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Abstract

After a short historical reminder, the paper states that corporate mobility remains a real political issue. To clarify matters it proposes to distinguish between a formal seat transfer, being the choice for a different legal regime, and a de facto seat change that would not affect the applicable company law, the host state not being entitled to apply its company law rules. A future directive should be based on this distinction, prescribing the formalities for the former, and stating clearly the consequences of the latter, thereby also defining the limits within which the general good can be invoked.

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Is a directive on Corporate Mobility needed?

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The political issues underlying the matter of corporate mobility are quite important. They relate not only to the efficiency of our company systems, and hence the efficiency of our economic apparatus. They also raise interesting questions of national sovereignty and of economic competition among the member states.

A – a short historical introduction.

In the 1960s, the topic of corporate mobility – the term was not usual at that time – stood high on the agenda: an ambitious treaty was negotiated among the then six member states[1]. The attempt failed because as is well known, one member state had changed from the real seat system towards the incorporation system. Whether that decision has prevented the treaty to be adopted, remains for history to explore.

Later on, the topic disappeared from the political agenda, at least apparently. Indeed, the failure to adopt the said treaty was an armistice, not a victory for any of the parties who continued to haggle over the choice whether to prefer the real seat over the incorporation doctrine. The failed attempts to enact directives on the corporate structure, on groups, on cross border mergers all have some links with this unsolved question. Lawyers attributed the dispute to the dividing line between the real seat and the incorporation theory. Others – and I think that their arguments are more convincing – attributed the standstill to the politics underlying the harmonisation process. One wonders today why the founding fathers of company law in the early sixties decided that company law should be harmonised. The Treaty does not contain an explicit order to that effect, as it only dealt with the cross border use of the freedom of establishment[2]. One interpretation – a rather diabolic one – is that the harmonisation was used to increase the minimum level of regulation in all member states. It was proclaimed that by harmonising the domestic company laws the economic systems would be strengthened. One effect was clearly that some of the states that obviously had adopted a lower standard of regulation, were obliged to raise their level of regulation, hence making their national company law less attractive. If one pursues this reasoning, one of the objectives of company law harmonisation may have been to stop the "unhealthy" competition from one of the member states as this lenient regulation would have made the other states' legal regime less attractive and might have resulted in a certain emigration to the state of least regulation.

Regulatory competition, it seems, played an important role from the beginning: member states used harmonisation to defend their own system, and avoid it to be challenged by other, more

[1] Convention on Mutual Recognition of Companies and Legal Persons, 1968, the text may be found in *Revue Trimestrielle deDroit Européen* 1968, p. 400; an English version is in EC Bull. Sup. 2, 1969.

[2] Art. 44 (2)(g) of the Treaty of 25 march 1957 establishing the European community, latest consolidated version published in O.J. C 325, December 24 2002, p. 33-184.

attractive systems. And companies to a certain extent availed themselves of this type of competition, the more so as the more attractive regime was also attractive in terms of taxation.

During the following decennia, the issue was not explicitly discussed except as far as the possibility was concerned for German companies to re-incorporate abroad: as German co-determination would have been at stake, the issue was not considered politically mature and hence the existing armistice continued.

The stalemate lasted until the late nineties. Two developments triggered the change towards a more open scenery. First the European Company Statute. After memorable discussion a compromise was reached on workers' codetermination, freeing the way to the adoption of the regulation on the European Company Statute. The Statute allows companies not only to merge cross border, but also to transfer their seat from one jurisdiction to another[3]. The two main types of corporate mobility were thus achieved. The price remains relatively high: one first has to create a European Company, to be able to move to another jurisdiction. Therefore, the question remains whether the price is worth it. Now that the cross border merger directive has been adopted, the advantage of the SE is equally reduced[4].

The other, far more significant factor of change were the four cases of the ECJ, well known today under the name of the parties involved, i.e. Centros, Überseering, Inspire Art and Sevic[5]. This is not the place to summarise these cases. Suffice it to say that they changed considerably the possibility for national law to restrict access to foreign companies to their national legal order. Mobility is hence allowed, although the conditions under which mobility can take place needs to be further clarified.

B - Is corporate mobility a real issue?

