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The long path to a broad reading of the  
Freedom of Establishment and its  
impact on the Brexit era

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# I. Summary

The freedom of establishment is an expression of the Internal Market. On the one hand, the EU tries to strengthen the Internal Market, but on the other hand, Member States have a fear to lose their national control, making them eager to restrict the free movements granted by the Internal Market doctrine. The contradiction becomes visible in regard to the cross-border movement of companies in the EU.

Due to the lack of harmonization in the area of cross-border movement of companies, the CJEU had to take over the role of interpreting and harmonizing the law. The cross-border movement of companies was subject to several cases in front of the CJEU where the Court distinguished between emigration and immigration cases, which were not comparable. While immigration cases were covered by the freedom of establishment, cases of emigration were governed by the national law of the home Member State. The Court's judgements were not stringent in regard to the interpretation of the freedom of establishment. A liberal interpretation of the freedom of establishment was only applicable in immigration cases, while the Court applied a narrow definition in emigration cases. The differentiation lacks a convincing argumentation.

Until *Polbud*, it was questionable whether companies were allowed and if yes, under which conditions, to transfer their registered seat to another Member State without changing their main place of business. *Polbud* put an end to the discussion and allowed the sole transfer of the registered seat even without any economic link to the host Member State. The freedom of establishment also includes a freedom of choice of the applicable law, allowing companies to re-incorporate in their Member State of choice even after they were initially incorporated in a different Member State.

The freedom of choice of the applicable law can be used by British companies who are affected by Brexit if the UK leaves the Internal Market. Companies, that are only incorporated in the UK, but have their real seat elsewhere in the EU, are after Brexit not per se accepted as a valid company. They can neither refer to the freedom of establishment nor to the principle of mutual recognition. After the UK will leave the Internal Market, these companies will be governed by the national laws of each Member State. The new freedom gained by the *Polbud* judgment helps companies to exit the UK before Brexit to still be a part of the Internal Market and be able to be subject to the freedom of establishment. A new Directive on cross-border conversions of companies proposed by the European Commission in Spring 2018 could give companies, if implemented on time, a legal certainty for their cross-border movement that *Polbud* is not able to provide.

## II. Abbreviations

|                         |   |
|-------------------------|---|
| Art                     | Article   |
| CJEU/Court              | Court of Justice of the European Union          |
| EU/Union                | European Union                                  |
| Ibid                    | In the very same place                          |
| Member State/<br>States | Member State/States of the European Union       |
| TEU                     | Treaty on European Union                        |
| TFEU                    | Treaty on the Functioning of the European Union |
| UK                      | United Kingdom                                  |

# 1. Introduction

One of the purposes of the EU is to create an Internal Market, Art 3(3) TFEU. Art 26(1) TFEU obliges the EU to implement and to maintain the Internal Market which is legally defined in Art 26(2) TFEU as an area with free movements of goods, persons, services and capital. The freedom of establishment extends the rights of workers regulated in Art 45 TFEU to self-employed and legal persons. It is one of the fundamental freedoms of the EU, protected by Art 49 TFEU. One highly discussed aspect of the freedom of establishment is the cross-border transfer of companies in the EU. There are many reasons for a company to transfer its seat to another state: an actual change of the economic activity, a choice of a less restrictive Company Law or sociopolitical aspects. Due to the lack of a harmonized Company Law in the EU, Member States often try to prohibit a transfer of a company with reference to their national law. It is then for the CJEU to define the scope of the freedom of establishment and to remove barriers. The last judgement by the CJEU regarding the cross-border movement of companies was *Polbud*<sup>1</sup>, where the Court adopted a broad reading of the freedom of establishment.

Brexit makes the discussion of a cross-border movement of companies even more relevant. Although it is not decided yet which consequences will follow Brexit, it becomes more and more likely that the UK will leave the Internal Market. Leaving the Internal Market has a lot of disadvantages e.g. taxation, custom duties and no mutual recognition. A big question for all UK companies should therefore be, after reviewing the consequences, whether an exit of the UK before Brexit is the better option. British companies have to assess whether the costs and efforts of a cross-border transfer of the company outweighs the disadvantages of not being a member of the Internal Market anymore. In order to be able to assess this question, companies have to know under which conditions they are allowed to transfer their company to a different Member State.

## 1.1 Research Questions

The Thesis will ask and answer two questions.

1. Is *Polbud* in line with the old Case Law on the cross-border transfer of companies by the CJEU or can the judgement be seen as a deviation from the old Case Law? What are the consequences of the judgement?
2. What is the scope for British companies after *Polbud* to exercise their freedom of establishment to move their company to another Member State before Brexit happens?

I will start with general explanations about the Internal Market project (Chapter 2) to clarify the foundation of the freedom of establishment. The freedom of establishment cannot be discussed without having a look at the disparities between the objectives of creating an Internal Market and the national interests of Member

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<sup>1</sup> C-106/16 *Polbud* — Wykonawstwo sp. z o.o., in liquidation [2017] ECLI:EU:C:2017:804.

States. Afterwards, the scope of the freedom of establishment will be ascertained (Chapter 3). The Thesis will concentrate on the freedom of establishment of companies, Art 49, 54 TFEU. The differences between the incorporation doctrine and the real seat doctrine will be explained and the Case Law on the cross-border movement of companies until 2012 will be examined. This will be accompanied by a description of the choice of law and a lack of harmonization regarding Company Law in the EU. The Thesis will then review the new Polbud judgement by the CJEU (Chapter 4). The differences between the old Case Law and Polbud will be pointed out as well as an evaluation of Polbud in light of the Internal Market will be made. Regarding consequences of Polbud, the question of a race to the bottom will be discussed. In the last Chapter, the Case Law will be analyzed in the practical context of Brexit (Chapter 5). The impact of the Polbud judgement for companies affected by Brexit will be examined. It will be argued that it is possible for companies to exit the UK under the new defined freedom of establishment.

## 1.2 Method and Materials

I will assess the legal development of the cross-border movement of companies in the light of the legal objectives of the freedom of establishment and the Internal Market. This will be done by applying the EU legal method. The law will be interpreted with a teleological approach, meaning the interpretation of the freedom of establishment in light of the purpose, values, legal, social and economic goals that the EU tries to achieve. The teleological interpretation of EU law does not focus on the specific regulation in question, but on a systemic understanding of the EU legal order.<sup>2</sup> The general aim of the EU will be taken into consideration.

I will use mainly the Case Law of the CJEU and primary legislation of the EU. Due to the lack of secondary legislation in this area of law, it will only be mentioned where such legislation was proposed. Partially, usage will also be given to the Opinions of the Advocate Generals. Moreover, legal writing as well as preparatory legal writing and official documents of the EU will be taken into consideration to substantiate my interpretation of the law.

## 1.3 Definitions

For a better understanding, the words statutory seat, registered seat and registered office are used interchangeably to explain where the company is registered. The same applies for the definitions of real seat, central administration and main place of business which all describe the location where the management is located and often where the business activity takes place.

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<sup>2</sup> Miguel Poiars Maduro, 'Interpreting European Law: Judicial Adjudication in a Context of Constitutional Pluralism' (2007) 1 Eur. J. Legal Stud. 137, 140.

## 2. The Internal Market Project

The creation of the Internal Market is one of the biggest achievements of the EU. The Internal Market is defined in Art 26(2) TFEU as “an area without internal frontiers, in which the free movement of goods, persons, services and capital is ensured”. Its creation is one of the fundamental responsibilities of the EU, Art 3(3) TEU, to ensure a sustainable development of Europe, a highly competitive social market economy and a protection and improvement of the quality of the environment. An understanding of the Internal Market is indispensable when talking about a free movement provision.

This Chapter will therefore deal with the objectives of the Internal Market and the role of the Member States as sovereign states. Merging both perspectives can cause conflicts, which result in attempts of the Member States to restrict the free movements with an abuse of rights claim. Additionally, difficulties and opportunities of regulatory competition in the EU, arising from the lack of harmonization, will be shortly examined.

### 2.1 Objectives of the Internal Market

The Internal Market idea obliges the Union to create an area without frontiers in which free movements are ensured in all Member States. The four freedoms have to be seen as a broad concept and not as separate principles; all together they form a general applicable principle of the Internal Market.<sup>3</sup> The Internal Market serves economic as well as social objectives.<sup>4</sup> In economic terms, open markets for nationals and effective and efficient competition shall be achieved whereas in social terms the Internal Market shall bring consumer safety, social rights, labor policy and a good environment<sup>5</sup>. A functioning Internal Market “stimulates competition and trade, improves efficiency, raises quality, and helps cut prices”.<sup>6</sup> The general welfare for EU citizens shall be increased, while contributing to a “closer union among the peoples of Europe”<sup>7</sup>. The establishment of the Internal Market is an ongoing process which will never come to an end.

All national markets shall be merged to an EU market to ensure the free movements. Any barriers to trade between the Member States shall be eliminated.<sup>8</sup> There shall be no difference between the economic area in a single Member State and the EU as a whole. National regulations shall not be discriminatory on grounds of nationality. Domestic and imported products, foreign nationals and own nationals,

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<sup>3</sup> Armin von Bogdandy and Jürgen Bast, *Europäisches Verfassungsrecht, Theoretische und dogmatische Grundzüge* (2nd edn, Springer-Verlag Berlin Heidelberg 2009) 706.

<sup>4</sup> Paul Craig and Gráinne deBúrca, *EU Law: Text, Cases and Materials* (6th edn, Oxford University Press 2015) 608.

<sup>5</sup> *Ibid.*, 632.

<sup>6</sup> <[https://ec.europa.eu/growth/single-market\\_en](https://ec.europa.eu/growth/single-market_en)> (accessed 2018-05-23).

<sup>7</sup> Fact Sheets on the European Union, The internal market: general principles <[http://www.europarl.europa.eu/atyourservice/en/displayFtu.html?ftuid=FTU\\_2.1.1.html](http://www.europarl.europa.eu/atyourservice/en/displayFtu.html?ftuid=FTU_2.1.1.html)> (accessed 2018-05-23).

<sup>8</sup> *Ibid.*



etc. shall be treated the same.<sup>9</sup> They shall be protected not only against direct discrimination, but also against indirect discrimination or any other restriction on trade<sup>10</sup> that hinders “directly or indirectly, actually or potentially, intra-[EU] trade”<sup>11</sup>. However, such measures are only prohibited if they cannot be justified. Member States are only prohibited from introducing unjustified barriers to free movements. Justifications are only applicable in a restrictive way because they are the exception to the general rule of free movements.<sup>12</sup> National restrictions can for example be justified on grounds of treaty derogations (e.g. Art 36 TFEU regarding the free movement of goods) or mandatory requirements. Every justification has to meet the proportionality test developed in the Gebhard Case<sup>13</sup>: a justification has to be non-discriminatory, justified by overriding public interests, suitable and necessary.<sup>14</sup>

## 2.1.1 Achievement

The implementation of the Internal Market requires positive and negative harmonization. Negative harmonization means that national rules that hinder cross-border movements are prohibited whereas positive integration refers to overcoming barriers through harmonization of diverse national laws through secondary legislation.<sup>15</sup> Both serve different aims. Negative harmonization removes unjustified barriers to trade.<sup>16</sup> It can only be accessed case-by-case. Positive harmonization establishes homogeneous conditions in general terms. The classical way to implement the four freedoms is negative harmonization: national laws are prohibited because they discriminate foreign nationals or because they hinder the market access.<sup>17</sup> However again, both negative and positive integration are required to create the Internal Market.

The approach of negative harmonization is reinforced through the principle of mutual recognition.<sup>18</sup> The principle of mutual recognition was established by the CJEU in Cassis de Dijon.<sup>19</sup> It was a totally new approach meaning that a Member State has to accept foreign products if they are lawfully produced in another

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<sup>9</sup> Catherine Barnard, *The substantive Law of the EU: the four freedoms* (5th edn, Oxford University Press 2016) 18.

<sup>10</sup> Norbert Reich and others, *Understanding EU Internal Market Law* (Cambridge Intersentia 2015) para 7.2.

<sup>11</sup> C-8/74 Procureur du Roi v Benoît and Gustave Dassonville [1974] ECLI:EU:C:1974:82, para 5; C-110/05 Commission v Italy (*Trailers*) [2009] ECLI:EU:C:2009:66, para 33.

<sup>12</sup> Norbert Reich and others, *Understanding EU Internal Market Law* (Cambridge Intersentia 2015) para 7.3.

<sup>13</sup> C-55/94 Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano [1995] ECLI:EU:C:1995:411.

<sup>14</sup> *Ibid*, para 37.

<sup>15</sup> Paul Craig and Gráinne deBúrca, *EU Law: Text, Cases and Materials* (6th edn, Oxford University Press 2015) 608.

<sup>16</sup> Armin von Bogdandy and Jürgen Bast, *Europäisches Verfassungsrecht, Theoretische und dogmatische Grundzüge* (2nd edn, Springer-Verlag Berlin Heidelberg 2009) 721.

<sup>17</sup> Paul Craig and Gráinne deBúrca, *EU Law: Text, Cases and Materials* (6th edn, Oxford University Press 2015) 608.

<sup>18</sup> *Ibid*, 608.

<sup>19</sup> C-120/78 Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein (*Cassis de Dijon*) [1979] ECLI:EU:C:1979:42, para 14.

Member State.<sup>20</sup> The principle of mutual recognition should make it easier for producers to sell their products on foreign markets without the need to adapt other national standards.<sup>21</sup> The principle of mutual recognition was first established for the free movement of goods, but was quickly applied to all four freedoms and became a general principle of EU Law.

## 2.1.2 Consequences for Member States

The creation and maintenance of the Internal Market does not only require case-by-case prohibition of national regulations. It also requires efficient legislation to be able to exercise control over measures adopted at national level which undermine the Internal Market.<sup>22</sup> Thus, in the area of Internal Market Law, the principle of supremacy applies.<sup>23</sup> Member States do not only have to accept decisions by the EU, but they are even obliged to give effect to EU Law and they can be subject to penalties if they are unable to meet the requirements.<sup>24</sup> At the same time, Member States are afraid to lose their influence and autonomy. As a consequence of the process of harmonization and the implementation of the principle of mutual recognition, Member States are obliged to accept foreign regulations and standards although they are still considered to be sovereign states. The harsh duty of the Member States to cooperate with the EU conflicts with the wish of the Member States to set their own standards and regulations. The promotion of the Internal Market is accompanied by a fear of the Member States to obtain a lack of control. It triggers a conflict between the attempts of realizing the Internal Market and the autonomy and competences of the Member States. In this conflict, Member States more often try to restrict the objectives of the Internal Market.

## 2.2 Abuse of Rights

With the application of the principle of supremacy, Member States have limited possibilities to preserve their own standards.<sup>25</sup> They do not want the EU to overrule their own regulations, want to keep involved in the process and want to protect their own values. Therefore, Member States are eager to protect their own identity by creating barriers to the free movements<sup>26</sup> and to justify national regulations or a lack of mutual recognition. This is often done by a reference to an abuse of rights.

The situation of abuse regarding the four freedoms is always the same: a national (natural or legal person) wants to carry out a cross-border movement, which is prohibited by the national legislation of one of the Member States concerned and is therefore challenged by the national on the fact that the national legislation

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<sup>20</sup> Paul Craig and Gráinne deBúrca, *EU Law: Text, Cases and Materials* (6th edn, Oxford University Press 2015) 713.

