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Abstract

Il presente studio si propone di analizzare una delle libertà fondamentali dell'Unione Europea, la Libertà di Stabilimento, in particolare, concentrandosi sull'applicazione di questa libertà, garantita dal Trattato sul Funzionamento dell'Unione Europea (TFEU), alle società. Gli Articoli 49 e 54 del TFEU permettono alle imprese di poter beneficiare della Libertà di Stabilimento. L'Articolo 49 TFEU disciplina lo stabilimento "primario" e "secondario", mentre, l'Articolo 54 TFUE identifica quali imprese possono beneficiare della libertà garantita dal Trattato.

Il primo passo dell'analisi di questa libertà fondamentale consiste nello studiare le diverse teorie di riconoscimento delle società adottate da ciascuno degli Stati Membri dell'Unione Europea. Infatti, l'applicazione, da un lato, della teoria della "incorporazione", e, dall'altro lato, l'applicazione della teoria della "sede reale", da parte degli Stati Membri, ha creato problemi alle imprese Europee nel beneficiare di tale Libertà di Stabilimento.

In una tale situazione, è stato richiesto l'intervento della Corte di Giustizia Europea, che ha dovuto, nel corso degli anni, prendere una serie di decisioni volte a rendere applicabile la Libertà di Stabilimento in modo non discriminatorio nei confronti di tutte le società non residenti in un dato Stato Membro. Lo studio svolgerà una attenta analisi delle sentenze della Corte di Giustizia Europea al fine di tracciare: l'evoluzione che ha subito negli anni la Libertà di Stabilimento, i suoi ambiti di applicazione e la conformità della teoria della "sede reale" con le regole stabilite dal Trattato sul Funzionamento dell'Unione Europea. Inoltre, lo studio dedica una sezione specifica al tema del rapporto fra la Libertà di Stabilimento e le diverse politiche fiscali applicate dai diversi Stati Membri.

Scopo dello studio, oltre all'attenta analisi della Libertà di Stabilimento, è quello di sottolineare come il corretto funzionamento della libertà di stabilimento necessiti di una più profonda armonizzazione del diritto societario fra i diversi Stati Membri, e, inoltre, identificare alcuni strumenti legali utili per raggiungere tale risultato.

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CHAPTER 1 – INTRODUCTION

1.1 Introduction

The Freedom of Establishment is one of the fundamental Freedoms of the European Union. The right of Establishment, together with the others Freedoms, is necessary to assure the correct functioning of the Internal Market of the European Union.

Within the Treaty on the Functioning of the European Union, the Internal Market was created in order to ensure the "free movement of goods, persons, services and capital".[1] Thus, the contemporaneous correct functioning of each of the Freedoms of the European Union has gained critical importance, because if one of the European Freedoms does not work properly, then the correct functioning of the Internal Market could be jeopardised.

In this work, we will analyse the Freedom of Establishment within the European Union with specific focus of how this principle ought to be applied to corporate firms. Today, the economy resulted even more globalised, in an age where the information are sent in two different point of the word in few seconds, with the economy characterized by even more open markets and with a greater possibility to delocalize business activity. Thanks to this kind of economy, the corporations could benefit of a lot of different solutions in order to carry on their business. In fact, companies could carry on their business in many countries at the same time; or decide to transfer part or entire of their establishment abroad; or decide to establish a secondary office in another EU Member State. Thus, the Freedom of Establishment constitutes an important element to be taken into account in connection with the location and re-location of corporations.

[1] Article n. 26 p. 2 of TFEU

In the Second chapter, we will focus on the different recognition theories adopted by each of the EU Member States. In fact, some EU Member States adopted the “incorporation” theory, while other EU Member States apply the “real seat” theory. The application of these different recognition theories by each Member State created critical issues in the application of the Freedom of Establishment to companies, which could only be resolved by the ECJ through a long series of decisions, which will be analysed in depth in the following chapter.

In the third chapter, first we will focus on the analysis of the articles 49 and 54, TFEU, concerned, respectively, with primary and secondary Freedom of Establishment and with the conditions under whom a corporation is entitled to enjoy it. Then, we will analyse the different cases decided, over years, by the European Court of Justice. The analysis of these cases is important because it helped in defining the scope of the Freedom of Establishment, when companies are involved, and because it resolved the question, raised among scholars, whether or not the “real seat” theory could coexist with the provisions concerning the Freedom of Establishment.

In the fourth chapter, the study briefly analyses the problems relating to the harmonization of the legal systems of the EU Member States. In fact, the correct functioning of the Freedom of Establishment is tied to the level of the harmonization of the legal systems of the different EU Member States.

This analysis of the evolution, over the years, of the Freedom of Establishment, concerned with companies’ “nationality”, will lead me to face some issues dealing with the current status of the Freedom of Establishment, and, in particular, with the current level of compliance with the EU law concerning the Freedom of Establishment, with respect to the “real seat” theory. Then, the

study will deal with the problem of the current harmonization of corporate law and with the issue whether or not there should be more harmonization throughout the EU, in order to improve a more consistent application of right of Establishment and, finally, with what kind of legal techniques could be used in order to attain a better level of harmonization.

CHAPTER 2 - THE DIFFERENT THEORIES OF THE CORPORATE RECOGNITION WITHIN THE EU LAW OF THE “INTERNAL MARKET”

2.1 Introduction

A corporation created in accordance with a specific Law of Business Organizations does not incur any problems until it carries on its business within the State of incorporation. However, in an increasingly globalized economy, characterized by even more open markets and with a greater possibility to delocalize business activity, corporations could carry on their business in many countries, or decide to transfer part or entire of their establishment abroad or decide to establish a secondary office in another EU State. In this kind of economy, it could be increasingly difficult to identify which corporate law should govern the corporation[2]. In fact, whereas natural person and corporation hold a specific nationality, for corporations having connecting factors with different States, it is not easy to distinguish their nationality.

The possibility to transfer the formal or real seat of the corporation, within the European Union, has been a very controversial topic in European company law. Legal continuity of the transferred company, its recognition in the State of destination (and sometimes in the State of origin), the rules applicable to the company that "emigrates", are all issues subject to the legal systems applied in the countries involved in the transfer. The provision implementing the fundamental Freedom of Establishment within the European common market, as stated for the first time in the Treaty establishing the European Economic Community, tried to make easier the transfer of the seat of the corporation[3].

However, since its introduction European corporations faced some problems with their own freedom of establishment, due to

[2] TORINO, R., *Diritto di stabilimento delle società e trasferimento transnazionale della sede. Profili di diritto europeo e italiano*, p.153 and foll.
[3] BORG-BARTHET, J., *The Governing Law of Companies in EU Law*, p.4 and foll.

limitations created by domestic legislation of each EU Member State and their respective private international law rules, that affected foreign companies right of establishment[4]. Such problems occurred especially when a EU Member State A company wished to transfer its main office or to establish a branch office in another EU Member State B. Two doctrines: the "Incorporation theory" and the "Real Seat theory", as disparately used by each EU Member States in order to determine which national corporate law should be enforced vis-à-vis a (foreign) corporations, were important driving factors in defining the issues about the scope of Freedom of Establishment[5]. The European Court of Justice tried to overcome these problematic legal issues through its decisions, thereby establishing the illegality of some national rules that conflicted with the companies' right of establishment.[6] In order to understand scope and implications of the issues, the European companies were confronted with exercising their freedom of establishment prerogatives, and with fully understanding the legal issues presented to (and solved by) the European Court of Justice during the past quarter of a century or so.

2.2 The "Incorporation" theory

The incorporation theory has its origins from the contractual theories of the corporations; the basic assumption of this theory is that only the will of incorporators is necessary to create the connection between the law of the chosen country and the

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[4] BECHT, M., MAYER, C., WAGNER, H. F., *Where Do Firms Incorporate? Deregulation and the Cost of Entry*, p.241-243

[5] MUCCIARELLI, F. M., *Companies' Emigration and EC freedom of establishment*, p.282 and foll. See also JOHNSON, M., *Roll on the 14th Directive – Case law fails to solve the problems of corporate mobility within the EU – again,* p. 10.

[6] TORINO, R., *Diritto di stabilimento delle società e trasferimento transnazionale della sede. Profili di diritto europeo e italiano*, p.153 and foll.

company[7]. Therefore, the company will be subject to the laws where the act of incorporation was completed (i.e. where it was filed with the competent national authority)[8]. The act of incorporation creates the sufficient connective link between the company and the legal system of the State, whereas the physical presence and/or personal connection with the State of incorporation would not be required[9]. The incorporation theory is generally applied by common law jurisdictions and partially by some civil law jurisdictions as Denmark, Netherlands, Sweden[10], Switzerland, Russia[11] and Finland.

The company that adopts the incorporation theory could transfer its administrative seat in another juridical system without necessarily incurring in a winding up proceeding. Therefore, the corporation that has transferred its administrative seat remains subject to the corporate law of the State of incorporation, even if the corporation carries on its business only in another State. Generally, the corporate law of a State adopting the incorporation theory does not affect its "national" corporation that transferred its "real" seat in the host State, i.e. in another jurisdiction.

Thus, the theory of incorporation enables the corporation's founders to identify and choose *ex ante* the corporate law rules that better would fulfil their needs, due to the fact that the corporate law could remain unchanged throughout the life of society even if its real seat will be transferred abroad[12]. Therefore, under the incorporation

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[7] BORG-BARTHET, J., *The Governing Law of Companies in EU Law*, p.51 and foll.

[8] GELTER, M., *Centros, the Freedom of Establishment for Companies, and the Court's Accidental Vision for Corporate Law,* p.3.

[9] BORG-BARTHET, J., *The Governing Law of Companies in EU Law*, p.49-51.

[10] Article 154 of the swiss Internationales Privatrecht.

[11] Articles 1202-1203 of the Russian Civil Code.

[12] ROTHE, N., *Freedom of Establishment of Legal Persons Within the European Union: An Analysis of the European Court of Justice Decision in the Überseering Case*, p.1110-1113.

theory, the place where the corporate business will be effectively exercised and the place where the company will be practically administered are not deemed as controlling factors in order to identify the nationality of the corporation, i.e. the corporate law rules to whom the company is subject.

Jurisdictions adopting the theory of incorporation had to face the problem of "letterbox companies" creation: letterbox companies carry out their commercial activity in a State different from the State of incorporation (where they only have a "mail address"), so benefiting of a jurisdiction with a less strict legislation, sometimes deemed unable to properly protect the various categories of interested persons ("stakeholders") and others companies who would enter into a either contractual or non-conctractual relationship with the "letterbox" corporations[13].

2.3 The "Real Seat" theory

The real seat theory is adopted in the majority of civil law systems. Jurisdictions that adopt the real seat theory are essentially based on the idea that the company is ruled by the law of the place where the central management and control is located. The connecting factors in jurisdictions adopting the real seat theory are therefore objective and imperative, so that the founding members of a corporation do not have the possibility to choose on their own the more convenient law.[14]

The real seat theory enforces the national law of the country where the administrative headquarters is located, because the purpose of

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[13] PASCHALIDIS, P., *Freedom of Establishment and Private intenational law for Corporation,* p.12.

[14] GELTER, M., *Centros, The Structure Of Regulatory Competition In European Corporate Law,* p.248; PASCHALIDIS, P., *Freedom of Establishment and Private intenational law for Corporation,* p. 7; MUCCIARELLI, F. M., *Companies' Emigration and EC freedom of establishment,* p.284.

this theory is to protect economic interests of the host country. The national law of the country is applied to foreign entities that have a strong connection with the host State, with the objective to achieve two main objectives: The first goal is to avoid that the founding members of a corporation evade the national law by the creation of a pseudo-foreign corporation and the second is to protect the different stakeholders that enter in contact whit the corporation, providing a national law able to grant a sufficient level of protection.[15] In the event the company does not deal with its formation requirements, the State where the company has its real seat can subject it to two kind of sanctions: the first is to deprive the company of legal subject status, while the second sanction is to remove the limited liability right.[16]

The countries following this theory are France, Belgium, Poland, Greece, Latvia, Luxembourg and the Scandinavian countries. Some EU Member State jurisdictions, as the Italian, Spanish and Portuguese, decided to apply a mixed solution, half way between the real seat theory and the incorporation theory.[17]

EU Member states usually apply two kinds of real seat theory: “symmetric” and “asymmetric”.

A jurisdiction which applies the “symmetric” real seat theory does not accept the election of the applicable company law as made by the foreign corporation. The Member State adopting the “symmetric” real-seat doctrine binds its corporate law to the establishment of the

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[15] LOMBARDO, S., *La Libertà Comunitaria di Stabilimento delle Società dopo Überseering fra armonizzazione e concorrenza tra ordinamenti*, p.460.; se also N. ROTHE, *Freedom of Establishment of Legal Persons Within the European Union: An Analysis of the European Court of Justice Decision in the Überseering Case*, p.1111.

[16] http://europa.eu/epso/doc/en_lawyling.pdf

[17] BORG-BARTHET, J., *The Governing Law of Companies in EU Law*, p.49-51.; see also BECHT, M., MAYER, C., WAGNER, H. F., *Where Do Firms Incorporate? Deregulation and the Cost of Entry*, p.243.

real seat within the country and, on the other hand, states to renounce to export its corporate law; moreover companies that transfer their seat abroad have to wind-up the corporation and must then to reincorporate it in the new State.

When the "asymmetric" real seat theory is applied, the host State does not impose to the corporation any change in the applicable law rules: hence, a foreign corporate firm is free to choose its national corporate law and the place of its real seat does not matter. When, in a EU Member State, is applied the real-seat doctrine, a corporation wishing to avoid to incur in the obligations of its regulation, must move the corporation headquarters in another State, and become subject, through a transfer of the registered seat, to the LoBOs of the host State.[18]

2.4 A comparison between the recognition theories

As already pointed out, the incorporation theory argues that the legal order which created the corporation should also govern its organizations and its operations; according to this theory, the State of incorporation is supposed to be the most interested to regulate the internal affairs of the companies. One advantage of this recognition theory is that the parties involved in a proceeding should easily be put in the position to identify *ex ante* the law that governs the proceeding, certainty, predictability, uniformity of result, protection of justified expectation of the parties.[19] The incorporation theory was considered a driving factor of the economic development

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[18] BECHT, M., MAYER, C., WAGNER, H. F., *Where Do Firms Incorporate? Deregulation and the Cost of Entry,* p.241-243*;* see also ENRIQUES, L., GELTER, M., *How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law,* p.585.

[19] ROTHE, N., *Freedom of Establishment of Legal Persons Within the European Union: An Analysis of the European Court of Justice Decision in the Überseering Case*, p.1112.

of a country, and good examples of it are the Netherlands and the State of Delaware in the United States.[20] However, the incorporation theory shows some drawbacks, as, for example, the the State of incorporation law abuse or the indirect promotion of the letterbox companies (i.e. companies that do not have any substantial type of connection with the State of incorporation other than the very act of incorporation).[21] The most important critique to the incorporation theory is that it would have permitted the founding members to set up companies in legal system that are deemed more lenient under various respects.[22] The State of Delaware, for instance, registered a huge numbers of corporations when it decided to apply the incorporation theory. As a consequence, the principle of the "pseudo-foreign" corporation and some anti-abuse policies have been enforced in many common law and in Netherlands jurisdiction, in order to successfully face this kind of weakness.[23]

The real seat theory ensures that the law of the State most affected by the action of the corporation (i.e. usually its centre of administration) will be applied. The implementation of this theory provides a better protection of the host State domestic market and – so it is often argued- a better protection of stakeholders of the company (and especially of corporates creditors)[24].

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[20] PASCHALIDIS, P., *Freedom of Establishment and Private intenational law for Corporation*, p.16.

[21] NOVOTNÁ, P., *Freedom Of Establishment After Cartesio; see also http://www.businessdictionary.com/definition/letterbox-company.html; http://definitions.uslegal.com/l/letter-box-company/*

[22] PASCHALIDIS, P., *Freedom of Establishment and Private intenational law for Corporation*, p.16.

PASCHALIDIS, P., *Freedom of Establishment and Private intenational law for Corporation*, p.17.

[24] ROTHE, N., *Freedom of Establishment of Legal Persons Within the European Union: An Analysis of the European Court of Justice Decision in the Überseering Case*, p.1111.

However, the real seat theory may show some disadvantages, because sometimes it is not easy to determine the "real seat", as we could find different terms and concepts concerning the real seat theory in different States; finally, the real seat doctrine has been criticized also because it tends to limit the scope of the parties' autonomy in companies founding and in its selling of control.[25]

2.5 The "Nationality" of the corporations in Italy

Article 25(1) of Law no. 218 of May 1995 stated, as general rule, that corporations are governed by the law of the State of incorporation: thus, Italian system of private international law appears to follows, at first glance, the theory of incorporation.[26] However, in the second paragraph, article 25 states that in the case where the administrative seat or principal activity of the company is located in Italy, Italian law will be applied to govern the company, even if the constitution of the company was perfected in another jurisdiction.[27] Italian courts have the duty to interpret these terms. In those cases when the court decides that the administrative seat or the main corporate business purpose of the corporation is carried out in Italy, the real seat theory will replace the incorporation theory.[28]

In Italy as soon as the administrative seat or the centre of activities of the company are identified within the Italian territory, the company incorporated in another State will be subject to all requirements of the Italian law, including the requirement of registration. Corporations that do not comply with the requirement

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[25] PANNIER, M., *Nationality of Corporations Under Domestic Law: A Comparative Perspective*

[26] L. 31 Maggio 1995 n. 218

[27] MUCCIARELLI, F. M., *Companies' Emigration and EC freedom of establishment,* p.289.

[28] TORINO, R., *Diritto di stabilimento delle società e trasferimento transnazionale della sede. Profili di diritto europeo e italiano*, p.156 and foll; see also BORG-BARTHET, J., *The Governing Law of Companies in EU Law*, p.49-51.

of conforming to Italian law and the procedures of registration under Italian company law, will be penalized by establishing the application of the unlimited liability rule of the person(s) acting on behalf of the company.

According to article 25(2) of law no 218, the extent of article 25(1) covers the legal status of the entity, its name, its incorporation, transformation and dissolution, its capacity, its establishment and the powers of its organs, agency, the acquisition or loss of membership of the company and also the right and obligation resulting thereof, the liability for its obligations, and the consequences of breach of the articles of association.

CHAPTER 3 – THE CORPORATE RECOGNITION AND THE EU CASE LAW ON FREEDOM OF ESTABLISHMENT

SECTION 3.A: Freedom of Establishment and Corporate Recognition

3.1 Introduction

The Treaty on the Functioning of the European Union (hereinafter "TFEU"), articles 49 and 54 (formerly articles 43 and 48 of the TEC), provides a general framework about the Freedom of Establishment.

The Freedom of Establishment is one of the fundamental European freedoms and, together with all European freedoms, assure the functioning of the European Internal Market. The other European Freedoms ensure the free movement of people, goods, services and capitals. Thus, thanks to the EU Freedoms, the European internal market could work correctly; the incorrect application of one of the European freedoms could affect the proper working of the other freedoms and, as a result, the correct functioning of the European internal market.

The Freedom of Establishment with respect to companies was not followed by secondary European legislation: thus, the task to define its extent and to coordinate domestic provisions of international private law was left to the European Court of Justice.[29]

[29] Within the TFEU articles 50 and 81 provide a basis for legislation on the private international law of companies. Article 50 states: "1. In order to attain freedom of establishment as regards a particular activity, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee, shall act by means of directives…".

