

Companies crossing borders within Europe

Philippe Pellé*

First of all, I would like to thank Professor Lennarts and the Centre for European Company Law, sponsored by the Universities of Utrecht, Leiden and Maastricht, for inviting me to speak about companies crossing borders within the European Union. The Netherlands has been a trading nation for centuries and it seems only natural for the University of Utrecht to host such a seminar.

Corporate mobility seems to be the new frontier. But what do we actually mean by corporate mobility? In the 18th century, the first joint-stock companies, the Dutch East India Company and its British rival, the Honourable East India Company, were already crossing seas to provide spices to Europe. The maritime routes may not have been very safe, but no one was preventing any one from sailing the Seven Seas. After all, today, this is not much different. If we take our little Europe, companies are crossing borders every day. Businessmen, sales representatives or maintenance workers are canvassing the European market and beyond. Within the Schengen area, we no longer have to prove our identity by producing a passport as there are no longer physical borders to cross (which may sometimes create some difficulties with geography for our children). The same has applied for years to goods traded within the European Union. Customs controls still exist but these controls are random and not systematically exercised at the former borders. Services have been following the same path. Capital movement is in principle free within Europe. Therefore, if all the ingredients necessary to make a company tick, *i.e.* people, capital, goods, services, are free to move within Europe, we could legitimately deduct that companies are not only free to move across borders, but that they actually do. After all, there are already thousands of companies, of all shapes and sizes, which are established in more than one Member State through branches or subsidiaries, which offer their products and services to a potential market of 500 million consumers. In short, companies can already operate throughout the Single Market, have benefited and continue to benefit from corporate mobility. So what is the issue?

As a matter of fact, there may be specific circumstances where, even in a Single Market without borders, there may remain some hidden barriers to companies' legal mobility. The question is whether this is nothing more than an intellectual irritant for lawyers, university professors, and possibly Commission officials, or whether these 'hidden' barriers constitute actual obstacles for entrepreneurs and therefore represent an opportunity loss for job creation and economic growth in Europe. Unfortunately, economic evidence is scarce. The issue is therefore often tackled from an individual rights perspective and the European Court of Justice has been instrumental in pushing boundaries in this respect.

* Principal Administrator, European Commission. The views expressed are solely those of the author and do not commit in any way the European Commission.

1. Right of establishment

If we look at the company as a legal person and start to compare its ability to cross borders with that of a natural person, things may appear crystal clear at first sight but quickly become more complex, depending on how far we push the comparison.

Freedom of establishment is a fundamental right enshrined in the EC Treaty.

This comparison between legal persons and natural persons is actually enshrined in the Treaty of Rome itself. Article 48¹ of the Treaty requires that ‘companies 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 be treated in the same way as natural persons who are nationals of Member States’.

The combination of Article 48 and Article 43 ensures that a company of any Member State has the right to operate undertakings or set up agencies, branches or subsidiaries in the territory of any Member State.

By and large, companies in Europe have largely benefited from this freedom over the years. A look at the trend regarding intra-Community direct investment flows over the last 10 years shows that the right of establishment has been an important factor of economic integration at European level.

Obviously, this degree of freedom was not achieved in one day and enabling measures had to be taken. For many years, basically from 1968 (date of adoption of the First Company Law Directive) to 1989 (date of adoption of the 12th Directive), the EU approach to company law focused on establishing an equivalent level of protection of members of companies and third parties, a process that was actually inscribed in Article 44(2) (g) of the Treaty. It seems that at that time, this was also the lowest common denominator Member States could agree upon. A minimum that was relatively easy to reach as it essentially amounted to a replication at Community level of the main content of existing national laws, not forgetting some domestic peculiarities (which explain the presence of a significant number of options in some Directives – up to 40 in the Accounting Directives). According to some academics, the hidden agenda behind this approach was to stifle any possible attempt by Member States to engage in a ‘race to the bottom’. In particular, France was concerned that the Netherlands which had a more flexible corporate law and an attractive tax regime for foreign companies would become a European Delaware. Whether such a phenomenon would have occurred in the absence of harmonisation is unclear.

