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MARMARA ÜNİVERSİTESİ
AVRUPA TOPLULUĞU ENSTİTÜSÜ
AVRUPA BİRLİĞİ HUKUKU ANABİLİM DALI

FREEDOM OF ESTABLISHMENT OF COMPANIES IN THE LIGHT OF PRIVATE INTERNATIONAL LAW THEORIES

Yüksek Lisans Tezi

ENGİN AKAR

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İstanbul- 2006

ABSTRACT

This research with the title 'Freedom of Establishment of Companies in the Light of Private International Law Theories' explores the exercise of freedom of establishment by companies as provided under the articles 43 to 48 of the EC Treaty and the relationship between this fundamental freedom and the conflict of laws rules, which originate from the internal laws of the Member States. The goal of this research is to determine whether the private international law theories, which the Member States apply in order to ascertain the applicable law to a foreign company, the control center of which is located within their territories, constitute a restriction to companies' freedom of establishment guaranteed by the EC Treaty.

In the European Union there are two major theories, which the Member States make use of when determining the proper law of a foreign company. One of those theories is the 'real seat theory', which envisages the application of the law of the state, in which the company's centre of administration is located. The other mainstream theory is the incorporation theory, which, regardless of where the company's centre of administration is located, regards the place of incorporation for ascertaining the applicable law.

On the other hand, Article 48 of the EC Treaty provides that the freedom of establishment, which comprises the genuine economic activities through a fixed establishment for an indefinite period and is directly applicable since the expiration of the transitional period, also applies to the companies. It must also be mentioned that in accordance with the established case law of the European Court of Justice, freedom of establishment covers not only the prohibition of discriminatory measures based on nationality, but also the ones that hamper the exercise of this fundamental freedom or make it less attractive.

In this research, the relationship between the private international law theories applied by the Member States and the freedom of establishment regulated under the EC Treaty will be investigated and it will be examined whether the real seat theory obstructs the exercise of freedom of establishment as set forth by the recent case law of the ECJ.

ÖZET

‘Milletlerarası Özel Hukuk Teorileri Işığı Altında Şirketlerin Yerleşim Serbestisi’ adındaki bu çalışmada, Avrupa Topluluğu Antlaşmasının 43. ve 48. maddeleri arasında düzenlenen yerleşim serbestisinin şirketler bakımından uygulanışı ve bu serbesti ile üye devletlerin iç hukuklarına dahil olan kanunlar ihtilafı kurallarının ilişkisi incelenmektedir. Çalışmanın amacı, üye devletlerin merkezi kendi ülkelerinde bulunan yabancı şirketlere uygulanacak hukukun tespiti için başvurdukları milletlerarası özel hukuk teorilerinin, şirketlerin Avrupa Topluluğu Antlaşması ile garanti altına alınan yerleşim serbestisinden faydalanması bakımından bir kısıtlama oluşturup oluşturmadığını tespit etmektir.

Avrupa Birliği içersinde üye devletlerin merkezi kendi topraklarında bulunan yabancı şirketlere uygulanacak hukukun tespiti için kullandıkları iki temel teori bulunmaktadır. Bunlardan biri, şirkete idare merkezinin bulunduğu yerin hukukunun uygulanmasını öngören ‘Gerçek Merkez Teorisi’; diğeri ise, şirketin idare merkezinin nerede bulunduğunu hesaba katmaksızın kuruluş yeri hukukunun uygulanmasını öngören ‘Kuruluş Yeri Teorisi’dir.

Diğer yandan Avrupa Topluluğu Antlaşmasının 48. maddesi, geçiş döneminin tamamlanması ile birlikte doğrudan uygulanabilirlik kazanan ve belirsiz bir süre için bir başka üye devlette sabit bir yerleşme ile gerçek bir ekonomik faaliyette bulunmayı kapsayan yerleşim serbestisinin şirketlere de uygulanmasını öngörmektedir. Belirtmek gerekir ki, Avrupa Topluluğu Adalet Divanının yerleşmiş içtihatları uyarınca söz konusu yerleşim serbestisi sadece vatandaşlığa dayalı ayrımcılık içeren düzenlemeleri değil, aynı zamanda temel özgürlüğün uygulanmasını engelleyen ya da daha az çekici hale getiren her türlü düzenlemeyi kapsamaktadır.

Bu çalışmada üye devletlerde uygulanan milletlerarası özel hukuk teorileri ve Avrupa Topluluğu Antlaşması ile düzenlenen yerleşim serbestisi incelenip, gerçek merkez teorisinin Avrupa Topluluğu Adalet Divanının son yıllardaki içtihatlarında ortaya konulduğu gibi şirketlerin yerleşim serbestisi aleyhine bir kısıtlama oluşturup oluşturmadığı değerlendirilecektir.

Abbreviations

CMLR	Common Market Law Review
EBLR	European Business Law Review
EC	European Community
EC Treaty	Treaty establishing the European Community
ECJ	European Court of Justice
EEA	European Economic Area
EEC Treaty	Treaty establishing the European Economic Community
EEIG	European Economic Interest Grouping
EPC	European Private Company
EU	European Union
EuZW	Europäische Zeitschrift für Wirtschaftsrecht
GmbH	Gesellschaft mit Beschränkter Haftung (The German Limited Liability Company)
ICCLJ	International and Comparative Corporate Law Journal
ICLQ	International & Comperative Law Quarterly
JZ	Juristen Zeitung
NJW	Neue Juristische Wochenschrift
NZG	Neue Zeitschrift für Gesellschaftsrecht
OGH	Oberste Gerichtshof
SCE	European Cooperative Society
SE	Societas Europaea (The European Company)
Single Market	The internal market of the EU
UK	The United Kingdom
US	The United States
WBFV	Wet op de Formeel Buitenlandse Vennootschappen (The Dutch Law on the Formal Foreign Companies)
ZGR	Zeitschrift für Unternehmens- und Gesellschaftsrecht

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INTRODUCTION

One crucial element for constructing a highly competitive internal market, which has been set forth as one of the main objectives of the European Community, is the cross-border mobility of companies. More precisely, in order to reach a high level of competitiveness, the companies within an internal market should be made capable of transferring their seats freely, without being forced to re-incorporate or without being confronted with problems regarding recognition or any other national requirements, which could possibly render such transfer less attractive.

Given the enormous dissimilarities between the company law approaches of the Member States, though, this is not quite an easy task. Taking account of the characteristic historical backgrounds and the social policies of each Member State, a spontaneous uniformity in field of company law could not be expected. Dissimilarities arise, however, even in the fundamental features of national company law principles of Member States. Some Member States, for instance, attribute an essential significance to the worker co-determination in certain company types, while the company laws of other Member States are even ignorant of this very concept. This dissimilarity can also be seen in the perception differences as regards the global concepts such as minimum capital, creditor protection, protection of minority shareholders, limited liability etc. It makes perfect sense that a protective approach and a market-oriented liberal approach gives birth to an entire dissimilarity between company law rules.