Article 81 states: "1. The Union shall develop judicial cooperation in civil matters having cross-border implications, based on the principle of mutual recognition of judgments and of decisions in extrajudicial cases. Such cooperation may include the adoption of measures for the approximation of the laws and regulations of the Member States.

2. For the purposes of paragraph 1, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure, shall adopt measures, particularly when necessary for the proper functioning of the internal market,.."

Article 54 of the TFEU equates companies validly established in a EU Member State, having registered office, central administration, centre of business operations within EU, to natural persons national of a EU Member State.

Problems arise as the Member States adopt different ways to recognise the legal personality of a company and to identify the national law to which that organisation should be subject to.

This situation has characterized the European Union law concerning companies for many years and undermined the correct functioning of the European internal market, which is based on the free movement of goods, persons, services and capital. [30]

A key step in the harmonisation process of rules governing the recognition of companies has to be found in the 1968 Convention on the Mutual Recognition of Companies; however, has it will be further explained under paragraph 3.2 (infra), the convention failed to reach its objective because EU Member States refused to ratify it.[31]

Article 293 of the Treaty Establishing the European Community affirmed an important rule about the recognition and mobility of companies; in fact it stated: "Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals:

.. the mutual recognition of companies or firms within the meaning of the second paragraph of Article 48, the retention of legal personality in the event of transfer of their seat from one country to another, and the possibility of mergers between companies or firms governed by the laws of different countries;".

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[30] JOHNSON, M., *Roll on the 14th Directive – Case law fails to solve the problems of corporate mobility within the EU – again*, p.9-13.

[31] BORG-BARTHET, J., *The Governing Law of Companies in EU Law*, p.104 and foll.

The European Union up today does not start neither conclude any negotiation about the recognition and mobility of companies, or more in general regarding the corporate law, even if this matter was already faced by the Member States since a long time.[32]

3.2 Convention on the Mutual Recognition of Companies

The Member States on 29 February 1968 signed in Brussels the Convention on the Mutual Recognition of Companies, while at the same time the same Member States signed a protocol that allowed the European Court of Justice to interpret the Convention.[33]
The Member States were not able to reach an agreement, and finally the Netherlands decided not to ratify the Convention on the Mutual Recognition of Companies. This negative result could be considered an important driving factor that slowed the application of the rules concerning the Freedom of Establishment.[34]
Article 1 of the convention stated: "Companies under civil or commercial law, including co-operative societies, established in accordance with the law of a Contracting State which grants them the capacity of persons having rights and duties, and having their statutory registered office in the territories to which the present Convention applies, shall be recognized as of right.". This article shows that the theory of incorporation was the starting point, utilized by the Convention, to shape the mutual recognition of corporations.

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[32] However, it should be pointed out the importance of the Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies. This directive constituted an important step in the development of the Freedom of Establishment
[33] SANTA MARIA, A., *European Economic Law*, p. 9.
[34] BORG-BARTHET, J., *The Governing Law of Companies in EU Law*, p.110.

However article 3 of the Convention stated: "Notwithstanding the foregoing, any Contracting State may declare that it will not apply the present Convention to any companies or bodies corporate specified in Articles 1 and 2 which have their real registered office outside the territories to which the present Convention applies, if such companies or bodies corporate have no genuine link with the economy of one of the said territories.". This provision, together with article 4, shows as the Convention provided to Member States the possibility to avoid or interdict the use of the State of incorporation law and the possibility to adopt their national law. In addition, the provisions of the Convention could create uncertainty about the conflict between the real seat and the incorporation rules, and the European Court of Justice had to resolve the question that arise from this uncertainty.[35]
The Convention on the Mutual Recognition of Companies, despite the negative outcome[36], was an important step made by the Member States in order to harmonize corporate law.

3.3 The fundamental Freedom of Establishment within EU law

Articles 49 and 54 of the TFEU regulate the fundamental economic Freedom of Establishment; these general rules, over the years and together with the decisions of the ECJ, provided corporations and companies in general the necessary basis, in order to enjoy the Freedom of Establishment.
Article 49 set forth the so-called "primary" and "secondary" Freedom of Establishment; moreover the first sentence of Articles 49 of the

[35] SANTA MARIA, A., *European Economic Law*, p. 10-12.
[36] MUCCIARELLI, F. M., *Companies' Emigration and EC freedom of establishment*, p.276.

TFEU bans every restriction to Freedom of Establishment implemented by Member States.
The "primary" Freedom of Establishment[37] allows nationals of any Member State to transfer their domicile or residence, in order to pursue an economic relevant activity, in any EU Member State. The "secondary" Freedom of Establishment provides the freedom to: "... setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State."[38]
Member States are to same extent, still allowed to enforce their domestic laws and regulations in order to setup restrictions on Freedom of Establishment on (restrictive and proportional) grounds of "…public policy, public security or public health"[39] and moreover on ground of the exercise of official authority.[40] These types of restrictions have been constantly construed as an exception to the general Freedom of Establishment rules: the European Court of Justice clearly stated that this restrictions must be interpreted narrowly.[41] The ECJ, in the *Gebhard* case (1995) pinpointed that: "national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfil four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it.".[42]

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[37] Article 49, Par. 2, of TFEU.
[38] Article 49, Par.1, TFEU.
[39] Article 52, par.1, TFEU.
[40] Article 51 TFUE.
[41] WEISS, F., KAUPA, C., *European Union Internal Market Law*, P.243.
[42] Case C-55/94, Gebhard.

When Member States did not reach an agreement for the harmonization of corporate law and a secondary legislation about Freedom of Establishment was not available, the European Court of Justice took part in the integration and direct application of the articles 49 and 54 of TFUE.
Therefore, the rest thus chapter will be focusing in the analysis of the most relevant cases dealt with by the ECJ in the matter of Freedom of Establishment concerning companies.

SECTION 3.B: The decisions of the European Court of Justice ("ECJ") on Freedom of Establishment

3.4 Daily Mail

3.4.1 The Facts

The Corporation Daily Mail and General Trust PLC was a limited liability company incorporated in England with its real and formal seat in London. The Daily Mail corporation (hereinafter, simply "Daily Mail") made an application to the UK Treasury because it wanted to transfer its administrative seat (for tax purposes) in the Netherlands. The idea of the company, after having changed its seat to the Netherlands, was to sell a substantial part of its non-permanent assets and then buy, using the money obtained from the operation, a part of its shares. Thanks to the transfer of the seat, the company, as company resident in the Netherlands, could avoid the payment of capital gain tax and advance corporation tax[43] in the United Kingdom. Of course, taxes on income generated domestically would have been due to United Kingdom in any case.

United Kingdom applies the Incorporation doctrine: hence, a corporation can transfer its seat in another State without losing its nationality and maintaining its legal personality. In addition, the law of Netherlands adopts the incorporation theory, and it allows the transfer of the real seat.

However, the Daily Mail and General Trust PLC, before starting the transfer of seat, needed the consent of the Treasury of the United Kingdom for tax purposes.[44]

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[43] The United Kingdom tax that consists on prepayment of corporate taxes by companies distributing dividends to shareholders; abolished in 1999.

[44] According to the income and corporation tax act 1970 of United Kingdom, Section 482(1) stated: "Subject to the provisions of this section, all transactions of the following classes shall be unlawful unless carried out with the consent of the

Daily Mail and General Trust PLC brought an action before the Queen's Bench Division of the High Court of Justice arguing that under articles 52 of European Economic Community Treaty the Corporation could transfer its seat in the Netherlands without the prior consent of the Treasury of United Kingdom. The High Court of Justice decided to submit to the European Court of justice two preliminary questions.

The first question asked the European Court of Justice if articles 52 to 58 of the EEC Treaty (article 49 to 55 TFEU) allowed a corporation, with its central management and control in a Member State, to transfer its central management and control into another Member State without the prior consent or approval by the institution of the Member State of origin. The second question concerned the applicability to companies of Directive 73/148 on the abolition of restrictions on movement and residence of nationals of Member States within the European Community. [45]

3.4.2 The judgement of the ECJ

With regard to the first question, the European Court of Justice in its judgement affirmed that the national law where the company was incorporated and the national law where it decided to transfer its seat governs the conditions necessary to successfully complete the transfer.[46]

The Court reiterates that Freedom of Establishment is one of the fundamental Freedoms of the Community and that the rules concerning the Freedom of Establishment have been directly applicable to nationals of Member States since the end of the

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Treasury, that is to say" and continue in letter (a) "for a body corporate resident in the United Kingdom to cease to be so resident."

[45] Report for the Hearing — Case 81/87 p.5488.

[46] Judgment of the Court in case 81/87 point (14).

transitional period. The provisions concerning Freedom of Establishment should be applied also to the corporation as legal person. These rules aimed to ensure that natural persons and corporations of a Member State receive the same treatment of nationals (including corporations) of the host Member State. Moreover, these provisions do not allow obstacles implemented by the Member State of origin to the establishment of its nationals and corporations in another Member State.[47]

As stated before, articles 52 and 58 of the Treaty afford companies the fundamental economic Freedom of Establishment: companies can also set up agencies, branches or secondary offices and have the right to incorporate in another Member State. The *Daily Mail* case differs from the above described situation because the corporation asked to re-incorporate in another Member State while, at the same time, wanted to retain its legal status as a corporation of United Kingdom.[48]

According to the statements of the Court, some Member States allow their companies to transfer their central administration into another Member State; however, Member States are free to implement certain types of restrictions, but the legal consequences change depending on the considered Member State.[49] The Court, in this judgment, assumed a conservative position, thereby adopting a cautious interpretation of the Treaty rules.

Therefore, the European Court of Justice stated: "unlike natural persons, companies are creatures of the law and, in the present state of Community law, creatures of national law. They exist only by

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[47] Judgment of the Court in case 81/87 point (15).

[48] VALK, O., C-210/06 Cartesio *Increasing corporate mobility through outbound establishment.* P.159

[49] Judgment of the Court in case 81/87 point (20).

virtue of the varying national legislation which determines their incorporation and functioning". Moreover, the Court considered on the same level the three connecting factors, set forth in (today) article 54 par. 1 TFEU, i.e., registered office, central administration and principal place of business of a company. Furthermore, no agreements were accomplished between the Member States to the effect of retaining the legal personality, when a company decided to transfer its registered office from a Member State to another.[50]

Under these conditions, the European Court of Justice specified that the provisions provided by article 52 and 58 do not resolve the problems concerning the connecting factors and the transfer, from one Member State to another, of the registered office or real head office of a company; these matters should be addressed by future legislation or conventions. Hence, according to the Court, Articles 52 and 58 of the Treaty "cannot be interpreted as conferring 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.". Therefore, a company incorporated in a Member State, with the registered office therein, does not have any right, provided by the Treaty, when decides to transfer its central management and control into another Member State.[51]

The European Court of Justice answered to the second question arguing that the Directive 73/148 of 21 May 1973 governs only the movement and residence of natural persons. The provisions hold by the directive are not applicable by analogy to legal persons.[52]

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[50] Judgment of the Court in case 81/87 point (19).
[51] Judgment of the Court in case 81/87 point (21).
[52] Judgment of the Court in case 81/87 point (28).

3.4.3 Comments to the ECJ judgement

The European Court of Justice in its ruling of the debated *Daily Mail* case confirmed the validity of the tax rules enforced by the United Kingdom. The Court put the different connecting factors on the same level, thus there could not be drawn a preference regarding one of the connecting liks set forth in article 54 TFEU (registered office, central administration and principal place of business of a company).

In its judgement the European Court of Justice specified that the corporations are creatures of the national law. According to the European Court of Justice, companies exist only by virtue of the varying national legislation which determines their incorporation and functioning. Through its ruling, the European Court of Justice confirmed the possibility for the EU Member States of Incorporation to govern the conditions by which a corporation could transfer its seat into another EU Member State. Thus, in an outbound case, a corporation, because its functioning and incorporation is to be governed by the EU Member State of Incorporation, must comply with the requirements of the State of origin before transferring its seat into the host EU Member State.

The Judgement of the European Court of Justice produced different reactions among scholars and jurists; they theorized that the primary Freedom of Establishment ended due to the judgement of the Court. According to this theory the judgment of the Daily Mail case undermined the functioning of the EU internal market and in general blocked the European integration. [53]

Other Scholars argued that the Daily Mail decision, gave an advantage position to the real seat theory within the conflict between

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[53] BORG-BARTHET, J., *The Governing Law of Companies in EU Law*, p.112.

the recognition theories, in contrast with the *Sergers* case[54] judgement, which seemed to favour the incorporation theory instead. However, it should be considered that the dispute did not present conflicts about the recognition theories or the connecting factors of the company, because both the United Kingdom and the Netherlands, applied the criterion of the incorporation theory.[55]
Behrens, argued that Member State could choose between the two recognition theories freely, but, in his opinion, the real seat theory (as adopted in Germany and in other jurisdictions) would breach the provision concerning the Freedom of Establishment, because he considered that the real seat theory involved unjustifiably and discriminatory restrictions to corporations that wanted to transfer their seat both in Germany and outside.[56] Conversely Loussouarn, affirmed that the case law undermined the position of the real seat

[54] Mr. Segers, a Dutch citizen, in April 1981 formed a limited liability company accordingly to the United Kingdom law, and placed the headquarters of the company in London. Mr Sergers wanted to carry on his business exclusively in the Netherlands through a branch named Slenderose Ltd.
In July 1981, Mr. Segers gave to the Slenderose Ltd all the shares of his Dutch company called Free international promotion, whose headquarters was placed in the Netherlands.
In order to obtain sickness insurance benefits, Mr Segers registered as sick with the Association called the Bedrijfsvereniging voor Bank. That body refused to grant him such benefits because in its opinion he had no the necessary employment contract with Slenderose Ltd.
The Court of Justice found that such treatment constitutes an indirect obstacle to the Freedom of Establishment, because through its rules the Netherlands restricts the free establishment of the company of the other Member State.

[55] GELTER, M., *Centros, the Freedom of Establishment for Companies, and the Court's Accidental Vision for Corporate Law*, p. 16-19.
[56] PASCHALIDIS, P., *Freedom of Establishment and Private intenational law for Corporation*, p.36.

theory. Finally, The European Court of Justice in its judgement assured that the rules of the Treaty were not used to avoid national tax laws.[57]

3.5 Centros

3.5.1 The Facts

Mrs Bryde was the shareholder and administrator of the Centros ltd. In 1992, the administrator asked for the registration of the act of incorporation of the company in the Danish registrar, because Mrs Bryde wanted to open a subsidiary in Denmark. The objective of Centros ltd was to carry out its businesses in many commercial sectors, including the provision of loans. [58] However, the company shareholders, the Danish couple composed by Mrs Bryde and her husband, effectively wanted to carry out, through the corporation, only an activity of import and export in the wine sector.[59]

Under the Danish law, companies established in a Member State when whishing to carry out an activity in Denmark have to establish a branch there. The Danish Trade and Companies Board firstly must register the corporation and only after this step the company is allowed to carry out its economic activity. [60]

The Danish Trade and Companies Board refused to register a branch of the English corporation, based on the assumption that its shareholders were both resident in Denmark and wanted to operate only their import and export business in Denmark.

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[57] PASCHALIDIS, P., *Freedom of Establishment and Private intenational law for Corporation*, p.37.

[58] Opinion of Advocate General La Pergola.

[59] Judgement of the Court, Case 9. 3. 1999 — Case C-212/97 point (2).

[60] Opinion of Advocate General La Pergola; see also Articles 117-122 of Lovbekendtgørelse.

After the refusal to register by the Danish authorities, Centros ltd brought an action before the Østre Landsret. Centros Ltd did not accept the refusal because in its opinion articles 52 and 58 of the EC Treaty gave to it the right to establish a branch in Denmark.
The Supreme Court of Denmark brought the question before the European Court of Justice asking: "Is it compatible with Article 52 of the EC Treaty, in conjunction with Articles 56 and 58 thereof, to refuse registration of a branch of a company which has its registered office in another Member State and has been lawfully founded with company capital of GBP 100 (approximately DKK 1.000) and exists in conformity with the legislation of that Member State, where the company does not itself carry on any business but it is desired to set up the branch in order to carry on the entire business in the country in which the branch is established, and where, instead of incorporating a company in the latter Member State, that procedure must be regarded as having been employed in order to avoid paying up company capital of not less than DKK 200.000 (at present DKR 125.000)?".[61]
Centros Ltd had been established in United Kingdom probably in order to avoid the narrower Danish corporate law concerning the minimum required capital and to pursue its activity only in Denmark through a Danish subsidiary.
The Danish Trade and Companies Board rejected the demand of registration because, according to its opinion, the corporation wanted, through the branch, to establish in Denmark its main place of business. According to the Danish government articles 52 and 58 of the EC Treaty were not to apply because the shares of the company were held by persons resident in and nationals of Denmark

[61] Judgement of the Court, Case 9. 3. 1999 — Case C-212/97 point (13)

who wanted to conduct their business there. Therefore, there were not the transnational elements necessary to apply the Treaty articles.[62]

3.5.2 The Judgement of the ECJ

According to the European Court of Justice when a national of a Member State decides to establish a company in another Member State having, in his opinion, a less restrictive corporate law does not constitute an abuse of the Freedom of Establishment. The rules of the Treaty guarantee the primary and secondary Freedom of Establishment for nationals and companies of the EU Member States, moreover even if the company law among the Member States is not fully harmonised, this circumstance does not constitute an impediment for the Freedom of Establishment.[63]

The European Court of Justice in its judgment resumed its decision of the *Sergers* case, arguing that a corporation has the right to benefit of the Treaty rules, notwithstanding it does not carry out any economic activity in the State of incorporation and conducts its business entirely in the State were its branch is located. These elements are not sufficient to demonstrate the presence of an abuse or an illicit behaviour, hence the Member States cannot hinder the application of the EC Treaty provisions.[64]

Articles 52 and 58 of the Treaty do not allow Member States to refuse to register a secondary office of a corporation formed accordingly to the law of a Member State “with the result that the secondary

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[62] BORG-BARTHET, J., *The Governing Law of Companies in EU Law*, p.114.

[63] Judgement of the Court, Case 9. 3. 1999 — Case C-212/97 point (27) and point (28).