What is certain is that corporate mobility was not high on the agenda: cross-border mergers of companies were only possible in a few situations, not to mention the possibility for a company to transfer its seat. The opening offered by Article 293 of the Treaty (ex. Article 220) remained a dead letter. That Treaty Article envisaged that Member States would enter into negotiations with each other to ensure mutual recognition of companies and the retention of the legal personality in the event of the transfer of seat from one Member State to another. A Convention on Mutual Recognition of Companies and Legal Entities was signed in 1968 in Brussels but did not pass the ratification stage (it is said that this was because in the meantime one of the then

¹ However, the ECJ made a very important distinction between natural and legal persons. In the *Daily Mail* Case (ECJ 27 September 1988, Case 81/87, [1988] ECR 5483), it laid down that ‘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’. The ECJ made it clear that the rules on company formation fall within the competence of national law.

6 Member States – the Netherlands – had switched from the real seat system to the incorporation system).

Has the situation evolved for the better over the last years?

The lines have started to move to some extent with the adoption in 2001 of the regulation on the European Company Statute, more recently with the adoption of the Cross-border Mergers Directive, and perhaps more significantly with the recent case law of the European Court of Justice (*Centros*, *Überseering* and *Inspire Art*).

2. The SE

The SE Regulation was adopted some 30 years after the Commission introduced a first proposal (1970). That is to say: (1) after the Commission in 1989 completely rewrote its initial proposal for a comprehensive statute, independent from national laws; and (2) after a compromise was found on worker's codetermination.

The economic rationale for the SE was to offer a European flagship to companies, but mostly to grant them the possibility to organise their business more efficiently and cheaply across different jurisdictions. The SE Statute enables groups to merge their European subsidiaries with the SE. This consolidation process resulting in the conversion of subsidiaries into branches can save companies all the costs related to the running of subsidiaries in multiple Member States with different legal systems. No need for a separate board of directors, or for a separate auditor, no different accounting rules to follow, no need for a potential army of legal advisors on different corporate laws as all the companies in the group would follow a single body of company law.

As a matter of fact, the European Company Statute is the first piece of Community legislation that allows for cross-border mergers (this is actually one way to form an SE) as well as the transfer of seat of a company to another jurisdiction. In respect of the latter, it should be underlined that this transfer has to apply jointly to the registered seat and to the head office (real seat).

So with all these advantages, one would expect to count SEs by millions when we have about 90 of them, a few on paper as shelf SEs, but most of them active ones.

This discrepancy between expectations and reality may partly be explained by the delays in the national implementation of the Directive on workers' participation to the organs of the SE. The Directive was fully implemented in all 27 Member States only at the end of last year. So we still may see a surge in the number of SEs in the coming months.

However, some commentators consider that the SE is not attractive enough as its formation is costly both in terms of money and management time. The minimum capital requirement of €120.000 is viewed as too high for small and medium sized companies. A private limited company cannot be transformed into an SE (the governing structure is inappropriate). The negotiation on workers' participation is often seen as the major drawback of this European legal form because of its complexity and the time it takes to complete the procedure (often a year or more).

Furthermore, the question of the exit tax on the transfer of the seat of the SE is unresolved. Like for any other company, there is at present no system to ensure the deferral of the taxation of capital gains or hidden reserves. If no permanent establishment remains in the Member State the SE is leaving, the tax will have to be liquidated. Is this a reason why we do not see SEs moving around in search of the best corporate law regime? Or is it simply that this parameter is irrelevant?

In practice, at least until now, the SE form seems to have been used more as a legal form additional to or competing with national ones rather than a vehicle for mobility.

This situation may change over time. In 2009, the Commission will produce a report on its ex-post evaluation on this new European legal form. We will have to consider whether some amendments are necessary to make the SE more attractive. Mme Noëlle Lenoir will provide us with some hints about this, as last March she handed over a bulky report containing a series of suggestions about this to the French Ministry of Justice.

3. The Cross-border Mergers Directive

However, with regard to corporate mobility, many specialists consider that most companies tempted by the SE as a vehicle to move their primary establishment from one Member State to another would rather wait for the Tenth Company Law Directive on cross-border mergers to be fully implemented: (1) because the procedure on co-determination, even if copied from that of the SE, has to be completed within 6 months, like in a merger operation, a longer period would be potentially be very detrimental to the life of the companies involved in the merger operation; (2) because the resulting company could be a national form of interest (a British limited or a new GmbH).