Dissimilarity in company laws brought about two conflicting private international law theories in the course of time. Countries having more protective and rigid company law rules felt the need of protection against the use of companies governed by lax company law rules and intended to apply their domestic company law rules to foreign companies having their real seats within their territories. This private international law doctrine, which is commonly referred to as the ‘real seat theory’, assumes that the country, in which a company has its real seat, is most strongly affected by the activities of such company, and therefore uses the real seat

of a company as the decisive connecting factor when ascertaining the law applicable to a company. On the other hand, the liberal approach, which manifested itself as 'the incorporation theory', provides that the place of incorporation of a company should be regarded, irrespective of the location of its real seat, as the decisive factor in respect of determination of the law applicable to a company.

These two conflicting theories set out the principles of companies' cross-border mobility within Europe -even in the EC era- for a long period. This being so, a seat transfer into a country adhering to the real seat theory had costly consequences. For example, Germany, the leading adherent of the real seat theory, refused to recognize a limited liability company having its real seat in Germany as such, unless it re-incorporated under German company law rules. Consequently, such company used to lose everything it gained as a result of being duly incorporated, most importantly its legal personality, the limited liability of its shareholders and its capacity to be a party to legal proceedings.

Turning back to European Community's objective of creating a competitive internal market, Article 43-48 of the EC Treaty provides a freedom of establishment, which comprises the genuine economic activities through a fixed establishment for an indefinite period. This provision, which also applies to the companies, is directly applicable as of the expiration of the transitional period. Therefore it does not need to be supplemented with any secondary legislation and has supremacy over the national legal provisions of the Member States. Furthermore, it was proved by the case law of the European Court of Justice that the freedom of establishment comprised not only the exclusion of discriminatory measures based on nationality, but also any measures that hinder the exercise of this fundamental freedom or make it less attractive.

The question to be asked here is whether the application of the real seat theory should be regarded as to be hindering the exercise of the freedom of establishment of companies, or making it less attractive. This question, for a long time, constituted a major academic debate for the EC lawyers, some of whom asserted that the provision of Article 48 included a hidden conflict of laws norm, which set forth the application of the incorporation theory. In the view of some

authors, even when the freedom of establishment should not be regarded as having a conflict of laws aspect, the real seat theory was inappropriate for the exercise of the freedom of establishment and therefore should be abolished. Another group of legal scholars, on the other hand, claimed that the freedom of establishment provided by the EC Treaty had no consequences for the national private international laws of the Member States.

The latter view seemed to be supported by the ECJ's judgment in *Daily Mail* case, as it was held in this judgment that the EC Treaty provisions conferred no right on a company incorporated under the legislation of a Member State and having its registered office there to transfer its central management and control to another Member State. However, after some ten years, the *Centros* decision provoked the debate as to the conformity of the real seat theory with the freedom of establishment, this time, however, in favour of the incorporation theory. According to this decision, a Member State was obliged to register the branch of a company duly formed under the laws of a Member State, even though the company did not pursue any activities in the state of incorporation. A number of legal scholars considered this attitude of the ECJ as to be acknowledging the end of the real seat theory in respect of foreign companies from other Member States. But the belief that the real seat survived was still quite common, for the actors of the *Centros* case both adhered to the incorporation theory. The ECJ was expected, in the view of these scholars, to take account of the real seat theory, so long as a Member State applying the real seat theory would be involved in a similar case. *Überseering* decision proved this wrong. It was then clear that the real seat theory was eliminated, at least as regards the recognition of foreign companies' legal capacity and capacity to sue and be sued. The advocates of the real seat theory claimed this time that the decision of the ECJ should be understood in a narrow sense. The case solely dealt with the legal capacity and the capacity to be party to legal proceedings. The Court did not point out whether the internal or external relations of a company remained subject to the law of incorporation. The real seat theory could still be applied when updated in accordance with the principles set out in *Überseering* judgment. But it could not. A 'further nail in the coffin of the real seat theory' did not take so long. With its

Inspire Art judgment, the ECJ made it clear that the application of the real seat theory was incompatible with the freedom of establishment of companies, this time in every aspect.

What the ECJ did was exactly what the EC legislators neglected to do. It set out the principles for securing the freedom of establishment of companies within the EU. But it is still doubtful whether the European Community is prepared for such an extensive freedom for companies. There seems to be no change in 'present state' of the Community law, which was referred to in the Daily Mail judgment. The so-called 'Deleware Effect' is still intimidating and some EU Member States fear of invasion of *billige Gesellschaften* (cheap companies). Furthermore, the approach taken by the Community legislator in the Statute for a European Company (SE) seems to be inconsistent with that of ECJ. Contrary to the principles set out in the decisions of the ECJ, a SE does not enjoy an unlimited freedom of establishment as it is subject to a change in the applicable law in case of a seat transfer.

The focal purpose of this study is to set out the relationship between the national private international law theories in respect of determination of the governing law of a company and the freedom of establishment of companies provided under the EC Treaty. It will be explored whether the application of the real seat theory should be considered incompatible with the freedom of establishment of companies and the recent case law completely undermined the application of the real seat theory, or the real seat theory can still be applied, albeit not in its purest form.

This research has the ambition of investigating neither the European Company Law, nor the particular company laws of the Member States. Both the European Company Law and the company laws of the Member States will only be mentioned, insofar as it is necessary for illuminating the relationship of conflict of laws and companies' freedom of establishment, and also the outcomes of elimination of the real seat theory. Moreover, the regulatory competition, which may

possibly arise from the incorporators' choice of law, will not be made subject to this research.

In order to provide a comprehensible reading, I considered it appropriate to begin with scrutinizing the national conflict of laws theories. This consideration is based on the chronological antecedence of the conflict of laws theories and on the assumption that the relevant EC Treaty provisions are more or less rooted in the traditional theories. Furthermore, in order to avoid confusion arising out of verbosity, I solely examined the relevant aspects of the freedom of establishment rather than providing a comprehensive research thereon. When the correct comprehension of the discussion so required, I deemed it necessary to explain the relevant decisions of the ECJ in an extensive fashion, likewise most of the scholars contributing in this field. After revealing the relevant aspects of the two different concepts, *i.e.* the private international law and the freedom of establishment, I examined the very relationship between them. I did so by determining the disputed issues arising from the ECJ decisions on a case-by-case basis and by reflecting the approach of the legal circles to these disputed issues. By way of scrutinizing the relationship between the private international law and the freedom of establishment, I tried to find out whether the freedom of establishment has a conflict of laws dimension, and, if so, to which extent. After setting forth the conflict of laws dimension of the freedom of establishment, I revealed the law applicable to a company in cross-border seat transfers by taking account of each potential way of seat transfer. I pursued this method under the following outline:

In Chapter I, the long-established conflict of laws theories in respect of determination of the governing law of a company will be dealt with. In this Chapter, all relevant aspects of the real seat theory and the incorporation theory will be displayed in detail. After that, the reconciliatory attempts made by the doctrine and arising out of the exercise of the states will be looked at briefly. Finally, the practical outcomes of seat transfer will be examined in a situation-by-situation basis in the light of the given conflict of laws theories.

