark and the UK. Among the new Member States, jurisdictions based on common law systems, such as Malta and Cyprus, also refer to the incorporation principle. Furthermore, Hungary, Czech Republic and Slovakia follow the incorporation theory.

Opposed to the principle mentioned above, according to the real seat theory, the law governing the company must be the law of the place of its real seat.⁸ What exactly has to be understood as the real seat of a company can be different between various countries, but mostly the place of its central management and control will be considered to constitute the real seat. Member States adhering to the real seat theory are Germany, Austria, France, Italy, Belgium and Luxembourg. Within the new Member States the jurisdictions of Latvia, Estonia, Lithuania, Poland and Slovenia support the real seat theory, which can be partly explained by the general similar approach in these countries as under German law.

⁶ Dyrberg, Full free movement of companies in the European Community at least?, ELRev 2003, p. 528 f.

⁷ Kindler, in Münchener Kommentar, Internationales Gesellschaftsrecht, para 265 ff; Gower/Davies, Principles of Modern Company Law, p. 14.

⁸ Kindler, Id., para 312 ff.

The real seat theory is rather focused on economic reality and actual practice and applies its legal order to all entities that are effectively directed from its national territory.⁹ The incorporation principle has a more theoretical approach by looking at the formal detail where a company was founded and does not pay attention to a possible change of an undertaking's headquarters. According to this technique, all foreign legal entities have to be recognised following the rules applicable in the State of the company's origin. The application of the real seat theory would come to a different result; the recognition of companies claiming to belong to a jurisdiction which is not the one in which their real seat is established would be refused.¹⁰

As in practice the seat will often be where the company is incorporated, the two different principles do not cause any difficulties regarding the determination of the relevant applicable national law. However, in situations where the place of the seat and the place of incorporation do not coincide, problems arise regarding the law governing a company's affairs. The controversial effects of the two systems become especially obvious in cases involving the crossing of State borders.¹¹

To give an example, such a setting would occur, if a company is formed in a Member State applying the incorporation theory and then moves its central management and control to another Member State following the real seat theory. The State of origin would still consider the undertaking to be a validly formed legal person. Nevertheless, the Member State providing the new place of central management will apply its own law due to the real seat theory. Non-compliance with the relevant rules in the host Member State for having legal personality, would therefore require the company in question to re-incorporate itself in the Member State following the real seat system. For this Member State, the firm will not exist as such, unless it has been set up in accordance with its own domestic law.

The previous example illustrates that the incorporation principle is more favourable towards the mobility of companies because the legal status of undertakings is determined regardless of the State in which its activities are effectively carried out.¹² Thus, for companies moving across borders to countries representing the real seat theory their opportunities to conduct business there might be limited or complicated by requiring re-incorporation or to satisfy further criteria under the host Member State's internal law. Companies tried to challenge these requirements imposed on them and finally, the ECJ had to deal with these issues. It had to decide whether such requirements entailed obstacles to the free movement of companies and if they could be justified. The Court was demanded on several occasions to rule on the compatibility of national legislation with EU law. In the following sections, the most important cases in this field will be described and analysed.

⁹ Wymeersch, *The transfer of the company's seat in European Company law*, CMLR 2003, p. 661.

¹⁰ *Id.*, pp. 661 f.

¹¹ *Id.*, p. 661 f.

¹² Dyrberg, *supra* note 6, pp. 528 f.

Against the background given above, the case law will also be examined in the light of the incorporation and real seat theory in the following chapter and how the ECJ deals with these different principles.

2.2 Segers: No discrimination against foreign incorporation

In *Segers*,¹³ Mr Segers, a Netherlands national and the director of a company incorporated under English law, brought an action against the Netherlands authorities after he was refused to benefit from the sickness insurance scheme. Mr Segers had overtaken an English company and in the time after had incorporated into this firm his one-man business as a subsidiary whose registered office was in the Netherlands. When he became the director of the company, all of its business was conducted by the subsidiary in the Netherlands. During the legal proceedings to obtain insurance benefits, the national courts ruled that he would only be entitled to receive benefits, if the registered office of the company was in the Netherlands, but not as long as he was a director of a company incorporated under foreign law. The question to be dealt with by the ECJ was whether the refusal of the benefits merely on the grounds of the location of the registered office was compatible with the provisions on the freedom of establishment.

To answer this question, the ECJ stated that a company formed in accordance with the law of another Member State and which conducts its business through a subsidiary in the Member State where it seeks to be established cannot be denied of the benefit at issue. To apply a different regime depending on whether the company seat was established in another Member State was considered to be contrary to Article 48.¹⁴ Furthermore, the Court ruled it was irrelevant that the company did not conduct any business in the country where it had its registered office, but was entirely operating through a subsidiary in another Member State.¹⁵

Thereby, the Court clarified that a company would still be established in the Member State where it was incorporated, even if the principal place of business could be found in another State of the Community. It is noticeable that, although the company in question did not conduct any business in the State of incorporation, but was operating exclusively through a form of secondary establishment in another State, the ECJ was willing to acknowledge the company's establishment in the first country. The approach taken by the ECJ can be seen as a first step of the Court to guarantee for companies the same freedom that was already available for natural persons. In *Segers*, the equality between natural persons and legal persons in the meaning of Article 43 EC and Article 48 EC was strongly emphasised. According to the ECJ, the corporate seat of a company had to

¹³ Case C-79/85, *D.H.M. Segers v. Bestuur van de Bedrijfsvereniging voor Bank-en Verzekeringswezen, Groothandel en Vrije Beroepen* [1986] ECR 2375.

¹⁴ *Segers*, para 14.

¹⁵ *Segers*, para 16.

be qualified as the connecting factor with the legal system of a Member State, like nationality in the case of natural persons.¹⁶

2.3 Daily Mail: Emigration stopped at the border

A few years later, a different scenario also dealing with restrictions on companies was presented in the Daily Mail case.¹⁷ A United Kingdom company proposed to transfer its central management and control outside the United Kingdom to the Netherlands, in order to avoid substantial UK capital gains taxes on assets, which it intended to sell after having transferred its residence. According to UK law, the consent of the Treasury was necessary to allow a company to transfer its central management and control outside the UK while maintaining its legal personality and its status as a UK company. The company mainly argued on the basis of Articles 43 and 48 EC. The question was whether the Treaty provisions on freedom of establishment implied the right of a company incorporated in one Member State to transfer its central management to another Member State.

The Court held that as far as primary establishment is concerned, the said Articles did not confer on a company incorporated under the law of a Member State, the right to transfer its central management and control and its central administration to another Member State while retaining the status of a company incorporated under UK law.¹⁸ Nevertheless, the ECJ stressed the prohibition of Member States to hinder the establishment in another Member State of a company incorporated under its legislation. However, this freedom was limited to a mere form of secondary establishment in another Member State, as was held to be the general way to exercise the establishment in another country.¹⁹ In its reasoning, a clear reference to the autonomy of national law of the Member States was made by stating that companies were creatures of national law and that their existence was totally dependant on national legislation.²⁰ While in Segers, the Court came to the conclusion that the Netherlands regime was contrary to Articles 43 and 48 EC, it ruled in Daily Mail that differences in national laws regarding the connecting factors could not be solved on the basis of the Treaty Rules on freedom of establishment.²¹ At first sight, the subsequent case of Daily Mail seems to contradict the finding of Segers. When looking closer to the two cases, one can make a difference between the settings. In Segers, the Court had to deal with restrictions imposed by the host Member State of the company whereas in Daily Mail the country hindering the company was the domestic Member State where the company was incorporated. Furthermore,

¹⁶ Segers, para 13.

¹⁷ Case C-81/87, R. V. HM treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust PLC [1988] ECR 5483.

¹⁸ Daily Mail, para 24.

¹⁹ Daily Mail, para 16 f.

²⁰ Daily Mail, para 19.

²¹ Daily Mail, para 23.

the right to a secondary establishment was not made more difficult, but only the transfer of the central administration while keeping its legal personality in the first State. Nevertheless, it is questionable why the ECJ made a distinction between these situations, given the notion of the Court that the rights of Articles 43 ff. EC would be meaningless, if Member States could hinder the establishment of a company in another Member State. One possible reason for distinguishing between these situations can be found in the tax issue that was involved. Since this field is very sensitive and has to be left to the Member States, the Court was maybe more willing to acknowledge that the transfer of the central administration of a company could be made subject to certain restrictions. Moreover, one can easily understand that States do not want to allow taxable substance to be freely transferred abroad. Nonetheless, it has to be mentioned that tax debts can be recovered in other EU jurisdictions as well and therefore arguments appear to allow emigration of companies in the same way as their immigration.²² However, it remained to be seen whether *Daily Mail* was considered to be a change in the Court's jurisprudence or whether in fact it wanted to make a distinction based on the different situations.

2.4 Centros: Legal forum shopping becomes good practice

The *Centros* case²³ concerned a company that was registered in the UK where it had its primary establishment. The actual purpose for registering in the UK was not to conduct business there, but to fall under the low requirements of the UK national company law regarding the setting up of a company and the minimum share capital. The main goal of *Centros* was to operate through a branch in Denmark where it would have needed to satisfy higher standards, had it incorporated the company in that Member State. The Danish authorities refused to register the branch of *Centros* based on the fact that *Centros* was actually not setting up a secondary establishment in Denmark, but rather a principal establishment, since the entire business was to be conducted there. The Danish Board of Trade and Companies expresses its view that *Centros* was trying to circumvent national rules, such as the requirement of a minimum capital. The ECJ had to answer the question whether the company could rely on the freedom of establishment and whether the Danish treatment towards *Centros* could be justified.

The ECJ started off to acknowledge a Member State's right to take measures against the circumvention of their national legislation in case that nationals take improperly advantage of the provisions of Community law. Nevertheless, in the following part the Court states that the choice of a national to set up a company in a Member State whose rules of company law seem to him the least restrictive and to build up a branch in another Member State did not constitute an abuse of the right of establishment. On

²² Wymeersch, supra note 9, pp. 661, 678.

