

Roll on the 14th Directive – Case law fails to solve the problems of corporate mobility within the EU – again

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Article 48 TEC

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

The recognition of companies under the differing theories of Company law among Member States has always served to potentially undermine one of the fundamental freedoms of EC law, freedom of establishment, to the extent of rendering it practically impossible for a legal person to move its registered office¹ between some member states without liquidation and re-incorporation in the new state, no easy or simple task and one that gives rise to a range of taxation liabilities. Article 43 TEC (old Art 52) grants free movement of establishment to natural and legal persons, and Article 48 (old 58) quoted above clarifies this right and then goes on to state how a ‘company or firm’ is to be defined under European law.

Faced with this seemingly intractable problem, Freedom of Establishment has in certain cases remained a theoretical right only for some European companies – secondary legislation to enforce or clarify Member State obligations has not been forthcoming² and the legal and political will to challenge the status quo has been non-existent. After the cases of Centros³, Uberseering⁴, and Inspire Art⁵, the claim by commentators is now that following these judicial pronouncements, effective enforcement of Arts 43 and 48 are achieved and secondary legislation is no longer necessary. European Community problems have been solved – again – by an active Court of Justice willing to bring recalcitrant member states to heel over their treaty obligations.

This paper will suggest that the case decisions, while to be welcomed within their restricted remit, simply do not address the problems of primary establishment caused particularly by the affiliation of some member states to the ‘real seat’ doctrine, and if the Community is serious about taking the internal market forward with the concept of the truly European Company, then legislation, possibly in the form of the long-awaited and increasingly unlikely to happen Fourteenth Company law Directive, is a must. This will serve two purposes, firstly to force member states to face up to their obligations under treaty law in a way consistent with other areas of free movement,

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¹ Or central administration or principal place of business as alternates under Article 48.

² Contrast with free movement of workers

³ *Case C-212/97 Centros Ltd v Erhervs-og Selskabsstyrelsen [1999] ECR I-1459*

⁴ *Case C-208/00 Uberseering v Nordic Construction Company Baumanagement – not yet reported*

⁵ *Case C-167/01 Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd*

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where fundamental treaty rights are at stake, and secondly, to clarify the scope of justificatory restraints on the freedom of establishment for companies in order to uphold the uniformity and coherence of Community law.

The Problem

Article 48 instructs member states to treat a legal person, i.e. a company or firm, the same way as it would be obliged to treat a natural person, i.e. a citizen of a member state and hence a citizen of Europe⁶ wishing to establish themselves in another member state (the host state) other than their country of origin (the home state). Although this is qualified in later case law where the ECJ recognises that a legal person is in a more complicated situation than a natural person by virtue of them being able to have a presence in more than one place simultaneously, and hence the provisions cannot be exactly analogous. Problems arise from the different ways that member states recognise the legal personality of a company, and the nationality of the law that applies to that organisation within their systems of company law. Broadly speaking, a member state will either subscribe to the 'incorporation' theory or the 'real seat' theory, although the Nordic registration system at issue in *Inspire Art* could be seen as a different system, in reality it is simply a modified application of the incorporation theory.

Member state systems that work on the incorporation theory recognise a company as a legal person, with all the protection that involves for the individuals behind the veil, providing it is incorporated in one of the other member states. The company is also deemed to operate under the company rules of the member state in which it is incorporated. Therefore a company (P) incorporated under English law, but with its head office or principle place of business in another member state, would be seen as a valid legal person, subject to English company law, in another incorporation state, for example, Ireland or the Netherlands. In this scenario, the approximation of a legal person to a natural one is unproblematic, a company is seen as a creature of the member state under which it is created, much the same as a citizen of a member state must be accepted by other member states as a citizen of Europe. However, such a company would only be recognised and seen to be subject to English law in Germany, a 'real seat' theory state, if the company's central office or main place of business was also within England. If P was incorporated in England but actually had its head office and main place of business in France, German law would recognise French law as the system which is applicable to that company. If P were not incorporated under French law and was therefore not a legal person in that respect, neither would German law recognise P as a legal person. The problem becomes more complicated still when a real seat company refuses to recognise a company which has incorporated under its own laws, but whose main centre of business has become another state. P would then not be recognised within its 'home state' and therefore would not be recognised even by incorporation states as it will not be a legal person in respect of its home country's company law. The above is an approximation of the general way in which the 'real seat' theory works, although different member states may allow the emigration of companies subject to shareholder votes and the amendment of company constitutions. These processes are often complicated however, and may in reality demand

⁶ Art 17 EC

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liquidation and a re-incorporation in the host state, something a company will wish to avoid. Italy on the other hand, will recognise a foreign company on the basis of reciprocity for the recognition of Italian companies in the other member state. This is a particularly bizarre state of affairs given the ECJ's robust rejection of the concept of reciprocity in other areas of European law – the Treaty, it has stated, 'gives rise to absolute obligations, not reciprocal ones.'⁷ From a European, free movement angle then, the incorporation theory is to be much preferred over the 'real seat' theory.