Chapter II gives the reader an overview of the freedom of establishment, in particular, of companies. Firstly, an analysis of the relevant EC Treaty provisions will be made. The decisions of the ECJ will be referred to frequently, for the clues for defining certain concepts can be found in the case-law. After putting a special emphasis on the distinction between primary establishment and secondary establishment, justifications of restrictions on freedom of establishment of companies will be presented.

Chapter III explores the relationship between freedom of establishment of companies and the national conflicts of laws theories, which constitutes the main purpose of this research. All debated aspects in this regards will be reflected in this Chapter. The key decisions of the ECJ will be discussed in detail, when the explanation of the circumstances so requires. After revealing the current position of the conflict of laws norms in the light of freedom of establishment, the practical outcomes of seat transfer will be examined in a situation-by-situation basis, but this time by taking the freedom of establishment into consideration. After exploring the principles set out in the case law of the ECJ, the provisions on the Statute for a European Company will be touched on and the inconsistency with the ECJ's case-law will be displayed. Lastly, the Proposal for the Fourteenth Council Directive on the transfer of the registered office of a company from one Member State to another with a change of applicable law will be illuminated in the light of the principles mentioned above.

1 CHAPTER: I - GOVERNING LAW OF COMPANIES IN PRIVATE INTERNATIONAL LAW

1.1 GENERAL

Legal status of foreign companies and their cross-border movements used to be within the exclusive scope of study of private international lawyers and, furthermore, it is claimed that the basic provisions of Articles 43 and 48 are more or less rooted in the traditional theories.[1] Therefore, for a proper analysis of the freedom of establishment of the companies, traditional private international law approaches must be thoroughly studied in the first place.

As very well known, private international law consists of the rules for determination of the applicable law among the private laws of more than one country to a certain legal matter involving a foreign element.[2] Determination of nationality and legal capacity of natural persons has never been controversial in the legal doctrine. On the other hand, things are not exactly the same as far as the legal persons are concerned.[3] It has been asserted that, unlike natural persons, legal persons are not subject to nationality.[4] Considering the fact that the law applicable to a natural person is her national law, that the companies do not have nationality removes the possibility to determine the law applicable to companies through reference to the national law.[5]

The intensity of the contemporary commercial relationships and the fact that the legal persons transact in foreign countries as well as in their home states increase

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[1]Stephan Rammeloo, "Corporations in Private International Law : a European Perspective", Oxford; New York : Oxford University Press, 2001 p.9

[2] Gülören Tekinalp, 'Milletlerarası Özel Hukuk Bağlama Kuralları', İstanbul: Beta, 2004, p. 13

[3] Questions whether legal persons have nationality, and whether a nationality is necessary for legal persons have been subject to extensive academic debates. For these debates see Gülören Tekinalp, 'Türk Hukukunda Ortaklıkların Vatandaşlığı', İstanbul Üniversitesi Hukuk Fakültesi'nin 50. yıl Armağanı : Cumhuriyet Döneminde Hukuk, 1973, p. 554

[4] Aysel Çelikel, "Milletlerarası Özel Hukuk", İstanbul, Beta, 2004, p. 185. For the view asserting that the legal persons have nationality, see Tekinalp, 'Milletlerarası Özel Hukuk', p. 67, footnote 36.

[5] Tekinalp, "Milletlerarası Özel Hukuk", p.67

the significance of the role of determination of the law applicable to the companies.[6] If there were a unity between the legal systems all over the world, there would not be such a problem as the conflict of laws.[7] However, the legal rules governing the companies within Europe present an enormous diversity. This has also found reflection in field of private international law rules regarding the legal status of companies. This diversity has a number of consequences that can cause some complications for and possibly jeopardize the application of the freedom of establishment of companies as provided in the EC Treaty. Leaving the complications regarding the freedom of establishment aside, in this Chapter of my study, I will scrutinize in depth the international company law, the theories for setting out the criteria for determination of the applicable law and the practical outcomes of the cross-border movements of companies under the light of the respective theories.

1.2 CONCEPT OF RECOGNITION

The recognition of foreign companies has always been subject to discussions due to the uncertainty of the concept of recognition. It has been questioned whether the content of the recognition is limited to the obligation to observe the personality and the capacity of the legal person or whether it also comprises the legal consequences of corporate status.[8] The concept of recognition has been understood to be pointing at the question of 'being' and 'legal capacity' of a company formed under the law of a foreign country.[9] However it is unanimously accepted that the recognition of foreign companies primarily concerns the conditions, under which a foreign company can transact in host state as a 'legal subject'.[10]

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[6] Tekinalp, p. 67
[7] Çelikel, p. 9
[8] Kurt Lipstein, "Law Relating to the Movement of Companies in the European Community", Festschrift für Peter Schlechtriem: zum 70. Geburtstag / herausgegeben von Ingeborg Schwenzer und Günter Hager, Tübingen : Mohr Siebeck , 2003, p. 530
[9] Monika Brombach, "Das Internationale Gesellschaftsrecht im Spannungsfeld von Sitztheorie und Niederlassungsfreiheit', Düsseldorf: Jenaer Wissenschaftliche Verlagsgesellschaft, 2006, p. 22
[10] Peter Behrens, "Der Anerkennungsbegriff des Internationalen Gesellschaftsrechts", ZGR, 2, 1978, p. 500

Recognition can be considered in two different senses.[11] In narrow sense, recognition does not deal with the law to be applied to the company and considers a company 'as a legal subject, i.e. a bearer of rights and duties, nothing more or nothing less'.[12] In this sense, the concept of recognition has a *Fremdenrechtlich* aspect in itself and is used in field of *Fremdenrecht* for the admission to economic activities in the host state.[13] As to the law applicable to the company, the recognition in narrow sense does not provide us with any clues.

On the other hand, recognition in broad sense means the outcome of the process of ascertaining the proper law to be applied to a company.[14] Accordingly, matters such as formation, structure, functioning of organs, dissolution and winding up of a company are governed by the proper law determined in accordance with the recognition process.[15] The concept of recognition in this broad sense appears to be a conflict of laws norm.