In the US, companies often use cross-state mergers to move their registered seat from one state to another. The same approach could now emerge in the European Union. It should in principle be sufficient for a company in Member State A to transfer its registered seat to Member State B to create a new company in Member State B and be absorbed by the new company.

It is still early days to predict who will use the Cross-border Mergers Directive and whether it will be a success.

4. The impact of the case law of the Court of Justice on companies' freedom of establishment

In contrast, the recent case law of the European Court of Justice seems to have had more impact on companies' mobility and freedom of establishment than Community secondary legislation.

The *Centros* case² has been particularly striking in this respect. The *Centros* case concerned two Danish citizens who wanted to set up a company to run a business in Denmark but who did not want to put the money upfront to comply with Danish minimum capital requirements. Instead, they decided to register a private limited liability company in London with a one-pound capital and carry out their actual economic activity in Denmark as a branch. The registration of the branch was refused by the Danish authorities who considered that this legal 'construction' was solely motivated by the desire to circumvent Danish capital requirements and hence constituted an abuse of law. One could say that this only a matter of perspective. The Court ruled that it was contrary to the Treaty for a Member State to refuse to register a branch of a company formed in accordance with a law of a Member State and that the legal construction (company in the UK and branch in Denmark) could not in itself constitute an abuse of right of establishment. The requirements set by Denmark did not pass the proportionality and necessity test.³ Creditors

² ECJ 9 March 1999, Case C-212/97, *Centros Ltd. v. Erhvervs-og Selskabsstyrelsen*.

³ P.m. 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 way; 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 to attain it.

could look for other protection mechanisms than a minimum capital requirement (e.g. bank covenant, etc.).

What is striking is not so much the decision of the Court as what ensued as a result. Lawyers and company service providers saw this as a bounty. As showed by an empirical study conducted by Marco Becht, Colin Mayer and Hannes Wagner,⁴ after the judgment of the Court in *Centros*, comforted by the later judgements in the *Überseering*⁵ and *Inspire Art*⁶ cases, one saw a surge in the registration of new companies in the UK (considered to be one of the cheapest and most efficient regimes for company formation) which had all their operations in other Member States. In 2005, there were nearly 20.000 companies registered in the UK, having their head office in other Member States. That is five times more than in 2001, just after the Court delivered its opinion in the three cases mentioned.

In particular, in 2005 there were 12,019 companies registered in the UK and operating in Germany (as compared to 516 in 2001). Similarly, there were 2,127 companies registered in the UK and operating in the Netherlands in 2005 (as compared to 91 in 2001).

De facto, the *Centros* case had been seen as a green light for a number of people residing in Member States with high requirements and costs regarding the formation of companies to incorporate in Member States with lower formation costs, whilst running their business (assets, employees, shareholders) in their Member State of origin. *Centros* opened the front of regulatory competition between corporate law systems, allowing companies to go cherry-picking from their armchair.

With its decision in the *Überseering* case, the ECJ confirmed *Centros*. This decision was interpreted by some commentators as opening the way to the transfer of the real seat. However, it should be underlined that in the *Überseering* case, this result is that of the 'inbound' recognition of the real seat. As in *Centros*, the company was created in one Member State to operate through a head office located in another Member State. There was actually no transfer of head office from one Member State to another, but an issue of recognition and acceptance, without further requirements of the existence of the head office of a company legally constituted in another Member State.

With these recent cases, including *Inspire Art*, the Court has to a large extent weakened some of the rigidities of national corporate law doctrines and has moved the European legal scene towards mutual recognition of companies. One may wonder whether we have now reached a Nirvana where companies can move as they wish in the EU and in particular whether registered seats or head offices can move around.

As a matter of fact, despite the more recent case law, the *Daily Mail* jurisprudence has remained untouched until now. The Court of Justice has not clearly forbidden Member States to impose restrictions on the transfer of the real seat of a company incorporated under their law to another Member State.⁷ Therefore, a company may be required to fulfil certain conditions when moving its real seat from a Member State in which it is registered if such country decides to impose such requirements (such as obtaining approval from certain public authorities).