[64] Judgement of the Court, Case 9. 3. 1999 — Case C-212/97 point (29).

establishment escapes national rules on the provision for and the paying-up of a minimum capital."[65]

The Danish Trade and Companies Board affirmed that the minimum capital requirements were necessary in order to guarantee the financial soundness of the corporation and to protect all of the company creditors by anticipating the risk of fraudulent bankruptcy due to the companies insolvency.[66] The European Court of Justice responded to this reasoning considering the judgement of the precedent case law. The Court explained that "national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfil four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it."[67]

The measures taken by the Danish authorities did not comply with the requirements of the Gebhard test. Firstly the refusal of The Danish Trade and Companies Board to register the company's branch did not protect company creditors, because if the corporation had carried its business also in United Kingdom the Danish authorities would have agreed to register the branch of Centros ltd. Hence, company creditors in this situation would have been exposed in the same way. Secondly, according to the European Court of Justice the Danish authorities could apply measures which could

[65] Judgement of the Court, Case 9. 3. 1999 — Case C-212/97 point (30).
[66] Judgement of the Court, Case 9. 3. 1999 — Case C-212/97 point (32).
[67] Judgement of the Court, Case 9. 3. 1999 — Case C-212/97 point (34).

interfere in a minor way against the fundamental European Freedoms.[68]

The European Court of Justice answered the question arguing that: "It is contrary to Articles 52 and 58 of the EC Treaty for a Member State to refuse to register a branch of a company formed in accordance with the law of another Member State in which it has its registered office but in which it conducts no business…". According to the European Court of Justice restrictions to the establishment of a company subsidiary validly registered in another Member State are not acceptable, even if the corporation does not carry out any business in the State of incorporation and wants to carry out its entire business in the country were intends to establish its branch. For the European Court of Justice the fact that a corporation is incorporated in a State were the corporate law is less strict, with the aim to avoid the narrower corporate rules of the State were the corporation intends to establish the secondary office and to really carry on its business, is an allowed operation. The Court continues stating "That interpretation does not, however, prevent the authorities of the Member State concerned from adopting any appropriate measure for preventing or penalising fraud, either in relation to the company itself, if need be in cooperation with the Member State in which it was formed, or in relation to its members, where it has been established that they are in fact attempting, by means of the formation of a company, to evade their obligations towards private or public creditors established in the territory of the Member State concerned.".[69]

[68] Judgement of the Court, Case 9. 3. 1999 — Case C-212/97 point (37).
[69] Judgment of the Court 9. 3. 1999 — Case C-212/97 point (39).

3.5.3 Reactions to the Centros judgement

The Centros case law is considered one of the leading case concerning the Freedom of Establishment because it confirmed the precedent judgement of the Sergers case law. In fact, according to the point of view of the Court an operation such as the proceeding falls within the scope of the provisions concerning the Freedom of Establishment. Thus, thanks to the decision of the European Court of Justice, a corporation validly incorporated into an EU Member State could open a branch into another EU Member State even if the corporation carry on its economic activity only in the EU Member State where it opened its branch.

The ruling of the European Court of Justice introduced an important innovation in the Centros case law. The Court decided to adopt in this case law an instrument able to assess the compatibility of the restriction enforced by an EU Member State with the right of Establishment. The Court applied the Gebhard test in order to identify a possible breach of the right of establishment by the Denmark authority.

This case concerned the recognition of a formally foreign company, rather than the connection between a company and its state of incorporation, nevertheless the decision of the European Court of Justice created a debate among the scholars about the relationship between the compatibility of the real seat theory and the Freedom of Establishment.

The German jurists were particularly interested in the relationship between the real seat theory and the Freedom of Establishment. For example, Forsthoff based his assumption getting as basis the most restrictive German jurisprudence concerning the matter of branch of foreign corporations recognition. Forstthoff started his study

asking to himself what could had happened if the Centros case was to confront German jurisprudence. He argued that according to this doctrine Centros Ltd did not exist as a legal entity because Germany applies the real seat doctrine, which is accepted by the European Authorities ("principal place of business" is one of the three connecting links mentioned under art. 54TFEU). Moreover, the European authorities did not express any condition to the choice on the matter of private international corporate law. Thus, through these arguments, Forsthoff tried to explain that the Centros case did not hit the admissibility of the real seat theory and in addition, the author shows that the precedent decisions of the European Court of Justice were not changed by the judgement of the Centros case.[70]
Professor Kindler, another German jurist, stated that from the *Daily Mail* decision the European judges had shown impartiality between the choices of the corporate law. In his opinion, the Freedom of Establishment is subject to the private international corporate law and the recognition theory choosen by a Member State. Therefore, whether a corporation formed accordingly to a foreign corporate law is subject to the German corporate law, due to the German recognition theory, could not carry out its economic activity under the foreign corporate law.[71]
Denmark failed to refuse the recognition of Centros ltd and to avoid the opening of a branch of that corporation because it based its justification on the abuse of the European rules. Germany and the countries that adopt the symmetric real seat theory might refuse the

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[70] BALLARINO, T., *Sulla mobilità delle società nella Comunità Europea, da Daily Mail a Überseering: norme imperative, norme di conflitto e libertà comunitarie*, p. 681.
[71] BALLARINO, T., *Sulla mobilità delle società nella Comunità Europea, da Daily Mail a Überseering: norme imperative, norme di conflitto e libertà comunitarie*, p. 682, 683.

registration of the branch due to the fact that according to this particular recognition theory the legal entity did not exist. Centros ldt had to wind-up and then incorporate in the country where it decided to locate its real seat.

Some authors argued that the decision of the European Court of Justice made it impossible to use the real seat theory within the European Union; hence the only possible solution was to replace the real seat theory and apply the incorporation theory. The Austrian Supreme Court few month later declared that the real seat theory could not be used due to the judgement of the *Centros* case. The supporter of the real seat theory condemned the decision of the Austrian Supreme Court because in their opinion the Austrian Supreme Court thought that the Danish corporate law applied the real seat theory and assumed that the European Court of Justice ruled on the choice of the recognition theory adopted by the Member States.[72] On the other hand, some author pointed out that both United Kingdom and Denmark applied the incorporation theory, thus under this condition the real seat theory was not touched by the decision of the European Court of Justice.

Some scholars affirmed that due to the *Centros* decision the real seat doctrine cannot be used to hinder the transfer of the real seat of a corporation out from the Member State of origin to another Member State, forcing the corporation to a prior winding up.[73] Member States should take measures in order to recognise the foreign companies established accordingly to the criteria of the registered office, the central administration, the centre of business operations, identified

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[72] GELTER, M., *Centros, the Freedom of Establishment for Companies, and the Court's Accidental Vision for Corporate Law,* p.23.

[73] EBKE, W. F., *Centros- Some realities and Mysteries-*, p.627.

by the article 54 of the Treaty on the Functioning of the European Union.

Another school of thought argued that it was the European Court of Justice through the judgment in the Centros case to elevate the incorporation theory as the European doctrine of corporate law, but in some cases the EU Member States could apply their mandatory statutory lex fori instead the incorporation theory.[74]

However, a large majority of scholars sustained that the decision of the European Court of Justice did not concern the primary Freedom of Establishment or the choice of the corporate law, but instead that decision concerned only the secondary Freedom of Establishment.[75]

The judgement of the *Centros* case lead to a debate concerning the company policy issue. Therefore, the decision of the European Court of Justice started a competition among the EU Member States about the corporate law. This kind of competition according to the scholars will lead to a "race to the bottom" of corporate law; hence, business will be interested just in the most suitable corporate law.[76]

Finally, the judgement of the Centros case helped to better understand and to narrow the doctrine of abuse of the European laws. According to the decision stated in the Judgement of the European Court of Justice, national courts have to decide "case by case, on the basis of objective evidence, of abuse or fraudulent conduct on the part of the persons concerned in order, where appropriate, to deny them the benefit of the provisions of Community law on which they seek to rely, they must nevertheless assess such conduct in the light of the objectives pursued by those

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[74] EBKE, W. F., *Centros- Some realities and Mysteries-*, p.627.

[75] EBKE, W. F., *Centros- Some realities and Mysteries-*, p.628.

[76] BALLARINO, T., *Sulla mobilità delle società nella Comunità Europea, da Daily Mail a Überseering: norme imperative, norme di conflitto e libertà comunitarie*, p. 680.

provisions."[77] Moreover since the Centros case, the issues concerning the abuse of the European provisions was faced widely in the *Van Binsberg* case and then in the *TV-10* case. Van Bisbergen was a Dutch national and a Dutch legal representative. Van Binsbergen during the course of a proceeding, decided to transfer his residence from the Netherlands to Belgium. Thus, his capacity, as a legal representative, to represent the party in question before the Centrale Raad van Beroep (one of the three highest administrative courts in Netherlands) was questioned, because a provision of Netherlands stated that only persons established in the Netherlands may act as legal representatives before that court. Van Binsbergen argued that this rule was contrary to articles 59 and 60 of the Treaty.

The European Court of Justice stated that the specific requirements which a EU Member State requires to persons providing such a service, comply with the provisions of the Treaty, when these requirements are needed in order to apply professional rules, justified by the public interest, which are binding upon any person established in the State in which the service is provided. According to the European Court of Justice, the requirements enforced by the EU Member State comply with the Treaty when "the person providing the service would escape from the ambit of those rules being established in another Member State".[78]

In fact, a EU Member State can apply rules in order to prevent that a person providing services entirely or principally within its territory to benefit of article 59 of the Treaty, with the purpose "of avoiding

[77] Judgement of the Court, Case 9. 3. 1999 — Case C-212/97 point (25)
[78] Judgement of the Court, Case 3. 12. 1974 — Case 33/74 point (12)

the professional rules of conduct which would be applicable to him if he were established within that State".[79]

The TV-10 case concerned a proceeding between a Luxembourg public limited company and the Commissariaat voor de Media (the supervisory body for broadcasting in the Netherlands). The Dutch authority argued that the TV-10 was established in Luxembourg in order to avoid the national rules of the Netherlands. The national Court of the Netherlands asked to the European Court of Justice whether a company, as TV-10, established into a EU Member State, wishing to provide services exclusively or almost exclusively into another EU Member State, could rely on article 59 of the Treaty. Moreover, the national Court asked to the ECJ whether a EU Member State could consider a corporation, as in the aforementioned example, as one of its national companies and, in this way, subject the corporation to its law. The European Court of Justice stated that a corporation, such that in the proceeding, could be equated to a national company. Thus, the ECJ decision prevents a corporation from establishing into another EU Member State in order to avoid national rules of the EU Member State of origin.

Thanks to the *Centros* case was clarified that establish a corporation in a Member State in order to benefit of the less restrictive corporate law or the lower taxation does not correspond -*per se*- to an abuse of the European provisions.[80]

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[79] Judgement of the Court, Case 3. 12. 1974 — Case 33/74 point (12)

[80] Judgement of the Court, Case 5. 10. 1994 — Case C-23/93; see also Judgement of the Court, Case 3. 12. 1974 — Case 33/74 and see also S. M. CARBONE, *Brevi riflessioni sull'abuso del diritto comunitario: commercio internazionale ed esercizio delle libertà individuali*, p. 71-75.

3.6 Überseering

3.6.1 The Facts

The Überseering case started with the litigation between the Überseering BV, a corporation formed accordingly the Netherlands law and registered on 22 August 1990, and the Nordic Construction Company Baumanagement GmbH (hereafter NCC). In October 1990, Überseering purchased a plot of land in Düsseldorf for carrying out its economic activity. In November 1992, NNC entered into a project-management contract with Überseering with the task of refurbish a motel and a garage situated on that piece of land. NCC completed the restructuring operation, but Überseering claimed that the paintwork was defective. [81]

In December 1994, two German nationals residing in Düsseldorf decided to acquire all the shares in Überseering.[82] Überseering tried without success to obtain a compensation from NCC because of the defective work. Thus in 1996 the corporation brought NCC before the German Regional Court, asking the reimbursement of DEM 1 163 657.77, plus interest, in order to recover the costs incurred in remedying the claimed defects and consequential damage.[83]

The German Regional Court rejected the action and then also the Higher Regional Court took the same decision. According to the German Courts Überseering, after the acquisition of the shares by German nationals, had transferred its real seat. Hence, the German Court stated that Überseering, having been incorporated in the Netherland and having its real seat in Germany, could not bring legal

[81] Judgement of the Court, Case C-208/00, point (6).
[82] Judgement of the Court, Case C-208/00, point (7).
[83] Judgement of the Court, Case C-208/00, point (8).

proceeding in Germany because under the German law the corporation did not have the legal personality.[84]

The proceedings was brought before the Bundesgerichtshof, which asked the European Court of Justice to make a preliminary ruling. The Bundesgerichtshof took the case law showed in the point 4 and 5[85] of the judgement as starting point, and explained its point of view indicating that was preferable to continue on the path laid by the precedent case law for three main reasons.[86]

The first reason showed by the Bundesgerichtshof recommended to use one governing law for corporation. This kind of solution would have the advantage to avoid the legal uncertainty.[87] The second reason explained that the incorporation theory allows the entrepreneurs to choose the corporate law that suit them best. However, the incorporation theory do not consider the effect, on third parties and on the State where the place of administration is located, caused by the economic activity of the corporation, when the place of administration is located in a different State in respect to the State of incorporation.[88] Finally, the German Courts, in the third reason, suggested that the application of the real seat theory does not allow the circumvention of certain vital interests, such as the interest of the creditors, the minority shareholders and finally the interest of the employees of the corporation.[89]

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[84] Judgement of the Court, Case C-208/00, point (9).

[85] The point 4 and 5 of the judgement explained that, According to the settled case-law of the Bundesgerichtshof, which is approved by most German legal commentators, German law apply the real seat theory. According to this theory the place were the centre of administration is located identifies the legal capacity of a corporation and the law that must be applied to it.

[86] Judgement of the Court, Case C-208/00, point (12) and (13).

[87] Judgement of the Court, Case C-208/00, point (14).

[88] Judgement of the Court, Case C-208/00, point (15).

[89] Judgement of the Court, Case C-208/00, point (16).

The Bundesgerichtshof underlined some point of the previous case law about *Centros* and *Daily Mail* which showed the uncertainty of the German Court concerning the Freedom of Establishment.[90]

First, the Bundesgerichtshof asked to the European Court of Justice if articles 43 and 48 of the Treaty Establishing the European Community allow German authorities to deny the legal capacity to a corporation, and therefore the possibility for it to become party to an action, validly incorporated under a foreign corporate law of a EU Member State, because Germany adopts the real seat theory. Secondly, whether the EU provisions rule that the legal capacity and the capacity to be a party to legal proceedings of a company must be decided according to the law of the EU Member State where the company completed its incorporation.[91]

In the observation submitted to the European Court of Justice the NCC, the German, Italian and Spanish Governments, firstly, based their thinking on the provisions of the Article 293 EC. According to the proposal sent to the Court, article 293 EC is based on the assumption, accepted by all the Members States, that a "company incorporated in one Member State does not automatically retain its legal personality in the event of its seat being transferred to another Member State and that it is necessary for the Member States to enter into a specific convention to that effect — a convention which has not as yet been adopted". Thus, in the absence of an agreement on the mutual recognition of companies, it is possible, according to the EU provisions concerning the Freedom of Establishment, for a corporation, which had transferred its real seat into another EU Member State, to lose its legal personality.[92]

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[90] Judgement of the Court, Case C-208/00, point (18) to (20).
[91] Judgement of the Court, Case C-208/00, point (21).
[92] Judgement of the Court, Case C-208/00, point (25) to (28).

Moreover, NCC and the German, Spanish and Italian Governments resumed the *Daily Mail* case to foster their point of view. The *Daily Mail* case concerned the connection existing between a company and the Member State where the company completed its incorporation. According to the NCC and the aforementioned Governments the reasoning applied by the European Court of Justice could be applied also in the *Überseering* case, where a company validly incorporated under the law of a Member State is deemed to have transferred its real seat into another Member State. In this situation the corporate law that should be applied to the corporation concerns the national law while the EU provisions on Freedom of Establishment are left out.[93]

3.6.2 The Judgement of the ECJ

The European Court of Justice started its findings rejecting the NCC and the German, Spanish and Italian Governments point of view. The Court stated that, in circumstances as those described in the previous paragraph, the Community Provision on Freedom of Establishment are relevant for the situation.[94]

After this statement, the European Court of Justice moved on to explain why it rejected the reasoning of the NCC and the German, Spanish and Italian Governments based on the ground of article 293 of the Treaty Establishing The European Community.[95]

According to the Court: "Article 293 EC gives Member States the opportunity to enter into negotiations with a view, inter alia, to facilitating the resolution of problems arising from the discrepancies between the various laws relating to the mutual recognition of

[93] Judgement of the Court, Case C-208/00, point (30).
[94] Judgement of the Court, Case C-208/00, point (52).
[95] Judgement of the Court, Case C-208/00, point (53).

companies and the retention of legal personality in the event of the transfer of their seat from one country to another". Then, the European Court of Justice continued stating that even if no convention were concluded under the provision of the Treaty, the exercise of the Freedom of Establishment cannot be blocked by this inaction.[96]

The European Court of Justice rejected also the argument presented by the NCC and the German, Spanish and Italian Governments founded on the *Daily Mail* case. The Court argued that the Überseering did not present any demand asking the transfer of its seat. Moreover, the Netherlands, the State of incorporation of Überseering, considered the corporation validly incorporated under its law, notwithstanding the fact that all the shares of the corporation passed under the control of persons resident in Germany. In fact, the Netherlands did not ask for the corporation winding-up.[97] For this reasons, the Court concluded its reasoning affirming: "There are, therefore, no grounds for concluding from *Daily Mail* that, where a company formed in accordance with the law of one Member State and with legal personality in that State exercises its freedom of establishment in another Member State, the question of recognition of its legal capacity and its capacity to be a party to legal proceedings in the Member State of establishment falls outside the scope of the Treaty provisions on freedom of establishment, even when the company is found, under the law of the Member State of establishment, to have moved its actual centre of administration to that State.".[98]

[96] Judgement of the Court, Case C-208/00, point (54), (55) and (57).
[97] Judgement of the Court, Case C-208/00, point (65) to (72).
[98] Judgement of the Court, Case C-208/00, point (73).

The European Court of Justice showed in detail the difference between the free movement of capital and the Freedom of Establishment. According to the Court, the community provisions on the free movement of capital rules the acquisition by one or more natural person residing in a Member State of shares of a company incorporated in another Member State; but the shareholding does not confer to the shareholder the power to control and manage the economic activity of the corporation. On the contrary, when the holding of the shares of the company by the natural persons confers to them the power to control and manage the economic activity of the corporation, the Community provisions about Freedom of Establishment should be applied.[99]

The European Court of Justice decided that the refusal of standing before the national Courts, to a company validly incorporated under the law of another Member State and that have its registered office there, because the host Member State applies the Real Seat theory, is considered as a restriction of the Freedom of Establishment.[100]

Finally the European Court of Justice recognised the importance of restriction to the Freedom of Establishment in order to prevent the general interest such as the protection of the interests of creditors, minority shareholders, employees and the taxation authorities. However, the endeavour to protect these interests cannot justify the refusal of the legal capacity to a corporation. According to the European Court of Justice the provisions of the Freedom of Establishment conferred, to the corporation validly incorporated under the law of a Member State, the capacity to be a party to legal proceedings.[101]

[99] Judgement of the Court, Case C-208/00, point (77).
[100] Judgement of the Court, Case C-208/00, point (82).
[101] Judgement of the Court, Case C-208/00, point (92) to (94).

3.6.3 Reaction to the judgement

The Judgement of the European Court of Justice in the *Überseering* case law was particularly important because it clarified that articles 293 EC should facilitate the attainment of Freedom of Establishment, but "the exercise of that freedom can none the less not be dependent upon the adoption of such conventions" encouraged by article 293 EC. Thus, corporations that satisfy the conditions set in by article 48 EC can benefit of the right of Establishment stated in articles 43 EC and 48 EC, which have been directly applicable since the ending of the transitional period. With the ruling of the *Überseering* case, it becomes clear that restrictions of the Freedom of Establishment are not allowed, *in primis* because the EU Member States did not adopt any convention on the mutual recognition of companies, which could justify such restrictions.