²³ Case C-212/97, *Centros Ltd. V. Erhvervs- og Selskabsstyrelsen* [1999] ECR I-1459.

the contrary, this practice was considered to be inherent in the exercise of the freedom of establishment. According to the ECJ, the relevant Treaty provisions are intended to enable companies to have their central place in one Member State and to pursue business activities through forms of secondary establishment in other Member States.²⁴ Reference was also made to Segers where the Court had already clarified that the fact that a company did not conduct any business in the State of incorporation was not sufficient to prove any existence of abuse or fraudulent conduct.²⁵ The way of relying on the provisions of the freedom of establishment was not only held to be a non-abusive behaviour; it was moreover not possible for the Danish authorities to justify their restrictions. The ECJ found that the refusal to register Centros as a branch in Denmark was not justified for overriding reasons of creditor protection or to prevent fraud because less restrictive means would have been available to use.²⁶

The ruling of Centros came as a surprise, in particular among legal scholars. One reason for this reaction was the fact that the company's activities were not caught by the abusive criteria. In contrast, the choice of a Member State with very low standards for the incorporation of a company was said to be simply an exercise of the right of establishment. Although there is no expressed reference to the Daily Mail case, the Court found in Centros that the absence of Community harmonisation in the field of company law was irrelevant for this case.²⁷ This part of the judgement is striking, since the absence of legislative harmonisation was used in Daily Mail not to apply Article 43 EC. The Centros case was considered by some scholars to reflect the willingness of the ECJ to remove the last restrictions on the free movement of companies in the Community by judicial activity. Furthermore, the ruling was said to be intended to complete the internal market by allowing competition among national rules.²⁸ After Centros the question remained whether the decision of Daily Mail was refined or whether it would still be upheld, since there was no notion of this case in Centros. Besides, it had to be specified when a company would be abusing the provisions of establishment and what sort of restrictions Member States were entitled to impose on foreign companies.

Another case dealing with a similar issue was brought to the ECJ just three years later.

²⁴ Centros, para 26 f.

²⁵ Centros, para 29; Segers, para 16.

²⁶ Centros, para 35-37.

²⁷ Centros, para 28.

²⁸ Cabral/Cunha, "Presumed innocent": Companies and the Exercise of the Right of Establishment under Community Law, ELRev. 2000, p. 157.

2.5 Überseering: Principle of mutual recognition affirmed

In this case²⁹, a follow up case of the Centros decision, a company, Überseering, was incorporated under Netherlands law and registered in that country in 1990. In the same year they acquired land in Germany and engaged a company, NCC, for construction works on this land. After the completion of the work, Überseering claimed that the work by NCC was defective. Before starting legal proceedings against NCC in 1996, all the shares in Überseering were acquired by two German nationals. The claim for damages brought by Überseering was dismissed by the Regional Court finding that because of the acquisition of its shares by two German nationals, Überseering had transferred its actual centre of administration to Germany. Since Germany is following the “real seat theory” to determine which law governs the activities of a company, it came to the conclusion that German law had to be applied due to the real seat of Überseering in Germany. According to the German Code of Civil Procedure, a party must have legal capacity to be able to sue another party. Überseering was denied to have legal capacity under German law because it was incorporated in the Netherlands. It would have needed to be reincorporated in Germany to receive legal capacity under German law and consequently to be able to bring an action for damages in German courts. The Federal Supreme Court finally made a reference for a preliminary ruling under Article 234 EC to the ECJ. The main question was whether Articles 43 and 48 EC preclude a Member State to deny a company’s legal capacity according to its own domestic law if the company has moved its actual centre of administration to that Member State on the basis that the company has been validly incorporated under the law of another Member State.

The ECJ decided that the denial of the company’s legal capacity by the Member State of immigration was incompatible with the free movement of establishment. The Court stressed again in this case that the freedom of establishment conferred by Article 43 EC entitled Community nationals to set up and manage undertakings under the same conditions as are laid down by the law of the Member State for its own nationals.³⁰ It stated that a necessary precondition for the exercise of the freedom of establishment was the recognition of companies and their branches by any Member State in which they wish to establish themselves.³¹ Although the Court acknowledged that the interests of creditors, minority shareholders, employees and the treasury could be considered as imperative requirements in the general interest, which under certain circumstances could justify restrictions on the freedom of establishment, any possible justification was denied in the case at issue.³² Furthermore, the Court drew a distinction to the

²⁹ Case C-208/00, *Überseering v. Nordic Construction Company Baumanagement GmbH (NCC)* [2002] ECR I-9919.

³⁰ *Überseering*, para 56.

³¹ *Id.*, para 59.

³² *Id.*, para 92 f.

Daily Mail case on the facts. In *Daily Mail*, the issue at stake was whether the jurisdiction of formation allows a company to transfer its actual centre of administration to another Member State whilst retaining its legal personality in its State of incorporation. Here, the *Überseering* Court recalled its holding in *Daily Mail*, stating that these questions were determined by the national law in accordance with which the company has been incorporated. Thus, that law may declare the continuing legal personality subject to restrictions on the transfer of its actual centre of administration to a foreign country.³³ Thereby the Court shows clearly its support for the *Daily Mail* holding. It has to be remembered that the Court's finding in *Daily Mail* concerned State powers within its own jurisdiction and is not connected to a cross-border relationship dealing with State powers towards companies from another Member State.

Even though it is possible to draw such a distinction between the two cases, the findings of the ECJ can be criticised insofar that the distinction seems to be arbitrary. It has been argued that the differentiation between the two settings does not follow from the statements made in *Daily Mail* and was not implied in that judgement.³⁴ The argument that freedom of establishment relates only to immigration, but leaves the States free to deal with emigration is rather theoretical and leaves reality aside. National regulators would be entitled to continue to impose substantial restrictions on the free movement of legal entities, thereby jeopardising the free movement of legal persons. Due to the different national systems of legislation, the situation would be very unbalanced, certain States being entitled to stop their corporate "citizens" at their borders, others allowing free movement.³⁵ It has to be awaited whether the principles set out in *Daily Mail* will be applied to companies in the future to companies which wish to emigrate and to transfer their central administration from one Member State to another.

2.6 Inspire Art: Knocking out the real seat theory?

In the following case³⁶, *Inspire Art Ltd.*, a private company limited by shares established in the UK where it had its statutory seat was involved in legal proceedings with Dutch authorities. Immediately after its formation, the company started doing business in the Netherlands; no business was ever conducted in the UK. In fact, from the very beginning the founders of the company only intended to take advantage of the liberal rules of British company law, but not to carry out any economic activity in the UK. A branch of the company was registered in the Netherlands without the indication that *Inspire Art* was a formally foreign company. However, according to the Dutch law on formally foreign companies, such an

³³ *Id.*, para 70.

³⁴ Woolridge, *Überseering: Freedom of establishment of companies affirmed*, pp. 227, 232.

³⁵ Wymeersch, *supra* note 9, pp.661, 676.

³⁶ Case C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd*, ECR [2003] 00000.

indication was necessary. In addition, Inspire Art would have been required as a formally foreign company under the relevant Dutch law to comply with the relevant provisions on minimum share capital. If the minimum capital requirements were not complied with, Dutch law requires the directors of the company to be personally jointly and severally liable for the debts of the company. The Dutch authority took the view that the indication of a formally foreign company was mandatory on the ground that Inspire Art traded exclusively in the Netherlands. Inspire Art was of the opinion that it was not obliged to fulfil the conditions set out under Dutch law.

Therefore, the question was brought to the ECJ was whether the additional conditions laid down in the Dutch legislation to incorporate a branch of a foreign company were contrary to the Treaty provisions on the freedom of establishment. Furthermore, the Court was asked whether the application of the provisions at issue were justified.

The ECJ decided again clearly in favour of the freedom of establishment. To begin with, the Court ruled that the relevant Dutch provision containing further disclosure requirements was in breach of secondary EC law.³⁷ The Directive³⁸ the Dutch legislation was violating concerned disclosure requirements in respect of branches opened in a Member State by certain companies governed by the law of another State. It was stated that the listing of potential disclosure requirements was exhaustive in the Directive³⁹ and that it did not permit any disclosure rules going beyond the provisions already entailed in it. According to the Court, the differences in respect of branches and obligations imposed on them between the laws of the Member States could only be overcome, if safeguards for companies are made equivalent throughout the Community.⁴⁰ Since a provision corresponding to the Dutch domestic law could not be found in the enumeration of the Directive, the relevant legislation was held to be inadmissible. As a consequence, the Court inferred that no justification for this breach of secondary EC law was possible.

In the following, the Court dealt with the stipulation of Dutch law on a minimum share capital and the sanction of personal liability in case of non-compliance. The ECJ referred to its earlier judicature and held that it was immaterial that a company had been set up in a particular Member State with the sole aim of using lenient company law rules and to establish itself in another Member State where its entire business was to be conducted.⁴¹ Thus, it did not constitute an abuse to choose a jurisdiction only for its liberal rules. Once more, as already mentioned in *Überseering*, the ECJ drew a distinction between the *Daily Mail* case and *Inspire Art*. It was emphasised again that *Daily Mail* concerned the relation between a company and the Member State where it was incorporated and the possibility to retain legal personality there while transferring its actual seat to another Member State.

³⁷ *Id.*, para 65 ff.

³⁸ Eleventh Council Directive 89/666/EEC of 21 December 1989, OJ 1989 L 395, p. 36.

³⁹ *Inspire Art*, para 69.

⁴⁰ *Id.*, para 67 f.

⁴¹ *Id.*, para 95 ff.; *Segers*, para 16; *Centros*, para 17 f.

In contrast, Inspire Art regarded the application of legislation of that State where the company carries out its business, while it was incorporated in another Member State.⁴² Consequently, the Court ruled that the law at stake was violating the provisions on the freedom of establishment. Moreover, its application could not be justified for reasons of imperative requirements. The Dutch authorities relied on public interest reasons such as the protection of creditors and the fairness in business dealings. Due to the fact that Inspire Art hold itself out to be a foreign and not a Dutch company, the ECJ found that the company's creditors were sufficiently informed.⁴³ The incompatibility of the minimum capital provisions with the freedom of establishment led automatically to the corresponding sanctions being incompatible with Community law as well.