<sup>21</sup> *Ibid.*, 622.

<sup>22</sup> Stephen Weatherill, *The Internal Market as a Legal Concept* (Oxford University Press 2017) 5.

<sup>23</sup> *Ibid.*, 8.

<sup>24</sup> Armin von Bogdandy and Jürgen Bast, *Europäisches Verfassungsrecht, Theoretische und dogmatische Grundzüge* (2nd edn, Springer-Verlag Berlin Heidelberg 2009) 38.

<sup>25</sup> Niamh Nic Shuibhne, *The Coherence of EU Free Movement Law: Constitutional Responsibility and the Court of Justice* (Oxford University Press 2013) 86.

<sup>26</sup> Elke Cloots, *National Identity in EU Law* (Oxford University Press 2015) 118.

contravenes the free movements.<sup>27</sup> The liberalism of the markets made it easy for nationals to create a cross-border dimension to be able to assess the matter under EU Law<sup>28</sup> and to avoid obligations that would have been imposed on them under national law. It is often enough to refer to the differences between the national regulations to find an infringement of the Internal Market regulations.<sup>29</sup> Member States argue that this deliberate creation of a cross-border dimension should be prohibited on grounds of an abuse of rights, but the EU focuses on a removal of barriers to free movements rather than on abuse of rights. The difference in the perspective expresses the tensions between the Internal Market idea and the sovereign responsibilities of the Member States.

The origins of the abuse of rights doctrine can be found in Van Binsbergen<sup>30</sup>. The Court ruled that a Member State is allowed to establish measures to prevent the use of the free movement if the national only makes use of the freedom to circumvent stricter national law.<sup>31</sup> The CJEU later applied the same doctrine to all four freedoms but did not specify the notion of abuse. It was not until Emsland-Stärke<sup>32</sup> that the concept of abuse of rights was defined. The CJEU established a two-condition test to determine an abuse of rights:

*“A finding of an abuse requires, first, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the Community rules, the purpose of those rules has not been achieved. It requires, second, a subjective element consisting in the intention to obtain an advantage from the Community rules by creating artificially the conditions laid down for obtaining it.”<sup>33</sup>*

The abuse of rights doctrine was further developed by the Case Law of the CJEU and was supported by the extensive citation by European authorities.<sup>34</sup> It could also be explained as an area where it was never intended that the free movements bring any advantages and basically reaffirms the general principle that a restriction of free movements has to be adequately justified.<sup>35</sup>

The CJEU generally recognizes the possibility of an abuse of rights justification for national regulations.<sup>36</sup> The objectives of the Internal Market do not protect abusive practices “that is to say transactions carried out not in the context of normal commercial operations, but solely for the purpose of wrong-fully obtaining

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<sup>27</sup> Vanessa Edwards and Paul Farmer, ‘The Concept of Abuse in the Freedom of Establishment of Companies: a Case of Double Standards?’ in Anthony Arnall and others (eds), *Continuity and Change in EU Law: Essays in Honour of Sir Francis Jacobs* (Oxford University Press 2008) 208.

<sup>28</sup> see for example: C-370/90 R v. IAT and Singh, ex parte Secretary of State [1992] ECLI:EU:C:1992:296; C-34/09 Ruiz Zambrano [2011] ECLI:EU:C:2011:124.

<sup>29</sup> Armin von Bogdandy and Jürgen Bast, *Europäisches Verfassungsrecht, Theoretische und dogmatische Grundzüge* (2nd edn, Springer-Verlag Berlin Heidelberg 2009) 716.

<sup>30</sup> C-33/74 Johannes Henricus Maria van Binsbergen v Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid [1974] ECLI:EU:C:1974:131.

<sup>31</sup> Ibid, paras 12, 13.

<sup>32</sup> C-110/99 Emsland-Stärke GmbH v Hauptzollamt Hamburg-Jonas [2000] ECLI:EU:C:2000:695.

<sup>33</sup> Ibid, paras 52, 53.

<sup>34</sup> Niamh Nic Shuibhne, *The Coherence of EU Free Movement Law: Constitutional Responsibility and the Court of Justice* (Oxford University Press 2013) 90, 91.

<sup>35</sup> Stephen Weatherill, *The Internal Market as a Legal Concept* (Oxford University Press 2017) 133.

<sup>36</sup> C-212/97 Centros Ltd v Erhvervs-og Selskabsstyrelsen [1999] ECLI:EU:C:1999:126, para 24 with further references to the Case Law of the CJEU.

advantages under EU law”.<sup>37</sup> The abuse has to be established on a case-by-case basis. In practice, the Court normally finds that an action by a national has not abused any rights.<sup>38</sup> A wide interpretation of the Treaty is applicable. It is a natural consequence of the principle of supremacy that EU Law overrules national legislation. The use of the free movement provisions does not amount to an abuse of rights even if it results in the use of the most favorable laws.<sup>39</sup> Only “wholly artificial arrangements” can be seen as an abuse of law<sup>40</sup>, but they are difficult to prove for Member States. The Emsland-Stärke test set high standards for an abuse. Both the objective side and the subjective side have to be fulfilled. Member States have the burden of proof to show that an abuse of rights rather than the use of the Treaty provision is given<sup>41</sup> even though the dividing line between abuse and use is difficult to define<sup>42</sup>. The Court is more eager to protect the idea of the Internal Market than to empower Member States to prevent an abuse of their laws.

## 2.3 Regulatory Competition

In the absence of positive harmonization, Member States are free to choose their applicable law. The principle of mutual recognition and the lack of an efficient abuse of rights doctrine raises the question of a regulatory competition between the Member States. Member States could compete against each other to offer the best laws in the EU. Regulatory competition could result in a “race to the bottom” where the standards of the law will be lowered by all Member States to offer the best laws and to achieve the most from the Internal Market. A race to the bottom is one of the biggest fears of the Internal Market although it can be seen either as a problem or an opportunity.<sup>43</sup>

Critics argue for a race to the bottom through regulatory competition. Member States are selfish and want to attract nationals that bring advantages for the Member State. Therefore, regulatory competition will lead to more lenient laws. The development would be a big problem for the EU, because the Internal Market does not promote gentle laws but economic and social welfare. On the other hand, regulatory competition is seen as an opportunity leading to a “race to the top”. It leads to more optimal laws and regulations. Nationals do not choose the least regulatory laws, but the laws that are most suitable. Both are not the same. Only unnecessary regulations will be eroded, making the laws more effective. However, in the end, it is for the EU legislator to fully rule out the possibility of a race to the bottom through positive harmonization.

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<sup>37</sup> C-155/13 *Società Italiana Commercio e Servizi srl (SICES) and Others v Agenzia Dogane Ufficio delle Dogane di Venezia* [2014] ECLI:EU:C:2014:145, para 30; C-255/02 *Halifax plc and Others v Commissioners of Customs & Excise* [2006] ECLI:EU:C:2006:121, para 69.

<sup>38</sup> Niamh Nic Shuibhne, *The Coherence of EU Free Movement Law: Constitutional Responsibility and the Court of Justice* (Oxford University Press 2013) 85, 86.

<sup>39</sup> C-212/97 *Centros Ltd v Erhvervs-og Selskabsstyrelsen* [1999] ECLI:EU:C:1999:126, para 27.

<sup>40</sup> C-196/04 *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECLI:EU:C:2006:544, para 55.

<sup>41</sup> Paul Craig and Gráinne deBúrca, *EU Law: Text, Cases and Materials* (6th edn, Oxford University Press 2015) 821.

<sup>42</sup> Opinion Advocate General Geelhoed of 27<sup>th</sup> February 2003 on Case C-109/01 *Secretary of State for the Home Department v Hacene Akrich* [2003] ECLI:EU:C:2003:112, para 173.

<sup>43</sup> Alexandre Saydé, *Abuse of EU Law and Regulation of the Internal Market* (Bloomsbury Publishing 2014) 245.

## 3. Freedom of Establishment

The freedom of establishment is an undeniable cornerstone of the Internal Market in the EU.<sup>44</sup> It is regulated in Art 49 TFEU and allows an economic operator to pursue an economic activity in a stable and continuous way in one or more Member States of the EU.<sup>45</sup> According to Art 49 TFEU, “restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited”. The provision secures the right to take up and pursue activities as self-employed persons and to set up and manage undertakings on the same condition applicable to nationals of the Member State of establishment. Because of the broad reading of the wording, Art 49 TFEU does not only prohibit unequal treatment, but also any other unjustified impediment.

### 3.1 Establishment of Companies

The freedom of establishment does not only apply to individuals, but is equally applicable to legal persons, Art 54 TFEU. Art 54(1) TFEU expresses that “companies or firms formed in accordance with the law of a Member State [...] shall [...] be treated in the same way as natural persons who are nationals of Member States”. However, an equal treatment between nationals and companies is not fully possible. While nationals of a state exist because of birth, companies can only exist if they are created by law. It is therefore necessary to have a closer look on the definition of the term “company”.

Art 54(2) TFEU contains a broad definition of a company or firm. Any company or firm constituted under civil or commercial law except for those which are non-profit making are covered by the Treaty. The Treaty focuses on a functional approach: what matters is the economic activity of the legal person, not its legal form. Regarding the form of establishment, the Treaty covers both the primary establishment and the secondary establishment of a company. While the primary establishment includes the right to set up and manage companies, the right to set up agencies, branches or subsidiaries is covered by the secondary establishment. The freedom of establishment involves the “actual pursuit of an economic activity through a fixed establishment in that state for an indefinite period”.<sup>46</sup>

Companies exist only by virtue of the varying national legislation which determines their incorporation and functioning.<sup>47</sup> They are creatures of national law. To be established in a Member State, it is sufficient that a company is formed in accordance with the law of one Member State and has its registered office, principal

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<sup>44</sup> Hana Horak and Kosjenka Dumancic, ‘Cross-border transfer of the Company seat: one step forward, few steps backward’ (2017) 14 US-China L. Rev. 711, 711.

<sup>45</sup> Nicola De Luca, *European Company Law: Text, Cases and Materials* (Cambridge University Press 2017) 9.; see also C-55/94 Reinhard *Gebhard* v Consiglio dell’Ordine degli Avvocati e Procuratori di Milano [1995] ECLI:EU:C:1995:411, para 25.

<sup>46</sup> C-196/04 *Cadbury Schweppes* plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue [2006] ECLI:EU:C:2006:544, para 53.

<sup>47</sup> C-81/87 R v HM Treasury and Commissioners of Inland Revenue, ex p *Daily Mail* and General Trust PLC [1988] ECLI:EU:C:1988:456, para 19.

place of business or central administration somewhere in the EU.<sup>48</sup> This idea applies even if the company solely conducts its business through a secondary establishment in a different Member State to its incorporation.<sup>49</sup> Any company that fulfills the national requirements is recognized as a company in the EU and can rely on the freedom of establishment.

Because the connecting factor for companies is the national law, the definition of a company differs between the Member States. There are not only different company forms with different requirements regarding e.g. liability, control or minimum capital, but Member States can also choose freely between two different connecting factors to decide when a company is considered to be a national company.

### 3.1.1 Two different Approaches

Member States are free to apply two different doctrines to determine the connecting factor of their companies. They can either refer to the registered seat (incorporation doctrine) or the real seat (real seat doctrine). According to the incorporation doctrine, a company is governed by the law of the country where it is incorporated (registered) while the real seat doctrine applies the law of the country to a company where its headquarters or main place of business is located.<sup>50</sup> In the absence of harmonization in the EU, both doctrines are acknowledged. The Treaty has no preference for one of the theories: Art 54 TFEU puts equal footing on the registered office, central administration and principal place of business.<sup>51</sup>

The incorporation doctrine does not connect the place of registration with the principle place of business. The company will be subject to the national law regardless of whether it has any business activity in the home Member State. This allows companies to transfer their central administration to another Member State without losing their legal personality. The applicable national law does not change as long as the company is incorporated in that Member State. Compared to this, the real seat doctrine does not differentiate between the registered office and the central administration. Both have to be placed in the same country. Due to a lack of the connecting factor, the company would lose its legal personality if it moved its central administration to another Member State.

The transfer of the company's seat is affected by the applicable doctrine in the involved Member States. The differences between the two doctrines have an effect on the rules and procedures governing cross-border transfers.<sup>52</sup> They can create barriers to the freedom of establishment in different ways. From an academic point of view, the simultaneous application of both doctrines makes it virtually impossible for companies to move around in the EU.

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<sup>48</sup> C-79/85 D. H. M. *Segers* v Bestuur van de Bedrijfsvereniging voor Bank- en Verzekeringwezen, Groothandel en Vrije Beroepen [1986] ECLI:EU:C:1986:308, para 16.

<sup>49</sup> *Ibid*, para 16.

<sup>50</sup> Commission Staff Working Document on the Impact assessment on the Directive on the cross-border transfer of registered office, Part I, 12<sup>th</sup> December 2007 (SEC(2007) 1707) 9.

<sup>51</sup> C-81/87 R v HM Treasury and Commissioners of Inland Revenue, ex p *Daily Mail* and General Trust PLC [1988] ECLI:EU:C:1988:456, para 21.

<sup>52</sup> Hana Horak and Kosjenka Dumancic, 'Cross-border transfer of the Company seat: one step forward, few steps backward' (2017) 14 *US-China L. Rev.* 711, 717.

### 3.1.2 Lack of Harmonization

As already explained above, no codified European Company Law is given in the EU. Attempts of positive harmonization were made through the enactment of different Directives covering specific areas of Company Law. Discussions about a 14<sup>th</sup> Company Law Directive on the Cross-Border Transfer of a Company's Registered Office (14<sup>th</sup> Company Law Directive) started already in 1993 when the Commission of the European Communities published a study on transfer of the head office of a company from one Member State to another.<sup>53</sup> The 14<sup>th</sup> Company Law Directive would have harmonized the connecting factor for companies, at least making the application of the different national Company Laws easier. However, no harmonization regarding the cross-border transfer of companies is yet achieved. The last time the 14<sup>th</sup> Company Law Directive failed, the European Commission decided that the Directive will add no further value to the current situation of the cross-border transfer of companies.<sup>54</sup> Nonetheless, in April 2018 another attempt was made to harmonize the cross-border movement of companies, but no valid Directive is yet adopted.<sup>55</sup> Up until now, the lack of harmonization between the different national Company Laws and their conflicting rules are a serious obstacle to the free movement of companies.<sup>56</sup> It results in a huge need for clarification in the Case Law. The CJEU has to take over the role as the "quasi-legislator"<sup>57</sup> although it can only rule on a specific case.

## 3.2 Case Law on the cross-border transfer of Companies

This chapter will analyze the Case Law of the CJEU on the cross-border transfer of companies and will identify the scope of the freedom of establishment. This is needed to be able to compare the scope of the freedom of establishment before and after *Polbud*. Over time, the CJEU was able to rule on different scenarios to describe the scope and possible limitations of the freedom of establishment regarding the cross-border transfer of companies. The Court thereby had to balance free movements of the Internal Market on the one hand and the Member States autonomy regarding Company Law on the other hand.<sup>58</sup> Two considerations have to be taken in mind while reviewing the Case Law. First of all, because of the absence of a harmonized European Company Law, national legislations are applicable. Member States prohibit the cross-border transfer of a company on

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<sup>53</sup> Commission of the European Communities: Study on transfer of the head office of a company from one member state to another, carried out by KPMG European Business Centre, published 1993-06-30, accessible via <https://publications.europa.eu/en/publication-detail/-/publication/d1dbac11-12ce-4b94-b28d-414c6da0edd7/language-en> (accessed 2015-05-23).