This may seem a more theoretical problem than a practical one, Drury⁸ makes the point that a company incorporated in a particular member state should not want to move its head office out of that state with all the disruption and cost that would entail, particularly when modern means of communication facilitate business worldwide, when it will be simpler and cheaper for it just to open a branch office in another member state. He goes on however, to suggest that a company may open a branch in a host state which becomes very successful and over time, the de facto head office of a company incorporated in another member state. In such a scenario, if the home state is an incorporation state, it will recognise the company, and therefore so will other incorporation states. If the home state is a real seat theorist, then it, and hence all other member states will not recognise it as a valid company. Real seat supporters say this is justified in order to ensure that the law most relevant to that company is the one that governs it, and therefore if a company doesn't conform to the laws of that country, other states should not recognise it as a company at all. The joint and several liability which will then arise in respect of the directors of the company should act as an incentive for those individuals to conform to the laws of the country where their business is carried out, to the benefit of the customers, creditors and shareholders of that company.

The real question is how has this state of affairs existed for so long within a Community which proclaims as one of its guiding principles the creation of, 'an area without internal frontiers in which free movement of goods, persons, services and capital is ensured.'⁹ Article 48 specifically gives a choice of three different connecting factors between a company and a member state, registered office, central administration or principle place of business, to take account of the different systems of company law used within the Community, and there is a further obligation upon member states in Article 293;

'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 for 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...'¹⁰

At the time of writing, no such negotiations have been entered into on the basis of Article 293, but this doesn't detract from the clear legal duty of member states, under articles 43, 48, 293 and 10 to give effect to treaty obligations, yet Article 234

⁷ Cases 90 & 91/63 *Commission v Luxembourg and Belgium (re import of Powdered Milk Products)* [1964] ECR 625

⁸ R Drury 'Migrating Circumstances' 1999 – 24 *European Law Review*

⁹ Article 14(2) TEC

¹⁰ Article 293 TEC

references to the ECJ appear to have been unhelpful in this respect and article 226 or 227 actions have not been brought. Conventions which have aimed to harmonise member states laws, such as the Convention on the Mutual Recognition of Companies, have foundered because member states have refused to ratify them¹¹. It is against this background, that the exploration of the recent case law should be set.

The case law

Centros¹²

Centros was incorporated and hence obtained its legal personality under English law. The directors of the company were both Danish, and in fact the company never did any business at all in England, it traded only in Denmark. Danish authorities refused to register the company on the grounds that it was incorporated in England only to avoid the minimum paid up share capital provision that was required by Danish company law.¹³ On an Article 234 reference the ECJ held that the refusal to register the company by the Danish was contrary to Articles 52(43) and 58 (48), and that the avoidance of the relevant provision of Danish law was not a justification for the breach. The court did say that Denmark could take measures to combat fraud or to intervene if the company was trying to avoid obligations towards public or private creditors in Denmark.

Uberseering¹⁴

Uberseering was formed under the law of the Netherlands and had its registered office there, but subsequently, according to Germany, transferred its real seat to Germany. Germany is a real seat theory state, and as the company was not formed according to its laws, German would not recognise Uberseering as a legal person able to be a party to legal proceedings within the state. The ECJ held that Germany could not refuse to recognise Uberseering and locus standi must be granted, dismissing an argument that a negotiation under Art 293 was necessary, and distinguishing the Daily Mail¹⁵ case from the one at hand.