With the judgement of Inspire Art, the ECJ has confirmed its wide interpretation of the provisions on the freedom of establishment, which could also be seen in its previous case law. Compared to the ruling of *Überseering*, the Court has contributed to further clarification. In *Überseering*, the Court held that a company's legal personality and its capacity to be a party to legal proceedings must be respected all over Europe. In Inspire Art, the ECJ extends this obligation to the entire legal system of the state of incorporation.⁴⁴ Thus, this case shows again the Court's willingness to promote the mobility of companies and to eliminate possible burdens laid down by national legislation restricting the free movement of undertakings.

When it comes to justifications of national restrictions, the ECJ admits in the *Überseering* case that the law of the host state can be applied within certain situations as mandatory requirements. However, it is remarkable that in Inspire Art there is no reference to this part of the *Überseering* decision, although the Dutch authorities brought various grounds for justification forward. As far as this element of Inspire Art is concerned, the Court has been criticised for its way of arguing.⁴⁵ Firstly, the ECJ is said to have denied any possibility of justification for the Dutch legislation without giving a detailed explanation. The lack of further examination of the rules in question has been opposed and the Court's reasoning has been titled as "unconvincing" and "lapidary".⁴⁶ Furthermore, what the Court has claimed as sufficient protection for creditors, namely that the company in question was holding itself out as a British limited company and was not pretending to be a Netherlands firm has been met with criticism. When comparing the company forms of Germany and Austria, doubts remain as to whether this statement can be hold true.⁴⁷ In both national legal orders, companies use "GmbH" to indicate that they are a private limited company. Therefore, a creditor will not automatically know that he is dealing with a foreign

⁴² *Id.*, para 103; *Überseering*, para 62.

⁴³ *Id.*, para 135.

⁴⁴ Kersting/Schindler, The ECJ's Inspire Art Decision of 30 September 2003 and its Effects on Practice, German Law Journal, Vol. 4 No.12, <http://www.germanlawjournal.com/article.php?id=344>, p.7.

⁴⁵ *Id.*, p. 4.

⁴⁶ *Id.*

⁴⁷ *Id.*

company. Besides, creditors will only seldom examine the commercial set-up of a foreign undertaking.⁴⁸ Especially, in the field of non-contractual liability creditors are not aware of the legal form of the company owing them a debt.⁴⁹ Therefore, the ECJ's reasoning will be inapplicable, if the creditor status is based on tort instead of contractual liability.⁵⁰

Regarding the last point, it has to be admitted that tort creditors cannot benefit from the fact that a company trades under the title of the place of incorporation. Nevertheless, the judgement refers to specific circumstances and cannot be transferred to all possible cross-border scenarios. Therefore, the Court might have come to a different conclusion, if the company involved had traded under the form of a "GmbH". In the case at issue, there was no risk for a limited company as Inspire Art to be confused with a Dutch form of company.

In general, the judgement of Inspire Art is merely the logical consequence of the previous decisions, initiated with Centros and Überseering. It was not surprising that the Court continued its "in dubio pro freedom of establishment" approach.⁵¹ The host State is largely restricted to impose additional requirements on foreign companies and to apply its own law. This point of view will also have an impact on national legislation, since it seems to be very likely that Member States have to compete in order to attract companies to incorporate under their law.⁵² One aspect of interest is the impact of the judicature on the real seat theory that will be analysed more detailed in the next Chapter.

⁴⁸ Eidenmüller, *Mobilität und Restrukturierung von Unternehmen im Binnenmarkt*, JZ 2004, pp. 24, 27.

⁴⁹ Rehberg, *Inspire Art-Freedom of establishment for companies in Europe between "abuse" and national regulatory concerns*, *The European Legal Forum* 2004, pp. 1 f.

⁵⁰ Leible/Hoffmann, *Wie inspiriert ist "Inspire Art"?*, *EuZW* 2003, pp. 677, 682.

⁵¹ Ziemons, *Freie Bahn für den Umzug von Gesellschaften nach Inspire Art?!*, *ZIP* 2003, pp. 1913.

⁵² Horn, *Deutsches und europäisches Gesellschaftsrecht und die EuGH-Rechtsprechung zur Niederlassungsfreiheit-Inspire Art*, *NJW* 2004, p. 893.

3 Impact of case law on the real seat theory

In the following, the implications of the ECJ's jurisprudence will be analysed in the light of the real seat theory.

3.1 Mobility of companies within the EU after Inspire Art

The outcome of the recent cases decided by the ECJ has led to wide discussions among legal scholars, practitioners and academic writers.⁵³ After Centros, Überseering and Inspire Art companies are enabled to move between Member States without changing the law that covers their affairs, since according to the Court's rulings the law of the home State is decisive. To illustrate the influence of the judgements on the mobility of companies, the possible settings for the migration of companies will be examined. For this purpose, the division between Member States following the real seat theory and those supporting the incorporation theory will be used in order to outline different results.

When applying the incorporation and the real seat theory, there are four different situations involving cross-border elements when a company moves between different Member States. Below, the four situations will be outlined, and it will be analysed in how far the ECJ's case law has an impact on the different outcomes.

3.1.1 From incorporation State to incorporation State

The first scenario occurs when a company originating in a State following the incorporation principle moves to another incorporation State. This setting was at issue in Centros where Centros was formed under UK law, but intended to conduct its entire business in Denmark through a form of secondary establishment. The Court clearly stated in this decision that any additional requirements going beyond those that are necessary to form the company validly in the country of origin constitute a restriction on the freedom of establishment. Therefore, the company has to be enabled by the

⁵³ Altmeyden, Schutz vor "europäischen" Kapitalgesellschaften, NJW 2004, pp.97; Bayer, Die EuGH-Entscheidung „Inspire Art“ und die deutsche GmbH im Wettbewerb der europäischen Rechtsordnungen, BB 2003, 2357; Behrens, Das Internationale Gesellschaftsrecht nach dem Überseering-Urteil des EuGH und den Schlussanträgen zu Inspire Art, IPRax 2003, 193 ff.; Drygala, Anmerkung zu EuGH NJW 2003, 331 ('Inspire Art'), EWIR 2003, 1029.

host State to unlimited access to the other jurisdiction.⁵⁴ A similar case was presented in *Inspire Art* when the company at stake was governed by UK law and wanted to register a branch in the Netherlands, both countries applying the incorporation principle. Again, the Court stressed that any further requirements for the company's secondary establishment had to be abolished.

This result does not seem to be surprising, having the background of the incorporation theory in mind. Since the supporter of this principle claim to govern a company's affairs with the law of the State of incorporation, it seems to be obvious that no further criteria are to be satisfied in cross-border movings. For that reason, it is all the more remarkable that the parties involved in *Centros* were arguing about a refusal to register because the host State simply did not simply accept the lawful formation in the country of origin according to the rules of the home State. A possible explanation for the adverse reaction of the host State can be found in the fact that *Centros* did not intend to establish a mere branch in Denmark, but wanted to operate entirely through this "secondary" form of establishment. Therefore, the Danish authorities feared a circumvention of their national law and consequently a loss of incorporation fees and tax income, so that economic reasons very likely played a decisive factor in the refusal to register. However, the cases of *Centros* and *Inspire Art* have clarified that national restrictions will no longer be accepted. Hence, a company moving between Member States both supporting the incorporation theory will be free to carry out its activities in another Member State, once the company is lawfully set up in the country of origin.

3.1.2 From incorporation State to real seat State

A second situation regards companies coming from incorporation States and transferring their place of central management and control to a jurisdiction following the real seat theory. This was the setting in *Überseering* where a company incorporated in the Netherlands moved to Germany because German nationals had acquired the shares of the company. Before the ruling of the ECJ, a situation such as described would have led to the conflict that the State of origin would make the undertaking subject to its jurisdiction due to the incorporation principle, whereas the host State would declare its own jurisdiction applicable following the real seat theory. On the basis of *Überseering*, the host Member State will have to recognise the company's legal capacity. However, under exceptional circumstances mentioned in *Centros* and *Überseering*, the host State can impose restrictions within overriding public interests.⁵⁵ Nevertheless, to a wide extent the home State's rules will continue to govern the company in its internal and external organization. Thus, this situation illustrates that companies coming from an incorporation background benefit immensely from the recent jurisprudence

⁵⁴ Wymeersch, *supra* note 9, pp. 661, 685.

⁵⁵ *Centros*, para 34; *Überseering*, para 92.

of the ECJ, since they do not have to comply with extra conditions framed by the State supporting the real seat theory.

3.1.3 From real seat State to incorporation State

A third hypothetical scenario takes place in cases where a company is originating in a real seat country and moves its centre of management and control, the real seat, to a country with an incorporation jurisdiction. Several difficulties might arise under these circumstances. Pursuant to the real seat theory, the jurisdiction would cease to apply as soon as the undertaking has changed its real seat. Nevertheless, the host Member State following the incorporation theory would refer back to the first State as to the applicable law, since the company was incorporated in that State. Thus, a company might lose its legal capacity under the State of the real seat theory and might not be able to regain it under the law of the new State.⁵⁶ This would seriously impede the freedom of establishment of companies. Although the States at issue in *Überseering* and *Inspire Art* do not fall under the third hypothesis, it can be derived from these rulings that the company continues to exist after a cross-border transfer of the real seat. This means that the company remains subject to the law of the Member State where it was founded, under the current hypothesis a supporter of the real seat theory. For the host State it is unproblematic to accept the law of the State following the real seat theory to be applicable, since this reflects the strict idea of the incorporation principle. It is more problematic for the home State turned to the real seat theory to acknowledge that companies founded in its territory remain subject to that law. It has been argued that the continuing application of the law of the Member State following the real seat theory cannot be assumed, since this considers the relation between a Member State and a company emigrating from this Member State. The only case regarding emigration was the *Daily Mail* case where the UK was allowed to impose restrictions, so that the company could not transfer its central management to another Member State. However, this does not exactly answer the question for the hypothetical case whether the company is still governed by the law of the country of origin or whether this only applies under certain circumstances.