The *Überseering* case shows how EU Member States did not yet resolve and understood the issues raised by the European Court of Justice in the *Daily Mail* case. The NCC and the German, Spanish and Italian Governments tried to foster their point of view through the Daily Mail case. However, the *Überseering* case was fundamentally different from *Daily Mail*, because the former was concerned with way in which the host EU Member State treats a company which is validly incorporated in another EU Member State and which is exercising its freedom of establishment in the host EU Member State. The European Court of Justice resumed its precedent ruling whereby: "a company, which is a creature of national law, exists only by virtue of the national legislation which determines its incorporation and functioning". Thus, the national provisions of the host EU Member State could not deny the legal personality of a corporation validly formed into another EU Member State, if,

according to the LoBO of that State, the connecting link falls within those set forth in article 54 TFEU.

Moreover, as noted above, in the *Überseering* case the issue identified in the *Daily Mail* case concerning the differences existing in the national legislation are not yet resolved by the European legislation or conventions.

This decision of the triggered additional discussions among scholars concerning the future of the real seat theory. Some Authors argued that the decision took by the European Court of Justice had the effect of eliminating the application of the real seat theory by the remaining Member States. Other commentators took the position that the future decisions of the case law presented to the European Court of Justice concerning the choice of law issues, will be solved in favour of the Community and of the single market.[102]

There is no doubt that the decision of the European Court of Justice deeply impacted German international corporate law and the international corporate law of other EU Member States applying the real seat theory.

There were two main streams of interpretation of the judgement. The broad interpretation theorised that the Court decision abolished the real seat theory, while, at the same time, the Court embraced the incorporation doctrine. However, a narrower approach to the European Court of Justice decision, theorised that the European Court of Justice in *Überseering* involved just a modification to the real seat doctrine. Through this recognition theory modification of the European Court of Justice ensured that a corporation validly formed under the law of a EU Member State will obtain the legal recognition within all the EU Member States. The decision of the

[102] PASCHALIDIS, P., *Freedom of Establishment and Private intenational law for Corporation*, p.49.

European Court of Justice focused only on the recognition of the legal capacity of a foreign corporation, but the Court did not make any reference about which law, the law of the State of Incorporation or the law where the real seat of the corporation is located, should govern the corporation life.[103]

Moreover, according to the opinion of Shanze and Jüttner, the *Überseering* case did not undermine the existence of the real seat theory; in their opinion the European Court of Justice decides only whether the application of the real seat theory could deny the legal personality to a validly formed corporation and registered into another Member State. Other authors affirmed that the decision of the European Court of Justice did note improve the condition of the European Internal Market, concerning only the validity of Überseering legal personality. In fact, the European Court of Justice argued:

"Indeed, its very existence is inseparable from its status as a company incorporated under Netherlands law since, as the Court has observed, a company exists only by virtue of the national legislation which determines its incorporation and functioning (see, to that effect, Daily Mail and General Trust, paragraph 19)."

In the judgement (point 81), the European Court of Justice never pointed out the prevalence of the incorporation theory over the real seat doctrine. What triggered the breach of the European provisions were some specific rules of the German company law, not the application of the recognition theory in its general terms.[104]

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[103] ROTHE, N., *Freedom Of Establishment Of Legal Persons Within The European Union: An Analysis Of The European Court Of Justice Decision In The Überseering Case,* p.1134.

[104] PASCHALIDIS, P., *Freedom of Establishment and Private intenational law for Corporation*, p.51.

Thus, the European Court of Justice did not resolved (and it did not intend to resolve), the issue about which of the two recognition theories should prevail and be applied by the EU Member States. For this reason, the narrower interpretation of the decision of the European Court of Justice affirmed was correctly assuming that the real seat theory would be still compatible with the provisions concerning the Freedom of Establishment up to the point where its enforcement would lead to the denial of the legal capacity of a company correctly formed and operating according to the LoBO of its State of origin.

The *Überseering* decision allows entrepreneurs to benefit of a wider choice of corporate laws within the European Union and fosters the mutual recognition of companies among EU Member States. Thanks to the judgement of the European Court of Justice, a company, formed accordingly a corporate law of one Member State, with its real seat placed into another Member State can benefit of its legal personality within all the EU Member States and can access to all local courts in order to enforce its own rights.

The decision in the *Überseering* case makes more interesting to incorporate a company in one Member State, which is deemed to have the better corporate law for the corporation's founding shareholders, while the company at the same time carries out its economic activity entirely in another EU Member State. Again (as in *Centros* and in other cases still to be discussed *infra* in this section) this assumption raises the doubt among scholars of a "race to the bottom"[105] among the corporate laws of the EU Member States.

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[105] The race to the bottom is a phenomenon that lead governments to deregulate their Law on Business Organizations or to reduce their fiscal imposition, in order to attract or retain corporations in their jurisdictions. Thus, this phenomenon, if not properly controlled, will lead to a damage for all the parties directly or indirectly related with the corporation.

However, some scholars thought that the judgement in the *Überseering* case could lead instead to a process of more intense harmonization among EU Member States.[106]

On July 2001, while the judgement of the *Überseering* case was not yet released, the second chamber of the Bundesgerichtshof, the German Supreme Court, in order to preserve the German version of the real seat theory stated in *Jersey* case that a limited liability company formed under the law of the Channel Island of Jersey and having its real seat in Germany is considered by the German law not as a Jersey company but as a civil law partnership (Gesellschaft Bürgerlichen Rechts) or as a commercial partnership (Offene Handelsgesellschaft). These two kinds of firm have the possibility to stand before the national Courts, but their partners are personally liable for the debts of the partnership. This latter decision of the German Supreme Court was probably rendered on a wrong assumption, because the German Court thought that Jersey was part of the United Kingdom and therefore part of the European Union and could benefit of the provisions concerning the Freedom of Establishment.[107] The decision of the Bundesgerichtshof was criticised because the Jersey rule did not respect the provision of the Freedom of Establishment making less attractive for the foreign corporation to exploit the Freedom of Establishment. The Jersey rule did not respect the four-factor test set forth in the *Gebhart* case. [108]

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[106] ROTHE, N., *Freedom Of Establishment Of Legal Persons Within The European Union: An Analysis Of The European Court Of Justice Decision In The Überseering Case,* p.1136.

[107] BGH, decision of 1. 7. 2002 - II ZR 380/00; see also http:// lexetius.com/2002, 1515.

[108] EBKE, W. F., *The European Conflict-of-Corporate-Laws Revolution: Überseering, Inspire Art and Beyond, International Legal Developments in Review: 2003* p.12-15.

3.7 Inspire Art case

3.7.1 The Facts

The Inspire Art case concerned the application of the Wet op de Formeel Buitenlandse Vennootschappen of 17 December 1997, a law on formally foreign companies, by Inspire Art Ltd (hereinafter WFBV), a company regularly formed under the LoBO of United Kingdom.[109]

Article 1 of the WFBV identified as a "formally" foreign company a corporation or a company validly formed under a law, different from the law of the Netherlands, and with legal personality, which carries out its economic activity exclusively or almost exclusively in the Netherlands, and, finally, which does not hold any real connection with the State where it was formed accordingly with the law of that. Under Articles 2 to 5 of the WFBV the "formally" foreign companies were subject to various obligations concerning the company's registration in the commercial register, an indication of that status in all the documents produced by it (i.e. sent out in the course of its business activity), the minimum share capital and the drawing-up, production and publication of the annual (financial) documents. The corporations and companies not complying with the requirements stated by the WFBV were "punished" with the joint and several liability of its directors.[110]

Inspire Art was, as noted, a limited liability company validly formed under the law of England and Wales, and its registered office was in Folkestone (UK). Inspire Art had a single director, whose domicile was in the Netherlands, more precisely in The Hague. The company director had the authorization to act alone and independently in the

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[109] Judgement of the Court, Case C-167/01 point (2).
[110] Judgement of the Court, Case C-167/01 point (23).

name of the company. The corporation started its economic activity on 17 August 2000 through a branch located in Amsterdam under the name of Inspire Art Ltd. The corporation contrary to the provision stated in article 1 of the WFBV, was registered the commercial register of the Chamber of Commerce without indicating its status of "formally foreign company".[111]
On 30 October 2000 the Netherlands Chamber of Commerce asked to the local Court (Kantongerecht te Amsterdam), as mentioned in article 1 of the WFBV, to declare and then to file a registration amendment in the commercial register, that Inspire Art ltd was a "formally foreign company". Inspire Art resisted to the argument of the Chamber of Commerce of the Netherlands, and thus the proceeding was suspended and the European Court of justice was asked to answer two questions.
The European Court of Justice had to decide whether the provisions of the "Wet op de formeel buitenlandse vennootschappen", of 17 December 1997, in particular those laid down in article 2 to 5 of the WFBV, did apply to the UK company in such case, and if those provisions did comply with or were contrary to the Community Law. The second question was to understand if the provisions of the WFBV were justified under the reason written in article 46 EC Treaty in force at that time.
The Chamber of Commerce and the Netherlands, German, Italian and Austrian Governments together were united to support the compliance of the WFBV provisions in respect to the articles 43 and 48 of the EC Treaty.
This pull of EU Member States argued that the rules applied by the Netherlands Chamber of Commerce were not contrary to the

[111] Judgement of the Court, Case C-167/01 point (32), (34).

Freedom of Establishment, because they did not regard "neither the formation of companies under the law of another Member State nor their registration". The enforcement of the WFBV did not hinder the recognition and the subsequent registration of the companies identified by the mentioned law. Thus, the Community provisions about the Freedom of Establishment had been respected.
Moreover, the Chamber of Commerce and the Netherlands, German, Italian and Austrian Governments considered irrelevant the Court's holding in *Centros*, because that case concerned only the registration of foreign companies, while the Member States were still free to enforce such conditions for the carrying out of certain trades, professions or businesses, as they deemed necessary in their unfettered judgement.
The Netherlands Government stated that its system of incorporation is "extremely liberal" for companies incorporated under the law of another Member State wishing to carry out an economic activity in the Netherlands. However this extremely liberal system of law created an unexpected consequence. In the Netherlands even more companies were formed abroad, while carrying out principally or exclusively their economic activity in the Netherlands with the aim of avoiding the mandatory provisions of the corporate law of the Netherlands.[112]
According to the Chamber of Commerce and the Netherlands, German, Italian and Austrian Governments the provisions of the WFBV forced companies formed under a law of a another EU Member State to comply with additional requirements, while they carry out their economic activity in the Netherlands. The task of this additional obligations is to ensure that third parties and other

[112] Judgement of the Court, Case C-167/01 point (77), (78) and (79).

company's stakeholders are conscious that the legal entities identified by the WFBV law were formally foreign companies and, moreover, the aim was to ensure third parties subscribing contracts with the formally foreign corporations, the same guarantees that they had subscribing contracts with Dutch companies. Hence, the opinion of the Chamber of Commerce and the Netherlands, German, Italian and Austrian Governments was that the conditions imposed by law of the Netherlands aimed to protect consumers and creditors and that these rules were to be respected both by Dutch and foreign companies.[113]

The Chamber of Commerce and the Netherlands, German and Austrian Governments continued their analysis referring to the judgment of the *Daily Mail* case. They started their thought on the words wrote by the European Court of Justice in the *Daily mail* case in which the Court held that articles 43 EC and 48 EC allow Member States to determine the relevant factor connecting a company to their national legal order. Thus, the Chamber of Commerce and the Netherlands, German and Austrian Governments continued their assumption arguing that the Community provision allows adopting, under private international law, rules to be applied to companies that fall partly within the scope of Netherlands law. Hence, the WFBV considered, as connecting factors, not only the place of incorporation, but also the place where the company carries out its business.[114]

The Inspire Art, the United Kingdom Government and the Commission affirmed that the provisions of the WFBV would have foreclosed the complete functioning of the rules under articles 43 EC and 48 EC, concerning the Freedom of Establishment. From its point

[113] Judgement of the Court, Case C-167/01 point (81), (82).
[114] Judgement of the Court, Case C-167/01 point (83).

of view the Wet op de formeel buitenlandse vennootschappen imposed to comply with obligations which have the result to render the Freedom of Establishment less attractive for companies formed under the law of another Member State and intending to carry on entirely or almost entirely their activities in the Netherlands.
According to the Inspire Art, the United Kingdom Government and the Commission the Community provisions concerning Freedom of Estblishment allow entrepreneurs to form companies in one Member State with the only purpose to establish the company into another Member State where they decide to carry out their entire economic activity. In fact, the European Court of Justice in the *Centros* and *Sergers* cases stated that forming a company in one Member State and then establishing the company into another Member State where the main business is entirely carried out is not an abuse of the provisions concerning the Freedom of Establishment. According to the Court, this kind of operation does not constitute an abuse of the Community rules even if made with the unique purpose to avoid the stricter corporate law of the host Member State.[115]

3.7.2 The Judgement of the ECJ

The European Court of Justice started its judgement stating, according to its previous judgements in *Segers* (point 16) and *Centros* (point 17), that the Freedom of Establishment allows a company formed in one Member State to establish itself into another Member State with the only purpose to carry out its entire economic activity therein. Only in the event of fraud became relevant to investigate the reasons why a company decided to be formed in a particular Member State.[116]

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[115] Judgement of the Court, Case C-167/01 point (91).
[116] Judgement of the Court, Case C-167/01 point (95).

The European Court of Justice reaffirmed[117] that the fact that if a company was formed in a particular Member State in order to enjoy of the benefit arising from a more suitable legislation does not constitute abuse of the provisions concerning the Freedom of Establishment, even if that corporation carries out its economic activity entirely or mainly in that second State.

According to the European Court of Justice the WFBV impedes the complete functioning of the right of Establishment of companies, because the application of the WFBV rules to a branch of a company formed in anther EU Member State, in particular the provisions concerning the minimum capital and the liability of the directors, influences the Community rules.[118]

The European Court of Justice remembered again that the *Daily Mail* case concerned the relations "between a company and the Member State under the laws of which it had been incorporated in a situation where the company wished to transfer its actual centre of administration to another Member State whilst retaining its legal personality in the State of incorporation.".[119]

Thus, according to the Court, articles 43 and 48 of the EC Treaty do not allow the provisions on minimum capital requirements and unlimited liability of the directors of the company, as they were provided for under the WFBV, which consequently constitutes a restrictions on the Freedom of Establishment of "formally foreign companies" such as Inspire Art Ltd.[120]

The Chamber of Commerce and the Netherlands, German and Austrian Governments argued that the provisions of the WFBV,

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[117] Judgement of the Court in *Segers*, point (16), and in *Centros*, point (18).
[118] Judgement of the Court, Case C-167/01 point (101).
[119] Judgement of the Court, Case C-167/01 point (103).
[120] Judgement of the Court, Case C-167/01 point (104).

concerning the directors' liability and the minimum capital requirements, are necessary “to counter fraud, protect creditors and ensure that tax inspections are effective and that business dealings are fair”. According to their point of view, these rules are admissible both by article 46 of the EC Treaty and by overriding reasons of public interest.[121] They further specified that these rules concerning the minimum capital requirements provided the protection to all creditors against the risk of fraudulent insolvency, because the formally foreign corporations are usually formed with insufficient corporate capital. The minimum capital requirements were also justified by the Chamber of Commerce because they hindered the fraudulent or risky behaviour by companies that do not have real connection with the State of incorporation.[122]

The European Court of Justice answered to these arguments stating that the article 46 EC does not cover the protection of creditors, the fight against improper recourse to freedom of establishment, and the protection of both effective tax inspections and fairness in business dealings. Thus, the Court had to analyse these arguments bearing in mind just the possible overriding reasons of public interest. However, the European Court of Justice resumed its former judgements in the previous case law and pinpointed again that “national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must, if they are to be justified, fulfil four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the public interest; they must be suitable for securing the attainment of the objective which they pursue, and they must not go beyond what is necessary in order to attain it”.

[121] Judgement of the Court, Case C-167/01 point (109).
[122] Judgement of the Court, Case C-167/01 point (117).

The European Court of Justice stated that Inspire Art ltd presented itself as an England and Wales company. Thus, for the creditors of the corporation it was clear that the matters of the minimum capital requirements and the liability of its directors were governed by the law of England and Wales. In addition, it did not constitute a sufficient proof of the existence of abuse or fraudulent conduct of the Community provisions the formation of a company in one Member State, where it does not carry out any economic activity, in order to establish a branch into another Member State, where for the company the corporate law is more suitable and where the company decides to conduct its entire business activity. For that reason, the Members State could not deny the corporation to benefit from the Community law.[123]

Finally, for the European Court of Justice, neither the Chamber of Commerce nor the Netherlands Government, on the matter of fairness in business dealings and the efficiency of tax inspections[124], provided to the European Court of Justice the necessary proofs to demonstrate that the rules of the WFBV satisfy the criteria of the Gebhard test[125].

The European Court of Justice concluded its decision stating that articles 46 EC, the protection of creditors, the combat of abuse of Community law, the guarantee of fairness in business dealings and the efficiency of tax inspection do not justify restriction of the Freedom of Establishment on the basis of a national law, such as the WFBV.[126]

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[123] Judgement of the Court, Case C-167/01 point (135) and point (137).

[124] Judgement of the Court, Case C-167/01 point (140).

[125] The three criteria of efficacy, proportionality and non-discrimination.

[126] Judgement of the Court, Case C-167/01 point (142).

3.7.3 Reaction to the Inspire Art Judgement

In the Inspire Art case law the European Court of Justice have to rule on the compatibility of a national law with the right of Establishment. The Court through its ruling stressed some of its precedents ruling made in the *Centros* and *Überseering* cases. The Chamber of Commerce and the Netherlands, German and Austrian Governments based their thought on the precedent ECJ's statements in the *Daily Mail* case. However, their thoughts were deemed wrong, because these parties overestimated the similarities between these two cases.

Thus, The European Court of Justice had to clarify to the parties that *Daily Mail* was concerned only with the relationship between a company and the Member State under the laws of which it had been incorporated. In fact, in *Daily mail* the company wished to transfer its actual centre of administration to another Member State whilst retaining its legal personality in the United Kingdom, i.e. the EU Member State of incorporation (and UK adopts the incorporation theory). Through this ruling, it started to become evident that the EU Member State of incorporation has more power to discipline the transfer of its national companies, whereas the host EU Member State has a narrower scope to govern the Establishment of the corporation of the other EU Member States. In fact, the host EU Member State has to justify those provisions that would effectively restrict the Freedom of Establishment of a foreign company, on the grounds of public policy, public security or public health: each and every provision must comply with the four factors of the *Gebhard* test.

The European Court of Justice in the *Inspire Art* case had to explain again that the right of Establishment conferred to the EU

corporations consists in the possibility for them to be formed in one Member State and to establish themselves into another Member State with the only purpose to carry out their entire economic activity therein. The Court specified that the corporations are free to choose the corporate law under which to be incorporated according to their needs and preferences. This operation does not constitute an abuse of the right of Establishment *per se*. Thus, corporations validly formed under the law of an EU Member State are entitled to establish a branch into anther EU Member State in order to pursue their economic activity. The necessary connecting factor with the specific EU Member State is to be identified by one of the following: the place of the company registered office, the central administration and the principal place of business. Even if this ruling was not new in the European jurisprudence, it helped the EU Member States to better understand the scope of the abuse of the European Freedom of Establishment.

The European Court of Justice, in the *Inspire Art* case, was called to face again the problems of EU law compliance arising between the provisions concerning the Freedom of Establishment and national rules. Already the previous decisions of the European Court of Justice in *Centros*, *Daily Mail* and *Überseering* created, among scholars, an academic debate if the real seat theory was able, possibly with the necessary modifications, to coexist with the Freedom of Establishment, or not.