Moreover, taking the recognition of companies as a conflict of laws norm, it has been discussed whether the concept of recognition and the applicable law to the companies are identical. Some authors claim that the recognition of companies and the applicable law to the companies are independent matters and these two concepts could be subject to different connecting factors.[16] Some other authors, by contrast, suggest that these two concepts are principally identical and the recognition of companies constitutes a fragment of the applicable law to the companies.[17]

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[11] Behrens suggests three different meanings for the concept of recognition. Accordingly recognition deals with a) under which conditions a foreign company can get established in host state and carry out economic activities; b) what kind of legal action is required for participation in the domestic legal traffic or c) ascertaining of the legal order whose incorporation requirements should be applied to the company.

[12] Rammeloo, p. 10

[13]Christoph Ann, "EU-weite Unternehmenmobilität nach dem Vorentwurf einer Richtlinie zur grenzüberschreitenden Sitzverlegung von Kapitalgesellschaften", Ünal Tekinalp'e Armagan, III. Cilt, Beta , İstanbul 2003, p. 10

10; Brombach, p.22

[14] Rammeloo, p. 10

[15] Rammeloo, p. 10

[16] Behrens, p.510

[17] Behrens, p.510

1.3 PRIVATE INTERNATIONAL LAW THEORIES FOR DETERMINATION OF THE GOVERNING LAW OF A COMPANY

As a branch of private international law, international company law deals with the determination of the legal system governing valid incorporation and activities of companies, i.e. *lex societatis*[18], so long as a foreign element is involved that gives rise to a conflict of laws.[19] As was mentioned above, however, in determination of *lex societatis*, the European legal systems do not seem to be quite in uniformity. Private international law is a discipline of national law and therefore it is reasonable that it differs from country to country. Consequently the conflict rules as regards the companies vary within the Europe.

The criteria, which are the mainly applied in Europe, are the real seat criterion and the incorporation criterion.[20] The reasons underlying this variation of national conflict rules regarding companies can be seen in the historical developments in field of company law.

The law governing the companies has been a problematic subject ever since the corporal structure of the companies started to render complexity. For example in the England of 18th century, the concession system and the act of state doctrine were applied.[21] In the era of industrialization and colonization, the Great Britain as a world power of its time was in need of a legal instrument that would protect its benefits in double sense: Firstly the English companies needed to function abroad on reliable grounds through the export of the English law. Secondly it would be easier to protect English companies that transferred their seat abroad, when they were under English law, even after the transfer of seat.[22] In compliance with the increasing liberality of the English corporate law in 19.century, the English incorporation rules became comparably lax. A company was considered to be subject to the law of the country it was established in. This reduced the possible

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[18] German word for "lex societatis" is Gesellschaftsstatus, English: company statute.
[19] Hans C. Hirt, "Freedom of Establishment, International Company Law and the Comparison of European Company Law"; EBLR, Nov. 2004, p. 1194; Enrico Vaccaro "Transfer of Seat and Freedom of Establishment in European Company Law" EBLR, Dec. 2005, p. 1349
[20] Çelikel, p. 185; Tekinalp, p. 68
[21] Tekinalp, p. 68
[22] Jesper Lau Hansen, "A New Look at Centros – From a Danish Point of View" EBLR, 13, 2002, pg. 86.

endangering of British public because the requirements of other laws were more stringent. The majority of the foreign companies that had their seat in England were from the commonwealth countries anyway. Their laws were similar to that of England.

With the acceleration of the industrialization, a contractual and liberal company law view was developed in the United Kingdom. The use of British companies as a vehicle for enterprise became common in the states, where more rigid company law rules were applied to companies.[23] In such a screen, it was preferable for the parties to choose to get established in the United Kingdom, in order to be subject to its lenient company law rules. Under such circumstances, the States having more rigid company law rules containing mandatory provisions sought to deal with this by not allowing the companies to choose the law of another State simply by getting established there.[24]

Leaving the nuances aside, there are two mainstream theories for ascertaining the proper law governing a company and setting out the legal criteria for recognition of a company as a validly constituted entity.[25] These theories are the real seat theory[26], that uses the location of a company's centre of administration or seat as the connecting factor, and the incorporation theory[27] that determines the applicable law by referring to the place of incorporation of the company.[28] These two mainstream theories will be examined thoroughly in the following part. After examining these theories, other theories that did not find widespread application will be looked at briefly.

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[23] The situation in the United Kingdom prior to the acceleration of industrialisation was the contrary. The company law of French was deemed to be more liberal and the French incorporated companies were favoured vessels for enterprise. For further details about this, see Hansen, p. 86, 87.
[24] French for the concept of circumvention of law. See also Hansen.
[25] Alexandros Roussos "Realising the Free Movement of Companies" EBLR, January/February, 2001, p. 8; Jürgen Basedow, "Die Freizügigkeit für Handelsgesselschaften in Europa und das Internationale Privatrecht", Ünal Tekinalp'e Armağan, Cilt III, Beta , İstanbul 2003; p. 24.
[26] Sitztheorie, siège reel.
[27] Gründungstheorie.
[28] Tekinalp, p. 71; Çelikel, p. 185; Basedow, p. 23.

1.3.1 THE REAL SEAT THEORY

1.3.1.1 Main Features

Even though it is difficult to trace the origins of the real seat theory, it is assumed that it dates back to 19th century and finds its basis on nation state theories developed in France and Germany.[29] It is alleged that it originates from the thought of sovereign states to provide control over their territories.[30] In respect of determining the governing law of a company, the real seat theory uses the centre of administration of the company as the decisive and objective connecting factor.[31] The centre of administration or the real seat of the company, however, is not the place mentioned in the charter or any of the constitutional documents of the company.[32] For an accurate assessment of the real seat theory, the concept of real seat should be examined in the first place.

1.3.1.2 Concept of 'Real Seat'

The concept of seat according to the real seat theory implies the centre of administration of a company.[33] The centre of administration, in accordance with the theory, is the place, where the fundamental company decisions are implemented into day-to-day business activities.[34] In other words, where the board of directors, general assemblies and the boards of auditors congregate and perform their duties[35],

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[29] Erik Werlauff, "The Main Seat Criterion in a New Disguise", EBLR, 12, 2001, p. 2
[30] Rammeloo, p. 11
[31] Wulf-Henning Roth, "From Centros to Überseering: Free Movement of Companies, Private International Law, and Community Law", ICLQ, p. 180; Eva Micheller, "Recognition of Companies in Other EU Member States", ICLQ, v.52, 2003 p. 522; Werlauff, p.2; Tekinalp, p. 69; Werner Ebke, "The "Real Seat" Doctrine in the Conflict of Corporate Laws", The International Lawyer, vol. 36, No. 3, p. 1022.
[32] Roth, p. 181
[33] The German phrase for the centre of administration is "effektiver Verwaltungssitz", which means the "effective administrative seat" when literally translated.
[34] This definition of 'Real Seat' was made by the *Bundesgerichtshof* in its judgment of Mar. 21, 1986. See von Christian v. Bar and Peter Mankowski, "Internationales Privatrecht", München : C.H. Beck, 2003 p. 569; Werner Ebke "The Real Seat Doctrine", p.1022.
[35] Tekinalp, p. 69.