Inspire Art¹⁶

Inspire Art was incorporated under English law, but was operational only in the Netherlands. The Dutch WFBV¹⁷ required 'formally foreign' companies to register as such and imposed extra duties upon such companies as regards administrative procedures and filing of documents. The ECJ held these requirements to be in breach of EC law, in so far as they required procedures not covered by the second, fourth and eleventh company law Directives. As these directives were meant to harmonise member state laws in this respect, their requirements were exhaustive. To hold otherwise would plainly defeat the object of harmonisation altogether. Further, although Article 12 of the eleventh directive provides that Member states may impose 'appropriate penalties', it was for the national court to decide if the imposition of joint

¹¹ In this case the Dutch

¹² Case C-212/97 Centros Ltd v Erhervs-og Selskabsstyrelsen [1999] ECR I-1459

¹³ Some £17,000 as opposed to £100 in the UK.

¹⁴ Case C-208/00 Uberseering v Nordic Construction Company Baumanagement – not yet reported

¹⁵ Case 81/87 R v HM Treasury Ex p. Daily Mail [1988] ECR 5483

¹⁶ Case C-167/01 Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd

¹⁷ Wet op de Formeel Buitenlandse Vennootschappen.

and severable liability for directors and auditors¹⁸ was proportionate and non-discriminatory.

The Netherlands argued that the Company was in fact recognised under Dutch law, (an incorporation theorist), and therefore there could be no breach of the freedom of establishment. The rules were likewise non-discriminatory as they aimed to give protection to those dealing with the company, a mandatory requirement of Dutch law which was also imposed on Dutch companies. Such 'Brass Plate' companies, said the Dutch, should not fall under Articles 43 and 48 at all, as those rules refer to secondary establishment, and are concerned with allowing an established company to spread into other domains. The issue here was one of primary establishment, as the main, indeed the only branch of Inspire Art was in the Netherlands, therefore, it was to Dutch law that it ought to comply. The ECJ rejected these arguments and held that the WFBV was contrary to Articles 43 and 48 in so far as it imposed restrictions on companies validly constructed in another member state. This breach was neither allowable under Article 46 nor justified by overriding reasons related to public interest as they were ineffective and disproportionate.

The point was made by the Court, both in Inspire Art and Centros, that investors or creditors will know the company is incorporated in the UK and are thus free to make up their own minds whether to invest or not, or whether they should obtain additional guarantees from the company in question. It was also said that had Centros carried out the tiniest amount of business in the UK, the Danish would not have refused registration, but arguably creditors and investors were potentially in as much peril from sharp business practice in that situation as in the present one. The refusal to register in Centros and the extra procedures in Inspire Art were thus held to be disproportionate and ineffective.

The case law and the judgements show a welcome methodology from the ECJ, which is in line with other free movement pronouncements. Firstly, is the national law dissuasive of free movement of companies? If so, is there a derogation available under Article 46, and if not, may a measure fall within a member states mandatory requirements, being objectively justified, non-discriminatory and proportionate.

The Problem Still?

One of the first things to notice about the above case law was that two of the decisions involved member states which adhere to the incorporation theory of company law, and therefore implicitly recognised the legal personality of the incoming company anyway, according to their own laws. With this in mind, it can plainly be seen as discriminatory to refuse to register such a company, or to impose extra duties upon it, by clear analogy to free movement of goods case law where mutual recognition makes it unlawful for a state to deny a product entry to its market, or to make the producers comply with extra specifications unneeded in the products home state. Uberseering is the only judgement which directly calls into question a member states adherence to the sticking point in freedom of establishment, the real seat doctrine, dealing as it does with Germany, but even this case, it is contended, has little to do with a widening of the concept of primary establishment within the Community.

¹⁸ Except if within the remit of the fourth company law directive, which Inspire Art was.

All the cases quoted fail to address the main problem of primary establishment, the fact that the home member state in question still has full freedom to choose whether or not a company has legal personality within that state in the first place. If the issue is primary establishment, that is, the initial registration of a company, member state F can decide how that initial registration must proceed. An incorporation state will have a rule of incorporation which will be unconcerned with the geographical location of the main place of business or head office of that company, a real seat state will require that both are situated within its territory. Although Uberseering appears to have dealt with the problem of a company, M, moving out of a state it was validly incorporated within, it does not touch upon the problem of M wishing to move out of state F where the real seat theory holds sway. Once F's chosen 'connecting factor' is gone from that state, F will no longer recognise M as valid and therefore neither will another member state. The point of Article 48 holds up here only if the phrase 'formed in accordance with the law of a member state' is taken literally in that if – in a real seat state – the real seat is present within the member state at the time of incorporation, then that company cannot thereafter 'lose' its incorporated status by subsequently moving its real seat out of that state's territory. If this interpretation is not given, then a company moving its real seat out of a state that adheres to the real seat theory is not a company formed in accordance with the law of a member state and falls without the protection of Article 48. If the question of citizenship of a natural person is solely the concern of that person's home member state, then it isn't open to that person, denied citizenship in one member state, to move across the border and claim all the rights of European citizenship in another. Likewise, it is difficult to see how a company failing to meet the laws required for its incorporation in a member state, whatever those laws may be, can demand to be seen as a valid company by the rest of the European Community. Articles 43 and 48 simply do not seem to give that right, nor should they.