The judgement of the European Court of Justice in *Inspire Art* reinforced the opinion among scholars that the real seat doctrine could coexist with the Community provisions concerning the Freedom of Establishment. In fact, the real seat theory found itself narrowed by the last judgement of the European Court of Justice but it was not abolished by the decision of the Court, therefore

Article 54 TFUE still guarantees the real seat theory applicability within the EU Member States.

A comparative analysis of *Daily Mail* case and *Inspire Art* case shows that the scope of applicability of the real seat theory depends on the role assumed by the EU Member State which applies the aforementioned doctrine. With regard to Freedom of Establishment, the State of Incorporation has a wider scope in applying its corporate law whereas the host Member State, due to the disparate judgement of the European Court of Justice, has a narrowed scope in applying its corporate law.

The Chamber of Commerce and the Netherlands, German and Austrian Governments tried to justify the WFBV on the ground of the creditors' protection. However, the European Court of Justice rejected the argument of the Chamber of Commerce and the Netherlands, German and Austrian Governments. Such a decision of the European Court of Justice lead the scholars to the point of view that Member States have to change their approach to the protection of creditors and in general of stakeholders.[127] The Member States could empower their measures concerning the protection of the creditors and other stakeholders focusing on better information and financial disclosure made by the corporations.

The opinion of the Advocate General Alber pointed out the uncertainty that hovered among the Governments of Member States. This happened especially when the representative of the German Governments asked during the oral hearing to the European Court of Justice the possible way to hinder the creation of the "brass plate companies" (companies with no "real" existence other than a brass nameplate at its registered address) that were considered to abuse

[127] EBKE, W. F., *The European Conflict-of-Corporate-Laws Revolution: Überseering, Inspire Art and Beyond, International Legal Developments in Review: 2003,* p. 47.

the Community provisions on Freedom of Establishment. The AG Alber argued that it is not a duty of the European Court of Justice to find an answer to this kind of questions. According to the opinion of the Advocate General, the Member States must find the solution necessary to prevent any type of abuse made by the corporations. The AG Alber explained that the European Court of Justice, under article 220 EC, is able to interpret the provisions of the Treaty. Thus, the Court has to identify the scope given to the provisions contained within the European Treates. [128]

Some scholars after the decision of the European Court of Justice in Inspire Art case resumed the precedent decision of the Court in *Überseering*. They noted that the Court in point 92 of that judgment held: "It is not inconceivable that overriding requirements relating to the general interest, such as the protection of the interests of creditors, minority shareholders, employees and even the taxation authorities, may, in certain circumstances and subject to certain conditions, justify restrictions on freedom of establishment". Thus, in *Inspire Art* case the European Court of Justice makes impossible to benefit of the statement part of the judgement of *Überseering* case.[129] In fact, the European Court of Justice stated that a restriction to the right of Establishment derived by a domestic provision, such as those of the proceeding, concerning the minimum capital requirements and the liability of directors, cannot be justified on the ground of the protection of creditors.[130]

[128] Opinion of the Advocate General Alber, *Inspire Art* case, point (122) and (123).
[129] KERSTING, C., SCHINDLER, C. P., *The ECJ's Inspire Art Decision of 30 September 2003 and its Effects on Practice*, p. 1284.
[130] Judgement of the Court, Case C-167/01 point (142).

About the issue of protecting corporate creditors, the European Court of Justice affirmed that the Inspire Art shows itself as a company governed by different corporate laws; in particular, Inspire Art appeared governed by both the law of England and Wales and that of the Netherlands. Thus, the creditors of the corporation were sufficiently informed that the corporation was subject to different rules concerning the minimum capital and directors' liability.
Some authors made a drastic example to demonstrate that the point of view of the European Court of Justice could not be totally correct. They took as an example the corporate laws of Austria and Germany. The Austrian private limited companies, according to Section 6 (1) of the Austrian law on private limited companies, are required to have a minimum capital of Euro 35.000, whereas the German private limited corporations, according to Section 5 (1) of the German law on private limited companies, required Euro 25.000 as minimum capital. Both in Austria and in Germany the private limited corporations use the acronym GmbHG to show their legal form. Thus, there is no certainty that a creditor of one of these two Member States is in fact enabled to understand the origin of a corporation. Finally, some scholars stated that the arguments of the European Court of Justice concerning the transparency of the market could work with regard to contractual creditors, but should not be applied with regard to the tort creditors.[131]
Finally, scholars and jurist, after the judgement of the European Court of Justice, started to study the possible consequences of the restrictions of the right of Establishment based on the protection of the interest of the employees.

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[131] KERSTING, C., SCHINDLER, C. P., *The ECJ's Inspire Art Decision of 30 September 2003 and its Effects on Practice*, p. 1284.

The protection of the employees' rights, especially if they affect constitutional values, could allow Member State to restrict the Freedom of Establishment. For instance, the German law apply the co-determination[132] rules for companies having certain characteristics. It was not clear whether an host EU Member State has the power to apply its provisions, such as the representation of labor on the board, to a corporation validly formed into another EU Member State but that carry out most or the entire part of its economic activity in the host EU Member State.

Some Scholars argued that German law about the co-determination could justify, restrictions to Freedom of Establishment. However, there were many doubts on the applicability of this rule to the pseudo-foreign companies, because with high probability the co-determination rule does not meet the four-factor test developed by the European Court of Justice and this rule does not fall within the scope of article 46 EC.[133]The rule on co-determination can be applied both to pseudo-foreign and to national companies, therefore it is considered as non-discriminatory. In any case, the issues, as the representation of foreign employees, the remodelling of the governance structure of the real foreign corporation to the co-determination rule and the recognition of the co-determination rule

[132] Codetermination in Germany is a concept with a solid history that involves the right of workers to participate in management of the companies they work for. Known as Mitbestimmung, the modern law on codetermination is found principally in the Mitbestimmungsgesetz of 1976. The law allows workers to elect representatives for almost half of the supervisory board of directors. The legislation is applied to public and private companies, so long as there are over 2000 employees. For companies with 500-2000 employees, one third of the supervisory board must be elected.

[133] EBKE, W. F., *The European Conflict-of-Corporate-Laws Revolution: Überseering, Inspire Art and Beyond*, p. 32-33.

by the EC Member State of incorporation, are not considered because real foreign corporation are left out from this problem.[134]
However, the application of the German co-determination rule to the pseudo-foreign corporations could possibly be considered as a restriction of the article 43 EC and 48 EC concerning the Freedom of Establishment. This because the application of the German rule about the compulsory participation of the employees to the management of the pseudo-foreign companies makes the right of establishment less attractive and hinders the Freedom of Establishment. Moreover, it is important also to consider if the co-determination rule does not go beyond what is necessary in order to attain its objective and, therefore, it complies with the requirement of proportionality. The authors argued that the Directive on the European Works Council guarantees a minimum level of protection to the employees. They also noted that the co-determination in the other EU Member States is not considered necessary to protect employees interests. Finally, the argument of the European Court of Justice based on the information, as in Inspire Art case, is applicable also when employees enter into a contract with the pseudo-foreign corporation. In fact, employees are aware that the company is subject to the corporate law of another EU Member State and therefore they can be considered protected. Thus, the application from the host State of its corporate law to a pseudo foreign corporation might be considered as a breach of the Freedom of Establishment.[135]

[134] KERSTING, C., SCHINDLER, C. P., *The ECJ's Inspire Art Decision of 30 September 2003 and its Effects on Practice*, p. 1286.
[135] KERSTING, C., SCHINDLER, C. P., *The ECJ's Inspire Art Decision of 30 September 2003 and its Effects on Practice*, p. 1287.

3.8 Sevic

3.8.1 The Facts

The *Sevic* case concerned the corporate mobility. Sevic System was a German company which in 2002 concluded a merger agreement with a Luxemburgish corporation called Security Vision (SVC). The merger agreement caused SVC dissolution without liquidation and the transfer of all its assets to Sevic System. However, the Amtsgericht Neuwied, the local court, refused the application for registration of the merger in the commercial register because in its opinion the article 1 paragraph 1 of the Umwandlungsgesetz (UmwG) did not allow mergers between legal entities that were not established in Germany.

At the proceeding time, the European institution had not completed the Cross-Border Merger Directive. Thus, there was not any European law enforced that ruled the operation. In fact, the Advocate General Antonio Tizzano in his opinion specified that the European Commission tried, for many years, to enforce some provisions in order to provide to the Member States an European law able to rule cross-border mergers.[136]

Sevic Systyem was contrary to the local court decision and appealed it with the Landgericht Koblenz which asked to the European Court of Justice an interpretation of the Community law. The question submitted to the European Court of Justice asked for the compatibility of the German provisions, the Umwandlungsgesetz, concerning the mergers of the corporations with articles 43 EC and 48 EC.

[136] Opinion of Mr Tizzano — Case C-411/03 point (7) and (8).

3.8.2 The Judgement of the European Court of Justice

According to the point of view of the Advocate General Tizzano, the provisions concerning the Freedom of Establishment allowed legal persons to access and carry out an economic activity into another Member State in the same manner, and under the same conditions, as the legal persons of the host Member State. Thus, articles 43 and 48 of the EC Treaty do not just allow legal persons to move into another Member State in order to carry out an economic activity there, but, moreover, they afford the right of establishment together with all the functional and complemental aspects, which are linked to the corporation's economic activity.[137] According to professor Tizzano, the national provisions concerned aspects that are not complementary but essential to the carrying out of the corporation economic activity.

Moreover the Advocate General Antonio Tizzano, underlined that the intention of the Sevic System corporation was to maintain in Luxembourg, after the merger of the two companies, assets, personnel and means of production belonging to the incorporated company, the SVC. In this way the Sevic case could be considered and studied not only as a case concerning the primary Freedom of Establishment, but also as a case of secondary Freedom of Establishment, due to the fact that Sevic System wanted, by the merger, establish a secondary place of business abroad.[138]

The Advocate General considered the precedent judgement of the European Court of Justice that affirmed: "all measures which prohibit, impede or render less attractive the exercise of that freedom" must be considered as restriction to the Community law

[137] Opinion of Mr Tizzano — Case C-411/03 point (29) and foll.
[138] Opinion of Mr Tizzano — Case C-411/03 point (34) and foll.

concerning the Freedom of Establishment. Thus, national measures which hinder or discourage the application of provisions concerning the Freedom of Establishment are prohibited, due to the Community rules and the jurisprudence of the European Court of Justice. Thus, Tizzano concluded his opinion arguing that the German UmwG rules hinder the right concerning the Freedom of Establishment blocking both German companies to establish themselves in other EU Member States and companies of other EU Member States to access the German market by means of mergers.[139]

The European Court of Justice started its judgement stating that Articles 43 EC and 48 EC can be used to discipline a merger such as the merger of the Sevic case. The European Court of Justice confirmed the point of view of the Advocate General Antonio Tizzano stating that: “a merger such as that at issue in the main proceedings constitutes an effective means of transforming companies in that it makes it possible, within the framework of a single operation, to pursue a particular activity in new forms and without intrerruption, thereby reducing the complications, times and costs associated with other forms of company consolidation such as those which entail, for example, the dissolution of a company with liquidation of assets and the subsequent formation of a new company with the transfer of assets to the latter.”.[140]

The European Court of Justice concluded its reasoning arguing: “Articles 43 EC and 48 EC preclude registration in the national commercial register of the merger by dissolution without liquidation of one company and transfer of the whole of its assets to another company from being refused in general in a Member State where one of the two companies is established in another Member State,

[139] Opinion of Mr Tizzano — Case C-411/03 point (44) and (50).
[140] Judgment of the Court, Case C-411/03 point (16) and (21).

whereas such registration is possible, on compliance with certain conditions, where the two companies participating in the merger are both established in the territory of the first Member State.”.[141]

3.8.3 The consequences of the ECJ judgement

The ruling of the European Court of Justice in the *Sevic* case clarified that the provision concerning the Freedom 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 the economic life of the country effectively and under the same conditions as national operators”. These ruling confirmed the point of view of Advocate General Tizzano and identified in a general way the boundaries of the right of Establishment. Thus, the cross-border merger between two companies governed by different corporate laws fall within the scope of the right of Establishment.

The European Court of Justice decision resumed its precedent ruling which stated “it is not possible to exclude the possibility that imperative reasons in the public interest such as protection of the interests of creditors, minority shareholders and employees, and the preservation of the effectiveness of fiscal supervision and the fairness of commercial transactions, may, in certain circumstances and under certain conditions, justify a measure restricting the freedom of establishment”. EU Member States can apply restrictions to the right of Establishment, but these restrictions must justify under the grounds noted by article 52 TFEU or respect the conditions set out by the Gebhard test.

[141] Judgment of the Court, Case C-411/03 point (31).

3.9 Cartesio

3.9.1 The Facts

Cartesio was a Hungarian limited partnership formed on 20 May 2004. On 11 November 2005, Cartesio filed a transfer request with the Bács-Kiskun Megy Bíróság, the Regional Court of Bács-Kiskun, whereby its real seat would have been moved to Gallarate (Italy), whereas, at the same time, the company asked to maintain its status as a company subject to the Hungarian law.

Hungary adopts the real seat theory and its corporate law states that the operational headquarters and the registered office of a corporation must be placed in the same state, therefore, on 24 January 2006, the application for the transfer of Cartesio seat was rejected because that the Hungarian law did not allow a corporation incorporated under the Hungarian law to transfer its seat into another State, at the same time remaining subject to the Hungarian law. According to the Hungarian law, a corporation, in order to be allowed to such an operation, should first go through dissolution and winding-up of its business and then re-incorporate in another jurisdiction.

The Hungarian Regional Court of Appeals decided to stay the proceeding while waiting for an answer to the four questions posed to the European Court of Justice. Three questions concerned the power of the Regional Court to submit such a reference under article 234 EC and one question concerning the Freedom of Establishment. In addition, the Regional Court asked whether articles 43 and 48 of the EC Treaty allowed for national rules to impede the transfer of the seat of a corporation into another State, unless prior dissolution of the local entity was completed (prior dissolution rule).

The Advocate General Poiares Maduro argued that the *Cartesio* case did not fall outside the scope of the Community provisions concerning the Freedom of Establishment. In the opinion of the Advocate General, national provisions permitting a corporation to transfer its administrative headquarters only within its national borders "treat cross-border situations less favourably than purely national situations.". Thus, these national corporate law provisions appear to discriminate the exercise of the fundamental freedom of establishment. Moreover, he argued that Cartesio wanted to carry on an economic activity for an indefinite period of time and through a stable establishment in Italy. Therefore, the European Treaty provisions concerning the Freedom of Establishment should be applied.[142]

The Advocate General resumed the previous statement of the European Court of Justice expressed in the *Daily Mail* case, where the Court acknowledged the power of a EU Member State to decide on "life and death" of a corporation formed under its corporate law. However, the Advocate General argued that the European Court of Justice in its judgement on the *Centros*, *Überseering* and *Inspire Art* cases, took a different conclusion with regard to the decision it took in *Daily Mail*. Prof. Maduro acknowledged and fostered the reasoning of Advocate General Tizzano in his opinion concerning the *Sevic* case. Tizzano had affirmed in his opinion that : "It is evident from the case law that Article 43 [of the] EC [Treaty] does not merely prohibit a Member State from impeding or restricting the establishment of foreign operators in its territory, it also precludes it from hindering the establishment of national operators in another Member State. In other words, restrictions "on entering" or "on

[142] Opinion of Advocate General Poiares Maduro, Case C-210/06, p. (25).

leaving" national territory are prohibited" under the Freedom of Establishment rules.

Thus, Maduro rejected the opinion that EU Member States are free to determine "life and death" of a corporation formed under their corporate law, because the provisions concerning the Freedom of Establishment influenced the corporate law of any EU Member State. The Advocate General further underlined the importance of the primary right of Establishment for small and medium-sized corporations, because for such companies "an intra-Community transfer of operational headquarters may be a simple and effective form of taking up genuine economic activities in another Member State without having to face the costs and the administrative burdens inherent in first having to wind up the company in its country of origin and then having to resurrect it completely in the Member State of destination". According to the Advocate General point of view, the winding-up of a corporation and its subsequent incorporation into another EU Member State represents for it a huge expense of time and resources.

The Advocate General Maduro took the view that the Treaty allowed State law restrictions on Freedom of Establishment on the grounds of general public interest[143]. However, the Hungarian Government did not submit any public interest justifications. Moreover, the Hungarian law did not provide any possibility for a corporation formed under its corporate law to transfer its operational headquarters into another EU Member State. The only way for a corporation was to first wind-up and, then, to reincorporate in the selected EU Member State; the Hungarian law did not provide any

[143] An example could be the prevention of abuse or fraudulent conduct, the protection of the interests of, creditors, minority shareholders, employees or the tax authorities.

other condition for a corporation formed under its corporate law for such an operation. Thus, in the light of all these considerations, the Advocate General suggested to the European Court of Justice to consider the Hungarian provisions not compatible with the provisions stated in Articles 43 and 48 of the EC Treaty.

3.9.2 The Judgement of the ECJ

The European Court of Justice in *Cartesio* maintained the previous holding, as expressed twenty years before in the *Daily Mail* case. The European Court of Justice concluded its ruling stating that, at the present status of the Community law, Articles 43 and 48 of the EC Treaty allowed the corporate law of a Member State, where a corporation decided to be originally incorporated, to prohibit such corporation to transfer its seat into another EU Member State, while at the same time retaining its status as a corporation subject and governed by the corporate law of the EU Member State of incorporation.[144]

In reaching such conclusion, the Court resumed its ruling where it affirmed that companies are creatures of national law and they exist only by virtue of the national legislation which determines its incorporation and functioning rules.[145] The European Court of Justice again pinpointed, in its decision, the equivalence of the three connecting factors of the registered office, central administration and principal place of business of a company identified by Article 43 and 48 of the EC Treaty, today article 49 and 54 of the TFEU.

In *Cartesio,* point 108, the European Court of Justice explained that the EEC Treaty considered the differences existing within the corporate laws of the EU Member States. These legal differences

[144] Judgment of the Court, Case C-210/06, point (124).
[145] Judgment of the Court, Case 81/87 point (19).

among EU Member States concerned *inter alia*, the connecting factors required by corporations formed under their respective corporate law and the difference existing between rules concerning the transfer of real seat or of registered seat from the EU Member State of incorporation and another EU Member State were the real seat or the registered seat is to be transferred. For the Court this kind of problems should be solved by future legislation and conventions and it cannot be determined by the provisions on the right of establishment provided by the Community law, as the Court already stated in the *Daily Mail* case.[146]

Moreover, according to the Court, each EU Member State retains the power to choose the connecting factor(s) necessary for a corporation to be considered validly formed under its corporate law and the connecting factors allowing the corporation to retain its status as a "national" company. Thus, such a power would enable a EU Member State to deny a corporation subject to its corporate law to transfer its seat into another EU Member State, without prior dissolution.

After clarifying the connecting factors' scope and the EU Member States right to determine them, the Court specified that a situation such as that occurring in *Cartesio* case should be considered differently in comparison to a situation in which a corporation validly established in one Member State decides to transfer its seat with an application asking the change of the applicable national law.[147] In such a case, the corporation decides to convert itself into a form of company disciplined by the corporate law of the host EU Member State. The European Court of Justice specified that, in this kind of situations, the requirement of winding-up or liquidation of the corporation will be considered as a restriction of the Freedom of

[146] Judgment of the Court, Case C-210/06, point (108).
[147] Judgment of the Court, Case C-210/06, point (111).