i.e. the centre of gravity of the company.[36] This place is geared to the activities of the organs having authority for the management of the company and coincides whether automatically with the meeting places of the company management organs or with the habitual residences of these organs, but principally with the latter.[37] When an authoritative organ carries out its operative transactions at a place other than its habitual residence, than this place would be regarded as the seat of the company.[38]

The courts, in determination of the real seat, take account of several factors. However, German Courts, although to a very limited extend, acknowledged exceptions from a firm application of the real seat theory if the real company seat could not be determined.[39] In a situation, where there is a de facto double-seat of administration, which has not yet caused major difficulties, the German Courts will presumably hold that the real seat of the company will coincide with the seat fixed in the charter.[40]

The real seat theory has been widely criticized because of the difficulty of determining the real seat of a company. There seems to be no problems when all of the administrative divisions of a company happen to be situated within the same country.[41] Taking into consideration, however, that the economic activities has reached a multi-state level, it is clear that the concept of "real seat" implies a certain degree of imprecision and uncertainty, especially in cases where a *de facto* double real seat is involved.[42] The application of the real seat theory may cause legal uncertainty for the parties that deal with the company, because today's level of communication and travel may not let one to determine the real seat and consequently establishing the *lex sociatatis* would then be extremely challenging.[43]

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[36] Werlauff, p. 2.
[37] v. Bar/Mankovski, p. 569.
[38] v. Bar/Mankovski, p. 570.
[39] Baelz, Kilian & Baldwin, Teresa, "The End of the Real Seat Theory (Sitztheorie): the European Court of Justice Decision in Ueberseering of 5 November 2002 and its Impact on German and European Company Law", German Law Review, Vol. 3 No. 12, 01 December 2002 http://www.germanlawjournal.com/current_issue.php?id=214 (last accessed on 21.10.2006)
[40] Roth, p. 181.
[41] Rammeloo, p. 178.
[42] Roth, p. 181.
[43] Hirt, p. 1195-96.

In my view, without knowing which law is to be applied to the company, it would be unrealistic to speak of legal certainty. For example, a foreign company, the real seat of which is difficult to determine (or, although the German legal writers consider it impossible that a company can have more than one real seat), faces legal problems in the host country and thus, say, is sued or intends to initiate legal proceedings against another person in this country. In such a setting, the parties will not be able to predict the legal order, which the court will determine as applicable to the company, and consequently whether the company will be recognized as a duly incorporated legal entity or will have capacity to sue and be sued will be uncertain, if the host state adheres to the real seat theory.[44]

1.3.1.3 Scope of Applicable Law

The real seat criterion is commonly used for ascertaining the applicable law to the corporations; however, whether it can be applied to incorporated business associations such as general partnerships and limited partnerships is subject to discussions.[45] In this research, legal persons subject to the application of the real seat theory will be referred to as companies.

As to the scope of the applicable law, there is not much discrepancy between the real seat theory and the incorporation theory: once the proper law of the company is determined, this legal system should be applied whenever possible.[46]

As the real seat theory is not codified by the German legislator, the scope of application has been developed case by case. Briefly, with the words of the *Bundesgerichtshof*, the law of the state of real seat governs a company's birth, its life and its death.[47] More precisely, the applicable law to a company includes its formation, its legal capacity, its corporate constitution, its management and

[44] See also Hirt, p. 1196; Roth, p.181.
[45] Tekinalp, p.70; Ebke, "The Real Seat Doctrine", p. 1023; Ebke, "Centros- Some Realities and Some Mysteries", American Journal of Comparative Law, 2000, p. 625.
[46] Rammeloo, p. 241.
[47] For furher details see Ebke, 'The Real Seat Doctrine", p.1023.

representation affairs, the liabilities of its organs and shareholders, its reorganization and finally its termination.[48]

However, a development on a case by case basis is not the case for all of the Member States applying the real seat theory. For instance, according to the *1995 Private International Law Code* of Italy, the matters to which the governing law applies have been listed exhaustively. Accordingly, the legal status; trade or corporate name; incorporation, transformation and dissolution; capacity; establishment, powers and operation modalities of the organs; agency; acquisition or loss of membership of the company or the association as well as the rights and obligations resulting therefrom; liability for obligations undertaken by the body; consequences resulting from infringement either of the law or of the memorandum of association are governed by the law of the country in which the company has its real seat.[49]

1.3.1.4 Underlying Policy

The real seat theory considers that only one state should have a say in respect of a company's internal affairs, because the most plausible state to provide the law applicable to a company is the state where the company has its real seat.[50] The underlying policy in adoption of the real seat theory is based on the presumption that the economy and the social environment of the state, where the company has its locus, is the state mostly affected by the activities of the company.[51]

It is the very core of the problem that the company law provisions of states, particularly common law states and continental European states vary a tremendous range. This apparent discrepancy between the company laws of states comes as no surprise when all the facts such as the socio-economic backgrounds and legislative processes' of these states are taken into consideration.

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[48] Horst Eidenmüller, 'Mobilität und Restrukturierung von Unternehmen im Binnenmarkt', JZ, 1/2004, p. 25.
[49] Rammeloo, p. 222.
[50] Ebke, "The Real Seat Doctrine", p. 1027.
[51] Alexandros Roussos, "Realising the Free Movement of Companies", EBLR, January/February 2001, p.8.

1.3.1.4.1 Party Autonomy

Although it is certainly left up to the incorporators where to establish the centre of the company, the real seat theory excludes party autonomy in respect of choice of law applicable to the company since it uses the real centre of administration as the connecting factor.[52] If we put it another way, the party autonomy that real seat theory grants to the incorporators of a company is restricted to a very limited extend, in that it recognizes the incorporators' choice of where they want their enterprise to have its principal place of business.[53] A company, which is created in accordance with the law of a country and has its real centre of administration within another country that adheres to the real seat doctrine, will be considered as not established effectively. This will lead to the consequence that either the company will no longer be considered to be a legal subject, or its managers will be deprived of the most important aspect of limited liability companies, i.e. limited liability.[54] For instance a company is incorporated in country A, and the real centre of administration of the company happens to be located in country B, in which the real seat doctrine is being followed. Since the country B takes the centre of administration as the subjective connecting factor, the company will be subject to the substantive law of country B and for the company is not incorporated in conformity with the company law provisions of country B, it will be treated as non-existent or how the company law envisages the treatment for such companies. The consequences of a seat transfer under real seat theory will be dealt with thoroughly in 1.4.