Since the situation for the third hypothesis is not directly covered by the ECJ's case law, one can find a possible answer when looking at the rationale of the rulings. In all the cases the Court has favoured the view that companies have to be acknowledged as such in other Member States, once they are legally founded in one Member State. The formation even had to be accepted without extra conditions by the Member State, if the rules regarding setting-up a business were not met in that State, but only in the State of incorporation. Decisive and governing the company's affairs was merely the domestic law of the State of origin. For that reason, it can be

⁵⁶ Wymeersch, *supra* note 9, pp. 661, 686.

assumed that a company would remain subject to the law of the State where it was founded, if it moves from a real seat theory country to an incorporation country. The ECJ has decided for the benefit of the freedom of establishment and has promoted the movement of companies. This freedom is realised to a wide extent, if a company has not to fulfil requirements laid down by the law of the host State, but continues to be subject to the law of its Home State.

3.1.4 From real seat State to real seat State

Lastly, a company can move between two Member States both applying the real seat theory. Such a move would result in the application of the host State's law, since both jurisdictions determine the applicable law corresponding to the location of the real seat of an undertaking. Previous to the recent Court decisions, by doing so the company would have to be adapted to the host State rules regarding the formation of an undertaking. With the case law established by the ECJ, it has been clarified that the situation described cannot lead to a denial of the company's legal existence and to an obligation to re-incorporate, but that the law of the home State continues to apply.⁵⁷ Nevertheless, it has been stressed in *Daily Mail* that the Member State of origin can impose limitations to the emigration of domestic companies to other Member States. Therefore, a company enjoys the freedom to move to a larger extent in this constellation, as long as the home State recognises the undertaking to be existent after emigrating. However, if the home Member State imposes a rule on the company to be wound up and liquidated in case of emigration to another Member State, the company cannot move freely to another real seat jurisdiction. At least, it is not possible anymore for the Member State hosting the company to impose higher standards than those required under the State of origin.

As a result from the above-mentioned constellations, it can be concluded that the case law of the ECJ has widened a company's possibilities to move between different jurisdictions to a considerable extent. Nevertheless, the mobility depends to a large extent on the home Member State and whether a company continues to exist after leaving its home jurisdiction under the law of the home State.

3.2 Denial of the real seat theory?

The examples given above illustrate that the case law has a strong impact on the Member States' abilities to impose restrictions on immigrating companies. This influence is not only limited to jurisdictions using the real seat as the connecting factor to determine the law governing a company's

⁵⁷ Triebel/von Hase, *Wegzug und grenzüberschreitende Umwandlungen deutscher Gesellschaften nach "Überseering" und "Inspire Art"*, Betriebsberater, 2003, pp. 2409, 2412; Wymeersch, *supra* note 9, pp. 661, 687.

affairs. Moreover, also those favouring the incorporation principle have been denied to narrow the application of the law of the home State and to confer parts of their own domestic law upon companies that are establishing themselves within a foreign jurisdiction. However, one cannot find a clear statement in the Court's reasoning in favour or in denial of the real seat theory.⁵⁸ For this reason, the ECJ's decisions have to be carefully considered as to whether the real seat theory continues to be applicable or ceases to exist.

Among some legal scholars, the real seat theory had been set aside already with the ruling in *Centros*. It was argued that the judgement entailed a clear tendency of the Court towards the incorporation theory by stating that the real seat of the company in Denmark was irrelevant and that only the valid formation of the company in the UK was decisive.⁵⁹ Contrary to this view was the approach by others, both scholars and judicial bodies who claimed that the decision regarded national law following the incorporation principle (Denmark) and could therefore not be transmitted to a jurisdiction supporting the real seat theory. Hence, the treatment towards foreign companies seeking establishment in Member States with the real seat theory should remain unaffected according to this view.⁶⁰ The argument of the latter approach was lessened by the follow up decision of *Überseering* where the ECJ reasoned that the valid formation of a company under foreign law had to be acknowledged also in a country where the real seat theory was dominant (Germany). Again, the ruling was partly welcomed and qualified as a complete denial of the real seat theory.⁶¹ Doubts remained from the other side and it was pointed out that according to the ECJ in *Überseering* it was sufficient to respect the company as a legal entity and that this condition was fulfilled if the formally foreign company was *ex lege* transformed into a German partnership.⁶² As far as this argument is concerned, it has to be mentioned that the transformation of a limited liability company into a German partnership does only partly acknowledge the valid formation of an undertaking in another Member State, as it is required by the ECJ. Furthermore, for the two forms of conducting business different laws as to liability standards apply. Therefore, a company cannot benefit from the entire freedom of establishment as set out in the Treaty and clarified by the European case law, if it is not accepted under the legal form chosen.

It is also important to look at the Court's decisions rather in the light of the freedom of establishment than from the different theory approaches. The Court is not entitled to decide on national company law matters, since no specific provision in the Treaty implies such power. Nevertheless, the Court can rule on matters concerning the Treaty freedoms, such as the freedom of

⁵⁸ Heiss, "Überseering: Klarschiff im internationalen Gesellschaftsrecht?", *ZfRV* 2003, pp. 90, 93.

⁵⁹ Behrens, *Das Internationale Gesellschaftsrecht nach dem Centros-Urteil des EuGH*, *IPRax* 1999, pp. 323 ff.

⁶⁰ OLG Düsseldorf, *NZG* 2001, 506.

⁶¹ Behrens, *supra* note 52, p.193.

⁶² Roth, *From Centros to Überseering: Free Movement of Companies*, *International and Comparative Law Quarterly* 2003, pp. 177, 195, 207.

establishment. In this field, it is able to set aside national law that is harmful to these freedoms. In cases of national provisions having a detrimental effect to the freedom of establishment, these provisions will have to be modified by a Member State in order to give precedence to higher ranking European law.⁶³ For this reasoning, the European case law does not directly touch upon the existence of the real theory, but indirectly affects it, if the effects of this principle are found to be incompatible with the freedom of establishment. Thus, the Court did not express its view on the real seat principle as such, but declared the effects to be contrary to EC law; only to this extent is the real seat theory inapplicable.⁶⁴ The effect in practice is nonetheless the same, since for the application of the real seat theory it does not matter, if it is the theory as such or the consequences of its use that are dismissed by the Court.

However, Member States may obviously still apply the mechanism of the real seat in relations not governed by Community law, for instance in relation to companies from third countries with which the Community has not concluded any convention having an effect on this matter.⁶⁵

Besides, a Member State can apply its national law within the scope of the public interest justification and to combat cases of abuse by foreign companies seeking establishment.

As a result, it has to be stated that the real seat theory cannot be applied anymore in its strict sense⁶⁶, if incoming companies are incorporated in other Member States. The valid formation of a company in one Member State enables the undertaking to move freely within the Community without facing restrictions by national law, as was at stake in *Centros*, *Überseering* and *Inspire Art*. In these cases national law of the corresponding host Member State was in question. It has to be further discussed, if the real seat theory also ceases to be applicable in situations of a transfer out of a Member State.

3.3 Immigration vs Emigration

While *Centros*, *Überseering* and *Inspire Art* concerned issues of immigration, that means the relationship between the host Member State and the incoming company, *Daily Mail* was dealing with emigration, covering the relationship between the country of origin and the company moving out of that Member State. After the recent case law on immigration and the denying effect on the real seat theory, discussions arose whether *Daily Mail* was still good law or whether it was overruled by the following decisions.⁶⁷ In *Daily Mail*, the company was refused to move its seat to

⁶³ Wymeersch, *supra* note 9, p. 661, 681.

⁶⁴ Horn, *supra* note 51, pp. 893, 896.

⁶⁵ Dyrberg, *supra* note 6, pp. 528, 535 f.

⁶⁶ Stoller, *Sitztheorie und Niederlassungsfreiheit von Kapitalgesellschaften*, *JuS* 2003, pp. 846, 848.

⁶⁷ Triebel, *supra* note 53, pp. 2409, 2411.

another country and keeping legal personality in the home State because the country of origin was entitled to limit the mobility of the company. While no reference was made to Daily Mail in Centros, the Court distinguished Überseering on the facts to Daily Mail, since only the latter one concerned the outbound situation.⁶⁸ Therefore, it has been argued that the Inspire Art ruling does not result in any change because the case was similar to Überseering. The State of incorporation should therefore be not obliged to continue to respect the legal personality it had granted before the company wanted to relocate its seat.⁶⁹

Looking at the Court's decisions, no expressed view can be found in its rulings whether the reasoning of Daily Mail would still be upheld or whether the same approach as to immigration cases would be taken. Nevertheless, having in mind the high value of the freedom of establishment that the Court has indicated in Inspire Art, it can be argued that the real seat theory should also cease to apply in emigration cases. Even though, no case since Daily Mail has brought forward involving this question, it remains more than doubtful that the Court would uphold its founding. It is important to consider that the freedom to move out of a Member State is the downside of the freedom to move into another Member State. If the precondition to leave one jurisdiction is not fulfilled, a company cannot establish itself in another Member State.⁷⁰ Therefore, a company can only rely on the principles developed by the ECJ, if the home State allows the transfer to another jurisdiction without losing its legal personality. Further application of the real seat theory in this field would lead to arbitrary results; depending on the state of the incorporation's legal system, companies may not be able to benefit from the ECJ's judicature.⁷¹ Hence, it has to be awaited how the ECJ deals with an emigration case in future, but the underlining rationale in the recent case law indicates that the freedom of establishment is interpreted very broadly. The real seat theory can still be applied to emigration cases, although this might change with the next decision by the Court on this matter.

As an indication for the Court's direction, the latest judgement of the ECJ on a French exit charge can be taken into consideration. The Lasteyrie du Saillant case concerned taxes on unrealised capital gains imposed on persons leaving France to live in another country.⁷² Under the French law, the charge is relieved, if the taxpayer complies with certain conditions, including setting up a guarantee. Lasteyrie du Saillant complained that this infringed his freedom to establish abroad. The ECJ confirmed that the French rules were contrary to the freedom of establishment because they hindered the exercise of the freedom to establish in another member state. Furthermore, the exit charge and guarantee were not justified to prevent tax avoidance. The Court held that the measure was disproportionate, since it

⁶⁸ Überseering, para 70.