There are several types of corporate mobility. One could distinguish cases in which new companies are formed in one jurisdiction, doing in business in another jurisdiction. Another type is the company migrating from one state to another, whether subjecting itself – voluntarily or not – to the latter's state company law: here the question is: what is migration? There may be several types of migration: a company could also establish a branch in another state, or a mere representative office: would these cases have to be treated similarly? And could the branch not become the head office once the business appears to be more successful

3 See artt. 7 and 8(1) of Council Regulation 2157/2001 of 8 October 2001 on the Statute for a European company (SE), O.J. L 294, November 10 2001, p. 1–21; Art. 7 of the regulation states that the registered office shall be located in the same state as the head office. The provision has been criticized as incompatible with the Court's holding in free establishment: see E. WYMEERSCH, "The transfer of the company's seat in European company law", *C.M.L.R.* 2003, p. 661; also in *Liber amicorum Jean-Pierre de Bandt*, Brussel, Bruylant, 2004, p. 767; C. Ph. SCHINDLER, "Überseering und Societas Europaea: vereinbar oder nicht vereinbar, das ist die Frage", *RdW* 3/2003, p. 122-125; but compare: F. BLANQUET, "La société européenne n'est plus un mythe", *Rev. Dr. Int. Comp.* 2001, p. 155, mentioning the problem of letter box companies; G. KEUTGEN and Chr. DARVILLE-FINET, "La société européenne: Les règles de fonctionnement", *Actualités du Droit* 2003, p. 129. Art. 8(1) states that the transfer of the seat does not create a new legal person: although the rules applicable to the legal person would be the rules of the transferee state, the person would remain the same, hence without effectuating a transfer of assets or liabilities.

4 See directive 2005/56 of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies, O.J. L 310 of November 25 2005, p. 1-9.

5 See Centros Ltd and Erhvervs-og Selskabsstyrelsen, Judgement of 9 March 1999, Case C 212/97, ECR, I-1459; Überberseering BV and Nordic Construction Company Baumanagement (NCC), Judgement of 5 November 2002, case C 208/00, ECR, I-9919; Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd, Judgement of 30 September 2003, case C 167/01, ECR, I-10155**;** Sevic Systems AG, Judgement of 13 December 2005, Case C-411/03, ECR, I-10805.

than in the home state? One admits that by creating a subsidiary, the company uses its freedom of establishment, but this does not raise issues of legal mobility. Finally, companies could merge on a cross border basis, whereby the resulting entity will be subject to a different legal regime than at least one of the merged entities. This is the technique usually followed in the US for changing the legal regime applicable to the company. Mobility therefore has many meanings.

The recent study by Becht, Mayer and Wagner[6] deals with a first type: it has identified numerous cases in which entrepreneurs mainly from Germany and the Netherlands have formed UK companies Ltd, in order to run a business in Germany or in the Netherlands. The explanation behind this type of U-turn incorporation lies in the radically lower capital requirements in the UK (in fact: £1.00 suffices) and in the action undertaken by incorporation agents in both countries. From the figures in Becht a.o. it clearly appears that this movement has gained momentum after the Centros and other cases became widely known on the European continent and once incorporation agents had seen a market in this kind of business. Most of these companies are fairly small, raising the fear that they would be used by mala fide founders or leading to a wave of insolvencies within a relatively short period of time. None of this has appeared up to now. There have been no cases of major companies re-incorporating abroad, although some have threatened to do so, probably to put pressure on their domestic tax authorities.

The UK is playing the role of a European Delaware, being the state offering the most attractive, in this case the cheapest incorporation service while offering a well developed and very flexible legal regime. Other states have awakened to the call of competition: France has reduced the minimum capital requirement to one euro for the sarl[7]. The debate about the minimum capital rule has accelerated: is this the right approach to offer protection to creditors and other third parties? New avenues are being investigated[8] and the Commission has issued a call for research in alternative creditor protection techniques[9]. Centros a.o. might develop as a trigger for a more fundamental change in European company law.

Other types of mobility aim at increasing the efficiency of company structures. One of the characteristics of the European business model is the widespread use of subsidiaries. Many larger groups own hundreds, even thousands subsidiaries. The need to create a subsidiary is often linked to the diversity in the legal systems in the 25 member states. This structure is cumbersome, expensive, and a threat to efficiency. Indeed, in each of the subsidiaries a separate board of directors is needed, often with a separate auditor, a local accounting system applies, and so on. Not to mention the local publication – and then translated !- requirements, a nuisance with little added value in our Internet times. Groups hesitate to convert their subsidiaries into branches, which generally are cheaper to run. Even in the banking sector, where capital requirements offer a handsome premium to integrating by way of branches, the

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6 M. BECHT, C. MAYER and H. WAGNER, "Corporate Mobility and the Costs of Regulation", European Corporate Governance Institute, Law Working Paper n° 070/2006 (May 2006).

7 See art. L. 223-2 C. Com., as amended by art. 1 of the "Loi pour l'initiave économique n° 2003-721 du 1er août 2003", Journal Officiel 5 August 2003.

8 See "Conference on Efficient Creditor Protection in European Company Law", Ludwig Maximilians Universität München, Munich, 1-3 December 2005.