1.3.1.4.2 Protection of the Groups Dealing With the Company

As one would expect, this discrepancy has reflections on the company law provisions regarding the protection of certain groups dealing with the company. While the Common law company law consists of more liberal provisions, the

[52] Roth, "From Centros to Überseering", p. 181.
[53] Ebke, "The Real Seat Doctrine", p. 1028.
[54] Rammeloo, p. 11.

continental European company law puts a special emphasis on protection of both third parties and persons like minority shareholders and employees attached to the company. A choice of company law and consequently allowing a company to be subject to a legal system with lax company law provisions could undermine the policies relating to the protection groups dealing with the company.[55] This being so, the persons dealing with a foreign company will, as the case may be, be subject to lenient company law provisions of a foreign law system, which will possibly be contrary to their interests. Therefore, in the view of the proponents of the real seat theory, the state, in which the company has its real seat, should have the authority to preside over the internal affairs of that company. Evidently, the aim of the real seat theory is to effectuate material, economic and social values of the country having the most significant relationship with a particular company.[56] By using the real seat as the decisive connecting factor, the mostly affected state becomes able to control a company effectively and to protect the company's creditors.[57] The incorporation theory, in the view of the proponents of the real seat theory, facilitates the creation of mere letterbox companies with the consequence that government authorities cannot control business transactions properly.[58]

Not only are the creditors, but also the employees, the minority shareholders of a company under state protection according to the real seat theory. The importance given those groups differs from country to country. For example, German company law provides a system of labor representation *(unternehmerische Mitbestimmung)* on the board of non-executive, outside directors.[59] This system is a German phenomenon[60] and does not have an equivalent in other EU Member States.

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[55] Ebke, p. 1028.
[56] Ebke, p.1028.
[57] Peter Kindler "Niederlassungsfreiheit für Scheinauslandsgesellschaften?", NJW, Vol.52, p.1993, 1994; Rammeloo, p. 177.
[58] Eddy Wymeersch, "The Transfer of the Company's Seat in European Company Law" CMLR, June, 2003, p. 2.
[59] Oliver Ginthör/Michael Barnert, "Der Aufsichtsrat: Rechte und Pflichten", Wien: Linde, p. 23; Ebke, "Some Realities and Some Mysteries", p. 648.
[60] Ebke, p. 649.

By making use of the real seat theory, Germany applies its workers co-determination rules to the companies having its real seat on its soil.[61]

Another aspect concerning the persons dealing with a foreign company is the burden of gaining information. The burden of gaining information on a potentially unknown legal order between the founders of the company on the one hand and the public dealing with the company on the other, must also be taken into consideration.[62] In addition to this, the real seat theory has some advantages in respect of the transaction costs.[63] On the other hand, it can be argued that the public dealing with the foreign company in question should be on notice that they are dealing with a company formed in accordance with the law of another state. This view was also adopted in the *Centros* judgment of the ECJ.[64]

By controlling the company effectively and protecting the persons dealing with the company through the help of the real seat theory, a state will not need to provide protection for the creditors of a company through other legal acts or by referring to *ordre public*. Therefore, it has been claimed that the real seat theory has a function of securing the substantive policies such as creditor and minority shareholder protection and the enabling of workers co-determination.[65]

1.3.1.4.3 Uniform Treatment and Fair Competition

The real seat theory puts a special emphasis on uniform treatment towards companies. It does so by requiring all companies having their real seat in a particular state be incorporated under the law of that state.[66] As a result of this, according to the proponents of the real seat theory, all of the actors of the market can have the opportunity to function at an equal level and the companies' evasion from that state's legal controls through incorporation in a jurisdiction that has less

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[61] It has been suggested that these rules should apply not only to companies having their real seat in Germany but also to those having their real seat beyond German borders and to dependent branches of companies in Germany. See Rammeloo, p. 186

[62] Wulf-Henning Roth, "Centros: Viel Lärm um Nichts?", ZGR, 2000, p. 333-,334; Roth, "From Centros to Überseering", p. 181.

[63] Roth, "Viel Lärm um Nichts?", p.334.

[64] Case C-212/97, Centros Ltd v Erhvervs- og Selskabsstyrelsen. www.curia.eu.int (27.06.2006)

[65] Roussos, p. 8; Hirt, p. 1195.

[66] Werner Ebke, "The European Conflict-of-Corporate-Laws Revolution: *Überseering*, *Inspire Art* and Beyond", EBLR, March, 2005, p. 13.

stringent laws can be prevented.[67] Consequently, all companies are subject to the same company law rules. Taking into consideration that the company laws of some states aim particularly at protecting certain groups such as creditors, minority shareholders, employees, and other stakeholders, the importance of providing equal treatment to all companies can be seen more clearly.[68] This equal treatment can be considered as a prerequisite for a fair competition.

1.3.1.4.4 Pseudo Foreign Companies

Pseudo-foreign companies are "incorporated in one state and transacting all or most of their business in another state".[69] A foreign company, according to the real seat theory will only be recognized if its principal place of business is located within the foreign state. If the principal place of business of a foreign company is located within a country following the real seat theory, the company will not be recognized as "foreign" and therefore governed by the law of the country, where its principal place of business is located.[70] A branch of pseudo-foreign company cannot be registered and under German law such a company would be treated as an *Offene Handelsgesellschaft,* the shareholders of which have personal liability.[71]

1.3.1.4.5 Effective State Control

By the acknowledgement of the real seat as the relevant connecting factor for determination of the law governing the company, the legal provisions of the most affected state remain applicable. The company stands in harmony with the law of the country, in which it, first of all, carries out its business. Thus, it can be claimed

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[67] Ebke, p. 13.
[68] Ebke, "The Real Seat Doctrine in the Conflit of Corporate Laws", p. 1027.
[69] Carsten Frost , "Transfer of Company's Seat – An Unfolding Story in Europe", Submitted as part of the LLM programme at Victoria University of Wellington.
http://www.austlii.edu.au/nz/journals/VUWLRev/2005/15.html#fnB12 (21.08.2006)
[70]Marc Lauterfeld, "Centros and the EC Regulation on Insolvency Proceedings: The End of the "Real Seat" Approach towards Pseudo-foreign Companies in German International Company and Insolvency Law?", EBLR, 2001, p. 79.
[71] Lauterfeld, p. 79.

that the seat criterion corresponds to the notions of "centre of gravity" and "the most significant relationship", which are established notions in field of private international law.[72] The seat theory enables the mostly affected state to be able to enforce its compelling legal rules and consequently provides the state adhering to the real seat theory with control over companies established in accordance with the law of another state but having their centre of administration in its territory.[73] By adopting the real seat theory, it can be prevented that weaker foreign regulations undermine higher domestic company law standards and intervene in the domestic social structure. Incorrect establishments are avoided and are corrected, because in such a case the legal consequence is the non-recognition of the company.