<sup>54</sup> Commission's reaction to the European Parliament Resolution on the European Private Company and the Fourteenth Company Law Directive on the transfer of the company seat, 14<sup>th</sup> June 2012 (2007/2643(RSP)).

<sup>55</sup> Section 5.3 of this Thesis further deals with the Proposed Directive on the cross-border transfer of the Registered Office by the European Commission.

<sup>56</sup> Norbert Reich and others, *Understanding EU Internal Market Law* (Cambridge Intersentia 2015) para 7.26.

<sup>57</sup> *Ibid*, para 2.27.

<sup>58</sup> Aaron Khan, 'Corporate mobility, market access and the internal market' (2015) 40 E.L.Rev. 371, 373.

grounds of their national regulations. Special characteristics of the national law can influence the outcome of the case, especially the application of the different doctrines. Secondly, it can be either the home Member State (emigration) or the host Member State (immigration) of a company which prohibits the transfer of the company. The differentiation between emigration cases and immigration cases by the CJEU also has an influence on the outcome of the case.

### 3.2.1 Daily Mail (C-81/87)

The first case in the series of judgements regarding the transfer of a company's seat is *Daily Mail*<sup>59</sup>. *Daily Mail*, a company incorporated under the law of the UK, wanted to transfer its central administration to the Netherlands. It requested the British tax authorities for approval of the transfer. The approval was only given under certain conditions and *Daily Mail* claimed that Art 49, 54 TFEU include the right to transfer the seat to the Netherlands without an approval by the competent authorities.

The Court started by ruling that under the present status of Community Law, it was for the home and the host Member State to regulate under which conditions a company is able to move its central administration from one Member State to another.<sup>60</sup> The UK was therefore validly able to restrict the transfer of the central administration.<sup>61</sup> The freedom of establishment did not confer “on companies incorporated under the law of a Member State a right to transfer their central management and control and their central administration to another Member State while retaining their status as companies incorporated under the legislation of the first Member State”.<sup>62</sup>

The judgement covered the situation of emigration. *Daily Mail* wanted to transfer some parts of its business to another Member State while remaining a company incorporated in the state of origin. Because the Treaty allowed Member States to restrict the freedom of establishment for emigrating companies<sup>63</sup>, it did not simultaneously contain a general right to transfer the central administration. Companies had to respect the laws of their home Member State. It was not the task of the CJEU to harmonize the different national laws, but only to prevent unjustified restrictions.

Taking into account the national characteristics of the UK law, the prohibition of the transfer of the central administration was no restriction on transactions that fall in the scope of the freedom of establishment.<sup>64</sup> The emphasis was on the characteristics of the national law and not on the freedom for the companies. Although companies were not prevented per se from moving their central administration to another Member State, it was allowed to impose restrictions on

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<sup>59</sup> C-81/87 R v HM Treasury and Commissioners of Inland Revenue, ex p *Daily Mail* and General Trust PLC [1988] ECLI:EU:C:1988:456.

<sup>60</sup> Ibid, para 14.

<sup>61</sup> Ibid, para 20.

<sup>62</sup> Ibid, para 24.

<sup>63</sup> Catherine Barnard, *The substantive Law of the EU: the four freedoms* (5th edn, Oxford University Press 2016) 384.

<sup>64</sup> C-81/87 R v HM Treasury and Commissioners of Inland Revenue, ex p *Daily Mail* and General Trust PLC [1988] ECLI:EU:C:1988:456, para 18.



emigrating companies.<sup>65</sup> The judgement promoted a narrow application of the freedom of establishment, making it impossible for Daily Mail to refer to the freedom of establishment. A possible explanation might be the difference between natural persons and companies or firms which the Court gave a lot of meaning. In comparison with natural persons, the existence of a company was hugely tight to the underlying legal orders.<sup>66</sup> It was the Member States that determined the incorporation and functioning of a company.<sup>67</sup> This definition autonomy could not be easily taken from the Member States.

Although the case dealt with two Member States that applied the incorporation doctrine, the Court appeared to favor the real seat doctrine. It confirmed those commentators who saw the real seat doctrine as a protective mechanism against a regulatory war between the company-friendliest laws.<sup>68</sup> In later years, the case was often used as a justification of the real seat doctrine in the EU.<sup>69</sup>

### 3.2.2 Centros (C-212/97)

The next important judgement by the CJEU was Centros<sup>70</sup>. The case concerned a secondary establishment. A Danish couple successfully registered a company in the UK, but never traded there. They then requested the *Erhvervs- og Selskabsstyrelsen* (the Trade and Companies Board) to register a branch in Denmark through which they wanted to pursue all their business activities. The Board refused the registration because Centros in fact wanted to establish a primary establishment in Denmark by circumventing stricter national requirements.

Before the judgement was given, it was a well-established principle that the four freedoms cannot be relied on in a case of abuse or fraud.<sup>71</sup> Nonetheless, the CJEU allowed the registration of the branch. It ruled that it is “immaterial that the company was formed in the first Member State only for the purpose of establishing itself in the second, where its main, or indeed entire, business is to be conducted”.<sup>72</sup> It was for the UK to establish the requirements applicable to a company. Companies formed in accordance with the law of a Member State are precluded from exercising their right of free establishment if prevented from registering a branch in another Member State.<sup>73</sup> It is no abuse of Art 49, 54 TFEU if a company wants to escape national rules on the provision for and the paying-up of a minimum capital, but

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<sup>65</sup> Catherine Barnard, *The substantive Law of the EU: the four freedoms* (5th edn, Oxford University Press 2016) 384.

<sup>66</sup> Norbert Reich and others, *Understanding EU Internal Market Law* (Cambridge Intersentia 2015) para 7.27.

<sup>67</sup> C-81/87 R v HM Treasury and Commissioners of Inland Revenue, ex p *Daily Mail* and General Trust PLC [1988] ECLI:EU:C:1988:456, para 19.

<sup>68</sup> Martin Gelter, ‘Centros, the Freedom of Establishment for Companies, and the Court’s Accidental Vision for Corporate Law’ (2015) ECGI Working Paper Series in Law, Working Paper N 287/2015 <<http://ssrn.com/abstract=2564765>> (accessed 2018-05-23) 15.

<sup>69</sup> *Ibid*, 15.

<sup>70</sup> C-212/97 *Centros Ldt v Erhvervs-og Selskabsstyrelsen* [1999] ECLI:EU:C:1999:126.

<sup>71</sup> Catherine Barnard, *The substantive Law of the EU: the four freedoms* (5th edn, Oxford University Press 2016) 393.

<sup>72</sup> C-212/97 *Centros Ldt v Erhvervs-og Selskabsstyrelsen* [1999] ECLI:EU:C:1999:126, para 17.

<sup>73</sup> *Ibid*, para 21.

rather the use of their freedom of establishment.<sup>74</sup> The Board was not allowed to refuse the registration of the branch.

Centros can be differentiated to Daily Mail because of two reasons. It dealt with an immigration case where the host Member State restricted the establishment of a branch. Secondly, Centros wanted to establish itself in Denmark while Daily Mail only moved its central administration to the Netherlands to fall under different tax obligations. Because of the different facts of the case, both cases cannot be fully compared.

Although Centros would not have been a valid company under Danish Law, the Danish authorities had to accept its legal status. The freedom of establishment included the protection of the secondary establishment even if it was the only place of business. The use of more favorable laws was no abuse of rights. Furthermore, the transfer of the company's central administration was not only attainable if both states applied the incorporation doctrine, but it was enough that the state of origin applied the incorporation doctrine. Member States were not able to question the valid incorporation in another Member State any more.<sup>75</sup>

Centros could therefore be seen as the end of the real seat doctrine.<sup>76</sup> However, Centros did not expressly prohibit the use of the real seat doctrine. Both the UK and Denmark applied the incorporation doctrine so that the Court did not have to comment on the situation where one or both of the States apply the real seat doctrine.

Therefore, some commentators suggested that the scope of Centros should be narrowed to Member States that apply the incorporation doctrine or only to secondary establishments.<sup>77</sup> The judgement should not take effect in countries applying the real seat theory. It did not take too long until the Court was able to clarify its Centros judgement.

### 3.2.3 Überseering (C-208/00)

In *Überseering*<sup>78</sup>, the CJEU was again confronted with the question whether and under which conditions a Member State had to acknowledge foreign companies. *Überseering* was a company incorporated under Dutch Law and had its central administration in Germany. When the company wanted to sue a contracting partner, the German court ruled that *Überseering* had no legal standing in Germany. *Überseering* did not fulfill the German legislation that the place of incorporation and the central administration had to be in the same Member State.

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<sup>74</sup> Ibid, paras 27, 30.

<sup>75</sup> Catherine Barnard, *The substantive Law of the EU: the four freedoms* (5th edn, Oxford University Press 2016) 395.

<sup>76</sup> Martin Gelter, 'Centros, the Freedom of Establishment for Companies, and the Court's Accidental Vision for Corporate Law' (2015) ECGI Working Paper Series in Law, Working Paper N 287/2015 <<http://ssrn.com/abstract=2564765>> (accessed 2018-05-23) 17 with further references.

<sup>77</sup> Ibid, 17 - 19.

<sup>78</sup> C-208/00 *Überseering* BV v Nordic Construczion Company Baumanagement GmbH [2002] ECLI:EU:C:2002:632.

The Court considered Daily Mail as inapplicable and referred to Centros.<sup>79</sup> Because Überseering was validly incorporated under Dutch Law, the company was entitled to exercise its freedom of establishment in Germany without the need to reincorporate as the same company in Germany.<sup>80</sup> “A necessary precondition for the exercise of the freedom of establishment is the recognition of those companies by any Member State in which they wish to establish themselves”.<sup>81</sup> Germany had to accept the legal personality of Überseering. The refusal constituted a restriction of the freedom of establishment.<sup>82</sup>

While in Centros both Member States involved applied the incorporation doctrine, Germany applied the real seat doctrine. Nonetheless, the CJEU confirmed and extended its judgement in Centros. Even though Germany applied the real seat doctrine, the Member State was not able to refuse the recognition of Überseering as a legal entity. The Court again emphasized the incorporation theory. After Überseering, it was impossible to restrict the application of the freedom of establishment only to Member States applying the incorporation doctrine which was claimed after Centros.<sup>83</sup> Yet, the Court did not claim the real seat doctrine inapplicable. The case would have been a good opportunity to finally solve the dispute between the two doctrines to achieve legal certainty in the EU which the Court let pass by.

Additionally, Überseering gave rise to another problem. Although Überseering dealt with an immigration scenario and cannot directly be compared with Daily Mail, it is alarming that the Court put more restrictions on an emigration case than on an immigration one.<sup>84</sup> In the light of the principle of equal treatment, both situations should have been dealt the same.

### 3.2.4 Inspire Art (C-167/01)

Inspire Art<sup>85</sup> was a company formed in accordance with the law of the UK and had a registered branch in Amsterdam where it also had its sole place of business. Under Dutch Law, the company was a “formally foreign company” and had to fulfill specific obligations. Inspire Art claimed that the obligations contravened the freedom of establishment.

In Inspire Art, the host Member State did not deny the secondary establishment (which it did in Centros) but imposed further obligations on the company. The secondary establishment could not be refused because the company itself did not fulfill the requirements of the host Member State’s national law. The Court ruled

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<sup>79</sup> Ibid, paras 41, 66.

<sup>80</sup> Ibid, paras 80, 81.

<sup>81</sup> Ibid, para 59.

<sup>82</sup> Ibid, para 93.

<sup>83</sup> Martin Gelter, ‘Centros, the Freedom of Establishment for Companies, and the Court’s Accidental Vision for Corporate Law’ (2015) ECGI Working Paper Series in Law, Working Paper N 287/2015 <<http://ssrn.com/abstract=2564765>> (accessed 2018-05-23) 20; Werner F. Ebke, ‘The European Conflict-of-Corporate-Laws Revolution: Überseering, Inspire Art and Beyond’ (2005) 16 Eur. Bus. L. Rev. 9, 26.

<sup>84</sup> Werner F. Ebke, ‘The European Conflict-of-Corporate-Laws Revolution: Überseering, Inspire Art and Beyond’ (2005) 16 Eur. Bus. L. Rev. 9, 23.

<sup>85</sup> C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd* [2003] ECLI:EU:C:2003:512.

that “the fact that the company was formed in a particular Member State for the sole purpose of enjoying the benefit of more favorable legislation does not constitute abuse even if that company conducts its activities entirely or mainly in that second State”.<sup>86</sup> The Dutch legislation had “the effect of impeding the exercise [...] of the freedom of establishment”.<sup>87</sup> However, the Court emphasized that Member States were generally allowed to put up certain restriction on companies in order to protect shareholders and creditors. It referred to the Gebhard formula that a justification has to be non-discriminatory, justified by overriding public interests, suitable and necessary.<sup>88</sup> The Dutch legislation did not fulfill these requirements and was therefore unjustified.

The judgement is in line with Centros and Überseering and was no surprise. It reaffirmed that the use of the most favorable law in the EU is no abuse of the right of establishment. It again limited the scope and the impact of Daily Mail, being the third judgment in a row favoring the incorporation doctrine although the judgements did not explicitly overturn Daily Mail.<sup>89</sup>

After the three judgements Centros – Überseering – Inspire Art, it was generally accepted that companies can freely choose their applicable law when they first incorporate under the law of a certain Member State. It was allowed to “pick and choose” the best legal form for their incorporation.<sup>90</sup> The scope of the freedom of establishment was broadened. Furthermore, they introduced the principle of mutual corporation for companies in the EU.<sup>91</sup> Although the judgements seemed to favor the incorporation doctrine, the Court again did not claim the real seat theory inapplicable. The CJEU left it to the Member States to decide which doctrine they want to use, but at the same time obliged them to respect the choice of another Member State.

### 3.2.5 SEVIC (C-411/03)

SEVIC<sup>92</sup> did not directly deal with the cross-border transfer of a company in the EU but concerned an inbound merger. SEVIC, a company incorporated in Germany, wanted to merge with a Luxembourg company. The relevant authority in Germany rejected the application for registration of the merger on the ground that the German law only allowed transformations for mergers between companies established in Germany.

The Court ruled that the freedom of establishment was also applicable to cross-border mergers. The “right of establishment covers all measures which permit or even merely facilitate access to another Member State and the pursuit of an economic activity in that State by allowing the persons concerned to participate in

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<sup>86</sup> Ibid, para 96.

<sup>87</sup> Ibid, para 101.

<sup>88</sup> Ibid, paras 132, 133.

<sup>89</sup> Paul Craig and Gráinne deBúrca, *EU Law: Text, Cases and Materials* (6th edn, Oxford University Press 2015) 814.

<sup>90</sup> Tim Drygala, ‘Europäische Niederlassungsfreiheit vor der Rolle rückwärts?’ [2013] *EuZW* 569, 569.

<sup>91</sup> Paul Craig and Gráinne deBúrca, *EU Law: Text, Cases and Materials* (6th edn, Oxford University Press 2015) 814.