Establishment, thus such type of restriction must be justified by the *Gebhard* test.[148]

The Commission underlined that the differences among corporate laws of EU Member States, in particular those concerning the connecting factors and the transfer of seat, were solved by the EU legislation concerning the transfer of seat, from one EU Member State to another EU Member State, by the regulation about the SE and the European Cooperative Society (SCE) and the European Economic Interest Grouping (EEIG).[149]

These regulations permit legal entities established in one EU Member State to transfer their registered office, and thus also their real seat, into another EU Member State without "it being compulsory to wind up the original legal person or to create a new legal person". However, this kind of operations involves a change of the national law applicable to the corporation that wants to transfer its seat.[150]

However, the European Court of Justice pointed that, in the present case, Cartesio wanted to transfer its real seat from Hungary to Italy, while at the same time remaining a company governed by Hungarian law: hence, such operation would not have involved any change in the national law applicable to the corporation.[151]

Finally, the Court specified that the *Sevic* case was different from the *Cartesio* case, because the case of Sevic System concerned the recognition by the EU Member State of incorporation of an establishment of the corporation into anther EU Member State by

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[148] Judgment of the Court, Case C-210/06, point (112) and (113).

[149] Judgment of the Court, Case C-210/06, point (115); The regulations cited by the Commission are: the Regulation No 2137/85 on the EEIG; the Regulation No 2157/2001 on the SE; the Council Regulation (EC) No 1435/2003 on the Statute for a European cooperative society (SCE).

[150] Judgment of the Court, Case C-210/06, point (117).

[151] Judgment of the Court, Case C-210/06, point (119).

the operation of a cross-border merger. Therefore, from the European Court of Justice point of view the two cases were fundamentally different.[152]

3.9.3 Considerations on the Judgement of the ECJ

The *Cartesio* case is considered a milestone of the Freedom of Establishment issue. The *Cartesio* case influenced and marked the boundaries of important right of Establishment features for companies. In fact, the case permitted to better analyse the outbound and the inbound cases and it apparently solved the issue concerning the real seat theory compatibility with the provisions of the Freedom of Establishment; it finally confirmed and specified the controversial rules stated by the European Court of Justice in the *Daily Mail* case.

The European Court of Justice introduced in its decision another important issue: in two points of the Cartesio's judgement, the European Court of Justice introduced the notion of "nationality" referred to the corporations. This is important, because the Court in the previous judgements argued: "unlike natural persons, companies are creatures of the law and, in the present state of Community law, creatures of national law."[153]

Überseering and *Inspire Art* decisions narrowed and outlined the *Daily Mail* case as a case concerning only the outbound corporate mobility. A.G. Tizzano and A.G. Maduro expressed the opinion that the *Daily Mail* decision ought to be repealed because, at the present state of the European law, the *Daily Mail* ruling allowed some unacceptable behaviours by EU Member States which hindered the

[152] Judgment of the Court, Case C-210/06, point (122).

[153] Judgment of the Court, Case 81/87 point (19) and Judgment of the Court, Case C-210/06, point (109) and (123).

transfer to other States of corporations formed under their corporate laws.

In *Cartesio* case, the European Court of Justice confirmed its previous *Daily Mail* decision, and stated again that “companies are creatures of national law and exist only by virtue of the national legislation which determines its incorporation and functioning”. Then, the European Court of Justice specified that the *Überseering* case shows that the corporate law of an EU Member State of incorporation provides legal personality to the corporation. Thus, it will be the corporate law of the EU Member State of incorporation to decide the necessary requirements for a corporation aiming to transfer its seat into another EU Member State without losing at the same time its legal personality. Moreover, any restriction on this kind of movement must comply with the conditions outlined in the *Gebhard* case (i.e. “they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it”[154]).

A joint analysis of the *Cartesio* case, together with the *Überseering* case, shows that the European Court of Justice studied the private international law provisions of the EU Member State where the corporation was formed. Any corporation seeking to benefit of the right of Establishment within the European Union must comply with the requirements written in article 54 TFUE. More precisely, the corporation must be formed accordingly under the corporate law of any of EU Member States, and then it must have its registered office, central administration or its principal place of business within the

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[154] Case C-55/94, Gebhard.

Union. None of these three connecting links shall be considered as prevailing with respect to the others.
It appears that the European Court of Justice would be willing to examine the private international law provisions of each EU Member State that is involved in a proceeding in order to determine which EU Member State complies with the provisions of article 54 of the TFEU whenever there is uncertainty about the nationality or the legal personality of a corporation. Thus, when the European Court of Justice faced the issues raised by the *Cartesio* case, it examined the connective link between the corporation and the Italian law. Since in the specific circumstances of the case there were no connecting factors between the Italian law and Cartesio, the nationality and the legal personality of the corporation could not be established in Italy. In fact, the company had its real seat and also its registered seat in Hungary, since it was formed and registered under the Hungarian law. In the *Überseering* case the corporation was formed under the Dutch law, whereas it was considered to have moved its administrative seat in Germany from a German law perspective. However, since the corporation was not incorporated under the German law, this circumstance permitted to the European Court of Justice to identify a restriction on the Freedom of Establishment in German corporate law. The European Court of Justice decisions in these cases and the previous decisions show that the State of incorporation retains a greater power in determining the life of the corporations formed under its corporate law.
It could also be noted that it appears that the European Court of Justice in its statement took the opportunity to give an indication about the transfer of the registered seat. In fact, the Court stated that, according to the point of view of the Commission, if Cartesio

had tried to move first its registered seat probably the regulation concerning the EEIG and SE could have been used in order to discipline this kind of operation.[155]

3.9.3. a A deeper focus on the emigration and immigration cases

The previous decisions of the European Court of Justice concerning the Freedom of Establishment and the Court's judgement in *Cartesio* provide a better understanding of the differences existing between an "emigration" and an "immigration" case law, concerning companies (as defined under article 49 and 54 of TFEU).

Centros, *Überseering*, *Inspire Art* cases can be considered as "inward" cases, whereas *Daily Mail* and *Cartesio* cases can be categorised as "outward" cases. In the "immigration" case law, the decisions of the European Court of Justice show that the national provisions of private international corporate laws, that were considered to constitute a restriction on the Freedom of Establishment, must comply with the four rules of the *Gebhard* case test[156]. Instead, the decisions of the Court rendered in *Daily Mail* and then in *Cartesio* appear to confirm the considerable power left to the EU Member States of incorporation over the company formed under their corporate laws.

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[155] Judgment of the Court, Case C-210/06, point (115) to (120).

[156] The Court in the Gebhard case stated that national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must comply with four conditions. They must:

1. be applied in a non-discriminatory manner;
2. be justified by imperative requirement in the general interest;
3. be suitable for securing the attainment of the objective which they pursue;
4. not go beyond what is necessary in order to attain it.

However, the European Court of Justice, even in its “outward” decisions did not left untouched the power of the EU Member States to regulate companies’ establishment. In fact, in its decisions the Court specified that, in a situation where a company governed by the law of one Member State moves to another Member State with the will to be subject to the national corporate law of the host Member State and to convert into a form of company which is governed by the law of the Member State to which it has moved, any restriction to the transfer of the company seat will be considered by the European Court of Justice as a Freedom of Establishment restriction. Thus, the Court would allow the EU Member State of incorporation to hinder the moving of a corporation only when the company wants to transfer its seat in another EU Member State while at the same time retaining its status (i.e. its “nationality”) as a corporation subject to the laws of the EU Member State of incorporation.

The Advocate General Maduro in his opinion showed his criticism with respect to the European Court of Justice judgement. According to his point of view, the *Daily Mail* judgement was not a good ground of decision. Maduro took up from the European Court of Justice’s statement in which it was affirmed that the provisions concerning the Freedom of Establishment did not allow an EU Member State of incorporation to hinder the establishment into another EU Member State of one of its nationals (including its companies formed under the rules of its corporate law).[157] Then, the Advocate General continued his thought[158] resuming the argument of the Advocate General Tizzano that in his opinion stated that: “Article 43 EC does

[157] Judgment of the Court, Case 81/87 point (16).
[158] Opinion of Advocate General Poiares Maduro, Case C-210/06, p. (28).

not merely prohibit a Member State from impeding or restricting the establishment of foreign operators in its territory, it also precludes it from hindering the establishment of national operators in another Member State".[159] Thus, once a corporation has been validly formed in a given EU Member State and therefore it falls within the scope of article 54 of the TFEU should be free to benefit from the right of Establishment.

The Advocate General Maduro admits that in some circumstances the national corporate law could require the compliance of some conditions before allowing the transfer of the real seat of a corporation formed under its national law. These conditions are acceptable when the EU Member State wants to prevent abuse or fraudulent conduct or the protection of interests of creditors, minority shareholders, employees or tax authorities of the corporation. In the same way, in a situation where the EU Member State of incorporation is no more able to monitor and control a corporation transferring its seat, a possible solution could be "to require that the company amends its constitution and ceases to be governed by the full measure of the company law under which it was constituted", so that the corporate law of the EU Member State where it transferred its real seat will govern it.[160]

The European Court of Justice decision in *Cartesio* adopted a different point of view in respect to the line of reasoning of the Advocate General Maduro. The Court reaffirmed its previous reasoning in the *Daily Mail* judgement. Thus, it appears that the line of reasoning behind its judgment is that the Community law provisions concerning the Freedom of Establishment provided the

[159] Opinion of Mr Tizzano — Case C-411/03 point (45).
[160] Opinion of Advocate General Poiares Maduro, Case C-210/06, p. (32) and (33).

possibility to choose the corporate law most suitable for entrepreneurs. However, once the corporation is established into one of the EU Member States, according to the jurisprudence of the European Court of Justice, if it wishes to transfer its actual centre of administration to another Member State, whilst retaining its legal personality in the EU Member State of establishment, could be hindered by the State of origin in moving its real seat.

On the contrary, a situation where a corporation validly established in one Member State, decides to transfer its seat with an application asking the change of the applicable national law, it has a different treatment by the European Court of Justice. In this kind of situation, any restrictions enforced by the EU Member State of establishment on the Freedom of Establishment must comply with the *Gebhard* test.

The solution founded by the European Court of Justice in *Cartesio* would not satisfy the opinion of the Advocate General Maduro, because, according to the opinion of the Advocate General any type of restrictions to the Freedom of Establishment should be prohibited. The decision of the European Court of Justice to prohibit the obstacles put by the EU Member State of incorporation to a company aiming to transfer its seat into another EU Member State whereas it wants to be subject to the law of the host Member State, is only partially compliant with the solution fostered by the Advocate General Maduro.[161]

Some critics raised from a comparison between the decision of the European Court of Justice in *Cartesio* and that taken in *Sevic*. In the *Sevic* case the Court ruled that the denial of the cross-merger of a German corporation with a corporation of Luxemburg was not

[161] Opinion of Advocate General Poiares Maduro, Case C-210/06, p. (35).

allowed by the provisions concerning the Freedom of Establishment. In particular, the *Sevic* case law concerned "the recognition, in the Member State of incorporation of a company, of an establishment operation carried out by that company in another Member State by means of a cross-border merger". *Sevic* case was identified by the ECJ as an "inbound" case and treated accordingly. On the contrary, the Court interpreted *Cartesio* as an "outbound" case.
In this way, the Court confirmed a method of ruling that distinguishes between immigration and emigration case. According to Borg-Barthet's opinion, this approach of the European Court of Justice created a situation that does not guarantee legal certainty. The author identifies two weak points in the ECJ decision: the first is the discrimination between similar cases based on the "inbound" vs. "outbound" principles and the second is the distance with general body of jurisprudence, which deals with fundamental freedoms. [162]
An article of Dr. Petronella pointing that the Sevic System case law shared some common elements with the Cartesio case law enforces this approach: firstly, both the cross-merger and the cross-transfer of seat are cross-border operation that the European Court of Justice recognises as an admissible exercise of the right of Establishment; secondly, these cross-border operations are not regulated and the national provisions are not able to provide a good law.[163]
An opinion favourable to the ECJ decision on *Cartesio* was expressed by Dr. Paschalidis who observed that the previous critical opinions are focused on Freedom of Establishment principles as it was stated

[162] BORG-BARTHET, J., *The Governing Law of Companies in EU Law*, p.134.
[163] PETRONELLA, V., *The Cross-Border Transfer of the Seat after Cartesio and the Non-Portable Nationality of the Company*, p. 253.

by article 49. TFUE, but do not keep enough in consideration which ruled by article 54 TFUE (conditions giving right to be subject to the Freedom of Establishment).
However, the judgement of the European Court of Justice in *Cartesio* enforced the distinction it had already operated between "inbound" and "outbound" cases and continues to foster the EU Member States LoBOs able to "hinder" the emigration of the companies, thus, in fact, limiting the scope of the right of Establishment.

3.9.3.b The status of "Real Seat" doctrine after Cartesio

Doubts related to applicability of the real seat theory within the European Union were cast by the *Cartesio* judgement of the European Court of Justice. According to the European Court of Justice, a EU Member State is free to choose both the connective factors that a corporation must respect if it wants to be incorporated under the law of the EU Member State and those mandatory connecting links (i.e. "national" of) for the corporation to retain its status of company belonging to the EU Member State of incorporation. The Court's reasoning continues as follows: "That power includes the possibility for that Member State not to permit a company governed by its law to retain that status if the company intends to reorganise itself in another Member State by moving its [registered or its real] seat to the territory of the latter, thereby breaking the [applicable] connecting factor required under the national law of the Member State of incorporation.".[164]
However, the scope of the real seat theory was narrowed by previous judgements, because the European Court of Justice specified that the application of the real seat theory, by the host EU Member State,

[164] Judgment of the Court, Case C-210/06, point (117).

cannot deny the legal personality of a corporation which transferred its real seat there in compliance with EU Member State of incorporation. Thus, after *Cartesio*, all doubts concerning the prevalence of one of recognition theories ceased, because the incorporation theory and the real seat theory were put on the same level.

3.9.3.c An analysis on the developments of the connecting factors set forth under Article 54 TFEU

The *Cartesio* ruling has been criticised by some authors, because the European Court of Justice did not seem to follow its previous reasonings expressed in *Centros* and *Überseering* cases. The European Court of Justice, in point n. 21 of *Daily Mail* case affirmed that the connecting factors included in article 48 of the EC Treaty (at present these connecting factors are part of article 54 par.1, TFEU) are to be considered at the same level. In *Centros* and *Überseering*, the Court stated that the company's place of registered office, central administration and place of business served as the connecting factors between a legal person and the legal system of a Member State in the same way as nationality does it in case of a natural person.[165]

In *Centros* and *Überseering*, the European Court of Justice considered the presence of any of the three connecting factors as a sufficient condition for enforcing the provisions concerning the Freedom of Establishment.

In the *Cartesio*, the European Court of Justice, although pointing again the equivalence of the connecting factors, at the end affirmed that the choice of the applicable connecting factors was a matter

[165] Judgement in Case C-208/00 (*Überseering*) p. (57); judgement in Case C-212/97 (*Centros*), p. (20).

that should be faced by EU Member States through future legislation and conventions.[166]

It appears that the issue of the connecting factors equivalence was interpreted in an opposite way between on one hand *Centros* and *Überseering* judgements and on the other hand *Cartesio* judgement. In *Centros* the equivalence of the connective factors allows the corporation to benefit of the right of Establishment, whereas in *Cartesio* case decision and also in the previous *Daily Mail* case judgement the equivalence of the connecting factors was considered by the European Court of Justice not sufficient to override national laws, directly applying the provision concerning the Freedom of Establishment.

According to Dr Borg-Barthet, this reasoning was based on the observation made by the European Court of Justice in the *Daily Mail*, where the Court held that the right of a corporation to transfer its seat was subject to the adoption of future legislation still to be adopted according to the Article 293 of the EEC Treaty. Then, the European Court of Justice, in *Centros* did not consider the Articles 293 of the EC Treaty. Moreover, the Court, in *Überseering*, specified that article 293 of the EC Treaty did not constitute a reserve of legislative competence vested in the Member States, but it only provided EU Member States with the necessary joint legislative powers in order to reach the objectives of the Treaty with respect to companies. Finally, in *Cartesio*, the European Court of Justice resumed its old statement exspressed in *Daily Mail*, whereby it appears that the right of Establishment did not have direct effect. Thus, the presence of any of the three connecting factors would not trigger the application of the provisions concerning the right of

[166] Judgment of the Court, Case C-210/06, point (106) to (109).

Establishment. The Court closed its argument in *Cartesio* by affirming that the EU Member States have the right to decide the connecting factors necessary for a company to be established and to continue to exist under their respective national corporate laws. The Author concluded its reasoning arguing that the Cartesio judgement was not sufficiently clear; therefore, the decision of the European Court of Justice did not create a new path in order to understand the role of the connecting factors in the corporation transfer of seat. In conclusion, it is not clear when the provisions concerning the Freedom of Establishment have a direct effect or not.[167]

A possible solution hypothesized by Dr. Paschaldis in order to successfully transfer Cartesio administrative seat in Italy, was to transfer it without making any request to the Hungarian authorities. At that time the Hungarian commercial register did not monitor the real seat position. Then, in such situation, the Hungarian authorities could have considered the board of directors meetings of Cartesio not valid, because they were not held where the place of incorporation was located. Then, the corporation could have tried to dispute the validity of the Hungarian corporate provisions requiring the same location for the registered and the real seats. Instead, the corporation did not try to dispute the validity of the real seat theory with the provisions concerning the Freedom of Establishment. In sum, Cartesio could have a better chance to demonstrate that the Hungarian corporate law provisions concerning transfers of seat abroad corresponded to a restriction of the right of Establishment. In fact, the application of the real seat theory usually involves the application, by the domestic courts, of the law where the real seat is

[167] BORG-BARTHET, J., *The Governing Law of Companies in EU Law*, p.133.

located. In addition, the real seat theory normally does not require the same location for registered and real seat.[168]

3.10 Vale

3.10.1 The Facts

The case law concerned the cross-border conversion of corporations within the single market. VALE Costruzioni Srl was an Italian limited liability company (s.r.l.) registered in the Rome commercial register. On 3 February 2006, VALE Costruzioni asked to the Italian authority to be removed from the Rome commercial register, because it aimed to transfer its seat and all its economic activity in Hungary. The Italian authority accepted the demand and removed, on 13 February 2006, VALE Costruzioni from the commercial register. Within the register under the heading “Removal and transfer of seat” was added an entry specifying that the corporation moved to Hungary. In fact, in the Italian commercial register, it was written that VALE Costruzioni selected Budapest as place of its new registered seat.

On 14 November 2006, the director of the VALE Costruzioni, together with another natural person, adopted the act of incorporation of the VALE Építési kft. VALE Építési is a limited liability company formed under the Hungarian law, that wanted to be registered in the Hungarian commercial register. In the preamble of the act of incorporation of VALE Építési was written, “the company originally established in Italy in accordance with Italian law has decided to transfer its seat to Hungary and to conduct business in accordance with Hungarian law”.

[168] PASCHALIDIS, P., *Freedom of Establishment and Private international law for Corporation*, p. 87.

On 19 January 2007, the Corporation submitted an application at the Fővárosi Bíróság (the Court of Budapest) for the registration of the VALE Építési under the Hungarian law. VALE Costruzioni was indicated as the predecessor in law of the VALE Építési in its application.