1.3.1.5 Countries Adhering to the Real Seat Theory

Today, the real seat theory is mostly adopted by the continental European countries.[74] Nonetheless, Germany can be said to be the protagonist in the application of the real seat theory, in its own language *Sitztheorie*[75]. As a matter of fact, the real seat theory is not prescribed by the German legislator. Lacking a written legal provision regarding the conflict of the laws in respect of cross-border company relations, the German courts apply the real seat theory.[76] Other than Germany, the real seat theory has been adopted by countries such has Belgium, France[77], Germany, Spain, Greece, Portugal and Luxembourg.[78]

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[72] Roth, "From Centros to Überseering", p. 182.
[73] Hirt, p. 1195.
[74] In fact the application of the real seat theory is subject to changes due to the recent decisions of the ECJ. This will be dealt with in Chapter III when examining the conflict of laws theories within the framework of freedom of establishment
[75] The real seat theory is not being applied uniformly by the countries adhering thereto. In legal literature regarding the conflict of laws theories, *Sitztheorie* implies the German version of the theory, which displays certain differences against other versions of the theory. However, in this thesis, all versions will be referred to as "the real seat theory" and in case of a material disparity between the versions, emphasize will be made.
[76] Rammeloo, p. 175.
[77] According to the Article 3 of French law 66-537 of 24 July 1966, "Companies whose seat is situated in French territory are subject to French law". For the same, see also Roussos, p. 8.
[78] Hirt, p. 1194-1195; Roussos, p. 8.

1.3.1.6 Criticism Points in the Seat Theory

One of the most criticized points regarding the seat theory is that the notion of the "headquarters" is too vague. Besides, the non-recognition of the company would lead to its nullity and the seat transfer of a company would become problematic.

1.3.1.6.1 Determination of the Real Seat

Given the level of the company transactions of today, it seems quite unrealistic to expect from a company to have a single place of administration, where all of its affairs are governed. This being so, it is sometimes hardly possible to point out a place as the real seat of a company. As far as the companies with more than one *de facto* real seat are concerned, determination of the real seat of this company can cause uncertainness.

1.3.1.6.2 Non-existence of the Company

According to the law of countries which adopt the real seat criterion as a connecting factor for determining the law governing the company, for instance according to the German law, the company that transfers its centre of administration to Germany is not recognized as a corporate entity unless it is re-incorporated under German law.[79] In such a case, if the country in which the company was incorporated follows the “state of incorporation theory”, the company will continue to be existent in this state, although it is considered to be non-existent in the host state, i.e. Germany. This situation would lead to a clear inconsistency.

[79] Hirt, p. 1195.

1.3.1.6.3 Obstacle for the Mobility of Companies

Difficulties for the seat theory arise when a company intends to move its seat into another country, which follows the real seat theory. It is certain that the real seat theory constitutes a significant obstacle against the mobility of companies, which is not in line with the freedom of establishment as provided in the EC Treaty.[80] When a company transfers its centre of administration to a state adhering to the real seat theory, generally the reincorporation of this company in the host state will be required.[81] This question as to whether the real seat theory is compatible with the freedom of establishment will be discussed thoroughly in the next chapter dealing with the implications of different theories in respect of international company law. In my view, however, regardless of the freedom of establishment as required by the EC Treaty, the real seat theory does not comply with the mobility requirements of companies when the contemporary economic realities are taken into account. From a limited liability principle point of view, when a company, whose shareholders have limited liability moves into, say, Germany, unless the company is re-incorporated in Germany, the shareholders of this company will not benefit from the principle of limited liability. This is the case also when a company incorporated under German law moves out of Germany. In this case, the company loses its legal personality and legal capacity and consequently the shareholders cannot benefit from the principle of limited liability under German law anymore.[82]

1.3.2 INCORPORATION THEORY

The incorporation theory is pre-dominantly applied in Anglo-American countries. In Europe Great Britain, Ireland, the Netherlands, Denmark, Austria, Italy and Switzerland are the countries that adhere to the incorporation theory.

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[80] Enrico Vaccaro, "Transfer of Seat and Freedom of Establishment in European Company Law", EBLR, Dec. 2005, p. 1350.
[81] Hirt, p. 1196.
[82] Hirt, p. 1196.

As was mentioned briefly above, according to the incorporation theory, the law governing a company is determined as per its place of incorporation. All of the legal matters that may affect a company, such as the validity of its formation, regulation of its internal affairs, shall, regardless of the fact that the company conducts its main business elsewhere, be determined according to the law of the State, in which the company is properly incorporated.

In defining the place where a company is incorporated and ascertaining the applicable law to a company, incorporation theory makes use of anthropomorphic concepts like 'domicile', 'nationality' and 'residence'.[83] In this respect, the concept of 'domicile principle' should be given a brief look.

1.3.2.1 Domicile Principle:

In Common Law approach, domicile is the basis of this conflict of laws rule to define a natural person's status, capacity and rights and the term as a connecting factor is referred to as *lex domicilii*. The nationality of a natural person is replaced by its domicile[84] under English law.[85]

Incorporation theory establishes an analogy between the birth of natural persons and legal persons. It does so by using the metaphor:

'Every person, natural and artificial, acquires at birth a domicile of origin by operation of law. In the case of the legitimate natural person it is the domicile of his father; in the case of juristic person it is the country in which it is born, i.e. in which it is incorporated.'[86]

As was mentioned above, the incorporation theory grants to the incorporators of a company the freedom to choose the proper law to be applied to the company. Consequently, determination of the status, capacity and rights of a legal person is done by using the domicile as the connecting factor, just like in the case of natural persons. And the domicile –the place of birth- of a company is the place of

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[83] Rammeloo, p. 131.
[84] This should not be confused with 'choice of domicile', which refers to the freedom to choose a new domicile once the age of majority is reached. The domicile here means the 'domicile of origin' acquired at birth.
[85] Brombach, p. 28.
[86] Roth, "From Centros to Überseering", p. 183; Rammeloo, p. 132.

incorporation.[87] As a natural consequence of this analogy between natural persons and legal persons, a company cannot have more than one domicile.[88]

Once a company obtains its domicile, it maintains it throughout its existence.[89] In the case of transfer of the statutory seat, however, since the company will be deemed to have lost its existence, the domicile will no longer adhere to the company.

The residence of a company is referred to only when taxation issues are involved. For taxation purposes, companies incorporated abroad will be determined resident in the country, in which their centre of control and management is located.[90] The concept of 'residence' of a company illustrates some similarities with the concept of 'real seat' of the real seat theory.