<sup>92</sup> C-411/03 *SEVIC Systems AG* [2005] ECLI:EU:C:2005:762.

the economic life of the country effectively and under the same conditions as national operators”.<sup>93</sup> The discrimination of a merger between companies from different Member States was a restriction of the freedom of establishment and was not justified.

The judgment clarified that the freedom of establishment did not only protect the primary and secondary establishment, but also all other structural changes. National rules should not interfere with corporate decision of restructuring.<sup>94</sup> Even though the case did not deal with a primary or secondary establishment, it was a good example on how the Court strengthened the freedom of establishment in practice. Firstly, it reflected the objective of eliminating restrictions on market access.<sup>95</sup> Secondly, even any indirect discrimination was prohibited. Thirdly, the judgment gave a practical solution of the transfer of a company’s registered seat or central administration to another Member State: to merge with a foreign company as long as the new Member State allows the change of the legal status for national companies.

### 3.2.6 Cartesio (C-210/06)

With *Cartesio*<sup>96</sup>, the CJEU had an opportunity to reconsider its position established in *Daily Mail* on emigration cases. *Cartesio* was a Hungarian company which wanted to transfer its headquarters to Italy without changing its legal form. The authorities refused to register the transfer of the headquarters with the argument that it was not possible under Hungarian Law to transfer its headquarters to another Member State while maintaining the Hungarian legal personality.

The Court distinguished two different situations in its ruling. The situation where the seat of a company incorporated under the law of one Member State was transferred to another Member State with no change as regards the law which governs that company had to be differentiated to the situation where a company governed by the law of one Member State moved to another Member State with an attendant change as regards the national law applicable.<sup>97</sup> In the first situation and in the absence of harmonized EU Law, the cross-border movement of a company’s seat could only be dealt with by national law.<sup>98</sup> Hungary was able to apply the real seat doctrine and prohibit the transfer of *Cartesio*’s headquarters. The freedom of establishment was not applicable. Only in the other situation, a Member State would not be allowed to restrict the company from converting itself into a company governed by the law of the other Member State.<sup>99</sup> The latter situation would have been covered by the freedom of establishment.

The judgement raised in an obiter dictum a new point of law when the Court stated that companies have a general right to convert themselves into a company governed

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<sup>93</sup> Ibid, para 18.

<sup>94</sup> Catherine Barnard, *The substantive Law of the EU: the four freedoms* (5th edn, Oxford University Press 2016) 388.

<sup>95</sup> Aaron Khan, ‘Corporate mobility, market access and the internal market’ (2015) 40 E.L.Rev. 371, 372.

<sup>96</sup> C-210/06 *Cartesio* Oktató és Szolgáltató bt [2008] ECLI:EU:C:2008:723.

<sup>97</sup> Ibid, para 111.

<sup>98</sup> Ibid, para 109.

<sup>99</sup> Ibid, para 113.

by the law of another Member State.<sup>100</sup> The autonomy of the Member State to define the connecting factor for a company to be incorporated under its law did not entitle the Member State to prevent the conversion of a company into a company governed by the law of another Member State unless the restriction of the relocation of the company was justified because of overriding requirements in the public interest.<sup>101</sup> A transfer which involved a change of the applicable law was covered by the freedom of establishment. The Court for the first time made a comment on the transfer of the registered seat to another Member State. This statement on the mobility of companies in the EU was gladly accepted by scholars.

The outcome of the judgement was different to the Opinion of the Advocate General. Advocate General Maduro stated in his opinion that Art 49, 54 TFEU “preclude national rules which make it impossible for a company constituted under national law to transfer its operational headquarters to another Member State”.<sup>102</sup> The Opinion of the Advocate General indicated that the situation in *Cartesio* should have been protected by the freedom of establishment. The freedom of establishment was greatly evolved after *Daily Mail*<sup>103</sup> and the former Case Law indicated a movement in the opposite direction of *Daily Mail*<sup>104</sup>. However, the CJEU decided differently and confirmed its judgement in *Daily Mail*. The refusal of exit was not contradictory to the freedom of establishment. Some commentators welcomed the decision of the CJEU because both *Cartesio* and *Daily Mail* dealt with an emigration case and thus the outcome of both cases should not have been different.<sup>105</sup> After the Court made it difficult for Member States to protect their national standards in *Centros* and *Inspire Art*<sup>106</sup>, *Cartesio* strengthened the rights of Member States. Others saw the judgement as putting an end to the debate of cross-border movements in the EU<sup>107</sup> and as a failure to bring a much-needed advancement of corporate mobility<sup>108</sup>. In *Centros – Überseering – Inspire Art*, the Court started a process to a more liberalized approach of the freedom of establishment, which it did not continue in *Cartesio*.

In light of the ongoing liberal interpretation of the freedom of establishment, *Cartesio* would have been a good opportunity to put equal footage on emigration

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<sup>100</sup> *Ibid*, paras 111, 112.

<sup>101</sup> *Ibid*, para 113.

<sup>102</sup> Opinion Advocate General Maduro of 22<sup>th</sup> May 2008 on Case C-210/06 *Cartesio Oktató és Szolgáltató* bt [2008] ECLI:EU:C:2008:294, para 35.

<sup>103</sup> Sinisa Petrovic and Tomislav Jaksic, ‘The ECJ Ruling in *Cartesio* and Its Consequences on the Right of Establishment and Corporate Mobility in the European Union’ (2010) 12 Eur. J.L. Reform 230, 281.

<sup>104</sup> Opinion Advocate General Maduro of 22<sup>th</sup> May 2008 on Case C-210/06 *Cartesio Oktató és Szolgáltató* bt [2008] ECLI:EU:C:2008:294, para 27.

<sup>105</sup> ‘EuGH zur grenzüberschreitenden Sitzverlegung – *Cartesio*’ [2009] NJW-Spezial 48, 49; see also C-210/06 *Cartesio Oktató és Szolgáltató* bt [2008] ECLI:EU:C:2008:723, para 122 where the Court indicates that *Cartesio* has more in common with *Daily Mail* than with *Centros*, *Überseering* and *Inspire Art*.

<sup>106</sup> Stefan Leible and Jochen Hoffmann, ‘Wie inspiriert ist „Inspire Art“?’ [2003] EuZW 677, 683; Daniel Zimmer, ‘Nach „Inspire Art“: ‘Grenzenlose Gestaltungsfreiheit für deutsche Unternehmen?’ [2003] NJW 3583, 3592.

<sup>107</sup> Veronika Korom and Peter Metzinger, ‘Freedom of Establishment for Companies: The European Court of Justice Confirms and Refines its *Daily Mail* Decision in the *Cartesio* Case C-210/06’ (2009) 6 ECFLR 125, 154.

<sup>108</sup> Sinisa Petrovic and Tomislav Jaksic, ‘The ECJ Ruling in *Cartesio* and Its Consequences on the Right of Establishment and Corporate Mobility in the European Union’ (2010) 12 Eur. J.L. Reform 230, 275.

and immigration cases and to allow the transfer. As stated above, after *Überseering*, it was easier to refer to the freedom of establishment in immigration cases than in emigration cases. The Court did not use this opportunity. The judgment reinforced the different assessment of emigration and immigration cases on the one hand and primary and secondary establishment on the other hand.<sup>109</sup> Therefore, the case was even interpreted as a “return to square one” in emigration situations.<sup>110</sup> The liberalized approach of the freedom of establishment was only applicable to immigration cases.<sup>111</sup> The judgement can therefore be seen as a step backwards from the already achieved rights for companies. It is regrettable that the Court did not use its possibility to equalize the Case Law on immigration and emigration situations although even Advocate General Maduro favored an abandonment of *Daily Mail*<sup>112</sup>.

Despite the fact that a different outcome of the case would have been preferred, one cannot claim that the Court contradicted its judgements in *Centros – Überseering – Inspire Art*. In the three latter judgments, the CJEU ruled that the *host* Member State was not allowed to put restrictions on the company but did not state that the *home* Member State was not in a position to do so. *Cartesio* again underlined the power of definition for Member States. The problem of the different connecting factors for companies was a problem which was “not resolved by the rules concerning the right of establishment, but which must be dealt with by future legislation or conventions”.<sup>113</sup> The Treaty did not restrict the Member State’s right to determine the connecting factor.<sup>114</sup>

### 3.2.7 Vale (C-378/10)

In *Vale*<sup>115</sup>, the Court for the first time had to deal with the actual cross-border transfer of a registered office. *Vale*, an Italian company, asked to be removed from the commercial register in Italy, because the company intended to transfer its seat and its business to Hungary. The company was deleted in Italy, but the Hungarian authorities rejected the application for registration. *Vale* was not a company incorporated under Hungarian law and therefore was not able to be registered.

The Court started by pointing out that the cross-border transformation of a company falls within the scope of the freedom of establishment.<sup>116</sup> “[A]ny obligation, under Articles 49 TFEU and 54 TFEU, to permit a cross-border conversion neither

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<sup>109</sup> Veronika Korom and Peter Metzinger, ‘Freedom of Establishment for Companies: The European Court of Justice Confirms and Refines its *Daily Mail* Decision in the *Cartesio* Case C-210/06’ (2009) 6 ECFLR 125, 125 (Abstract).

<sup>110</sup> Sinisa Petrovic and Tomislav Jaksic, ‘The ECJ Ruling in *Cartesio* and Its Consequences on the Right of Establishment and Corporate Mobility in the European Union’ (2010) 12 Eur. J.L. Reform 230, 254, 255.

<sup>111</sup> Sebastian Herrler, ‘Gewährleistung des Wegzugs von Gesellschaften durch Art. 43, 48 EG nur in Form der Herausumwandlung – – Anmerkungen zum Urt. des EuGH v. 16. 12. 2008 - Rs. C-210/06 (*Cartesio*)’ [2009] DNotZ 484, 492.

<sup>112</sup> Opinion Advocate General Maduro of 22<sup>th</sup> May 2008 on Case C-210/06 *Cartesio* Oktató és Szolgáltató bt [2008] ECLI:EU:C:2008:294, para 27.

<sup>113</sup> C-210/06 *Cartesio* Oktató és Szolgáltató bt [2008] ECLI:EU:C:2008:723, para 108.

<sup>114</sup> Aaron Khan, ‘Corporate mobility, market access and the internal market’ (2015) 40 E.L.Rev. 371, 374.

<sup>115</sup> C-378/10 *Vale Építési kft* [2012] ECLI:EU:C:2012:440.

<sup>116</sup> *Ibid*, paras 24 – 26.

infringes the power, referred to in the preceding paragraph, of the host Member State nor that State's determination of the rules governing the incorporation and functioning of the company resulting from a cross-border conversion."<sup>117</sup> Member States cannot be forced under the freedom of establishment to accept cross-border conversions. However, the principle of equivalence and the principle of effectiveness precluded Hungary to prohibit a cross-border conversion where a domestic conversion was allowed.<sup>118</sup> Because Hungary allowed nationals to convert into other company forms, the State was not able to prohibit the cross-border conversion of Vale.

The case dealt with a direct discrimination. Because the internal re-establishment was possible in Hungary, the Member State was not allowed to prohibit the cross-border re-establishment of foreign companies. Where it was difficult in other cases to restrict the cross-border movement of companies on different reasons (e.g. protection of third parties and abuse of rights), it is even more difficult for Member States to justify a direct discrimination.

The judgement supplemented *Cartesio*. Where *Cartesio* stated, that the home Member State must allow the conversion of a company to another legal form, Vale made sure that the host Member State was not allowed to prohibit the conversion either. However, and this might be the most important point of the judgement, the Court established the requirement of an economic link to be able to move freely in the EU. The "concept of establishment within the meaning of the Treaty provisions on the freedom of establishment involves the actual pursuit of an economic activity through a fixed establishment in the host Member State for an indefinite period".<sup>119</sup> The freedom of establishment did not include a right to separate the registered office from the central administration.

In contrast to the triad in *Centros – Überseering – Inspire Art*, but in line with *Cartesio*, the Court in *Vale* again strengthened the real seat doctrine. Companies were only able to rely on the freedom of establishment if they had an economic link to the host Member State. The need of a genuine economic activity could prevent companies from incorporating in one Member State and having their central administration in a different Member State, making the three above mentioned judgements obsolete.<sup>120</sup> A company had to fulfill the Member State's national requirements for companies during the entire period of its incorporation in the home Member State. Where *Centros* and *Inspire Art* established that companies can exercise their freedom of establishment after they were validly established in one Member State in general, *Vale* required companies to fulfill the requirements of their state of incorporation even after they were validly incorporated.<sup>121</sup> Only then a company was able to enjoy the freedom of establishment.<sup>122</sup> This meant that a company was not able to move freely in the EU when the Member State of incorporation followed the real seat doctrine or had other general applicable restrictions on the movement or conversion. The judgment brought only uncertainty

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<sup>117</sup> *Ibid*, para 30.

<sup>118</sup> *Ibid*, para 62.

<sup>119</sup> *Ibid*, para 34.

<sup>120</sup> Peter Kindler, 'Der reale Niederlassungsbegriff nach dem VALE-Urteil des EuGH' [2012] *EuZW* 888, 892.

<sup>121</sup> *Ibid*, 892.

<sup>122</sup> *Ibid*, 892.



and did not help to lighten the jungle of cross-border movements of companies in the EU.

### 3.3 Summary of the Case Law

Although the Court generally favors a broad concept of the freedom of establishment, the scope of the freedom of establishment depends mainly on the classification of an emigration or immigration case. The appraisal of the Case Law depends much on the way one looks at the different judgements on the cross-border movement of companies.

The Case Law on the cross-border movement is coherent in its differentiation between immigration and emigration cases. While immigration cases are covered by the freedom of establishment (*Centros*, *Überseering*, *Inspire Art*), cases of emigration are governed by the national law of the home Member State (*Daily Mail*, *Cartesio*).<sup>123</sup> It is the Member State that has the definition autonomy for its companies and in emigration cases, the Member State shall be able to rely to this right. That the Member State fulfills its definition autonomy is a requirement for the application of the freedom of establishment. It is not the freedom of establishment that open the space for the definition autonomy of the Member States, but the fulfillment of the definition autonomy is the requirement for the application of the freedom of establishment.<sup>124</sup> In the Court's view the freedom of establishment should not be used to overcome problems which arise from the different national legislation.<sup>125</sup> The freedom of establishment recognizes a right to enter, but no right to leave a Member State if the exit is not accompanied by a change of the applicable law. Allowing companies to freely leave a Member State, the definition autonomy of the Member States would have been restricted, because they could not define their own connecting factor anymore. The Case Law is in so far coherent.

However, the Court can be criticized for this approach because the CJEU makes reference to its subsequent Case Law without reviewing its own position. The classification between emigration and immigration is often not convincing especially in regards to the general coherent understanding of the four freedoms.<sup>126</sup> The CJEU always managed to distinguish the facts of the cases or make them corresponding to not be in a position where the Court would have needed to admit that it overruled a judgement.<sup>127</sup> It seems that the Court eagerly tried to differentiate

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<sup>123</sup> Hana Horak and Kosjenka Dumancic, 'Cross-border transfer of the Company seat: one step forward, few steps backward' (2017) 14 US-China L. Rev. 711, 716; Oliver Mörsdorf, 'Nun also doch! – Die überraschende Umdeutung der Niederlassungsfreiheit zur Rechtswahlfreiheit durch den EuGH im Urteil Polbud' [2017] ZIP 2381, 2381.