⁶⁹ Kersting/Schindler, supra note 44, pp. 1, 3 f.

⁷⁰ Ziemons, supra note 50, pp. 1913, 1919.

⁷¹ Kersing/Schindler, supra note 44, pp. 1, 4.

⁷² C-9/02, Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finance et de l'Industrie, ECR [2004] 00000.

applied to all persons moving abroad, regardless of whether there was a tax avoidance motive or not.⁷³

With this decision the ECJ has clarified that the freedom of establishment is applicable to the change of domicile of natural persons regarding restrictions in the host State as well as in the home State. Even though this ruling considered a natural person, it can be assumed that the Court will take a similar view to legal persons.⁷⁴ The equal footing of natural and legal persons within the freedom of establishment was underlined by the Court's case law and can also be found in Article 48 EC. Therefore, the *Lasteyrie du Saillant* case gives reason to expect that the ECJ will consider national restrictions hindering the emigration of a company to another Member State as contrary to the freedom of establishment.⁷⁵ Nevertheless, it has to be awaited if the ECJ in fact confirms its ruling regarding natural persons by transferring the reasoning to legal persons and thereby eliminates the differences between immigration and emigration.

3.4 Rationale for "dismissal" of real seat theory by ECJ

As far as immigration situations are regarded, the question arises why the ECJ found the results of the real seat theory to be contrary to the provisions on the freedom of establishment. Even though the Court did not directly address the real seat theory as such, it becomes obvious that the effects created by this theory are not welcomed by the Court. The ECJ is deciding clearly in favour of an extensive interpretation of the provisions of freedom of establishment. The approach taken by the Court corresponds to the Treaty objectives as set out in Article 2 EC. Among other tasks, the Community is also aimed to promote the development of economic activities in order to complete the economic union within Europe. The growth and competitiveness of European enterprises is furthermore an important goal. These goals have also been pursued by creating a better legal environment for enterprises.⁷⁶ Due to the fact that the EU is aimed to create an open market within the Member States, the Court supports the above mentioned objectives by promoting the mobility of companies to establish themselves in other Member States, regardless if in the form of primary or secondary establishment. It is obvious that the incorporation principle facilitates the mobility of undertakings because centres of management and control may be moved across the borders without any need to re-incorporation.⁷⁷ Opposed to this, the real seat theory limits a company in its possibilities to establish itself in another Member State. However, the incorporation

⁷³ *Lasteyrie du Saillant*, para 50 ff.

⁷⁴ Wachter, Thomas, Ende der Wegzugsbeschränkungen in Europa, http://www.gmbhr.de/heft/08_04/blickpunkt.htm.

⁷⁵ Id.

⁷⁶ Bovis, *Business Law in the European Union*, 1997, p. 21.

⁷⁷ Dyrberg, *supra* note 6, pp. 528 f.

principle opens up the possibility of creating mailbox companies, that means companies which do not have any other link with the State of incorporation than the incorporation.⁷⁸ The fact that the Court seems to accept this phenomenon indicates that it rather deals with certain disadvantages brought by stressing the law of the incorporation State to be applicable than to allow any restriction on the freedom of establishment. Having the overall aims of the Treaty in mind, the Court is trying to guarantee companies free access to the entire market in Europe. This is best to be achieved, if a company can move without any restrictions within the EU. Therefore, the opposite effect brought by the real seat theory is tried to be eliminated by the Court's rulings. The almost unlimited approval of the mobility shows how important the freedom of establishment is considered by the ECJ.

3.5 Real seat theory and national tax law

The repeated negations of the effects of the real seat theory by the ECJ have not only been approved by economic players such as companies within Europe, but also among tax lawyers. Especially in Germany, the clash between tax and civil law regarding the real seat principle appeared to be irreconcilable. Under German tax law, the application of the real seat theory was considered to be unacceptable with the relevant tax legislation. According to German tax scholars, the real seat theory offers opportunities to companies which leads to arbitrary results in the imposition of taxes.⁷⁹ This phenomenon can be explained by the different forms of taxation on limited liability companies on one hand and partnerships on the other hand. Regarding profits, the first one is taxed firstly as a corporate tax and later also as a tax for the individual shareholders, if a distribution of company profits takes place. Opposed to this system, partnerships fall only once under the tax law regime. The achieved profit is merely taxable among the partners proportionate to the number of partners, but not within the partnership as a legal person. Therefore, the system of a partnership is more desirable when it comes to taxes for profits because taxes must be paid only a single time. Since Germany was a strong proponent of the real seat theory, it did not automatically acknowledge a company's incorporation in another Member State, unless German law conditions for incorporation had been met. It was common practice to consider a foreign immigrating company as a partnership, since the requirements for setting up a partnership were less restrictive, as no minimum share capital is necessary. Had German law accepted the incoming undertaking as a limited liability company, it would have been enabled to impose higher tax rates that are valid for corporations. Following the real seat theory would mean that a company incorporated as a limited liability firm could avoid the applicable tax law rules by transferring the seat of the legal entity to another Member State. Consequently, the company would only be subject to the more advantageous tax imposition corresponding to partnerships. Therefore, the clear statement

⁷⁸ Id., pp. 528 ff.

⁷⁹ Wassermeyer, Überseering in the light of tax law, EuZW 2003, Editorial page.

by the ECJ that a company's legal status has to be acknowledged when its seat is transferred, brings an end to the conflict between German civil and tax law.

3.6 Real seat theory and Secondary EC law

After examining the implications of the ECJ's recent jurisprudence on the real seat theory, it has to be discussed whether the incompatibility of the consequences of this theory with the provisions on the freedom of establishment is also in line with Secondary EC law. In this context, the Regulation on the statute for a European Company⁸⁰ will be looked at closely.

3.6.1 The European Company

The debate on the European Company dates back several decades ago. On the basis of a draft proposal from 1966, the Commission published a first proposal on the statute for a European Company already in 1970.⁸¹ The delay was caused by a standstill in the Council of Ministers where unanimity was required. Resistance arose particularly on the question of board-level representation of employees within the European Company.⁸² After years of endless discussions the Regulation was adopted in 2001 and will come into force on October 8th, 2004. In this special case, implementation into national law is necessary, since the Regulation contains several references to the law of the Member States as governing law or the SE. The Regulation merely sets out the framework for the SE, but the Member States have to adopt specific provisions relating to the formation and operation of SEs.⁸³ Thus, the Member States have to set up accomplishing legislation to give full effect to the Regulation.⁸⁴

The Regulation will permit large public companies to become a European Company, the so-called "Societas Europaea" (SE). This legal entity is intended to be a public limited-liability company organised according to supranational EU law rather than according to the domestic law of one

⁸⁰ Council Regulation 2157/2001 of 8 October 2001 on the statute for a European Company (SE), OJ, L 294 of 10 November 2001, p. 1.

⁸¹ Commission proposal for a European public limited liability company to the Council of Ministers, OJ 124, 10.10.1970.

⁸² Working paper No. 6 on the European Company (SE), Agreement on worker involvement,

<http://www.seeuropenetwork.org/homepages/seeurope/europeancompany/sehistory.html>.

⁸³ see Article 9(1)(c) of the Regulation and Preamble, para 22.

⁸⁴ Schindler, Vor einem Ausführungsgesetz zur Europäischen Aktiengesellschaft, <http://www.ip.mpg.de/Enhanced/Deutsch/Verwaltung/SEAG.pdf>.

Member State.⁸⁵ The SE can be founded by way of a merger of two companies located in two different Member States, by forming a holding SE of two companies or by forming a subsidiary SE.⁸⁶ One of the main objectives is to enable companies to carry out their business on a Community scale by removing barriers of production and trade in order to improve the completion of the internal market.⁸⁷ Cooperation operations involving companies from different Member States give currently rise to legal difficulties and should be reduced by the approximation of Member State's company law.⁸⁸ Therefore the Regulation provides for the option for existing companies from different Member States to merge and to combine their potential.

3.6.2 Conflict between SE and case law

Regarding the seat of a SE, Article 7 of the Regulation states that the head office the company has to be established in the same Member State as its registered office.⁸⁹ This implies that the registered office and the seat of a company have to coincide. It seems questionable whether the application of the Article 7 is compatible with the ECJ's case law, since it can be inferred from the cases mentioned earlier that according to the Court a company can have its registered office in one Member State and actual place of business in another Member State. Thus, the rule in Article 7 seems to contradict the Court's jurisprudence. Nevertheless, Article 8 of the Regulation allows a SE to transfer its registered office to another Member State. However, in conjunction with Article 7 this means merely that the transfer of the registered office to another Member State is possible, but consequently the head office of the SE has to follow. The principles set out in Article 7 and 8 clearly indicate that the EU legislator basically follows the maxims of the real seat theory.⁹⁰ With the background of the case law on the freedom of establishment, the Regulation is not compatible with the rulings of the ECJ. The Court has indirectly established the incorporation theory in Primary EC law by negating the effects of the real seat theory.⁹¹ This leads to a discrepancy between the provisions in Article 43 EC ff. and provisions of Secondary EC law.

It has partly been argued that the requirement of Article 7 to establish the head office and the registered office in the same country was implied to

⁸⁵ Reid, *The Increasing Europeanisation of Company Law*, *Business Law Review* 2003, pp. 165, 167.

⁸⁶ Article 2 of Regulation 2157/2001.

⁸⁷ Preamble of Regulation 2157/2001, para 1.

⁸⁸ *Id.*, para 3.

⁸⁹ Article 7: "The registered office of an SE shall be located within the Community, in the same Member State as its head office. A Member State may in addition impose on SEs registered in its territory the obligation of locating their head office and their registered office in the same place."

⁹⁰ Ulmer, *Gläubigerschutz bei Scheinauslandsgesellschaften*, *NJW* 2004, pp.1201, 1210.