4 M. Becht, C. Mayer & H.F. Wagner, *Where Do Firms Incorporate?*, ECGI Law, Working Paper no.70/2006, August 2007, available online at www.ssrn.com

5 ECJ 5 November 2002, Case C-208/00, *Überseering BV v. Nordic Construction Co Baumanagement GmbH*.

6 ECJ 30 September 2003, Case C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd*.

7 *Daily Mail*, *supra* note 1, §70 ('a Member State was able, in the case of a company incorporated under its law, to make the company's rights to retain its legal personality under the law of that State subject to restrictions on the transfer of the company's actual centre of administration to a foreign country').

Since the home country may have legitimate reasons to impose certain requirements on companies wishing to transfer their real seat abroad (in particular to prevent any cases of abuse) Member States should not be entirely deprived of the right to impose such requirements (provided they remain proportionate and justified on public interest grounds).

5. Conclusion: do we need a Directive on the transfer of the company's seat?

Then the next question is whether some legislative action at Community level is needed or whether we should leave it to the European Court of Justice to continue to extend the boundaries of the right of establishment for companies.

In its Company Law and Corporate Governance Action Plan of May 2003, the Commission had announced as a medium term priority the issuing of a proposal for a Directive on the transfer of seat.⁸ This priority was confirmed by the public consultation we conducted in 2006 on the future priorities of the Action Plan, where around 80% of respondents considered that there is still a need for a Directive on the transfer of registered office.⁹

In the view of stakeholders, the Directive would facilitate the mobility of European companies, in particular SMEs, and allow them to locate their businesses in the Member State that best suits their needs. Many of the respondents mentioned that the existing measures still do not provide for a straightforward transfer of the registered office (the transfer of registered office is only possible through a conversion into an SE or a cross-border merger) and, therefore, European legislation is necessary.

Several respondents also emphasised that there is still uncertainty on the legal and tax consequences of transfer under the present law and on the effects of the jurisprudence of the European Court of Justice on the freedom of establishment. The need for a Directive to ensure legal certainty of the transfer as well as to guarantee proper protection of the interests of creditors, shareholders and employees in relation to the transfer was underlined.

However, hardly any economic argument was brought forward to justify such an initiative. The main line is one of principle. It may then be more appropriate for the Court to express an opinion here.

The *Cartesio* case currently pending before the Court might provide this opportunity. The case is about: (1) the applicable law in the case of a company registered and headquartered in a Member State which wishes to transfer its seat to another Member State; (2) whether such a company can transfer its registered office under Articles 43 & 48 of the Treaty; and (3) whether the transfer can be subject to conditions and approvals by either the state of incorporation or the host Member State. *Cartesio* is established in Hungary which until now applied the real seat doctrine but has since switched to the incorporation principle. There is no tax dimension in that case and *a priori* the questions are focused on the issue of the transfer of seat

We hope that the Court will be in a position to deliver an opinion concerning the transfer of both the registered seat and the real seat. We hope that the Court will push one step further its doctrine on the right of establishment. However, how far it can go, we do not know.

The Commission has decided that it would not come forward with a proposal for a 14th Company Law Directive at this stage, considering the scarce economic evidence proving the

8 Communication from the Commission to the Council and the European Parliament, Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward, COM(2003) 284 final, 21.5.2003.

9 Directorate General for Internal Market and Services, Consultation and hearing on future priorities for the Action Plan on modernising company law and enhancing corporate governance in the European Union (summary report) of July 2006, available online at http://ec.europa.eu/internal_market/company/consultation/index_en.htm

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case. Furthermore, it should be recalled that the Court of Justice should in the coming months give its opinion on the *Cartesio* case which may have a direct bearing on the issue of the transfer of a company's seat.

Nevertheless, a strengthening of the cooperation between tax administrations may be the necessary pre-requisite to lift the remaining tax hurdle, particularly exit taxation.

Ladies and Gentlemen,

Thank you for your attention. I believe it is time for me to leave the floor to specialists.