<sup>124</sup> Casper Behme, 'Der grenzüberschreitende Formwechsel von Gesellschaften nach *Cartesio* und *Vale*' [2012] NZG 936, 937.

<sup>125</sup> C-81/87 R v HM Treasury and Commissioners of Inland Revenue, ex p *Daily Mail* and General Trust PLC [1988] ECLI:EU:C:1988:456, para 23; C-208/00 *Überseering* BV v Nordic Construczion Company Baumanagement GmbH [2002] ECLI:EU:C:2002:632, para 69; C-210/06 *Cartesio* Oktató és Szolgáltató bt [2008] ECLI:EU:C:2008:723, para 108.

<sup>126</sup> Tilmann Frobenius, '„*Cartesio*": Partielle Wegzugsfreiheit für Gesellschaften in Europa' [2009] DStR 487, 487.

<sup>127</sup> See for example *Daily Mail* and *Cartesio*: both cases were compared by the CJEU although *Daily Mail* dealt with a problem that arose from national tax law restriction rather than from national

between immigration and emigration cases without having a proper reasoning for the differentiation.

On the other hand, and looking at the Case Law from a different perspective, the Case Law is not coherent regarding the promotion of a uniform concept of the freedom of establishment. In so far, the Court made several U turns in its different rulings. The restrictive approach in *Daily Mail* was followed by a more liberalized approach of the triad *Centros – Überseering – Inspire Art* and a strengthening of the incorporation doctrine. The three judgements broadened the scope of the freedom of establishment.<sup>128</sup> With *Cartesio* and *Vale*, the Court went back to a more conservative approach and an emphasis on the real seat doctrine. The broad concept of the freedom of establishment is only applicable in immigration cases. It is not satisfying that the classification of a case as immigration or emigration has such a big influence on the interpretation of the freedom of establishment. In light of a convincing and fair application of the freedom of establishment, it would have been welcomed if the Court had ruled for a liberalized approach in all situations. A generally applicable freedom of establishment would have been preferred.

The Case Law gives no clarification whether and to what extent EU Law allows the cross-border transfer of companies. A differentiation has to be made between the transfer of the central administration, the transfer of the registered office and the simultaneous transfer of both.

The transfer of the central administration depends on the facts of the case. As stated above, immigration companies have a right to move under the freedom of establishment while emigration companies have to hope for the home Member State to allow the transfer. Furthermore, the transfer of the central administration depends on the applicable national law. The state of incorporation has to apply the incorporation theory for companies to be able to relocate their central administration. In Member States applying the real seat doctrine, the connecting factor would be missing after the transfer.<sup>129</sup> If the transfer is possible under the given facts of the case, the incorporation in a country with lenient Company Law and the transfer of the central administration to another country after the incorporation is no abuse of the freedom of establishment (*Centros*). No intention is needed to actually provide businesses in the state of incorporation.

The simultaneous transfer of both company seats is possible as long as an economic link is given (*Cartesio*, *Vale*). Practically speaking, a change in the economic activity or a binational company is needed. The simultaneous transfer of the registered office and central administration is connected to the change of the legal form of the company<sup>130</sup>, because Member States still determine the connecting factor individually.

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company law restriction as it was the case in *Cartesio* (see: Sinisa Petrovic and Tomislav Jaksic, 'The ECJ Ruling in *Cartesio* and Its Consequences on the Right of Establishment and Corporate Mobility in the European Union' (2010) 12 Eur. J.L. Reform 230, 276, 277).

<sup>128</sup> Werner F. Ebke, 'The European Conflict-of-Corporate-Laws Revolution: *Überseering*, *Inspire Art* and Beyond' (2005) 16 Eur. Bus. L. Rev. 9, 28.

<sup>129</sup> Tobias Franz, 'Grenzüberschreitende Sitzverlegung und Niederlassungsfreiheit – eine systematische Betrachtung offener und geklärter Fragen' [2016] EuZW 930, 935.

<sup>130</sup> *Ibid*, 935.

Whilst the simultaneous transfer of both company seats was not discussed very controversial, the sole transfer of the registered office is more problematic. Some commentators say that EU Law and the Case Law of the CJEU allow the cross-border transfer of the registered office. Although *Vale* established the requirement of an economic activity in the host Member State, it does not overrule *Centros*. It is rather assumed that the main place of business always coincides with the place of incorporation.<sup>131</sup> Moreover, *Centros – Überseering - Inspire Art* dealt with the transfer of the central administration and the competences of the host Member State while *Vale* dealt with the competences of the host Member State regarding the transfer of the registered office. The outcomes of the judgements cannot be compared.<sup>132</sup> Consequently, the relocation of the registered office is covered by the freedom of establishment. Other commentators argue that the cross-border transfer of the registered office is not possible without the simultaneous transfer of the central administration.<sup>133</sup> The transfer requires the liquidation of the company in the home Member State and the reincorporation in the host Member State.<sup>134</sup> Because companies are only creatures of national law, it is up to the Member States to decide how to handle their companies.<sup>135</sup> The freedom of establishment only covers the freedom to choose the applicable law before the company is for the first time incorporated in a Member State. It does not cover the possibility of a reincorporation after a company was validly registered in one Member State.<sup>136</sup>

The better arguments favor the impossibility of the transfer of the registered office. In *Centros* and *Inspire Art*, the CJEU established that no change of the economic activity is needed for the transfer of the company. *Vale* declined this opinion. The transfer of a company requires an economic link which is only given if there is a simultaneous transfer of the registered office and central administration. There is no right for companies to have a different incorporation seat and real seat. Insofar, *Vale* abandoned *Centros* and *Inspire Art*. The Court overruled its own judgements. All three cases dealt with an immigration situation. *Vale* even dealt with a primary establishment and not only a secondary establishment as *Centros* did. The creation of letterbox companies clearly brings up the wrongfulness of the concurrence of the registered seat and the main place of business. Companies are not allowed to solely transfer their registered seat under the freedom of establishment that derives from the Case Law.

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<sup>131</sup> *Ibid.*, 935.

<sup>132</sup> Tim Drygala, ‘Europäische Niederlassungsfreiheit vor der Rolle rückwärts?’ [2013] *EuZW* 569, 573.

<sup>133</sup> See in comparison: Walter Bayer and Jessica Schmidt, ‘Grenzüberschreitende Mobilität von Gesellschaften: Formwechsel durch isolierte Satzungssitzverlegung’ [2017] *ZIP* 2225, 2229.

<sup>134</sup> Johan Meusen, ‘Freedom of establishment, conflict of laws and the transfer of a company’s registered office: towards full cross-border corporate mobility in the internal market?’ (2017) 13 *J. Priv. Int’l L.* 294, 296; Werner F. Ebke, ‘The European Conflict-of-Corporate-Laws Revolution: Überseering, Inspire Art and Beyond’ (2005) 16 *Eur. Bus. L. Rev.* 9, 24.

<sup>135</sup> Eva-Maria Kieninger, ‘Niederlassungsfreiheit als Freiheit der nachträglichen Rechtswahl’ [2017] *NJW* 3624, 3626.

<sup>136</sup> Oliver Mörsdorf, ‘Nun also doch! – Die überraschende Umdeutung der Niederlassungsfreiheit zur Rechtswahlfreiheit durch den EuGH im Urteil *Polbud*’ [2017] *ZIP* 2381, 2383.

## 4. C-106/16 Polbud

Until Polbud, it was not finally resolved how broad the scope of the freedom of establishment is after the company was already founded under the law of a specific Member State. It was possible to either say that the transfer of the registered office was allowed or that the rulings of the CJEU did not influence the transfer of the statutory seat.<sup>137</sup> The judgement in Polbud was an opportunity for the CJEU to further illuminate the freedom of establishment after a long line of divergent judgements and was highly anticipated.

### 4.1 Dispute in the main Proceeding

Polbud was a company established in Poland when the shareholders' meeting decided to transfer its registered office to Luxembourg in 2011. The decision was silent on whether the actual place of business should also be transferred. In 2013, a second resolution by the shareholders' meeting implemented the first decision. The registered office was transferred to Luxembourg. Polbud applied to the Polish authorities to remove the company from the commercial register. The authority asked for documents proving the liquidation of the company, a requirement which was needed under Polish Law to be deleted from the commercial register. The documents were not provided and the authority refused the removal. Polbud challenged the decision by the authorities.

The referring Polish court asked the CJEU

- whether Art 49 TFEU and Art 54 TFEU protect a situation where the company only transfers its registered office to another Member State, but does not transfer its main place of business; and
- whether a general obligation of liquidation prior to the removal from the commercial register is a necessary and proportionate justification for the restriction of the freedom of establishment.

#### 4.1.1 Opinion of the Advocate General

The request for an Opinion of the Advocate General reflects that a new point of law was raised. Advocate General Kokott delivered her Opinion on 4<sup>th</sup> May 2017.<sup>138</sup> She started by reiterating the definition of a cross-border transfer developed in Vale. A cross-border transfer is a “process whereby a company is converted into a company subject to the law of another Member State” and is depended on the legal system of both the home and the host Member State.<sup>139</sup> In Vale, the host Member State tried to restrict the cross-border conversion, whereas in Polbud it is the home

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<sup>137</sup> Tobias Franz, ‘Grenzüberschreitende Sitzverlegung und Niederlassungsfreiheit – eine systematische Betrachtung offener und geklärter Fragen’ [2016] EuZW 930, 935; Walter Bayer and Jessica Schmidt, ‘Grenzüberschreitende Mobilität von Gesellschaften: Formwechsel durch isolierte Satzungssitzverlegung’ [2017] ZIP 2225, 2229; Keve Kovács, ‘Der grenzüberschreitende (Herein-) Formwechsel in der Praxis nach dem Polbud-Urteil des EuGH’ [2018] ZIP 253, 254.

<sup>138</sup> Opinion Advocate General Kokott of 4<sup>th</sup> May 2017 on Case C-106/16 Polbud — Wykonawstwo sp. z o.o., in liquidation [2017] ECLI:EU:C:2017:351.

<sup>139</sup> Ibid, paras 22, 23.

Member State which concerns obstacles.<sup>140</sup> Although the Court examines a broad concept of establishment, Advocate General Kokott states that the more recent Case Law has shown that establishment “presupposes actual establishment in the host Member State and the pursuit of genuine economic activity there”.<sup>141</sup> Because Polbud only wanted to change the applicable Company Law, the process is not covered by the freedom of establishment.<sup>142</sup> The freedom of establishment does not allow economic operators to freely choose the law applicable.<sup>143</sup> A cross-border conversion is only caught where it is accompanied by actual establishment.<sup>144</sup>

The second part of the opinion deals with the general obligation to liquidate. The general obligation is a restriction of the freedom of establishment but could be justified by overriding reasons in the public interest.<sup>145</sup> However, “the general obligation to carry out a liquidation procedure goes beyond what is necessary” to either prevent abusive practices or to protect the creditors, minority shareholders and employees of a company.<sup>146</sup>

Advocate General Kokott concluded that Polbud cannot rely on the freedom of establishment because the company only wants to change its Company Law applicable. However, the general duty of liquidation is an unnecessary and disproportionate restriction of the freedom of establishment.

#### 4.1.2 Ruling of the CJEU

After *Vale* and the Opinion of the Advocate General Kokott, nearly everyone expected the Court to prohibit the transfer on the grounds that Polbud did not want to change its place of business.

The Court started by ruling that Polbud was a company formed in accordance with Polish law and able to rely on the freedom of establishment.<sup>147</sup> The Court then recalled its judgment in *Daily Mail*. The freedom of establishment includes the right to convert itself into a company governed by the law of another Member State as long as the legal requirements of that other Member State are met.<sup>148</sup> The power to define the connecting factor of a company or firm falls to each Member State.<sup>149</sup> The judgment then refers to *Centros* and *Inspire Art*. The freedom of establishment is even applicable where the main or sole part of the business is conducted through a secondary establishment.<sup>150</sup> Moreover, it is not an abuse, if a company wants to benefit from more favorable legislation.<sup>151</sup> It is not crucial that the transfer of the registered seat is accompanied by the transfer of the place of business to be

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<sup>140</sup> Ibid, para 23.

<sup>141</sup> Ibid, paras 34, 36.

<sup>142</sup> Ibid, para 38.

<sup>143</sup> Ibid, para 38.

<sup>144</sup> Ibid, para 38.

<sup>145</sup> Ibid, paras 48, 51.

<sup>146</sup> Ibid, paras 55, 66.

<sup>147</sup> C-106/16 *Polbud* — Wykonawstwo sp. z o.o., in liquidation [2017] ECLI:EU:C:2017:804, para 32.

<sup>148</sup> Ibid, para 33.

<sup>149</sup> Ibid, para 34.

<sup>150</sup> Ibid, para 38.

<sup>151</sup> Ibid, para 40.

protected by the freedom of establishment.<sup>152</sup> Art 49, 54 TFEU are even applicable to the transfer of the registered office of a company when there is no change in the location of the real head office of that company.<sup>153</sup>

On the second question, the CJEU ruled that the national legislation is able to impede or prevent the cross-border conversion of a company and is therefore a restriction of the freedom of establishment. Although overriding reasons in the public interest could justify a restriction<sup>154</sup>, the mandatory liquidation required by Polish Law went beyond what is necessary to achieve the objective of protecting the interests of creditors, minority shareholders and employees.<sup>155</sup> Moreover, the restriction cannot be justified on ground of preventing abusive practices. A regulation that refers to the general presumption of abuse will always be disproportionate.<sup>156</sup> Furthermore, the mere fact that “either the registered office or real head office of a company was established in accordance with the legislation of a Member State for the purpose of enjoying the benefit of more favorable legislation does not, in itself, constitute abuse”.<sup>157</sup>

## 4.2 Consequences for the Freedom of Establishment

Polbud was allowed to transfer its registered seat to another Member State without changing its place of economic activity. The company changed its legal form and nationality but never gave up its status as a company. Generally national safeguards might be accepted, but they were not proportionate in this case.

Polbud established that the freedom of establishment does not require a genuine link nor an identical registered seat and central administration. The judgement generally legitimated a transfer of the registered seat of a company in the EU. Companies are not only allowed to choose its state of incorporation freely in the EU, but they are also allowed to re-incorporate after they were established in a certain Member State without the change of their place of business.

The judgement confirmed *Centros* where the latter already allowed that companies do not need to have any economic activity in its state of incorporation. *Centros* already established that the pro-forma establishment of companies falls in the scope of the freedom of establishment. Even *Daily Mail* and *Cartesio* did not include a general requirement of an identical registered seat and central administration.<sup>158</sup> Polbud just reaffirmed the already established EU Law that a different registered seat and main place of business are allowed<sup>159</sup> and the differentiation cannot be seen as an abuse of rights even where the sole purpose for the separation is to enjoy the

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<sup>152</sup> Ibid, para 42.

<sup>153</sup> Ibid, para 44.

<sup>154</sup> Ibid, para 52.

<sup>155</sup> Ibid, para 59.

<sup>156</sup> Ibid, para 64.

<sup>157</sup> Ibid, para 62.