⁹¹ Kersting/Schindler, *supra* note 44, p. 8.

limit the consequence of Article 8.⁹² Article 8 extends the possibilities of SEs beyond the jurisdiction of the ECJ. The Court has held in *Daily Mail* that restrictions in emigration cases by the Member State of origin are justified under certain circumstances and that companies do not have a right to change their seat and retaining legal personality in their home State. Article 8(1) of the Regulation clearly states that a transfer of the registered office does not lead to the winding up of the SE or the creation of a new legal person. Thereby it can be seen that Article 7 restricts the mobility of companies, whereas Article 8 broadens it. To some extent scholars have argued that Article 7 EC could be justified in the view of companies' host States.⁹³ By requiring the head and registered office to be located in the same State, "letterbox companies" are tried to be avoided. If the office could be transferred unaccompanied by the head office, some "mala fide" practices could be undertaken from a different State, but affecting the State of the head office or vice versa.⁹⁴ Their position is weakened because they have to allow the transfer of a European Company. In order to place them in a better situation, Article 7 makes the transfer of the registered office more difficult by combining the head office with the place of registration.

Although the combined approach in Article 7 and 8 of the Regulation might be explained by safeguarding Member States' interests, the conflict with the ECJ's case law remains. Some scholars claim try to avoid the problem when they say that the European Company does not fall under Article 43 EC ff.⁹⁵ As a counterargument, it has to be mentioned that the European Company fulfils the requirements of Article 43, 48 EC and it is not logical why the first form of a transborder company in Europe should not be entitled to benefit from the principles of the Treaty. The fact that the Regulation includes clear incentives of the real seat theory can also be underlined by political reasons. The Commission proposing this Regulation is currently composed of two members of mainly those Member States who favour the real seat theory, whereas other countries send only one representative.⁹⁶ Hence, these Member States were able to influence the outcome of the proposal.

However, the discrepancy between Primary and Secondary EC law in this matter should be dissolved. The conflict can be illustrated by a scenario when a European Company wants to transfer its central administration without transferring its registered office to that state. It is of interest to speculate how the ECJ would treat such a situation.⁹⁷ If the judiciary finds the Treaty to prohibit Member States from laying down requirements for a company's establishment in another Member State, the Community legislator should be forbidden as well to require the concurrence of the head

⁹² Lange, Überlegungen zur Umwandlung einer deutschen in eine Europäische Aktiengesellschaft, *EuZW* 2003, pp. 301, 303.

⁹³ Schindler, "Überseering" und Societas Europaea: Vereinbar oder nicht vereinbar, das ist hier die Frage, *RdW* 3/2003, pp. 122, 124.

⁹⁴ Wymeersch, *supra* note 9, pp. 661, 691.

⁹⁵ Ulmer, *supra* note 86, pp. 1201, 1210.

⁹⁶ Germany, France, Italy and Spain are to be mentioned in this context.

⁹⁷ Woolridge, *supra* note 34, pp. 227, 235.

office and the registered office. The European legislator has to be active in adjusting the Regulation to avoid the incompatibility of the Regulation with Primary EC law.⁹⁸ When reading Article 69 of the Regulation, it seems as if the European legislative body has taken a different approach already into consideration. Article 69(a) provides that five years after coming into force the Commission shall forward a report on the appropriateness of allowing the location of a SE's head office and registered office in different Member States. Otherwise it is very likely that the ECJ will give superior rank to the principle of freedom of establishment in relation with the Regulation on the European Company.

3.7 Practical consequences of denial of real seat theory

Regarding the rulings of the Court, a more favourable view towards the incorporation theory cannot be overlooked. The effects of the real seat theory are incompatible with the freedom of establishment and can only continue to be applied when justified by overriding public interests. The question arises which practical consequences will come along with the denial of the real seat theory and the turn to the incorporation theory.

3.7.1 Race to the bottom

The expansion of the incorporation theory and the extended freedom of establishment for companies may lead to a competition between the different national legal orders in the field of company law.⁹⁹ If the law of the State of incorporation is decisive to cover the affairs of enterprises, companies will set up their business in the State with the most attractive company law rules. The approach taken by the ECJ implies that it is inherent in the freedom of establishment to form a company in a particular Member State for the sole purpose of enjoying the benefit of a more favourable legislation.¹⁰⁰

Nevertheless, the rationale of the Court is not totally immune towards criticism. The application of the real seat theory ensures that domestic mandatory interests are protected. Real seat systems are more oriented towards exercising close control over the entities operating within their territory by submitting them to their national legal order. The company should have a real link with the State of whose legal system it claims to be applicable.¹⁰¹ If incorporated under a foreign jurisdiction, companies are obliged to re-incorporate under the legal system of the State where they have their actual headquarters, their real seat. This limits companies in

⁹⁸ Ziemons, *supra* note 50, pp. 1913, 1918.

⁹⁹ Horn, *supra* note 51, pp. 893, 900.

¹⁰⁰ Inspire Art, para 96.

¹⁰¹ Wymeersch, *supra* note 9, pp. 661 f.

their freedom to move between Member States and prevents competition between jurisdictions in the field of company law.¹⁰²

On the other hand, the incorporation principle allows the founders of a company to choose freely the legal system they think most appropriate and keep the legal status, regardless of the State where its activities are carried out. This advantage of the incorporation theory for companies may lead to competition among Member States¹⁰³ in having the most lenient company laws to attract companies to establish their business in the Member State with the least restrictive rules. This practice is called as "race to the bottom" or as "Delaware syndrome".¹⁰⁴ The Delaware effect has been feared mainly by supporters of the real seat theory. It is said that the incorporation theory neglects the fact that the formation and operation of a business also affects interests of third persons of that country where the business is conducted, such as interests of creditors and employees.¹⁰⁵ Insofar as the real seat theory allows the application of domestic law, these interests can be pursued. Contrary to this principle, the incorporation theory does not offer this option; the law of the home State will be applied, even if the seat of the company is situated in another Member State where the entire business is carried out. Therefore, the interests of third persons in the host Member State are left aside because they are not governed by the law of that State. Especially for countries with high legal standards to interests of third parties, the absence of these laws will have a strong impact on their company law system. Companies may use the freedom of establishment to form a legal person in a Member State with lenient rules and set up a secondary establishment in another State where they plan to conduct their business. Thereby, they can circumvent certain rules in the latter State,¹⁰⁶ such as rules on workers co-determination, if the application of those provisions cannot be justified by reasons of the general interest.

3.7.2 "Healthy" competition between jurisdictions

Against the development to a race to the bottom it can be said that companies have to take into consideration future business partners when setting up their business. Therefore, an undertaking has to face difficulties in its legal relations, if it chooses to comply with very low standards regarding the requirements of incorporation.¹⁰⁷ Creditors will not enter into legal

¹⁰² Wouters, *European Company Law: Quo Vadis?*, CML Rev. 2000, pp. 257, 286.

¹⁰³ Wymeersch, *supra* note 9, pp. 661 ff.

¹⁰⁴ Reid, *supra* note 80, pp. 165, 167; Ziemons, *supra* note 50, pp. 1913, 1920. The US State of Delaware enacted laws very favourable towards companies. Many American companies are incorporated there without having another link with Delaware than the incorporation.

¹⁰⁵ Binz/Mayer, *Die ausländische Kapitalgesellschaft & Co. KG im Aufwind?*

Konsequenzen aus dem "Überseering"-Urteil des EuGH v. 5.11.2002, *GmbH Rundschau* 2003, pp. 249, 251.

¹⁰⁶ Zimmer, *Nach "Inspire Art": Grenzenlose Gestaltungsfreiheiten für deutsche Unternehmen?*, *NJW* 2003, pp. 3585, 3587.

¹⁰⁷ Roth, *Gläubigerschutz im Wettbewerb der Rechtsordnungen*, <http://www2.jura.uni-hamburg.de/le/Roth2.pdf>.

relations, if they are not sufficiently protected by law and have to fear financial losses in case of a company's insolvency due to a lack of safeguards for their economic interests. Furthermore, entrepreneurs who are not interested in meeting certain criteria to set up a business in a particular Member State, but seek to carry out all the company's affairs in that State, these businessmen are not taken seriously in their economic surrounding.¹⁰⁸ To use the domestic market and thereby demonstrate seriousness and sincerity can still make sense for entrepreneurs.¹⁰⁹ Since today's market is characterised by more transparency and information technology rich clients, customers and shareholders will be empowered to demand the highest ethical and legal standards.¹¹⁰ A "slim-line" Delaware effect might promote a healthy form of competition between the Member States opposed to the race to the bottom scenario. If a maximum level of disclosure of company information is the central aim of this decentralised agenda, then the competitive effect may even result in a "race to the top".¹¹¹ As far as disclosure requirements are concerned, it is noticeable that a number of provisions in Secondary EC law provide for protection of potential third persons dealing with companies.¹¹²

Moreover, competition within the internal market in the sector of goods, services and labour is well established. As a consequence, competition within the European Community includes also competition between the various legal orders to give full effect to competition in the former mentioned areas.¹¹³ The only way to opt for competition between jurisdictions is by easing rules on cross-border seat transfers. The fact that companies can change the jurisdiction and have to be recognised by the host Member State with no hindrances does increase the pressure on national legislatures to offer an attractive company law framework.¹¹⁴

Another counter-argument to a race to the bottom development is the lack of tax harmonisation. As Community law stands today, tax harmonisation has not been realised, so companies will still seek out Member States with the most advantageous tax regime.¹¹⁵

As a consequence of the latest European case law, the effect of "pseudo-foreign" companies, that means companies who carry out their business in one Member State and have as foreign element only the incorporation in another State, but no other real link to the place of incorporation have to be

¹⁰⁸ Altmeyden, supra note 52, pp. 97, 103.

¹⁰⁹ Kersting/Schindler, supra note 44, p. 8.

¹¹⁰ Reid, supra note 80, pp. 165, 167.

¹¹¹ Habersack, *Europäisches Gesellschaftsrecht*, pp. 19 f.

¹¹² For example, Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in other Member States, OJ 1989 L 395, p. 36; Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards for the protection of interests of members and others of public limited liability companies, OJ 1977 L 26, p. 1.

¹¹³ Ziemons, supra note 50, pp. 1913, 1916.

¹¹⁴ Wouters, supra note 97, pp. 257, 287.