Even more bizarrely, the phrase 'formed in accordance with the law of a member state, could be taken to mean formed in accordance with the laws of ANY member state, irrespective of the laws of the state the potential company is present in. A company could then demand that a real seat theorist like Germany incorporate it along the lines of the UK, where the concept of the 'brass plate' company is no problem as the registered office is the 'connecting factor' under English law. Although this would amount to a beneficial harmonisation of company law under the treaty, member state's outrage and intractability would not be difficult to imagine.

In this respect, Article 293, although sidelined by the judgements with which we are concerned, seems to be paramount. In *Daily Mail* the ECJ said:

'Treaty regards the differences in national legislation concerning the required connecting factor and the question of whether – and if so how – the registered office or real head office of a company incorporated under national law may be transferred from one Member State to another as problems which are not resolved by the rules concerning the right of establishment.'

Siems is of the opinion that the validity of the differing systems is therefore recognised and ventures that harmonisation by directive is the only way forward¹⁹, but

¹⁹ *Mathius Siems*, "Convergence, Competition, Centros and Conflicts of Law: European law in the 21st Century" (2002) *European Law Review* 27(1), pp 47-59

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this view seems to overlook Article 293 and the clear requirement for negotiations to allow companies to, inter alia, retain legal personality in the event of migration. In *Uberseering* the emphasis was on the phrase ‘so far as necessary’ and in that case, and the others, as the companies concerned fell within the definition in Article 48, the rights under Article 43 accrued to them and no further examination of the treaty was necessary. In our example of state F and company M above however, there would seem to be an obligation on F to enter into negotiations for the mutual recognition of M, with other member states even if it does move its real seat and hence becomes unrecognisable as a company under F’s laws national laws. The negotiations thus entered into would then force F to recognise a company that had moved its real seat out of its territory as well as a company moving its real seat into F, while still – presumably – being subject to the laws of its home member state. How this would work, and which national laws would apply in these scenarios would, of course, depend on the negotiations themselves. To take this to its natural conclusion, it would seem every member state is under such an obligation except incorporation states, a status reinforced by Article 10 TEC.

To this extent, the case law examined, does not concern primary establishment at all, but the problem of previously denied rights to secondary establishment clearly given under Articles 43 and 48. The fact that the *Centros*, *Uberseering* and *Inspire Art* judgements clearly uphold these rights is to be welcomed, but in fact the decisions appear to go not much further than already decided case law such as *Commission v France*²⁰ and *Segers*²¹. Indeed, in *Segers* the ECJ stated;

‘All that is required is the formation of a company under the law of a Member State, not necessarily the Member State in question.’²²

And in *Commission v France*, the ECJ made clear that the risk of a company evading taxes is not to be relied upon where a fundamental freedom such as establishment is involved,²³ a point re-emphasised in later cases. Why then the fuss about the *Centros* line of case law? Possibly because these later cases happened after the ‘seminal’ judgement in *Daily Mail*. *Daily Mail* appeared to throw previous case law into confusion as the ECJ found the necessity of British Treasury consent to a movement of a company’s head office was not in breach of European law. The ECJ in later cases has however been at pains to distinguish *Daily Mail*, and it could be submitted that it was a creature of its time and especially of its circumstances, which were unusual. The *Daily Mail* wished to move its head office to the Netherlands where it would not be liable for capital gains tax when it sold assets which would accrue the tax under English law. The company did not wish to move any assets or to do any business in the Netherlands, but in effect wished to change its nationality, the reverse of what has happened in other cases examined where a company wishes to retain its nationality under the state in which it was incorporated, but simply sought that other member states should recognise that nationality. As the creation of English law, it is relevant that the *Daily Mail* should comply with English law before it is able to don another legal personality in a foreign state, the Treasury was not preventing the

²⁰ *Case 270/83 Commission v France* [1986] ECR 273

²¹ *Case 79/85 Segers v Bedrijfsvereniging voor Bank en Verzekeringswezen* [1987] 2 CMLR 247

²² See paragraph 16 of judgement – emphasis added.