The Court of Budapest rejected the application for the registration of the VALE Építési in the commercial register and the Fővárosi Ítélőtábla (the Regional Court of Budapest) in its judgement of the appeal made by the corporation shared the same point of view. The Regional Court of Budapest rejected the application of VALE Építési because the Hungarian law did not allow a corporation formed and registered into another EU Member State to transfer its seat to Hungary and did not allow the corporation to benefit of the registration in the commercial register. However, Hungarian legislation allowed a corporation formed and incorporated in Hungary to be registered in the national commercial register as the predecessor in law of a company: but Hungarian law did not allow such a registration, if the predecessor was a company incorporated in another EU Member State.

VALE Építési brought an appeal to the Supreme Court of Hungary specifying that the refusal of the Hungarian Courts amounted to a restriction of its Freedom of Establishment, protected under EU law.

3.10.2 The Judgement

The European Court of Justice had to solve the case of a transfer of seat of a limited corporation validly formed according the law of one Member State. This corporation then decided to be removed from the commercial register of the EU Member State of incorporation in order to transfer its seat and to be registered in the company register of the host EU Member State, thus changing the applicable law

under which it was to be governed. Moreover, the European Court of Justice had to decide whether the provisions concerning the Freedom of Establishment should be applied and, if so, the effect of these provisions on the main proceedings.

The European Court of Justice with the first two questions of the referring Court had to decide whether articles 49 and 54 of the TFEU did or did not allow national law of the destination State to impede a corporation validly incorporated in another EU Member State from converting and being incorporated into a company of that EU Member State of destination.

The European Court of Justice declared that the Hungarian provisions fell within the scope of articles 49 and 54, TFEU. The Court concluded that the Hungarian provisions, allowing the conversion of the Hungarian national companies but, on the contrary, not allowing the same operation to a corporation formed into another EU Member State, were against the aims and the scope of Articles 49 and 54, TFEU.[169]

The European Court of Justice rejected the considerations made by the Hungarian, German, United Kingdom and Ireland Governments, which argued that the Hungarian provisions did not fall within the scope of Articles 49 and 54, TFEU, because a cross-border conversion lead to the incorporation of a company in the host Member State.

The European Court of Justice specified that a Member State has the power to identify both the connecting factors required to a corporation in order to be considered as incorporated under its national law and the connecting factors necessary for it to retain its status of corporation validly formed under the law of the EU Member

[169] Judgment of the Court, Case C-378/10, p. (33).

State of incorporation. According to the Court, a cross-border conversion, allowed under articles 49 and 54, TFEU, did not hinder or affect the power of the host EU Member State to identify its provisions that would govern and rule the incorporation and functioning of the company resulting from the cross-border conversion. Thus, the provisions concerning the Freedom of Establishment fall within the scope of articles 49 and 54, TFEU.[170]

Then the European Court of Justice analysed whether there was a restriction on the freedom of establishment and if a possible justification for such a restriction existed. The Court noted: "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. Consequently, it presupposes actual establishment of the company concerned in that State and the pursuit of genuine economic activity there."[171]

Then, the European Court of Justice identified a restriction on the right of Establishment, because the national provisions allowed only conversions of corporations having their seats already placed in Hungary. According to the Court's point of view, such national legislation represented a Freedom of Establishment restriction, because it treated differently the conversion of a national corporation and the cross-border conversion of a foreign corporation. In this way, corporations of the other EU Member States resulted disadvantaged in exercising their Freedom of Establishment in Hungary.

The European Court of Justice explained that the absence of a European Union secondary law concerning the cross-border

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[170] Judgment of the Court, Case C-378/10, p. (29) and (30).

[171] Judgment of the Court, Case C-378/10, p. (34).

conversions did not justify a different treatment, by national laws, of cross-border conversions, in comparison with the domestic conversions. Thus, the provisions concerning the Freedom of Establishment should be applied, even if there was not a European secondary law.[172]

Restrictions of the Freedom of Establishment based on the ground of overriding reasons in the public interest[173], preservation of the effectiveness of fiscal supervision and fairness of commercial transactions may be justified by the European Court of Justice. However, such restrictions must comply with the *Gebhard* four points test.[174]

The European Court of Justice concluded its reasoning concerning the first two questions of the referring Court stating that "Articles 49 and 54, TFEU, must be interpreted as precluding national legislation which enables companies established under national law to convert, but does not allow, in a general manner, companies governed by the law of another Member State to convert to companies governed by national law by incorporating such a company."[175]

Finally, the European Court of Justice answered the third and fourth questions. The referring Court asked whether articles 49 and 54, TFEU, allowed the host EU Member State to determine the national law to be applied to cross-border conversions. In particular, the referring Court was wished to understand whether the host EU Member State may refuse, for cross-border conversions, the notation of "predecessor in law" within the commercial register, because this notation was required to be filed with the commercial register of

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[172] Judgment of the Court, Case C-378/10, p. (38).

[173] An example could be the protection of the interests of creditors, minority shareholders and employees.

[174] Judgment of the Court, Case C-378/10, p. (39) and (40).

[175] Judgment of the Court, Case C-378/10, p. (41).

Hungary only for the domestic conversions. And furthermore, it wished to know whether and to what extent the host EU Member State, during the corporation registration, should trust the documents issued by the authorities of the EU Member state of origin.

The European Court of Justice argued that the national law of the EU Member State of origin and the national law of the host EU Member State must govern the cross-border conversions, because the current European secondary law does not provide any rule able to manage cross-border conversions. However, articles 49 and 54, TFEU, even if not providing any applicable rule for the cross-border conversions, prescribed that corporations governed by the law on another EU Member States, trying to convert into a corporation governed by the law of the host EU Member State, must receive the same treatment, by the national law, of the national corporations of the host EU Member State.[176]

The national provisions that, in absence of a European secondary law, will govern cross-border conversions must comply with the principle of equivalence[177] and effectiveness[178].

Thus, Hungarian provisions, governing corporations incorporation and operations, related to domestic conversions, must be applied and respected by the corporation of anther EU Member State aiming at a conversion into a (new) company governed by the Hungarian law. However, the European Court of Justice found that the Hungarian authorities denial to indicate within the Hungarian

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[176] Judgment of the Court, Case C-378/10, p. (42) and (43).

[177] The principle of equivalence assures that the nationals rules are not less favourable than those governing similar domestic situations.

[178] The principle of effectiveness assure that national provisions do not render impossible in practice or excessively difficult the exercise of rights conferred by the European Union legal order.

commercial register that VALE Costruzioni was the predecessor in law of the VALE Építési constituted a breach of the principle of equivalence. Moreover, the indication in the commercial register could be useful to inform creditors of the converting corporation. Finally, the authorities of the host EU Member State, during the examination for the corporation registration in the commercial register, must consider the documents issued by the authorities of the EU Member State of origin assuring the compliance of the provisions of its national law to that of host EU Member State. In fact, the refusal of the host EU Member State to consider the documents issued by the authorities of the EU Member State of origin (in this case, Italy) could make it impossible to complete the cross-border conversion. And, again, this would lead to a breach of the principle of effectiveness.[179]

3.10.3 The effects of the VALE judgement

The European Court of Justice, in *VALE Costruzioni*, interpreted the European Treaty provisions concerning the Freedom of Establishment as providing a rule that would allow a corporation, as defined under article 54 of the TFEU, to benefit of the cross-border conversion rules designed for domestic conversions.

The European Court of Justice specified in this decision that the only way to impede a cross-border conversion could be based on overriding reasons of the host State's public interest. The European Court of Justice introduced, in a clear manner, the guiding principles of "effectiveness" and "equivalence".

In fact, in the *SEVIC* case, the European Court of Justice stated that a different treatment of a cross-border merger vis-à-vis a national merger would constitute a restriction of Freedom of Establishment

[179] Judgment of the Court, Case C-378/10, p. (48) and foll.

under EU laws; thus, the national provisions concerning the domestic merger should be applicable also to the cross-border merger. Yet, in the *Sevic*, the European Court of Justice did not introduce the principles of effectiveness and equivalence.

Instead, in *VALE Costruzioni* the Court explained the meaning of the two principles: the principle of equivalence assures that the national rules are not less favourable than those governing similar domestic situations, whereas the principle of effectiveness assures that national provisions do not make impossible in practice or excessively difficult the exercise of rights conferred by the European Union legal order.[180]

The European Court of Justice, while still in the absence of European secondary legislation, through its ruling in *VALE* allowed EU Member States to apply their provisions to the cross-border mergers (principle of equivalence). Whereas, at the same time, the ruling of the Court held that the national provisions of the host EU Member State cannot hinder or make it impossible to benefit of the cross-border mergers. Thus, the national provisions that are deemed to make a cross-border merger impossible should be modified or eliminated. In order to reduce the gap existing between EU legislation and domestic provisions of the EU Member States, the EU Parliament and the Council approved the Directive 2005/56/EC on cross-border mergers.

The decision of the European Court of Justice brought an important change within the European law. At the first glance, the applicability of the two principles, within the European cross-border conversion, could appear clear and easily applicable. However, the Court's judgement raises some doubts, because the absence of an European

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[180] Judgment of the Court, Case C-378/10, p. (48).

secondary legislation complicates the understanding of the functioning of a cross-border conversion and the scope of the two aforementioned principles (of equivalence and of effectiveness).
The European Court of Justice in *VALE* further stated that the corporate law provisions of the host EU Member State should be applied to cross border conversions, as, for example, those requiring the company to draw up lists of assets and liabilities and property inventories.[181] The European Court of Justice also specified that the EU Member States, in absence of relevant European Union rules, ought to apply their detailed procedural rules designed to ensure the protection of the rights which individuals acquired under European Union law, so that the domestic laws of the EU Member State have the duty to govern this situations.[182] In this way, the European Court of Justice allowed both the EU Member State of origin and the host EU Member State to apply their respective national provisions in cross-border transactions. In fact, the Court specified that the host EU Member State should take into account the documents issued by the authorities of the EU Member State of origin. Thus, in such a cross-border conversion, the corporation must comply with two domestic national corporate laws.
The ruling of the European Court of Justice put the corporation aiming to fulfil a cross-border conversion in a complicate situation, because compliance with two different corporate laws could lead to great expenses of time and resources. Moreover, it could happen that the converting corporation cannot comply with all requirements of either national law involved in the transaction. Thus, while the principle of effectiveness could come help the corporation, the decision of which of the provisions should be respected or not by the

[181] Judgment of the Court, Case C-378/10, p. (52).
[182] Judgment of the Court, Case C-378/10, p. (48).

corporation would not be resolved by EU law. Thus, probably, the European Court of Justice will be called to resolve future issues concerning cross-border conversions.
As already noted, the domestic legislation of both the host EU Member State and the EU Member State of origin, in the absence of an European secondary legislation and/or mutual conventions, have to ensure the protection of the rights which individuals already acquired towards the converting company. However, the cross-border conversion could lead to situations were neither the corporate law of the host EU Member State nor the corporate law of the EU Member State of origin would lead to this result. Hence, the EU Member States should adjust their national laws in order to provide a better corporation stakeholders (including minority shareholders) interests protection. However, adjustments of the corporate law adopted by the EU Member State in order to protect stakeholders interest and allow cross-border conversions provide any guarantee to comply with the principle of effectiveness. Thus, such type of adjustments could in some cases result in a restriction of the Freedom of Establishment.
The Advocate General Jääskinen underlined the need of an agreement among the EU Member States. In his opinion the Advocate General noted that the VALE Costruzioni, at the time of the proceeding, did not longer existed under the Italian laws; thus, the transfer of seat accepted by the Italian law could not be completed because the corporation ceased to exist. According to the point of view of the Advocate General, this event led to a situation of uncertainty, because it made unclear whom the property of the corporation assets belonged to, and, in particular, to whom belonged those assets invested in order to comply with the minimum capital requirements that were necessary for the incorporation of VALE

Építési in Hungary, and whose persons were to be held liable for the obligations of the company before its registration. On the other hand, at the time of the proceeding, VALE Építési did not exist as a legal person, under Hungarian law, because its registration was rejected by the Hungarian authorities. However, the corporation, even if not registered, according an Hungarian law had the legal capacity required to initiate proceedings as a party before the National Court and before the Court of Justice. [183]

Moreover, the European Court of Justice in *VALE* argued (as it did in the judgement of *Cartesio*) that a Member State "has the power to define both the connecting factor required of a company if it is to be regarded as incorporated under its national law and as such capable of enjoying the right of establishment, and the connecting factor required if the company is to be able subsequently to maintain that status".[184] Thus, the authorities of the EU Member State of origin, adopting the real seat theory, could be in the position, depending on their domestic regulation, of rejecting the removal of the corporation from its commercial register, and in this way to impede the transfer of the company into another EU Member State, whether the corporation decides not to move also its headquarters. Thus, it is possible for a EU Member State that applies the real seat theory to hinder the conversion and the transfer of the registered seat of a company aiming to move into a EU Member State that applies the incorporation theory. Finally, it is not always clear, according to present EU legislation, under which circumstances a company is allowed to complete a cross-border conversion.

[183] Opinion of Advocate General N. Jääskinen, Case C-378/10, p. (43) and (44).
[184] Judgment of the Court, Case C-378/10, p. (29) and Judgment of the Court, in *Cartesio*, point (110).

The VALE Építési case law represents a good start in solving some of the issues concerning the cross-border conversions. However, some problems were still not solved, as, for instance, the protection of third parties related to the converting corporation. Moreover, the absence of a European secondary legislation and/or mutual conventions among EU Member States left it unclear what the future developments of the relation between the authority of the EU Member State of origin and the authority of the host EU Member State would be.

SECTION 3.C: EU Case Law on Corporate Fiscal policy

3.11 Introduction

The judgments of the European Court of Justice in de Lasteyrie du Saillant[185], Marks and Spencer[186], Cadbury Schweppes[187] and Commission v. Portugal[188] are concerned with the relationship between Freedom of Establishment and fiscal policies applied by each of the EU Member States.

In particular *Lasteyrie du Saillant* and *Commission v. Portugal* concerned capital gain issues, *Marks and Spencer* concerned losses deduction issues, *Cadbury Schweppes* concerned fiscal treatment of resident and non-resident subsidiaries' profits and *National Grid Indus* concerned taxes on the exchange rate gains. This last case is also central because it pointed out the fiscal issues related to the transfer of the legal seat, from one EU Member State to another, of a corporation.

[185] Judgment of the Court, Case C-9/02.
[186] Judgment of the Court, Case C-446/03.
[187] Judgment of the Court, Case C-196/04.
[188] Judgment of the Court, Case C-38/10.

3.12 Lasteyrie du Saillant and Commission v. Portugal

The case of de *Lasteyrie du Saillant* concerned a tax French law provision (in particular the article 167a of the French Code Général des Impôts), which required shareholders resident in France and aiming to transfer their tax residence into another EU Member State to pay taxes on capital gains that had not yet been achieved (i.e. realised).

The European Court of Justice in its judgement argued that the aim of the article 52 of the Treaty prohibited the Member State of origin from hindering the establishment in another Member State of one of its own nationals.[189]

According to Court's point of view, French tax law put a French company shareholder, aiming to transfer his tax residence into anther EU Member State at a disadvantage in comparison with a French company shareholder retaining his residence in France. In fact, the shareholder who retains his residence in France becomes liable to tax on income only when the capital gain is realised. On the contrary, for a shareholder deciding to transfer his tax residence abroad, according to France law, the increase on value becomes taxable even if profits have not yet been achieved. For the European Court of Justice, this different treatment of shareholders in relation with the taxation of value increase "is capable of having considerable repercussions on the assets of a taxpayer wishing to transfer his tax residence outside France, is likely to discourage a taxpayer from carrying out such a transfer".[190] Thus, the Court concluded its reasoning arguing that the provisions concerning the Freedom of Establishment, in particular those to be found under Article 52,

[189] Judgment of the Court, Case C-9/02, p. (42).
[190] Judgment of the Court, Case C-9/02, p. (46).

prohibited an EU Member State to enforce, provisions that allowed (in order to prevent tax avoidance) taxation of unachieved increases in value of the companies' shares.

In the *Commission v. Portugal*, the European Commission raised an objection against the tax legislation of the Portuguese Republic due to the different treatment of the unachieved capital gains, between a transfer of company activities to another Member State and the same operation made within the Portuguese territory, enforced by the Articles 76 A and 76 B of the Portuguese Corporation Tax Code concerns.

The European Court of Justice affirmed that the provisions of the TFEU Treaty on Freedom of Establishment are aimed at ensuring that nationals and companies of a foreign EU Member State are treated in the host Member State in the same way as nationals of that State. Moreover, the European provisions prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation. The Court continued indicating that, from the previous case law, "all measures which prohibit, impede or render less attractive the exercise of the freedom of establishment must be regarded as restrictions on that freedom".[191]

According to the European Court of Justice point of view the Portuguese national tax provisions constitute a restriction of the right of Establishment, because in the event of transferring the registered office and the effective management of a Portuguese corporation into another EU Member State and in the case of partial or total transfer of the assets of a company not resident in Portugal but permanently established in the State to another Member State,

[191] Judgment of the Court, Case C-38/10, point (26)

such a company is financially penalised, compared with a similar company maintaining its activities in Portugal. Thus, corporations deciding to transfer their registered seat or their real seat into another EU Member State are taxed on unachieved capital gains by Portuguese authorities. On the contrary, corporations deciding to transfer their registered seat or their real seat within Portugal will be only taxed on achieved capital gains. For the European Court of Justice such type of discrimination tends to discourage a corporation from transferring its activities from Portuguese territory to another Member State.

3.13 Marks & Spencer

Marks & Spencer was a company incorporated and registered under England and Wales law. The corporation was the holding company of a number of companies established in the United Kingdom and in other States.

Marks & Spencer brought before the European Court of Justice the issue on whether a law of the United Kingdom, allowing a corporation formed in the United Kingdom to deduct losses made by its local (i.e. resident) subsidiaries from its taxable profits, but on the contrary not allowing the same deduction for losses incurred made by non-resident subsidiaries would comply with the European law Freedom of Establishment.

The European Court of Justice stated that this different treatment between resident and non-resident losses constituted a restriction of the Freedom of Establishment. This was due to the fact that: “the exclusion of such an advantage in respect of the losses incurred by a subsidiary established in another Member State which does not conduct any trading activities in the parent company's Member State is of such a kind as to hinder the exercise by that parent

company of its freedom of establishment by deterring it from setting up subsidiaries in other Member States".[192]

3.14 Cadbury Schweppes

Cadbury Schweppes was the UK resident parent company of the Cadbury Schweppes group, which consisted of companies established in the United Kingdom, in other EU Member States and in non EU States.

The *Cadbury Schweppes* case concerned the different treatment between resident and non-resident subsidiaries made by the tax legislation of groups as implemented in the United Kingdom. United Kingdom tax laws considered taxable the profit of non-resident subsidiaries of the group, if the taxation level of the State where the subsidiary was established, on that profit was considerably lower. On the contrary, the profits of the resident subsidiaries were not considered as taxable income of the holding until actual distribution thereto.

According to the UK Government's point of view, the United Kingdom tax law was enforced in order to counter a specific type of tax avoidance. In facts, these tax law provisions were created in order to hinder the artificial transfer of profits by a UK resident company from the Member State in which they were made to a State with a considerably lower taxation (tax heavens), by establishing a subsidiary in that State (tax heaven) and then the carrying out of transactions intended primarily to effect such transfers to that foreign subsidiary.