<sup>158</sup> Peter Kindler, ‘Unternehmensmobilität nach „Polbud“: Der grenzüberschreitende Formwechsel in Gestaltungspraxis und Rechtspolitik’ [2018] NZG 1, 3.

<sup>159</sup> Walter Bayer and Jessica Schmidt, ‘Grenzüberschreitende Mobilität von Gesellschaften: Formwechsel durch isolierte Satzungssitzverlegung’ [2017] ZIP 2225, 2230.

benefits of more favorable legislation<sup>160</sup>. It is the core idea of the incorporation doctrine that both do not have to be in the same Member State. Furthermore, a justification of a restriction rarely ever succeeds.

Although there are many similarities of the freedom of establishment before and after *Polbud*, there was a U turn between *Vale* and *Polbud*. Where *Vale* required an actual establishment in the Member State<sup>161</sup>, no genuine link for the transfer of the registered office is needed anymore. Which was controversy discussed before *Polbud* is now allowed under the Case Law of the CJEU. A company can solely transfer its registered office to another Member State. *Polbud* goes even further than *Centros* and *Inspire Art*. Where the latter judgements only allowed the free choice of law when the company incorporated for the first time<sup>162</sup>; *Polbud* even allows the re-incorporation which means the choice of the law after the company was validly incorporated in one Member State which results in a change of the nationality of the company.<sup>163</sup> The freedom of establishment includes the freedom of choice of the applicable law. The scope of the freedom of establishment was broadened.

The freedom of establishment has its limits where a company wants to transfer its registered office to a Member State that applies the real seat theory. *Polbud* did not overcome the different application of the incorporation doctrine and real seat doctrine. The company has to fulfill the national requirements for companies of the Member State of incorporation in order to be able to profit from the freedom of establishment. Unlike the transfer of the central administration, the emphasis is on the host Member State rather than on the home Member State. It is the host Member State that can decide under which conditions a company is allowed to change its legal form.<sup>164</sup> Moreover, the freedom of establishment does not apply if mandatory requirements allow Member States to prohibit the transfer of the company although it will be difficult for Member States to implement a restriction that fulfills the strict criteria of the Court.

## 4.3 Critique

The case can be judged in light of the objectives of the Internal Market and the fear of the Member States for an abuse of rights. In the best situation, the Court would have found a perfect balance between the effective functioning of the Internal Market and the avoidance of over-interference in the Member State's autonomy.<sup>165</sup>

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<sup>160</sup> C-106/16 *Polbud* — Wykonawstwo sp. z o.o., in liquidation [2017] ECLI:EU:C:2017:804, para 40 with reference to the CJEU's judgements in *Centros* and *Inspire Art*.

<sup>161</sup> C-378/10 *Vale Épitési kft* [2012] ECLI:EU:C:2012:440, para 34 with reference to C-196/04 *Cadbury Schweppes plc* and *Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECLI:EU:C:2006:544, para 54.

<sup>162</sup> The re-incorporation could not be based on the freedom of establishment, see Jens C. Dammann, 'Freedom of Choice in European Corporate Law' (2004) 29 *Yale J. Int'l L.* 477, 487, 488.

<sup>163</sup> Eva-Maria Kieninger, 'Niederlassungsfreiheit als Freiheit der nachträglichen Rechtswahl' [2017] 50 *NJW* 3624, 3627; Peter Kindler, 'Unternehmensmobilität nach „Polbud“: Der grenzüberschreitende Formwechsel in Gestaltungspraxis und Rechtspolitik' [2018] *NZG* 1, 3.

<sup>164</sup> Peter Stelmaszczyk, 'Grenzüberschreitender Formwechsel durch isolierte Verlegung des Satzungssitzes' [2017] *EuZW* 890, 891.

<sup>165</sup> Aaron Khan, 'Corporate mobility, market access and the internal market' (2015) 40 *E.L.Rev.* 371, 390.

### 4.3.1 In the light of the Internal Market Objectives

The broad concept of the freedom of establishment can be appreciated in the light of the objectives of the Internal Market which were discussed in Section 2.1 above. Polbud finally solves the controversial discussion whether the cross-border movement of the registered office is allowed under EU Law and brings legal certainty to companies which did not want to transfer its registered office due to the former judgements of the CJEU. While Vale put the emphasis on the economic reasons of a transfer, Polbud again strengthened the legal reasons.<sup>166</sup> It was a good reminder that the freedom of establishment is still the general rule and should not be restricted.<sup>167</sup> Any exception of the rule needs to be interpreted strictly. National safeguards may only be accepted if they serve overriding requirements in the public interest.<sup>168</sup> Polbud does not change but supports this generally accepted approach in EU Law. Furthermore, the requirement of an economic link in Vale was criticized on several grounds. It is not apparent which intensity of the economic activity is needed and at which time the economic link has to be given.<sup>169</sup> It discriminates foreign companies, can easily be evaded and is difficult to enforce in practice.<sup>170</sup>

The freedom to choose the applicable law is one of the core idea of the Internal Market. It allows companies to react to changes in the actualities of the situation. Even though the place of business might be important for the Member State, e.g. regarding taxation or consumer protection, the most suitable law for a company is not always connected to the state where the business activity of the company takes place. It is not the aim of the Internal Market to dictate companies their business strategy.

Besides, the equal treatment between newly incorporated and already existing companies prohibits a different outcome of the judgement. Centros already allowed companies to benefit from the best choice of Company Law. It is not understandable why the same right should not be granted to already existing companies.<sup>171</sup> It should not make any difference if a company chooses a certain Company Law before its first incorporation or afterwards.<sup>172</sup> Against that opinion one could say that in cases, where the company after its incorporation in one Member State transfers its central administration to another Member State, the transfer of the central administration indicates that the company actually wants to establish itself in the host Member State.<sup>173</sup> This is not the case where the company only wants to transfer its registered

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<sup>166</sup> Hana Horak and Kosjenka Dumancic, 'Cross-border transfer of the Company seat: one step forward, few steps backward' (2017) 14 US-China L. Rev. 711, 716.

<sup>167</sup> Gitte Soegaard, 'Cross-border Transfer and Change of Lex Societatis After Polbud, C-106/16: Old Companies Do Not Die ... They Simply Fade Away to Another Country' (2018) 15 E.C.L.J. 21, 23.

<sup>168</sup> Ibid, 24.

<sup>169</sup> Tim Drygala, 'Europäische Niederlassungsfreiheit vor der Rolle rückwärts?' [2013] EuZW 569, 570.

<sup>170</sup> Ibid, 570.

<sup>171</sup> Gitte Soegaard, 'Cross-border Transfer and Change of Lex Societatis After Polbud, C-106/16: Old Companies Do Not Die ... They Simply Fade Away to Another Country' (2018) 15 E.C.L.J. 21, 23.

<sup>172</sup> Walter Bayer and Jessica Schmidt, 'Grenzüberschreitende Mobilität von Gesellschaften: Formwechsel durch isolierte Satzungssitzverlegung' [2017] ZIP 2225, 2230.

<sup>173</sup> Peter Kindler, 'Unternehmensmobilität nach „Polbud“: Der grenzüberschreitende Formwechsel in Gestaltungspraxis und Rechtspolitik' [2018] NZG 1, 3.



seat. However, it is not understandable why the company is then still allowed to have its registered seat in a different Member State. The allowance of a different registered seat and central administration should not be a matter of time.

The fundamental principle of equal treatment in the EU also applies in comparison to other forms of cross-border mobilities in the EU. The cross-border merger for example has never required any genuine economic link. There should not be a difference between the change of the nationality through a transfer of the registered seat or through a cross-border merger. Both have the same effect.<sup>174</sup>

In the light of the objectives of the Internal Market, the judgment in Polbud should not have been different and brings a lot of advantages.

### 4.3.2 In the light of the Abuse of Rights

On the other hand, Polbud can be criticized on different grounds and especially in the light of the abuse of rights which was explained in Section 2.2. Generally speaking, one could say that the judgement in Polbud is too liberal and does not allow enough protection of companies by Member States.

Polbud contravenes the well-known definition of an establishment which was first created in Cadbury Schweppes<sup>175</sup> regarding tax law and then transferred to a situation regarding Company Law in Vale.<sup>176</sup> Polbud has no actual pursuit of an economic activity through a fixed establishment in the host Member State. The company does not fulfill the requirements of a stable and continuous basis in that Member State. Under the definition, the company has to be present in the state. Polbud does not fulfill these requirements. The incorporation somewhere in the EU does not include the requirement of an *actual* establishment.<sup>177</sup> The judgement can be seen as dogmatically incorrect.<sup>178</sup>

Applying the Emsland Stärke – test, one can see that Polbud should have been prohibited from transferring its registered office. In General, Polbud meets the formal requirements of the freedom of establishment; the company has a right to take up and pursue an economic activity under the same regulations than nationals. However, the purpose of the freedom of establishment is the establishment of a primary or a secondary establishment and not the creation of a letterbox company. On the subjective side, Polbud wanted to obtain advantages from the applicable Company Law although there was no economic reasoning for the change of the

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<sup>174</sup> Keve Kovács, ‘Der grenzüberschreitende (Herein-)Formwechsel in der Praxis nach dem Polbud-Urteil des EuGH’ [2018] ZIP 253, 256.

<sup>175</sup> C-196/04 *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECLI:EU:C:2006:544.

<sup>176</sup> Johannes Hushahn, ‘Der isolierte grenzüberschreitende Formwechsel – Zugleich Anmerkung zum Urteil des EuGH v. 25.10.2017 in der Rechtssache Polbud’ [2018] RNotZ 23, 25.

<sup>177</sup> Peter Kindler, ‘Unternehmensmobilität nach „Polbud“: Der grenzüberschreitende Formwechsel in Gestaltungspraxis und Rechtspolitik’ [2018] NZG 1, 3.

<sup>178</sup> Peter Stelmaszczyk, ‘Grenzüberschreitender Formwechsel durch isolierte Verlegung des Sitzungssitzes’ [2017] EuZW 890, 893; one could even say that the judgement in Polbud is incompatible with the applicable law in force, see for example Peter Kindler, ‘Unternehmensmobilität nach „Polbud“: Der grenzüberschreitende Formwechsel in Gestaltungspraxis und Rechtspolitik’ [2018] NZG 1, 3.

registered office.<sup>179</sup> Polbud meets the objective and subjective criteria of the abuse of rights test.

After Polbud, the creation of a letterbox company in the EU is unproblematic. Letterbox companies have no other effect than to artificially implement a company in a Member State where it has no other connecting factor than the registration. The protection of the establishment of letterbox companies contradicts the rationale of the freedom of establishment.<sup>180</sup> Even in the view of the European Parliament the “misuse of post-box offices and shell companies with a view to circumventing legal, social and fiscal conditions” is one of the major concerns of the freedom of establishment and “should be prevented”.<sup>181</sup> Nonetheless, the EU leaves it to the Member States to adequately deal with letterbox companies.<sup>182</sup> The EU should not avoid its responsibilities nor delegate it to the Member States.

Member States lack the possibility to protect their own national standards. Companies can now move around in the EU as much as they want to. Having an economic activity in one Member State does not automatically mean that this Member State has any influence on the company. Additionally, a company normally has no economic reasons for the transfer of the registered office to another Member State than where its central administration is located. It either wants to avoid certain features of its national Company Law or wants to avoid its tax obligations.<sup>183</sup> Member States should be able to restrict such reasons of the avoidance of the applicable law under the abuse of rights doctrine.

Lastly, the protection of minority shareholders, creditors and employees should have made the Court skeptical about its own judgement. Member States will have difficulties to protect third parties. If a company transfers its central administration to another Member State, people in the host Member State recognize the company as a foreign company and can adjust to that. This possibility is not given where the company transfers its registered office to another Member State.<sup>184</sup> If the company re-incorporates in another Member State, it already has relationships in its home Member State. Contracting parties have no possibilities to do anything against their loss of rights.

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<sup>179</sup> The resolutions of the shareholder’s meeting of Polbud made no reference to the transfer of the place of business. However, Polbud asked the Court to order the reopening of the oral part of the procedure to be able to claim that Polbud in fact, wanted to move not only its registered office, but also its main place of business. The request was rejected by the CJEU. The foundation for the judgement of the CJEU therefore was that Polbud did not plan to change its place of business (C-106/16 *Polbud* — Wykonawstwo sp. z o.o., in liquidation [2017] ECLI:EU:C:2017:804, paras 19 – 25).

<sup>180</sup> Peter Stelmaszczyk, ‘Grenzüberschreitender Formwechsel durch isolierte Verlegung des Sitzungssitzes’ [2017] EuZW 890, 894; Johannes Hushahn, ‘Der isolierte grenzüberschreitende Formwechsel – Zugleich Anmerkung zum Urteil des EuGH v. 25.10.2017 in der Rechtssache Polbud’ [2018] RNotZ 23, 25.

<sup>181</sup> European Parliament, Plenary sitting document A7-0008/2012, Report with recommendations to the Commission on a 14th company law directive on the cross-border transfer of company seats, 9<sup>th</sup> January 2012 (2011/2046(INI)) 5.

<sup>182</sup> Peter Stelmaszczyk, ‘Grenzüberschreitender Formwechsel durch isolierte Verlegung des Sitzungssitzes’ [2017] EuZW 890, 894.

<sup>183</sup> Vanessa Edwards and Paul Farmer, ‘The Concept of Abuse in the Freedom of Establishment of Companies: a Case of Double Standards?’ in Anthony Arnall and others (eds), *Continuity and Change in EU Law: Essays in Honour of Sir Francis Jacobs* (Oxford University Press 2008) 208.

<sup>184</sup> Peter Kindler, ‘Unternehmensmobilität nach „Polbud“: Der grenzüberschreitende Formwechsel in Gestaltungspraxis und Rechtspolitik’ [2018] NZG 1, 4.

In the light of the abuse of rights doctrine, the Court's judgement has to be criticized. Polbud makes it impossible for Member States to preserve their own standards.

### 4.3.3 Further Comments

Whether one sees Polbud as either “good” or “bad” depends mainly on the preferred focus. As explained above, the judgment is to be welcomed in the light of the objectives of the Internal Market but should be dismissed in the light of abusive practices. Strengthening the EU goes hand in hand with promoting the Internal Market and losing national influences. Under the freedom of establishment, companies should have the same rights in the EU than they have in their home Member State. The judgement unquestionably focusses on a practical application. From that point of view, it is rarely possible to negatively criticize the judgement. Eventually, everyone must make up their own mind on how to evaluate the judgement.

What is undoubted is that Polbud did not solve the problem of the simultaneous application of the real seat doctrine and the incorporation doctrine. Up until Vale, the Court never favored one of the theories and it neither did in Polbud. Each Member State has the regulatory autonomy to define the connecting factor for its companies.

The autonomy of the Member States to either apply the real seat doctrine or the incorporation doctrine establishes an inherent barrier to the freedom of establishment.<sup>185</sup> The Member State of incorporation can in fact restrict the transfer of the registered office of companies if it applies the real seat doctrine.<sup>186</sup> The same applies if the company transfers its registered seat to a real seat country, it lacks the connecting factor needed under national law. Full legal certainty and equal treatment cannot be achieved before the application of the real seat theory is prohibited in the EU either by stringent Case Law of the CJEU or through positive harmonization.<sup>187</sup> It should not be dependent on the national law of a Member State whether the company is allowed to transfer its registered office.