9 Call for tender MARKT/2006/7/F, "Feasibility study on alternative to capital maintenance regime as established by the Second Company Law Directive 77/91/EEC of 13.12.1976 and the examination of the implications of the new EU accounting regime on profit distribution", second publication, 14 March 2006.

existence of subsidiaries remains widespread. Not that the subsidiaries are run as separate legal entities: subsidiaries are needed for a host of reasons and have sometimes been imposed by the banking supervisors to ensure more efficient supervision on the local entity. Within the EU, the requirement to create a subsidiary for exercising freedom of establishment would run contrary to the Treaty rules.[10] But for non-EU banking groups, this requirement often applies. In fact, large financial groups are often run as one integrated business, disregarding the existence of the legal entities. In banking-insurance groups e.g. the group is managed along business lines – e.g. retail, wholesale, asset management – irrespective of the legal entity to which the contracts have to be attributed. This may result in serious tension between the economic and financial reality, and the underlying legal structure.

Company mobility would contribute to facilitate this type of company integration, in the sense that by allowing cross border mergers, groups will be able to do away with many of these intermediate layers of command that very often only existed on paper. It would increase efficiency of running a larger group, reduce the cost of doing business and allow a better cross border integration.

In this field, one welcomes very strongly the initiative of the European Union to have adopted – finally one would say[11] – the directive on cross border mergers. This directive was unblocked only once a deal was struck on co-determination, illustrating what was stated above about the fear for regulatory competition.

Apart from mergers, formal seat transfers should also be allowed and that in all European states. In certain cases, a seat transfer may be the right way to streamline a group, e.g. by having all activities subject to the same legal system, or be a first step towards a full merger. A merger is a heavier and more costly technique to achieve a similar result. An adequate regime for seat transfers might stimulate regulatory competition in the market for merger regulations! One regulation would then compete with another.

The question arises: what is a "seat transfer"? Does it refer to the "registered office" or to the real seat, or to the seat as mentioned in the by-laws? It is well known that the "siège réel" that is used in many continental states does not correspond to the "registered office" followed in other jurisdictions. Therefore the issue is not how to transfer the seat – these are the mechanics for which the proposal for a 14th directive[12] offers a good starting point – but what are the consequences of transferring the seat? Does a seat transfer imply a change of the applicable legal regime, a change of what is called the "nationality" of the company?

The question deserves attention. In principle, apart from the formal aspect or the effect on other regulations – e.g. tax law - , the transfer of the seat may have an effect on the legal order that is applicable to the company. Under the "siège reel" doctrine, the transfer of the seat results in the company being subject to the law of the transferee state. This effect is obviously not triggered in case the registered office is changed, as under prevailing legal analysis, the registered office cannot be transferred out of the jurisdiction of formation. And is there any

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10 Commission of the European Communities v. Italian Republic (SIM-case), Judgment of 6 June 1996, Case C-101/94, ECR, I-02691.

11 The original proposal was published in 1985, Com(94) 727 Final, O.J. C 23, January 25 1985, p. 11.

12 See press statement of 26th February 2004, ref. IP/04/270 and the positive response in the "Summary report on the consultation and Hearing on Future Priorities for the Action Plan on Modernising Company Law and Enhancing Corporate Governance in the European Union", 6-2006, http://ec.europa.eu/internal_market/company/docs/consultation/final_report_en.pdf

legal effect to a transfer of the principal place of business, provided that is different from the real seat, or of the administrative headquarters?

This aspect also will deserve attention in a future directive. Only by allowing the registered office or the real seat to be transferred could a company effectively opt for a different legal regime. The ECJ case law has not dealt with this aspect, as the companies involved had not changed their registered office but had established themselves abroad, where the host law attempted to capture them.

C. A future Directive?

One should clearly distinguish between transferring the seat on a de facto basis, and a formal seat transfer. The first one does not necessarily trigger a change in the applicable legal system, and according to the previously mentioned case law, it rarely renders the regulation in the host state applicable. The formal seat transfer incorporates the decision of the company to adopt a different legal regime, both in the real seat and in the registered office regimes.