The European Court of Justice in this decision affirmed that such a legislation did not fully comply with the Freedom of Establishment provisions. This decision was due to the fact that the different

[192] Judgment of the Court, Case C-446/03, point (33).

treatment between resident subsidiaries and non-resident subsidiaries caused a disadvantage for those resident companies that have a subsidiary subject, in another Member State, to a lower level of taxation on income. In fact, according to the point of view of the Court, such legislation discouraged corporations from establishing, acquiring or maintaining a subsidiary in a Member State in which it is subject to such a lower taxation level.

3.15 National Grid Indus

National Grid Indus was a limited liability company incorporated under Netherlands law. Until 15 December 2000 its place of effective management was located in the Netherlands. National Grid Indus had a claim against a corporation of the United Kingdom, the National Grid Company Plc. The rise in value of the Pound Sterling against the Dutch Guilder induced an (unrealised) exchange rate gain of the corporation's claim. On 15 December 2000, National Grid Indus decided to transfer its administrative seat in United Kingdom. National Grid Indus, after the transfer of its administrative seat, was considered, according to Article 4 paragraph 3 of the Convention for the avoidance of double taxation and the prevention of fiscal evasion[193], to be resident in the United Kingdom. Therefore, only the United Kingdom was entitled to tax its profits and capital gains. Thus, during the final settlement of the unrealised capital gains at the time of the transfer, the tax Inspector in the Netherlands decided that the National Grid Indus should pay tax on the exchange rate gain.

[193] A convention ratified by The Kingdom of the Netherlands, the United Kingdom of Great Britain and Northern Ireland

The National Grid Indus refused the decision of the tax Inspector. Then, the main tax proceeding arrived before the European Court of Justice.

The referring Court first asked to the European Court of Justice whether the taxation by the Member State of Incorporation, of a company that decided to transfer its real seat into another EU Member State, was contrary to the Freedom of Establishment.

In response to such a question, the European Court of Justice ruled that "a company incorporated under the law of a Member State which transfers its place of effective management to another Member State, without that transfer affecting its status of a company of the former Member State, may rely on Article 49 TFEU for the purpose of challenging the lawfulness of a tax imposed on it by the former Member State on the occasion of the transfer of the place of effective management."[194]

The European Court of Justice stated that the transfer of the real seat of a corporation within the Netherlands is not subject to the taxation of unachieved capital gains. Thus, the different taxation of capital gains made by the Dutch authorities discouraged the will of a company incorporated under Netherlands law from transferring its real seat into another Member State. Therefore, this national legislation constituted a restriction of the right of Establishment.

However, the European Court of Justice stated that the need to ensure a balanced allocation of fiscal rights between Member States could justify the enforcement of an exit tax. However, according to the European Court of Justice point of view the Dutch exit tax was disproportionate in the light of the specific circumstances; thus the national legislator was required to review its national law. Hence,

[194] Judgment of the Court, Case C-371/10, point (33)

the national tax provisions requiring the payment of exit taxes on the amount of unrealized gains made by a company when it decides to transfer its seat could comply with the provisions concerning the Freedom of Establishment, to the extent that they were not disproportionate. The European Court of Justice indirectly applied within this case the *Gebhard* test. In fact, the national tax provisions would not have complied with the aforementioned test, because they went beyond what is necessary in order to attain their objective.

3.16 Comments on the cases on corporate fiscal policy

Over time, the provisions concerning the Freedom of Establishment started to affect many matters of law. The European Court of Justice in *Sevic* ruled that the cross-border mergers fell within the scope of the right of Establishment. Whereas, the Court in the *VALE Costruzioni* stated that also the conversion of a corporation may affect the right of Establishment.

Moreover, the European Court of Justice in its previous judgement (e.g. in the *Sevic* case) ruled that all domestic measures that would prohibit, impede or render less attractive the exercise of the Freedom of Establishment will be considered as a restriction of the right of Establishment, protected under Article 49 and 54 TFEU.

In the case law analysed in the previous paragraphs, the European Court of Justice had also to decide on the compliance of tax policies enforced by the EU Member States to a corporation aiming to transfer its seat into another EU Member State. Thus, the provisions concerning the exit taxes, according to the point of view of the European Court of Justice, would also fall within the scope of the provisions concerning the Freedom of Establishment.

These cases concerned both the transfer from the EU Member State of origin of the seat of a corporation into anther EU Member State,

and the compliance and validity of the exit taxes required by the EU Member State to the corporation transfer of seat.
The previous judgements of *Daily Mail* and *Cartesio* (both inward cases), were confirmed by the decisions took by the European Court of Justice in these case concerning tax laws. In fact, the previous statements of the European Court of Justice ruling that the provisions concerning the Freedom of Establishment which come within the definition contained in Article 54 TFEU, prohibiting the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation, were resumed also in these tax cases.
However, the decisions of the European Court of Justice showed that, for the Court, the exit taxes could comply with the European provisions, but the national tax rules must respect the principle of equivalence assuring that the national rules were not less favourable than those governing similar domestic companies' situations.
In fact, according to the European Court of Justice, the provisions of the Treaty allows, in case of transfer of the corporation's real seat from one EU Member State into another EU Member State, the EU Member State of origin to tax a capital gain arising within its territory.
According to the point of view of the Court, "such a measure is intended to prevent situations capable of compromise the right of the EU Member State of origin to exercise its powers of taxation in relation to activities carried on in its territory, and may therefore be justified on grounds connected with the preservation of the allocation of powers of taxation between the Member States."[195]
However, the powers of taxation of the EU Member States must be

[195] Judgment of the Court in National Grid Indus Case C-371/10, p. (46).

applied in compliance with the principle of equivalence as again emphasised by the European Court of Justice in *Commission v. Portugal*.

The provisions of the Treaty allows EU Member States to enforce national rules that permit taxation on unrealised capital gains in the event of a transfer of seat into another EU Member State or a cross-border asset relocation. However, the national provisions on the taxation of unrealised capital gains must be designed in order to avoid the cash-flow problems, which could arise, in case of a transfer of seat into another EU Member State, from those Member States of origin that require the immediate recovery of the tax of capital gains not yet realized.

CHAPTER 4 – CONCLUSIONS

4.1 The Evolution of the Freedom of Establishment

The Freedom of Establishment of companies within the European Union is disciplined by article 49 and 54, TFEU. The scope of the Freedom of Establishment, over time, faced several changes due to the cases submitted to the European Court of Justice. The evolution of the Freedom of Establishment started in 1988 with the Daily Mail case, and continued in 1999 with Centros, in 2002 with Überseering, in 2003 with Inspire Art, in 2005 with Sevic, in 2008 with Cartesio and finally in 2012 with VALE Costruzioni.

The *Daily Mail* constitutes the first evolutionary step made by the Freedom of Establishment of companies. The statement of the European Court of Justice was particularly important, because the Court affirmed that the national provisions of the EU Member States could determine the incorporation and functioning rules of companies formed under their respective company law. Thus, the EU Member States of Incorporation are to govern the conditions by which a corporation could form itself and the conditions necessary in order to transfer its seat into another EU Member State. In fact, the European Court of Justice affirmed: "unlike natural persons, companies are creatures of the law and, in the present state of Community law, creatures of national law. They exist only by virtue of the varying national legislation which determines their incorporation and functioning".[196]

The *Centros* case of 1999 was another leading case, because the European Court of Justice affirmed the possibility for a corporation validly incorporated into a EU Member State to open a branch into another EU Member State, even if the corporation carries on its

[196] Judgment of The Court in case 81/87, point no. 19.

economic activity only in the EU Member State where it opened its branch.

Moreover, the ruling of the European Court of Justice introduced an important instrument in the analysis of domestic corporate law provisions, the *Gebhard* test, that was used in order to assess the compatibility of the restrictions enforced by a EU Member State towards the right of Establishment.

However, the *Centros* case also faced the issue of the right of Establishment abuse. The European Court of Justice provided only a wide definition of "abuse": the Court Stated "that the fact that a company does not conduct any business in the Member State in which it has its registered office and pursues its activities only in the Member State where its branch is established is not sufficient to prove the existence of abuse"[197] of its right of Establishment.

In the cases following *Centros*, the European Court of Justice defined, on one hand, the scope of the power of the EU host Member States in restricting the Freedom of Establishment and in defining the legal personality of companies formed into another EU Member State. On the other hand, the European Court of Justice identified the situations in which corporations could benefit of the provisions concerning the Freedom of Establishment.

According to the *Überseering* judgement, the ECJ held that article 293 of the EC Treaty should facilitate the attainment of the right of Establishment; However, the actual exercise of the Freedom of Establishment cannot be dependent upon the adoption of the conventions envisaged under by article 293 of the EC Treaty. Moreover, thanks to the ruling of the Court, a corporation validly

[197] Judgement of the Court, Case 9. 3. 1999 — Case C-212/97 point no. 29.

formed in one EU Member State is entitled to obtain the legal recognition within all the EU Member States.

The scope of the provisions concerning the Freedom of Establishment was stressed and clarified again in the *Inspire Art* judgement. Through this judgement, the European Court of Justice defines the different roles held by the EU Member State of incorporation and by the host EU Member State, in connection with the right of Establishment of companies nationals of either Member State. The first was deemed to hold more power to discipline the transfer of its corporations, while the latter has a narrower scope to govern the Establishment of the corporations of the other EU Member States. In fact, the host EU Member State shall justify its provisions, which restrict the Freedom of Establishment, on the grounds identified by articles 52 TFEU and/or justified by the *Gebhard* test.

Pursuant to the *Sevic System* case, corporations involved in a cross-border merger could also rely on the provisions concerning the Freedom of Establishment. In fact, the European Court of Justice, confirmed that 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 the economic life of the country effectively and under the same conditions as national operators".[198]

The key decision rendered by the ECJ in the *Cartesio* case of 2008, led to focus on the different treatment of inbound cases as opposed

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[198] Judgment of the Court, Case C-411/03 point no. 18.

to outbound cases; it also fostered the long lasting discussion among scholars on the consistency of the "real seat" theory with the provisions concerning the Freedom of Establishment and, on this specific issue, the Court confirmed its precedent rendered in the *Daily Mail* case, back in 1988.

The Freedom of Establishment reached another important development in *VALE Costruzioni*, a case of 2012. The European Court of Justice ruled that the cross-border conversions were also covered by the rules concerning the Freedom of Establishment. Moreover, this case was also important, because it introduced the principle of equivalence and principle of effectiveness. These two principles will be fundamental in future decisions in order to determine whether the domestic legislation of a EU Member State could lead to a breach of the EU provisions concerning the Freedom of Establishment.

4.2 The problem of the Harmonization

Articles 49 and 54 of the Treaty on the Functioning of the European Union, discipline the Freedom of Establishment for companies validly incorporated into a EU Member State and with their registered office, central administration or principal place of business within the European Union: companies validly incorporated according to any law of business organization enacted in any EU Member State are deemed "national" of that EU Member State.

Thus, these Treaty rules provided a "national" corporation with the right to establish itself into another EU Member State, in order to pursue an economic activity there.

Therefore, thanks to the right of Establishment, corporations can locate their seat and/or open agencies, branches or subsidiaries in whatever EU Member State they like to.
On the end of the 1960s, the first effort made by the institutions in order to enforce the provisions concerning the Freedom of Establishment are based on the attempt to standardize corporate laws of the different EU Member States. The EU Member States should have ratified a special agreement among them, under Article 293 of the EC Treaty.
On 29 February 1968 the Convention on the Mutual Recognition of Companies was developed in order to achieve the aforementioned objective. However, the project was not ratified by the Netherlands, thus bringing this first effort to failure.
The European institutions decided to develop a process of harmonization based on common contents, in order to standardize the company laws of the various EU Member States. The European institutions started to enforce a series of directives, able to respect the different national laws of the EU Member States, aimed at introducing a good basis for a common European company law.
The European institutions, in one hand continued with the process of harmonization of the national corporate laws, while, on the other hand, introduced the European Company (SE). One of the objectives pursued by the European institution, with the introduction of the European Company, was to provide a corporate model accepted by all EU Member States regulations, in order to overcome the obstacles faced by the Freedom of Establishment.
However, the program of harmonization of company laws of the Member States and of introduction of a common European statute for Corporation, pursued by the European institutions, was hindered by the differences existing among national corporate laws

of the EU Member States. In particular, the workers' participation in the management and the regulation of groups of companies were (and still are) two subjects matter that caused several conflicts and multiple drafting of proposed directives and regulations that are still awaiting a definitive solution.[199]

Fortunately, however, the process of company law harmonization received a boost from the judgements by the European Court of Justice: in fact, the rulings of the Court in the various cases, that have been analysed in chapter 3 (retro), provided an important support in reducing the differences among the national rules of the EU Member State.

In fact, the *Centros* decision permitted to corporations, which fell within the scope of the Freedom of Establishment, to hold the registered seat in one EU Member State and the real seat into another EU Member State, in all those situations in which the national law allows such a split. However, under certain conditions set forth in *Daily Mail* (1988), a EU Member State can forbid corporations formed under its law from transferring their real seat out of its territory. However, a EU Member State cannot hinder a corporation, incorporated into another EU Member State, to carry on its economic activity therein; the place of the real seat should bear no influence under this respect.

The European Court of Justice with its judgements has denied to the EU Member State the possibility to ban the transfer abroad (into another EU Member State) of the registered seat of a company established in its territory. Therefore, the European court of Justice afforded corporations the right to transfer their registered office in

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[199] SANTELLA, P., *Perspectives of European Company Law,* p.25

another Member State, if the host EU Member State does not require at the same time the transfer of the real seat.

Thus, the process of harmonization, together with the rulings of the European Court of Justice, provided the possibility for the entrepreneurs wishing to incorporate their business to choose, within the European Union, the most suitable corporate law for their corporations. In fact, the best corporate law could be selected, not only at the moment of the incorporation, but also during corporate life.

The possibility for entrepreneurs to benefit of provisions concerning the Freedom of Establishment generated alarms among the EU Member States fearing a “race to the bottom” of the domestic corporate laws of the other Member States: in fact, corporations could decide to transfer their seat only in order to benefit of a “weaker” corporate law, i.e. a set of rules designed to foster the (economic) interests of some corporate stakeholders at the expenses of others.

The “race to the bottom” feared by EU institutions, academics and single Member States was evocative of a similar phenomenon occurred within the USA in the last century: the State of Delaware became, in the United States of America, the most popular jurisdiction for incorporation or transfer of seat among US corporations, mainly thanks to its laxer system of corporate law and to the presence of a highly qualified legal class. With rapid pace, the State of Delaware affirmed itself as the most active US State in the introduction and improvement of company law rules, in order to create an even more efficient legal system. However, in the long term, other States of the US started competing with Delaware in implementing corporate law rues that suited corporate constituencies, so triggering a sort of “race” among legal systems.

Thus, in the long term, the superiority of Delaware corporate law, reflected in the increasing number of new incorporations, was due to the ability to bring legislative innovation in its corporate law and to the efficiency of its legal class.
Therefore, the experience of the United States was studied in order to predict the possible consequences of some ECJ holdings on the Freedom of Establishment on the national legal systems of the EU Member States. In fact, as showed by the case law, there are many companies that may have good reasons to transfer their registered office into another EU Member State, in order to benefit of the more efficient and more suitable legal system of the host EU Member State. For example, some companies, formed accordingly to the law of one EU Member State, may have the incentive to transfer their registered office into another EU Member State, in order to provide more guarantees to creditors and minority shareholders, with a consequent reduction in the cost of credit and capital.[200] But, sometimes, the contrary may also be true.

4.3 Conclusions

The Freedom of Establishment could work properly only in a context where the differences that exist among the national rules of the EU Member States are minimised.
As discussed in the former paragraph, over the years, the Freedom of Establishment evolved significantly. The failure of the 1968 Convention among the EU Member States, brought the European institutions to develop a different solution in order to harmonize the national corporate laws. The European institutions utilised different types of legal act, as the European regulations, directives, decisions and recommendations, in order to harmonise the different legal

[200] SANTELLA, P., *Perspectives of European Company Law, p. 26.*

systems. However, particularly important was the role covered by the European Court of Justice, which defined the scope of the right of Establishment; even if the concerns about risks of a "race to the bottom" of the national corporate laws were suggested after some of its decisions (e.g. *Centros*) triggered by the Freedom of Establishment, the process of harmonization continued. Moreover, the judgement of the European Court of Justice, resolved most issues about the compliance of the real seat theory, with the provisions concerning the Freedom of Establishment. In fact, an analysis of the decisions of the European Court of Justice in the different cases, showed that, according to the Court, the real seat theory is substantially consistent with the right of Establishment, as it was set forth under Article 49 of the TFEU. The judgement of the Court could only narrow the scope of the EU Member States when applying the real seat theory.

In my opinion, the concerns about the regulatory competition, which could become a "race to the bottom" among the EU Member States, have been refuted. In fact, the EU Member States did not develop strong incentives to provide a "popular" legal form for the entire Union.[201] However, the European directives will frame this competition among the national provisions of the EU Member States. Thus, this particular situation should be sufficiently safe in order to avoid a "race to the bottom".

Moreover, a competition among the national corporate laws of the EU Member States could lead the more efficient of them to improve their national provisions and, consequently, to attract a higher number of corporations. At the same time, this competition could lead the less efficient EU Member States to develop and to adopt

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[201] GELTER, M., *Centros, the Freedom of Establishment for Companies, and the Court's Accidental Vision for Corporate Law*, p.42.

rules more appreciated by the legal class. Thus, this kind of competition could trigger a virtuous competition among the different national laws.
The harmonization necessary to the complete functioning of the Freedom of Establishment will be also useful in order to reduce the issue of the "forum shopping".[202] Thus, the harmonization of the national provisions could improve, on one hand, the equity and, in the other hand, the efficient administration of justice.
The Freedom of Establishment is one of the fundamentals economic Freedom of the European Union. The proper functioning of the right of Establishment is necessary for the good functioning of the whole Internal Market of the European Union. Thus, the proper functioning of the Freedom of Establishment is essentially intended to reach, for the Internal Market, an increased competition, an increased specialisation, larger economies of scale, and to allow to goods and factors of production to move to the area where they are most valued, thus improving the efficiency of the allocation of resources.
In my opinion, the only way to reach a good functioning of the Freedom of Establishment is to continue in the process of harmonization of the different national provisions.
The European Court of Justice, over years, through its ruling identified the scope of the right of Establishment. In fact, in the *Sevic System* case the Court decided that the cross-border mergers fell within the right of Establishment. Then, the Directive on cross-

[202] This phenomenon occur when the parties belong to different States, thus, are subject to different law. The different connecting factors applied by the jurisdictions of the States could lead into a situation where in line of principle both the national Court could hand the case. Thus, the party could try to stand before the national Court that it considers more convenient.

border mergers removed the gap existing by the judgement of the Court and the absence of a EU secondary law.

The case law and the judgements of the European Court of Justice showed that there is need of more European Directives (or Regulations) in order to sustain the decisions of the Courts. For example, European Directives aimed at the discipline and harmonisation of the provisions of the EU Member States concerning cross-border conversions, some common fiscal policy among the EU Member States and the regulation of the effects of the equivalence principle of the domestic connecting factors listed under article 54.1 TFEU, would help in building a common core of corporate rules within the “internal” market of the EU.

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