## 4.4 A race to the bottom?

In Polbud, the Court allowed companies to rely on a broad concept of the freedom of establishment while Member States were prevented from regulatory escape. The tension brings up the question of regulatory competition. Polbud approved that forum shopping is an activity that is protected by the freedom of establishment.<sup>188</sup> Forum shopping means that a company can freely choose the Member State with

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<sup>185</sup> Walter Bayer and Jessica Schmidt, ‘Grenzüberschreitende Mobilität von Gesellschaften: Formwechsel durch isolierte Satzungssitzverlegung’ [2017] ZIP 2225, 2231.

<sup>186</sup> Eva-Maria Kieninger, ‘Niederlassungsfreiheit als Freiheit der nachträglichen Rechtswahl’ [2017] NJW 3624, 3627.

<sup>187</sup> Walter Bayer and Jessica Schmidt, ‘Grenzüberschreitende Mobilität von Gesellschaften: Formwechsel durch isolierte Satzungssitzverlegung’ [2017] ZIP 2225, 2233.

<sup>188</sup> Gitte Soegaard, ‘Cross-border Transfer and Change of Lex Societatis After Polbud, C-106/16: Old Companies Do Not Die ... They Simply Fade Away to Another Country’ (2018) 15 E.C.L.J. 21, 24.

the most beneficial Company Law for the incorporation regardless of where the economic activity takes place.<sup>189</sup>

The regulatory competition could lead to a “race to the bottom”. The debate about a race to the bottom already started after the CJEU delivered its judgements in *Centros* and *Inspire Art*. Before the judgements were given, EU Law was not able to grant free choice to companies due to several legal and practical barriers.<sup>190</sup> Member States were not able to transfer their registered seat without transferring their real seat. After *Inspire Art*, the number of letterbox companies incorporated in the UK escalated<sup>191</sup>, arguably creating a regulatory competition between all Member States<sup>192</sup>.

Companies could have a keener interest to move to a Member State where the law puts the least burdens on companies. In the course of harmonization through regulatory competition, each national law could be reduced to the lowest common denominator to be in a competitive position in the EU. However, the free choice granted by the Court does not have to be generally bad. Only where Member States make their Company Law more management-friendly to attract more companies, a race to the bottom can be feared. On the other hand, the competition could also lead to more efficient Company Laws to benefit shareholders.<sup>193</sup> Regulatory competition will then lead to a race for quality. One should have in mind, that it is not the free choice itself that could harm the law, but the choice of a Company Law that suits the persons in control and not the company itself.<sup>194</sup> The problem of a possible race to the bottom increased after *Polbud*. Member States do not only compete against each other to attract companies to incorporate in their Member State, but every company becomes a potential customer of the best Company Law.

Nevertheless, the question of a race to the bottom in the EU is not as threatening as in the USA, where the “Delaware effect” led in 2016 to one single state having more than 1.2 million legal entities and 66.8% of all Fortune 500 company incorporated in that state.<sup>195</sup> The incentive for Member States and companies to start a race to the bottom are different in the EU compared to the USA.

In the USA, companies have to pay a franchise tax<sup>196</sup> in their state of incorporation which makes it more interesting for Member States to attract companies. Such direct taxation similar to the American one is not imposed by any European

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<sup>189</sup> Hanne Søndergaard Birkmose, ‘A ‘race to the bottom’ in the EU?’ (2006) 13 *Maastricht J. Eur. & Comp. L.* 35, 36.

<sup>190</sup> Jens C. Dammann, ‘Freedom of Choice in European Corporate Law’ (2004) 29 *Yale J. Int’l L.* 477, 506, 507.

<sup>191</sup> Michael Schillig, ‘Corporate Law after Brexit’ (2016) 27 *K.L.J.* 431, 437.

<sup>192</sup> Werner F. Ebke, ‘The European Conflict-of-Corporate-Laws Revolution: Überseering, *Inspire Art* and Beyond’ (2005) 16 *Eur. Bus. L. Rev.* 9, 52.

<sup>193</sup> For full discussion see Jens C. Dammann, ‘Freedom of Choice in European Corporate Law’ (2004) 29 *Yale J. Int’l L.* 477, 478, 479 and Hanne Søndergaard Birkmose, ‘A ‘race to the bottom’ in the EU?’ (2006) 13 *Maastricht J. Eur. & Comp. L.* 35, 39.

<sup>194</sup> Hanne Søndergaard Birkmose, ‘A ‘race to the bottom’ in the EU?’ (2006) 13 *Maastricht J. Eur. & Comp. L.* 35, 42.

<sup>195</sup> Delaware Division of Corporations 2016 Annual Report <<https://corp.delaware.gov/2016AnnualReport.pdf>> (accessed 2018-05-23).

<sup>196</sup> A franchise tax is a tax paid by the company to its state of incorporation which is based on the authorized shares of a company, see <<https://corp.delaware.gov/frtaxcalc.shtml>> (accessed 2018-05-23).

Member State and is unlikely to be imposed in the future.<sup>197</sup> Member States have lower motives to start a race to the bottom.<sup>198</sup>

Secondly, European companies have to consider social factors and a national connectedness to a greater extent than American companies. Although the number of companies being incorporated in the UK increased after *Inspire Art*, the impact of the judgement was not as big as feared.<sup>199</sup> An incorporation in a foreign legal form can have many disadvantages. Language barriers, cultural differences, lack of knowledge of the laws or the economic structure of the Member State can make it more difficult to do business for foreign incorporated companies. Another point to consider are the legal costs occurring in regard to the cross-border transfer of a company. The advantages of the host Member State must outweigh the costs of the transfer.<sup>200</sup>

Finally, regulatory competition in the EU can only occur where Member States apply the incorporation doctrine. No forum shopping is possible to Member States that apply the real seat doctrine.<sup>201</sup>

So far, no full regulatory competition has been achieved in the EU. Despite the fact that certain Member States may be more attractive for companies<sup>202</sup>, no Member State has yet developed a strong incentive to allocate a popular legal form for the entire EU. Not only the British Limited Liability Company is a profitable company, but also other Member States provide equally or even more accommodating laws.<sup>203</sup> The usefulness of Company Law depends much on the specific characteristics of the company itself. Furthermore, and even though many companies incorporated in the UK after *Inspire Art*, the UK was not willing to establish itself as a European Delaware and combated pseudo-English firms.<sup>204</sup> However, in the end, it is for the EU legislator to fully rule out the possibility of a race to the bottom. Full legal certainty and no negative effects of a race to the bottom can only be achieved through positive harmonization in the EU.

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<sup>197</sup> Hanne Søndergaard Birkmose, 'A 'race to the bottom' in the EU?' (2006) 13 *Maastricht J. Eur. & Comp. L.* 35, 60.

<sup>198</sup> See for comparison Jens C. Dammann, 'Freedom of Choice in European Corporate Law' (2004) 29 *Yale J. Int'l L.* 477, 521 where the author states that Member States always have a high incentive to compete for corporate charters.

<sup>199</sup> Tim Drygala, 'Europäische Niederlassungsfreiheit vor der Rolle rückwärts?' [2013] *EuZW* 569, 574.

<sup>200</sup> Hanne Søndergaard Birkmose, 'A 'race to the bottom' in the EU?' (2006) 13 *Maastricht J. Eur. & Comp. L.* 35, 55; Werner F. Ebke, 'The European Conflict-of-Corporate-Laws Revolution: Überseering, *Inspire Art* and Beyond' (2005) 16 *Eur. Bus. L. Rev.* 9, 53, 54.

<sup>201</sup> Gitte Soegaard, 'Cross-border Transfer and Change of *Lex Societatis* After *Polbud*, C-106/16: Old Companies Do Not Die ... They Simply Fade Away to Another Country' (2018) 15 *E.C.L.J.* 21, 24.

<sup>202</sup> E.g. the UK, see Werner F. Ebke, 'The European Conflict-of-Corporate-Laws Revolution: Überseering, *Inspire Art* and Beyond' (2005) 16 *Eur. Bus. L. Rev.* 9, 53.

<sup>203</sup> *Ibid.*, 54 with special reference to the Luxembourg law and the Dutch law.

<sup>204</sup> Martin Gelter, 'Centros, the Freedom of Establishment for Companies, and the Court's Accidental Vision for Corporate Law' (2015) ECGI Working Paper Series in Law, Working Paper N 287/2015 <<http://ssrn.com/abstract=2564765>> (accessed 2018-05-23) 26, 27.

## 5. Brexit

This chapter will deal with the practical application of the freedom of establishment after Polbud in the context of Brexit. If the UK leaves the Internal Market, many problems may arise for companies that are incorporated in the UK but have their main place of business somewhere else in the EU. Because of the freedom of establishment and because of the liberal approach by the CJEU, many companies incorporated in the UK to benefit from a lenient Company Law, especially without any minimum capital requirement. There are more than 330,000 of those companies which are registered in the UK but have their main place of business somewhere else in the EU.<sup>205</sup> These companies have to consider a transfer of the company from the UK to a different Member State.

The Chapter will start by outlining why the UK will most likely leave the Internal Market. Afterwards, the consequences for companies of leaving the Internal Market will be reviewed. Then, the scope for companies to exercise their freedom of establishment to move their company to another Member State will be examined. In this section, reference will be given to the above developed scope of the freedom of establishment. It is important to note that the subsequent considerations only apply to those companies that have no or only rare business activities in the UK. Companies that have their main or sole business activities in the UK have to consider other factors. In regards to any burden of trade between the EU and the UK after Brexit, it might even be favorable for those companies to stay in the UK.

### 5.1 Will Britain remain in the Internal Market?

After Britain voted in a referendum to leave the EU, the British prime minister started the process of leaving the EU on 29<sup>th</sup> March 2017 with a notice to the European Council. According to Art 50 TEU, the EU and the leaving Member State have two years to agree on the conditions of the country's withdrawal. During the two years period, the EU legislation is still applicable in the leaving Member State.

The future of the application of EU Law in the UK after the two years withdrawal period depends on the outcome of the negotiations between the EU and the UK. Theoretically, a “hard” or a “soft” Brexit and everything in between is possible. While a hard Brexit means that the UK will have no further agreement with the EU, a soft Brexit will lead to a situation where the UK stays in the Internal Market and rarely any changes will be made.<sup>206</sup> A soft Brexit would most likely refer to a “Norway – solution” where the UK stays in the European Economic Area (EEA) and which allows the application of the free movements even after the UK left the

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<sup>205</sup> John Armor and others, ‘Brexit and Corporate Citizenship’ (2017) ECGI Working Paper Series in Law, Working Paper N 340/2017 <[http://ssrn.com/abstract\\_id=2897419](http://ssrn.com/abstract_id=2897419)> (accessed 2018-05-23) 1, 9.

<sup>206</sup> Alex Hunt and Brian Wheeler, ‘Brexit: All you need to know out the UK leaving the EU’ of 10th May 2018 in BBC <<http://www.bbc.com/news/uk-politics-32810887>> (accessed 2018-05-23).

EU.<sup>207</sup> Another solution would be a trade agreement between the EU and the UK, governing specific areas of the Internal Market.<sup>208</sup>

The negotiations between the UK and the EU have not come to an end yet, but it becomes more and more clear, under which conditions the UK will leave the EU. Most likely, the UK will stay in the Customs Union, but will leave the Internal Market.<sup>209</sup> The Internal Market ensures the free movement of goods, persons, services and capital as if the EU was one country while the Customs Union only ensures a single trading area where all goods circulate freely without customs duties between EU countries and a universal system of customs duties for products from outside the EU<sup>210</sup>. The UK started the Brexit campaign because of two reasons: first, because of uncontrolled immigration and second, because of the lack of British influence on EU laws. Both fears contravene the idea of the Internal Market, making it unlikely that the UK will stay in the Internal Market after Brexit. Theresa May, the prime minister of the UK, even stated that the continuance in the Internal Market – in whatever way – would violate the people’s vote for a Brexit.<sup>211</sup>

## 5.2 Consequences of Brexit for Companies

The consequence of leaving the Internal Market is that free movements do not apply in the UK anymore. Furthermore, all general principles of the EU, including the principle of non-discrimination and the principle of mutual recognition will cease. Britain also refuses to be a part of the CJEU, which interprets and enforces rules of the Internal Market, meaning that the country will not be under the direct jurisdiction of the Court after the withdrawal.<sup>212</sup> Both situations mean that British companies can neither refer to the freedom of establishment nor to the Case Law of the CJEU that gave companies a great deal of freedoms.

### 5.2.1 Exit before Brexit

With the withdrawal of the UK from the EU, all advantages of the Internal Market lapse. British companies cannot refer to the freedom of establishment anymore. The UK will become a third country which can have severe consequences for

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<sup>207</sup> Marc-Philippe Weller and others, ‘Englische Gesellschaften und Unternehmensinsolvenzen in der Post-Brexit-EU’ [2016] NJW 2378, 2380; Marc Seeger, ‘Die Folgen des „Brexit“ für die britische Limited mit Verwaltungssitz in Deutschland’ [2016] DStR 1817, 1817.

<sup>208</sup> Eeckhout: Briefing, The Consequences of Brexit for the Customs Union and the Internal Market Acquis for Goods (PE 602.053) 1.

<sup>209</sup> See press releases, e.g. Bettina Schulz, ‘Einen harten Brexit wird es wohl nicht geben’ of 26th April 2018 in Die Zeit <<https://www.zeit.de/politik/ausland/2018-04/grossbritannien-brexit-theresa-may-eu-zollunion-parlament>> (accessed 2018-05-23); Thomas Colson and Adam Bienkov, ‘Theresa May suffers a major Brexit defeat on her plans to leave the customs union’ of 18th April 2018 in Business Insider <<http://www.businessinsider.com/brexit-theresa-may-defeated-by-lords-over-staying-in-the-customs-union-2018-4?r=US&IR=T&IR=T>> (accessed 2018-05-23).

<sup>210</sup> Catherine Barnard, *The substantive Law of the EU: the four freedoms* (5th edn, Oxford University Press 2016) 9.

<sup>211</sup> Theresa May, Lancaster house speech on 17<sup>th</sup> January 2017 <<https://www.gov.uk/government/speeches/the-governments-negotiating-objectives-for-exiting-the-eu-pm-speech>> (accessed 2018-05-23).

<sup>212</sup> Eeckhout: Briefing, The Consequences of Brexit for the Customs Union and the Internal Market Acquis for Goods (PE 602.053) 1.

companies. Third country companies are not per se accepted by the Member States, they cannot refer to the freedoms granted by the EU. It is not the principle of mutual recognition applicable, but the autonomous national Company Law of every Member State. Generally speaking, British companies can still exercise their business activities in the EU. However, Member States are allowed to refuse the access of the company to the Member State and British companies have no possibility to defend themselves against any potential unequal treatment.<sup>213</sup>

Whether British companies can continue their business activity in the EU after Brexit without greater consequences depends mainly on the application of the real seat doctrine or the incorporation doctrine in the Member State where the business activity takes place.<sup>214</sup> If the Member State applies the incorporation doctrine, the legal status of the company will not change. The Member State acknowledges the home state as the company's place of incorporation. The situation is different if the Member State applies the real seat doctrine. The company will become subject of the host Member State's law. The company is no valid company anymore and will be governed by the law of the host Member State instead of British Law. It is burdensome for UK companies as third country companies to establish themselves in this Member States. The involuntary change of the legal identity should not be underestimated. In the worst case, it can lead to the loss of the limited liability, being rather a partnership than a company.<sup>215</sup> Other consequences might not even be visible before Brexit happens. However, it is without doubt clear, that after Brexit, British companies will suffer from additional obligations and barriers.