According to the first hypothesis, companies that establish an operation in another state – is it a branch, a mere office, or has the centre of decision been transferred ? – are making use of their right to free establishment. This right cannot not be restricted by imposing burdensome requirements in the host state. Hence would it not be excessively burdensome if the host state required the company to conform itself to all rules of local company law, that the company would have to adapt its articles of incorporation and byelaws, change its governance and ownership structure or even to reincorporate? This "renationalisation" requirement would not be compatible with the principles of free establishment and non-discrimination, as the same requirement would not apply to branches. This was decided in the Überseering case: local requirements should remain limited to what is allowed under the "general good" exception with a view of protecting the local interests (creditors, employees), and reviewed on the basis of the well known fourfold touchstones for the "general good" which the Court has consistently read in a rather narrow sense. Corrective measures might be allowed[13], but a wholesale "nationalisation" goes beyond what is proportionally needed to allow a company to effectively function in another state. Whether a company that has maintained its original legal regime would offer less protection than a domestic one depends on the interests involved: as the Court remarked in Centros, the protection of creditors is not to be achieved by the host state requiring legal capital, as branches could trade without any such guarantee. But the outcome will be different if employee rights are concerned: these however should be linked to the enterprise, not to the company.

Whether that company is entitled to function in its host state without adaptation can be derived from the Überseering case, where, contrary to the prevailing opinion under German law, the company was entitled to bring legal proceedings according to the laws of its state of incorporation. It seems logical to extend this recognition to the legal body in general.

A company entering another state's legal area can continue to exist under its original legal regime, it does not have to adopt specific provisions in order to conform to local company laws, except to the extent that these might be needed for purposes of the "general good". This

[13] See § 92 Überseering case.

approach would also take care of the "creeping seat transfer", where over time more and more functions are located in another state, without explicit decision to transfer the seat.

If this would be the right interpretation, it would mean that on our local markets, companies of different nationalities would be acting alongside domestic companies, even if they had their head office or centre of administration in the host state. In fact, is this not that what we already can observe today, where foreign and domestic companies co-exist, and where the host market cannot determine whether the establishment is a principal office, a branch, or any other intermediate form?

A different case is that of the company formally deciding to transfer its seat, and hence opt for another legal regime.

Company mobility is more than de facto migration: companies should be allowed to voluntarily change their legal regime, and become subject to the laws of their host state. This change should not happen by surprise, by stealth, but be the consequence of a deliberate decision, and be executed in an orderly manner. Usually this will be linked to a formal decision to transfer the seat, whereby all interests involved will be affected. There might be a need for creditors who might fear to enjoy a lower degree of protection in the transferee state, to oppose the transfer, or at least to claim additional guarantees[14]. Minority shareholders also have a right to intervene in the procedure: should not a vote be taken in the general meeting, possibly with a qualified majority? These guarantees have been granted in case of a cross border merger: there are good reasons also to grant equivalent safeguards in case of a cross border merger. A seat transfer should also offer guarantees as to the procedures to be followed: the draft proposal for a 14th directive offer a good base for further discussion. In general one would like to see the same safeguards applicable as in case of the formation of a new company, e.g. in terms of formalities, disclosure but also of possibilities to see the decision annulled[15]. As in this case the company opts for another legal regime, it is evident that it will have to conform to the laws of that state, and have to adapt its articles of association, its governance, etc. Finally, the seat transfer should be allowed for all company types, raising some delicate question of rendering the European directive applicable to all types of companies, which is not the case today[16].

A final thought: should one link the change of applicable company law to a change of the seat? Both elements are not necessarily related: in a European perspective, a company located in state A could opt for the company law of state B. In practice however, the organisation of company law – e.g. business registry, disclosure, links to financial regulation – are so strongly linked to the seat, or the registered office, that it is simpler to maintain the applicable legal system linked to the seat, be it real seat or registered office.

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14 See the approach in art 23 of the Second Directive in case of a reduction of the capital, directive 77/91 of 13 December 1976, O.J. L 26, January 31 1977, p. 1.

15 See art 10 e.s. of the First Directive 68/151 of 9 March 1968, O.J. L 65, March 14 1968, p. 8–12; art 17 of the Cross border merger directive (see nt. 4) contains a stronger provision excluding any nullity.

16 Several of the issues mentioned here have been dealt with in the cross-border merger directive, supra nt. 4

Conclusion

The discussion about the seat transfer is by now largely settled. The ECJ have opened the flood gates, the legislation will now have to streamline the consequences. By allowing cross border mergers, a significant part of the matter has been solved. The SE also contributes to the solution, at the same time creating other externalities.

A distinction should be made between a voluntary seat change, which is in fact the choice for another legal system: this should be facilitated by a directive. It should apply to changes of the real seat and of the registered office as well, and clarify that both will result in a change of applicable law. A directive should not only deal with the mechanics, but make clear statements about the legal consequences.

A different case is the one in which a company develops activity in another state that may amount to a seat transfer under the real seat doctrine. Here the directive should make sure that this development does not subject the company to its host's laws. The directive should usefully specify which classes of provisions of general good could be considered applicable in that case. A restrictive reading would be preferred.

The answer to the question is: yes, a directive on the seat transfer is needed.

Financial Law Institute

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