¹¹⁵ Reid, supra note 80, pp. 165, 167.

accepted as a "by-product" of the exercise of the freedom of establishment. This can be inferred from the ECJ's case law. However, the obligation to acknowledge such enterprises does not necessarily lead to a deficit regarding the protection of domestic creditors.¹¹⁶ Member States are still able to apply restrictive measures on certain general interest grounds as mentioned by the ECJ, provided the necessary criteria are complied with. These justifications enable countries to apply provisions of their domestic law, even if the company was incorporated under a foreign jurisdiction. To use grounds for justifications may help Member States to prevent the race to the bottom which has been feared to arise.¹¹⁷

Against this background, it has to be expected whether the ECJ's reasoning leads to a "race to the bottom" or to a healthy form of competition between national legal orders. With the harmonisation through Secondary EC law, the lack of tax harmonisation and the remaining possible justifications, strong arguments are presented to avoid the development to very low standards in the field of company law.

¹¹⁶ Schulz, (Schein-)Auslandsgesellschaften in Europa-Ein Schein-Problem?, NJW 2003, pp. 2705, 2708.

¹¹⁷ Woolridge, *supra* note 34, pp. 227, 234.

4 Justifications for Member States

Due to the limited use of the real seat theory in future, the question arises which possibilities remain for the Member States to restrict the freedom of establishment. With the application of the real seat principle, Member States were enabled to apply their own domestic law to companies seeking to establish within their territory. Once an undertaking had placed its real seat in its territory, the Member State at issue applied its national provisions to the foreign company following the doctrine of the real seat theory. In practice, this allowed Member States to control the activities of companies to a great extent, even if the company was incorporated under a different jurisdiction. When the ECJ decided more in favour of the free movement of companies without any restrictions, especially in *Centros*, *Überseering* and *Inspire Art*, Member States had to accept the legal formation of a company under a foreign jurisdiction. In particular, countries that were supporting the real seat theory are affected by the wide interpretation on the provisions of the freedom of establishment given by the Court.¹¹⁸ Although it is very likely that it will take some time for Member States to switch from the real seat doctrine, the consequences of this rule will cease to affect companies to a certain extent, if Member States follow the Court's decisions. Therefore, it has to be discussed whether the free movement of companies is totally unlimited in future or whether Member States can impose certain restrictions on enterprises.

In the case law, various grounds for justification have been mentioned, not only by the parties involved, but also by the Court. Below, it will be examined more detailed in how far Member States can rely on justifications and whether they can be used as a replacement for the effects of the real seat theory.

4.1 Prevention of abuse

It is a settled principle of EC law that the citizens of a particular State cannot invoke the fundamental freedoms against their own country without the involvement of cross-border activity.¹¹⁹ To create cross-border situations artificially to avoid unattractive rules in a particular Member State was therefore held to be abusive.¹²⁰ In these cases, the ECJ allowed the Member States to take measures preventing the exercise of the freedoms of the

¹¹⁸ Rehberg, *supra* note 49, p. 1.

¹¹⁹ See, e.g., Case C-134/95, *USSL v. INAIL*, 1997 ECR I-195, para 19-23.

¹²⁰ See, e.g., Case C-33/74, *Van Binsbergen*, [1974] ECR 1299, para 13, Case C-229/83, *Leclerc*, [1985] ECR 1, para 27 concerning the export re-importation of books to France by a French national to circumvent the French law on book prices relying on the free movement of goods.

Treaty because the only purpose of the cross-border activity was the circumvention of national legislation.¹²¹

In the *Centros* case, the Danish authority claimed that the refusal to grant registration for a subsidiary of *Centros* in Denmark was justified because the establishment of a branch in Denmark would seem to be a way to avoid the national rules for and the paying-up of a minimum share capital.¹²² To prevent fraudulent insolvencies was another objective of the treatment towards the company. The Danish authorities are therefore of the opinion that the practice of *Centros* constitutes an abuse of the freedom of establishment, since it was circumventing the national legislation governing the formation of private limited companies.¹²³ The Court answers that Member States are entitled to take measures to prevent certain of its nationals from an improper circumvention of their national legislation by misusing the rights of the Treaty. Individuals are not allowed to take advantage of the provisions of Community law in an improper or fraudulent way.¹²⁴ Nevertheless, the Court continues to state that abusive behaviour may be established on a case-by-case basis. The benefit of the freedom of establishment can according to the ECJ only be denied, if abusive or fraudulent conduct is established in the particular case. In *Centros*, the Court came to the conclusion that no abusive behaviour had been committed. The Danish argument regarding the circumvention of national law was denied. The Court considered it to be completely in line with the exercise of the freedom of establishment to set up a company in a Member State with least restrictive company law rules and consequently to set up branches in other States.¹²⁵ Similar statements to the circumvention notion in cases of abuse were also made in *Inspire Art*.¹²⁶ While *Inspire Art* was merely following the reasoning developed in *Centros*, the outcome of the latter caused considerable surprise regarding the abuse issue. It was unexpected that the manner how the company tried to avoid stricter rules regarding the formation of the company was not caught by the abuse or avoidance exception.¹²⁷ After all, the main purpose of pseudo-foreign corporations such as *Centros* is to avoid the application of the law of the Member State in the territory of which the company conducts most of its activities. The judgements in *Centros* and *Inspire Art* concerned companies that were only formally foreign because they were not actually present in their State of incorporation. One could therefore argue that the element of an artificial cross-border activity mentioned in previous cases by the ECJ was contained in these situations as well.¹²⁸ Consequently, the Court should have allowed the Member States to use their national law regarding these undertakings. Nevertheless, the Court expressly refused to apply the circumvention doctrine.

¹²¹ Rehberg, *supra* note 49, pp. 1 f.

¹²² *Centros*, para 12.

¹²³ *Id.*, para 23.

¹²⁴ *Centros*, para 24.

¹²⁵ *Id.*, para 27.

¹²⁶ *Inspire Art*, para 136.

¹²⁷ Craig/de Búrca, *EU Law*, p. 798.

¹²⁸ Rehberg, *supra* note 49, pp. 1, 4.

Looking closer to the circumstances of the scenarios in *Centros* and *Inspire Art*, they can be distinguished from the types of abuse the ECJ has disallowed. In the cases discussed in this paper, the companies were founded in one Member State and then crossed the border for the first and only time, regardless if by a transfer of the actual seat or by setting up a secondary establishment. Contrary to these settings are cases where a company has its central administration in one country, moves to another country and then immediately returns for the sole purpose of subjecting certain rules of the first State.¹²⁹ Compared to this situation, the construction in *Centros* and *Inspire Art* is lacking the element to return to the first country and would not fall in the category that the Court has established before as cases of abuse.

The Court's reasoning clarifies that general intervention based on the establishment of the company and not on concrete findings of abuse will not satisfy the abuse criterion. It must be borne in mind that the founders of a company are free to choose whichever law suits them best. Corresponding to the ECJ's ruling, the mere choice of a set of general rules cannot be considered abusive, whatever the individual facts of the case may be because there is no reference point to qualify the choice as an abuse. This leads to the question whether abuse can be established at all.¹³⁰ If the choice of a company law system cannot constitute an abuse in itself, an abuse can only be established within the chosen legal system. However, such an abuse should be sanctioned within the chosen legal system of the home State. Thus, host Member States would not be able to apply their own domestic law and thereby substitute another legal system of the country where the company is incorporated.¹³¹

4.2 Mandatory requirements: Workers co-determination

Under the case law of the ECJ, measures hindering the freedom of establishment can also be justified under mandatory requirements. The Court mentioned this in *Centros*, *Überseering* and *Inspire Art*.¹³² While the Court speaks about national measures in general as possible justification, it names in *Überseering* specifically among others the protection of creditor interests and of employees as overriding requirements relating to the general interest. However, with reference to its previous case law, the Court repeated that those restrictions are only justified, if certain conditions are met. Firstly, national measures must be applied in a non-discriminatory manner, secondly, they must be based on imperative requirements in the general interest, thirdly, they have to be suitable for securing the attainment

¹²⁹ Rehberg, *supra* note 49, pp. 1, 4.

¹³⁰ Kersting/Schindler, *supra* note 44, p. 7.

¹³¹ *Id.*

¹³² *Centros*, para 34, *Überseering*, para 92, *Inspire Art*, para 132 f.

of the objective they pursue and lastly, they are not allowed to go beyond what is necessary in order to attain the objective.¹³³ Below, it will be examined to what extent countries supporting the feature of co-determination in their corporate structure can rely on this element as an overriding imperative requirement. For the purpose of this paper, reference is made exclusively to German co-determination law.

As far as Germany is concerned, there may be a special interest to apply the German rules relating to mandatory co-determination. In this context it has to be noticed that German company law unlike other company law systems is designed to serve not only the interests of shareholders, but also those of employees.¹³⁴ Under German codetermination law, employees participate in the management of corporations because they are represented on the boards of companies. In order to give the reader a better understanding, the concept of co-determination will firstly be explained in short terms.

4.2.1 Definition of co-determination

Co-determination is the structured participation of employees or their representatives in the company's formulation of objectives and in decision making.¹³⁵ The German system of co-determination functions by giving workers a voice in the supervisory boards of corporations. German public corporations have a two-tier board structure.¹³⁶ The managing board is in charge of the day-to-day operations, while the supervisory board is responsible for appointing and supervising the managing board. The most recent statute on codetermination is the Mitbestimmungsgesetz (MitbestG) of 1976.¹³⁷ According to this law, about half of the members of the supervisory board are elected from the employees of a company.¹³⁸ The Act is applicable to legal entities such as public companies and limited liability companies under the condition that they employ more than 2000 workers and regulates mainly the election procedure and composition of the supervisory board in the light of workers participation. By being represented in the supervisory board, co-determination rights in Germany are quite extensive and increase worker power considerably. This power is unique within the German system. Other legal systems do not have comparable forms of co-determination or confer co-determination rights only to decisions on which the management is presumably neutral.¹³⁹

¹³³ Case C-55/94, Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano [1995] ECR I-4165, para 37.

¹³⁴ Dammann, The future of codetermination after Centros: Will German corporate law move closer to the U.S. Model?, *Fordham Journal of Corporate & Financial Law* 2003, pp. 607f.