It is therefore compelling for companies to think about their future in the UK. Especially those companies with a holding structure in the UK or companies with no or insignificant turnovers in the UK should think about an "exit". Until the end of the negotiation period, the UK remains a full member of the EU and has to comply with EU Law.<sup>216</sup> It is thus possible to still take the advantages of the freedom of establishment and other general principles in the EU to exit the UK before Brexit.

## 5.2.2 Cross-border transfer of the Registered Office

Companies have different possibilities to escape the burdens of Brexit. They can either establish a *Societas Europae*<sup>217</sup> and transfer their registered office to a different Member State, be part of a cross-border merger<sup>218</sup> or transfer their registered office to another Member State. All possibilities will end with the exit of the UK.

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<sup>213</sup> Peter Böckli and others, 'The Consequences of Brexit for Companies and Company Law' (2017) Legal Studies Research Paper Series University of Cambridge, Paper No 22/2017 <[https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2926489](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2926489)> (accessed 2018-05-23) 6.

<sup>214</sup> *Ibid*, 11.

<sup>215</sup> E.g. Germany and Austria, see John Armor and others, 'Brexit and Corporate Citizenship' (2017) ECGI Working Paper Series in Law, Working Paper N 340/2017 <[http://ssrn.com/abstract\\_id=2897419](http://ssrn.com/abstract_id=2897419)> (accessed 2018-05-23) 17.

<sup>216</sup> <[https://europa.eu/newsroom/highlights/special-coverage/brexit\\_en](https://europa.eu/newsroom/highlights/special-coverage/brexit_en)> (accessed 2018-05-23).

<sup>217</sup> European Company which can be transferred to or merged with another company in other Member States more easily, Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE) [2001] OJ L294/1.

<sup>218</sup> Cross-border mergers are allowed under Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law [2017] OJ L169/46.



After *Cartesio*, Member States had to allow companies to emigrate if the emigration was affiliated with a change of the legal form. *Vale* specified this right and required the company to have a genuine economic link to the host Member State in order to be able to transfer its registered office. It would have only been possible for companies to exit the UK to that country where they have their main place of business. *Vale* did not allow companies to re-incorporate in the Member State of their choice. It was *Polbud* that clearly strengthened the rights of companies, allowing the cross-border transfer of the registered office without any connection to the host Member State. The transfer of the registered office led to a change of the applicable law. However, the company does not change its legal status, the legal identity maintains.<sup>219</sup>

*Polbud* made it possible for companies which want to exit the UK because of Brexit to choose the most suitable law in the EU and to re-incorporate there. Companies are free to choose their new state of incorporation. The CJEU could have had in mind the Brexit when giving its judgement in *Polbud*. The high number of British letterbox companies could have worried the Court.<sup>220</sup> The even more liberal interpretation of the freedom of establishment gives companies the possibility to escape the UK before it is too late.<sup>221</sup> Whether the CJEU had Brexit in mind or not, the outcome is in any event helpful for British companies.

Although the cross-border transfer of the registered office cannot be questioned anymore, it still creates two problems. First of all, the detailed requirements for the transfer of the registered office are subject to the case-by-case decisions of the courts. It was presented above that the jurisprudence of the CJEU is unpredictable. It is possible that the CJEU will rule out the possibility of a cross-border conversion without any genuine economic link to contradict the freedom of establishment in the next judgement. Secondly, the cross-border transfer of the registered seat is only covered by the jurisprudence of the CJEU. No codified national or European legislation exists. Both problems result in a legal uncertainty that will accompany the cross-border transfer of the registered office with an uneasy feeling.

### 5.2.3 Protection of the Status Quo?

British companies which were already established before the Brexit voting could still be subject to the freedom of establishment if their status quo is protected even after Brexit. Because they were already formed in accordance with British Law and enjoyed the freedoms of the Internal Market, they could be allowed to refer to that status even after the UK left the EU.

To plead for a protection of the status quo, one could say that it is not the fault of the companies that they lose their recognition.<sup>222</sup> They should not suffer from

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<sup>219</sup> Marcel Hagemann and Reimund Marc von der Höh, 'Brexit: Handlungsoptionen für eine Sitzverlegung aus den Vereinigten Königreich nach Deutschland' [2017] DB 830, 833.

<sup>220</sup> Oliver Mörsdorf, 'Nun also doch! – Die überraschende Umdeutung der Niederlassungsfreiheit zur Rechtswahlfreiheit durch den EuGH im Urteil *Polbud*' [2017] ZIP 2381, 2388.

<sup>221</sup> *Ibid.*, 2388.

<sup>222</sup> John Armor and others, 'Brexit and Corporate Citizenship' (2017) ECGI Working Paper Series in Law, Working Paper N 340/2017 <[http://ssrn.com/abstract\\_id=2897419](http://ssrn.com/abstract_id=2897419)> (accessed 2018-05-23) 18; Marc-Philippe Weller and others, 'Englische Gesellschaften und Unternehmensinsolvenzen in der Post-Brexit-EU' [2016] NJW 2378, 2382.

something they do not have any influence on. On the other hand, since the Brexit vote it is clear that the UK will leave the Internal Market. The withdrawal does not come unexpected although one could probably oppose that the UK and the EU even after a year of negotiations have not found a solution regarding the continuance of the UK in the Internal Market. Companies had enough time to evaluate the situation and to find solutions.<sup>223</sup> They could never expected that they will not be affected by Brexit. Furthermore, companies are not per se prohibited to have an economic activity in the EU, but they have to comply with the national regulations of the Member States.<sup>224</sup>

It is not likely that the status quo will be protected. Even pre-Brexit incorporations will be affected by the consequences of leaving the Internal Market.

## 5.3 Proposed Directive on the cross-border transfer of the Registered Office

On 25<sup>th</sup> April 2018, the European Commission published a Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions<sup>225</sup> (further referred to as the “proposed Directive”). The proposal intends to harmonize procedures at EU level for the movement of companies between different Member States. The new Directive would “make it easier for companies to merge, divide or move within the Single Market”.<sup>226</sup> The movement of companies also includes the cross-border transfer of the registered office (conversion). It will be possible to “move, merge or divide a company across national borders within the EU without incurring unnecessary burdens and costs, provided that the operation is not artificial or abusive and that the interests of stakeholders are protected”.<sup>227</sup>

In *Cartesio*, the CJEU stated that it is for the European legislator to provide regulations for the cross-border transfer of companies in the EU.<sup>228</sup> Maybe the broad interpretation of the freedom of establishment in *Polbud* after the statement of the CJEU in *Cartesio* was the final hint the European Commission needed to realize that it was time for unified regulations to rule out unnecessary burdens and costs for the transfer of a company within the EU. The European Commission might have further realized that companies in the Internal Market should have the possibility to transfer their registered seat freely without losing their legal personality.<sup>229</sup>

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<sup>223</sup> Marc Seeger, ‘Die Folgen des „Brexit“ für die britische Limited mit Verwaltungssitz in Deutschland’ [2016] DSStR 1817, 1819, 1820.

<sup>224</sup> *Ibid*, 1821.

<sup>225</sup> Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions (2018/0114 (COD)).

<sup>226</sup> European Commission, Press Release, Company Law: Commission proposes new rules to help companies move across borders and find online solutions, 25<sup>th</sup> April 2018 (IP/18/3508).

<sup>227</sup> European Commission, Fact Sheet, Frequently Asked Questions: New Company Law Rules (IP/18/3508).

<sup>228</sup> C-210/06 *Cartesio* Oktató és Szolgáltató bt [2008] ECLI:EU:C:2008:723, para 108.

<sup>229</sup> European Commission, Fact Sheet, Frequently Asked Questions: New Company Law Rules (IP/18/3508).

The potential of the Internal Market can only be released with the removal of barriers to trade.<sup>230</sup> A case-by-case approach by the CJEU or any other court is not sufficient to fully remove barriers to trade and at the same time protect employees, creditors and shareholders. Therefore, harmonized regulations are needed. Different to the above considerations about the 14<sup>th</sup> Company Law Directive, the proposal does not include an own Directive for the cross-border transfer of the registered seat but amends the Directive governing cross-border mergers in the EU. The proposed Directive will provide legislation for all cross-border movements of companies, leading to a general mobility policy instead of different Directives for different movements.

The proposed Directive allows the cross-border transfer of the registered office into another Member State, resulting in a conversion to a company of the host Member State. The cross-border conversion is covered in Art 86a of the proposed Directive, referring to the cross-border conversion as a “conversion of a limited liability company formed in accordance with the law of a Member State and having its registered office, central administration or principal place of business within the Union into a company governed by the law of another Member State”.

The proposed Directive reflects and accepts the Polbud judgement by the CJEU. It transposes the judgement into codified EU Law and confirms the very liberal approach of the freedom of establishment. However, the judgement was adapted in regard to artificial agreements. Under the proposed Directive, it is not possible to convert if the conversion is associated with an abuse of rights, Art 86c of the proposed Directive. Artificial agreements are not protected by neither the proposed Directive nor other EU Law.

It is questionable whether the provision on the exemption of artificial agreements is sufficient to restrict the abuse of rights. Artificial agreements are those which are aimed at obtaining undue tax advantages or at unduly prejudicing the legal or contractual rights of employees, creditors or minority members, Art 86c(3) of the proposed Directive. In the Case Law, the CJEU established that although the cross-border movement of the company can be an abuse of rights, the use of the freedom of establishment is no abuse. Member States were not able to claim an abuse of rights. The Directive does not give any further guideline on how to distinguish between the abuse and the use of the freedom of establishment. Therefore, the restriction of artificial agreement in the Directive could again be a dead end. It was always difficult to decide between the abuse and the use in the Case Law and it cannot be seen why it should become easier now. In Centros and Polbud, the companies were able to refer to the freedom of establishment although the facts of the case were a strong indication that there was no economic reason for their actions. In spite of the fact that the proposed Directive would establish a new structure where competent authorities of the home Member State will assess whether the transfer aims at abusive practices, it remains to be seen whether Art 86c of the proposed Directive has any practical importance. In the end, it will again be for the CJEU to interpret the regulation in any dispute.

The proposed Directive clearly shows which way the remaining Member States will go after Brexit. On the one hand, the Internal Market and the freedoms shall be

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<sup>230</sup> Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions (2018/0114 (COD)) 2.

strengthened, on the other hand, the EU leaves no space for fraudulent activities. After the Directive will be in force, companies finally have the legal certainty needed when it comes to the cross-border transfer of the registered seat.

Unfortunately, the proposed Directive might be published too late to be any help in the Brexit process. A Directive covering the cross-border transfer of the registered office could have been helpful for companies which want to emigrate from the UK to another Member State. It would have given them the legal certainty they do not have after *Polbud* and because of the case-by-case approach of the CJEU. It has to be seen whether the proposed Directive will come into force before it is too late to offer companies a helping hand.

## 6. Conclusion

The cross-border transfer of a company in the EU is a highly discussed topic. Even after a long line of judgements by the CJEU, it was unclear under which conditions a company can move to another Member State. While it was generally accepted that a company is able to transfer its central administration freely in the EU if the company is incorporated in a Member State applying the incorporation doctrine, the transfer of the registered office was highly discussed and, in my point of view, prohibited. The Case Law by the CJEU made visible the problem of a lack of codified EU Law: no general rule is applicable, but the Court decides on a case-by-case approach. What was allowed in one case could be prohibited in another and the other way around.

Polbud shed light on the situation of the cross-border transfer of the registered office. The analysis of the judgement showed the conflict between the promotion of the objectives of the Internal Market and the fear of Member States to lose their autonomy. Partially, the judgement is in line with the other Case Law on the cross-border movement of companies where it strengthened the right of companies to move freely in the EU without the need to fear an abuse of rights.

Apart from that, Polbud extended the freedom of establishment to a freedom of choice of the applicable law. The judgement implemented the right of re-incorporation for companies. Companies are not only allowed to incorporate in the Member State of their choice for the first time, but they can also re-incorporate in the Member State of their choice after they have been established in a different Member State. The judgement reinforces the rights of companies, supporting the Internal Market idea. In the light of the European idea, the judgement is welcomed although it erases any possibility for Member States to counteract an abuse of rights. In the Internal Market, which idea is to create an area without barriers to allow nationals to freely move around as it would be their own country, the protectionist attitude of Member States is inappropriate.

While the judgement brought lots of advantages for European companies and the promotion of the Internal Market, the judgement raised the fear of a race to the bottom. Member States compete again each other to attract the most companies not only in regard to new companies but also in regard to already existing companies. The fear is unfounded. The structure of the EU and the different national characteristics hinder a full race to the bottom. Furthermore, one should have in mind that it is not for the Court to prohibit forum shopping, but for the EU legislator to fully rule out the possibility of a race to the bottom.

The judgement in Polbud was delivered early enough to be a helping hand in the era of Brexit. Pre Polbud, companies were not allowed to solely transfer their registered seat to another Member State. The transfer of the registered seat always needed an economic link to the central administration. Now, companies can exit the UK before Brexit takes place to still be subject of the Internal Market regardless of their main place of business. They have the free choice of the host Member State as long as they fulfill the national requirements of the host Member State after the re-incorporation. In the light of Brexit, one can be nothing but happy that Polbud

finally allowed the re-incorporation in the EU. However legal certainty is not achieved as long as there is positive harmonization.

Positive harmonization in the field of cross-border movement of companies is indispensable. Previous attempts to harmonize the law were not effective. With the allowance of re-incorporation for companies, the EU was ready for a change. The European Commission in April 2018 finally realized that it was its turn to become active instead of relying to the CJEU to solve the problem. Positive harmonization is the only solution to provide regulations that on the one hand, give full effect to the Internal Market and the rights of companies and on the other hand, restrict regulatory competition and guarantee a sufficient level of protection for third parties.

The proposed Directive is much welcomed. It gives companies a legal framework for their actions and, in theory, solves the discrepancy between the objectives of the Internal Market and the fear of an abuse of rights. What is still problematic is whether the prohibition of artificial agreements has any practical influence. Although it is advantageous that the proposed Directive includes a prohibition of artificial agreement, it is still for the Court to decide on the scope and limits of this paragraph. Any decision by a Member State that restricts the conversion of a company will be challenged in front of the CJEU, referring to the phrase that the company only uses the freedom and does not abuse it. Therefore, one should not be too enthusiastic that the regulation will be any help for Member States to put greater control on companies. It seems that the inclusion of the prohibition was rather a political than a thoughtful decision against abusive practices to make Member States more eager to accept the proposed Directive.

Last but not least, it will be seen whether the proposed Directive will be any help for Brexit. It might be too late for the proposed Directive to come into force before Brexit will finally happen. Companies need a long lead time to prepare for the transfer of the registered seat and it is less than a year left until the two years withdrawal period ends. Even if it is too late, the impact of the proposed Directive will be enormous, giving companies for the first time a legal certainty for the cross-border movement in general and the transfer of the registered seat in specific which they never had before. The cross-border transfer of companies is no Brexit specific topic but happens all the time. It remains to be hoped that the proposed Directive will really become into force and will not be abandoned again.

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