²³ Paragraph 25 of judgement

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movement as such, simply asking that the company settle its tax liability²⁴ beforehand.

Centros, Uberseering and Inspire Art then, appear to restate and clarify, and, to an extent extend the reasoning found in *Commission v France and Segers* in so far as they have made clear that a 'real seat' member State cannot refuse to recognise a company validly formed under the law of another member state. This is the concept of the freedom of secondary establishment under Articles 43 and 48. None of the cases above however relate to the primary establishment of companies. The point has already been made that Article 48 will not protect companies if they are not formed in accordance with the law of a member State, the quote above from the Daily Mail case seems to suggest the ECJ is comfortable with this, and sees primary establishment as a question for member states. If member states are not to be in breach of EC law however, they must fulfil their obligations under the Treaty. It could be suggested that this area of law is not one that should be left to judicial sensibilities to develop, but should be served by specific secondary legislation. This eminently sensible point could be countered by the submission that secondary legislation is not necessary when the primary legislation, Art 293 is already there.

However, given the complexities of Article 293 and the logistics of all 15 (soon to be 25) Member States having to enter into agreements with everybody else to the same ends, some form of harmonising legislation would be a more uniform and effective way to go forward. Unless absolute harmonisation was desired – and this is difficult to envisage – it could be suggested, in line with other areas of EC law, that a minimised harmonisation regime could be adopted. This may be problematic. It would doubtless allow member states to impose more stringent standards on its own companies than it is allowed to impose on those moving in, which is, in effect, the situation the law is in at the moment. This would suggest the need for more robust rules in the area of primary establishment, in order to facilitate the concept of a 'European Company' and to counter any perceived 'race to the bottom' for member states national law in an effort to attract companies wishing to incorporate in the state where it is easiest and cheapest for them to do so²⁵.

The proposed Fourteenth Company Law Directive suggests a 'third way' for companies wishing to move their 'real seats' out of any member state, which is not dependant on either the incorporation or the real seat theory – although incorporation states will have to get used to the biggest change in procedure. Companies complying with this method of corporate mobility will retain their legal personality throughout the Community.²⁶ Potential problems with this approach are easy to see, in trying to please both the incorporation and the real seat theorists, the Commission may have ended up pleasing no-one, with incorporation states resentful at the major changes required in their laws, and real seat states unhappy at a 'watering down' of their robust 'connecting factor' ideals. The proposal also makes clear that refusing recognition within the framework must be subject to stringent controls and requirements of legitimate general interest, proportionality, minimum intervention,

²⁴ The Daily Mail argued that it should not be liable for tax that has yet to accrue, as is the case of capital gains tax, before a profit is realised.

²⁵ But see *Siems* Article fn 18 *post* for an argument why the 'Delaware effect' in Europe may be more feared than likely to happen.

²⁶ See article by *Drury* fn 8 *post*

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non-discrimination and transparency. It must be noted however, that due to problems encountered with 'employee participation' under the proposed Directive, this legislation is at least on hold, and possibly, after years in conception, doomed to failure.

Conclusion

If the foregoing arguments are accepted and Community rules are thereby imperative to solve the problem of diverse primary establishment procedure under national laws, then maybe the courses of action open to the Community are few. Such a substantial and fundamental concept should not be left in the hands of the ECJ to develop incrementally over time, unless the Court is to be concerned with the application of the Treaty as it stands, namely the effective enforcement of Article 293. Article 234 references and actions under Art 230 for failure to act may be appropriate here. Clear rules concerning primary establishment are, it is to be argued, a matter for legislation. If member state opposition was no object, then the demise of the real seat doctrine altogether would be welcomed, an EU that operated purely on the incorporation theory would be one with very few problems of either primary or secondary establishment, but the reality is that real seat states, particularly Germany, would fiercely defend their right to choose the 'connecting factor' of a particular company to the state, a choice explicitly recognised under Article 48 anyway. Therefore the Fourteenth Company Law Directive must be saved from failure, and presented as a commonsense and diplomatic way of solving a problem that has gone on for too long. The European Company Statute has shown that agreement in these matters can be reached and may provide a model of good practice in this area. Unless it does, the creation of 'an area without internal frontiers in which free movement of goods, persons, services and capital is ensured,' is as far away as ever.

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