¹³⁵ Lahovary, Employee Representation, Codetermination and Business Performance, <http://www.dti.gov.uk/cld/esrc2.pdf>.

¹³⁶ See §§ 76-117 Aktiengesetz (German Stock Corporation Act).

¹³⁷ Codetermination Act of 1976.

¹³⁸ See §§ 7 ff. Mitbestimmungsgesetz (Co-determination Act).

¹³⁹ Horn, *supra* note 51, pp. 893, 899.

4.2.2 Application of German Co-determination Act to foreign companies

Foreign incorporated companies could avoid the application of the German Act on co-determination because the relevant statutes apply only to specific types of corporations formed under German law.¹⁴⁰ To be applicable to foreign companies, it was partly suggested to use the co-determination rules by means of an analogical reasoning.¹⁴¹ Nevertheless, the way of analogy may only be used to fill gaps that were not intended by the legislature. However, the legislative material at the preparatory stage shows that an extension towards foreign companies was expressly not intended.¹⁴² Although the Co-determination Act in its current form cannot be applied to foreign enterprises established in Germany, the provisions can be changed by the national legislator and be extended to those companies.

4.2.3 Non-discriminatory application

Referring to the criteria set up by the Court, the rules on co-determination must be applied in a non-discriminatory manner. Discrimination in this context can also take place, if an equal treatment leads to unequal results. Due to the one-tier board structure in many foreign companies, the effect of co-determination would be very different from that one in a two-tier board structure. In order to ensure that the application of co-determination rules to foreign companies does not lead to discriminatory effects, the German legislator should provide more flexible rules.¹⁴³ Thus, the concept of workers participation in a two-board structured corporation should be added by a one-tier structured concept. Otherwise, it is made almost impossible for foreign companies to apply those rules without changing their whole organisational structure.

4.2.4 General interest

Furthermore, the application of co-determination rule must be based on imperative requirements in view of the general interest. In *Überseering*, the Court has expressly mentioned the protection of employees' interests as possible overriding interests to restrict the freedom of establishment. Co-determination serves the aim to offer social protection for employees. It is meant to create a balance between the power of the employer owning the facilities and having more economic power and the interests of workers that

¹⁴⁰ See § 1 MitbestG.

¹⁴¹ Zimmer, *Internationales Gesellschaftsrecht*, 1996, pp. 146 ff.

¹⁴² Bericht des Ausschusses für Arbeit und Sozialordnung, BT-Drucks. 7/4845, p. 4.

¹⁴³ Thüsing, *Deutsche Unternehmensmitbestimmung und europäische Niederlassungsfreiheit*, ZIP 2004, pp. 381, 384.

are providing their working forces.¹⁴⁴ Partly, it is doubted whether the Co-determination Act fulfils this criterion.¹⁴⁵ It has been argued that workers are merely protected under the provisions on co-determination, if the number of employees has reached a certain limit. Therefore, the need for a protection of workers interests is said to be not sufficient high enough, if not unexceptionally all workers enjoy the same rights. Furthermore, according to the critics the fact that the matter of co-determination is not regulated in the Regulation on the European Company, but is embraced in an additional document¹⁴⁶ giving more leeway to the Member States, shows that there is no uniform understanding in Europe to this aspect.¹⁴⁷ Against these arguments it has to be said that a uniform standard of protection is not required for all employees, but that it can vary even between different business sectors.¹⁴⁸ Moreover, the way to deal with co-determination in the context of the European Company is irrelevant to the question whether workers participation can be considered as a national overriding interest to restrict the freedom of establishment.¹⁴⁹ Moreover, the fact that the question of co-determination is regulated on a European basis, even with some discretion to the Member States, shows that this is not only a national issue. Article 11 of the Regulation accomplishing the European Company, which states that Member States should take measures to prevent the misuse of a SE to lessen employees' co-determination rights, stresses this.¹⁵⁰ Therefore, it can be assumed that the criterion of a general interest is fulfilled in the field of co-determination.

4.2.5 Suitability for attaining the objective

Within the suitability criterion it has to be mentioned that the means do not need to attain the objective completely, it is sufficient, if they are able to promote the attainment of the aim.¹⁵¹ As far as this point is concerned, co-determination cannot be denied to be able to support the aim it seeks for. With the representation of workers at a higher level in a company's organisation, they can influence in a better way the management and operations of the undertaking. Since they are elected up to a certain number to the supervisory board, the chances of employers increase to decide on essential matters regarding the company's affairs.

¹⁴⁴ Thüsing, supra note 141, pp. 381, 385.

¹⁴⁵ Eidenmüller, Wettbewerb der Gesellschaftsrechte in Europa, ZIP 2002, 2233, 2242.

¹⁴⁶ Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees.

¹⁴⁷ Ebke, Überseering-Die wahre "Liberalität" ist Anerkennung, JZ 2003, pp. 927, 931.

¹⁴⁸ Thüsing, supra note 141, p. 386.

¹⁴⁹ Id.

¹⁵⁰ Article 11 of Regulation 2001/86/EEC.

¹⁵¹ Thüsing, supra note 137, pp. 381, 387.

4.2.6 Necessity of means

Lastly, the rules on co-determination have to constitute a necessary means to attain the protection of workers' social interests. The application of the co-determination provisions must not go beyond what is necessary to attain this objective. It is not obvious how workers' interests should be protected to the same effect by a means, which has less impact on the employer. Thus, the rules of co-determination are necessary to attain the aim pursued with it. Therefore, the extension of the Co-determination Act to foreign companies established in Germany can be seen as a possible justification to restrict the freedom of establishment within the mandatory requirements set out by the ECJ.

5 Conclusion

The real seat theory has been tested in a number of cases in front of the ECJ. Starting with *Segers*, the Court has followed its approach to the recent *Inspire Art* judgement to extend the free movement of companies.

The Court's reasoning implies a more favourable attitude towards the recognition of a company, as it exists in its country of origin. Therefore, the ECJ tends to adopt certain features of the incorporation theory without fully turning to the incorporation principle. Nevertheless, the real seat doctrine will remain applicable in the domestic context and in relation to third countries. However, its importance will be reduced to a considerable amount.¹⁵² Although the Court has not expressly denied the applicability of the real seat theory, it has clarified that the effects are contrary to the freedom of establishment of companies. The Court's latest ruling in *Lasteyrie du Saillant* showed also a tendency towards eliminating the differences between emigration and immigration. Whether this approach will be transferred by the ECJ to the field of legal persons, has to be awaited.

The impact of this case law on the mobility of company is immense. Even if the ruling of *Daily Mail* stands still as good law, restrictions by Member States on enterprises seeking to establish themselves are limited by the Court's rulings. With the background of the recent decisions, enterprises can change their place of business by moving the seat or by establishing a branch in another Member State. The case law has also shown that the provisions on the freedom of establishment apply equally to primary and secondary establishment.

Reasons for this more favourable attitude towards the freedom of establishment can be found in the Treaty objectives. The Court wants to promote economic wealth and competitiveness of companies. The real seat principle is intended to ensure a more effective link with the State in which the company operates and thus be more apt to protect domestic mandatory interests. However, it appears that it also entails obstacles to the free movement of companies.¹⁵³ With the real seat theory companies already legally incorporated under a foreign jurisdiction within the Community have to re-incorporate their legal entity, if they have not complied with the provisions of the State where they want to establish themselves. This hinders companies in their mobility and causes extra costs to establish their business outside the place of incorporation.

Thus, the Court tries to remove existing barriers to the mobility of companies by imposing the obligation on Member States to recognise a company's valid corporation of a foreign jurisdiction.

¹⁵² Wymeersch, *supra* note 9, pp. 661, 695.

¹⁵³ Dyrberg, *supra* note, pp. 528, 530.

However, as far as the situation of emigration is concerned, the judgement of *Daily Mail* is still untouched. Nevertheless, the ability to move out of the jurisdiction of origin is the necessary pre-condition for moving into another jurisdiction. Therefore, the ECJ should treat these two situations in the same way.

It has to be waited which consequences the development of the case law by the ECJ will bring in practice. The extended freedom of companies to move is feared to leave to a race to the bottom because various Member States will lower their standards to attract companies to incorporate themselves in that particular State. Opposed to this concept stands a natural competition between the national legal orders in the field of company law. With the idea that parties dealing with companies demand transparency and that serious businesses are willing to meet certain conditions, a development to higher standards is more likely to occur combined with a “healthy” form of competition between national legal orders.

Regarding secondary EC law, it is noticeable that the principles developed by the Court, cannot be found in the Regulation on the European Company, coming into force in October 2004. The requirement that the place of incorporation and the place of a company’s real seat have to coincide is hardly possible to bring in line with the rulings of *Centros*, *Überseering* and *Inspire Art*. Possible explanations can merely be found in the different law-making procedure in the Commission and Council where the interests of particular Member States are more represented. With the accession of the new Member States and the new composition this balance is shifted, so it has to be waited, if a future change of the Regulation in question takes place.

In the field of justifications, Member States can impose their own legislation on foreign companies established in their territory to a limited extent. The Court has shown in its decisions a high barrier for arguments to be accepted as a justification.

International company law of the Member States is much more strongly determined by provisions at the Community level, as one would believe. The wide scope of the freedom of establishment, the strict requirements for justification and the multitude of criteria that have to be respected do not give much leeway.¹⁵⁴

However, Member States can impose restrictions in cases of abuse of the freedom of establishment. It has to be kept in mind that the mere choice of a legal forum cannot be considered as such an abusive conduct.

Similar to its *Cassis de Dijon* ruling, Member States can also impose certain restrictions as mandatory requirements, if particular criteria are fulfilled. Regarding co-determination, it would be possible to use the rules of the

¹⁵⁴ Rehberg, *supra* note 49, pp. 1, 8.

German Co-determination Act as restriction for foreign companies established in Germany.

Although company law has been harmonised to a certain extent in Europe, the Member States still have much leeway to use their own domestic law, even in case of the new European Company.

The extended freedom of establishment is a step to more mobility for companies within Europe, but it is not enough to guarantee for a competitive European economy.

Therefore, further harmonisation in the field of tax law, for example, should be brought on its way.

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