1.3.2.2 Underlying Policy:

The main policy behind the incorporation theory is *party autonomy*. Accordingly, the founders of the company are free to determine the law applicable to their company. According to the incorporation theory, a company is the creature of the legal system under which it was incorporated and hence that legal system is the best one to govern the matters in respect of validity of the company and internal affairs, activities and legal capacity of the company.[91] It has been asserted by its proponents that the incorporation theory complies with the legal sense since it is normal that the legal system, under which a company is incorporated, grants the legal capacity to the company.[92] It is also undeniable that the incorporation theory may present an incentive to incorporate under a law which offers advantages to those who may wish to create a company with wide powers but restricted liabilities or with no significant risk of allowing liability to affect individual officers or corporators.[93]

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[87] Adrian Briggs, "The Conflict of Laws", Oxford ; New York : Oxford University Press, 2002, p. 247
[88] Rammeloo, p. 132.
[89] Brombach, p. 28.
[90] Roth, "From Centros to Überseering", p.182.
[91] Roussos, p. 9.
[92] Tekinalp, p. 71.
[93] Briggs, p. 245.

The one of the most remarkable advantages of the incorporation theory lies in the fact that the determination of the connecting factor is simple and clear.[94] This being so, the incorporation theory is more plausible since it is uncomplicated for third parties to know which law governs the company they are doing business with.[95] Proponents of this theory set forth that the legal certainty is one of the fundamental advantages of the incorporation theory, as the statutory seat of a company is easy to ascertain, and this encourages the mobility of companies that intend to operate at an international level.[96]

Furthermore, by application of the incorporation theory, no problems as regards the recognition of a company will be faced so long as the company is duly incorporated under the jurisdiction of a country.[97] The company is not required to comply with the national regulations of the host state and is not affected in respect of legal capacity.[98] The change of the principle place of business will not lead to the change of the connecting factor according to the theory. The company will not be subject to any dissolution or winding-up in case of a transfer of its centre of administration according to the incorporation theory. Thus the applicable law will continue to be the one of the State of incorporation in case of a seat transfer. The governing law of the company will only be subject to a change in case it dissolves in the State of incorporation and validly incorporates in another State.[99]

The incorporation theory also seems to comply with the freedom of the establishment guaranteed by the EC Treaty.

1.3.2.3 Criticisms

The main criticism towards the incorporation theory is that the theory promotes the incorporation of the so-called pro-forma companies[100]. One of the purposes of states in adoption of the liberal incorporation theory is to encourage the free low

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[94] Hirt, p. 1195; Vaccaro, p. 1349.
[95] Tekinalp, p. 71.
[96] Matthias Siems, "Convergence, Competition, Centros and Conflicts of Law: European Company Law in the 21st Century", EURLR, 2002, Vol.27, p. 47, 48.
[97] Hirt, p. 1195.
[98] Tekinalp, p. 71.
[99] Vaccaro, p. 1349.
[100] These companies are also referred to as 'pseudo foreign companies' and 'mail box companies'

commerce.[101] Establishing a company in an incorporation theory country can be considered to be more attractive for the investors, because, by doing so, the investors are able to avoid from the rigid company law provisions of their country. 'Free entrepreneurship and a liberal attitude towards the recognition of foreign companies go hand in hand'.[102] This situation, however, is so likely to bring up situations of abuse and the circumvention of national company law rules. It is very normal that businessmen would prefer to be subject to more lenient company law provisions, particularly as regards the payment of the minimum capital. On the other hand, this apparently runs counter to the motives of that country when setting forth its minimum capital requirements. As a result, relying on the liberal regime of incorporation theory, formation of the so-called pro-forma foreign companies increased a great deal in the countries adhering to the incorporation theory but having rigid company law provisions.[103]

Under such circumstances, the states adhering to the incorporation theory but having rigid company law provisions, considering that creditors of purely pro-forma foreign companies are worthy of protection, sought to solve this problem by additional legal acts. Consequently, even in states that apply it, the incorporation theory is restricted by legal acts on creditor and shareholder protection, for instance under administrative regulations in the United Kingdom, or by particular provisions for pseudo-foreign companies in the United States.[104]

The Dutch Pro-Forma Foreign Companies Act of 1998 was one example of a legal act that subjects these corporations to local creditor protection rules.[105] This act laid down the requirements such as disclosure and minimum capital

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[101] Rammeloo, p. 102.
[102] Rammeloo, p. 102.
[103] The most remarkable example to this is the situation in the Netherlands prior to the Pro-Forma Foreign Companies Act. It has been reported of the "local window cleaner in the small village of Appingedam in the Northern rural district of the Netherlands, exclusively being engaged in business activities in the Netherlands, making use of the legal form of an English private limited company". See Rammeloo through referrence to Cohen Henriquez , p. 103.
[104] Robert R Drury "The Regulation and Recognition of Foreign Corporations: Responses to the Delaware Syndrome" (1998) 57 CLJ 165, 188 and following.
[105] Stefan Leible, "Wie Inspiriert ist Inspire Art?", EuWZ, 2003, p. 677; Joseph A. McCahery and Erik P.M. Vermeulen, "The Changing Landscape of EU Company Law", 33. http://www.tilburguniversity.nl/tilec/publications/discussionpapers/2004-023.pdf (last accessed on 24.09.2006)

requirements that a pro-forma company needed to comply with and the sanctions of non-compliance therewith expanded even to the unlimited liability of the managers of the company.[106] The provisions of this act were, however, held to be incompatible with the EC law by the ECJ in the Inspire Art judgment.[107]

Leaving the case law aside and theoretically speaking, the most remarkable issue in respect of providing creditor protection through separate legal acts is how to define a 'pro-forma foreign company'. At this point, the problem of definition of the 'real seat' of a company seems to take stage once again, although this time in disguise. Just like in the characterization problem of what exactly a company's real seat is, the relevant connecting factors pointing out whether a company is a pro-forma foreign company or a genuine one leads to a certain degree of ambiguity.[108]

States, which in fact adhere to the incorporation theory, contravene the freedom of choice of corporate law to be applied to a company by adopting legal acts such as Dutch Pro-Forma Foreign Companies Act and intervene in favor of the law of the place where the company has connections, carries out its commercial activities or has its centre of administration.[109] In this case, this approach of pro-forma foreign companies makes the incorporation criterion similar to the real seat criterion.[110]

In my view, protection through legal acts envisaging firm sanctions does not comply with the liberal regime of the incorporation theory. The real seat theory deals with abuses by pseudo foreign companies in advance, by making them subject to reincorporation. By doing so, no further legal act will be required. If this aspect of the real seat theory is to be criticized as not being compatible with the idea of a Single Market, incorporation theory supported with supplementary creditor protection acts should receive the same criticisms as it may hinder the Single Market at the same level. Adding to this the resemblance of determination of a foreign

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[106] Hirt, p. 1205.
[107] Case C-167/01, "Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd.". www.curia.eu.int (09.07.2006)
[108] Rammeloo, p. 112.
[109] Sibel Özel, "Avrupa Adalet Divanı'nın Inspire Art Kararı Üzerine Bir İnceleme", Prof. Dr. Tuğrul ANSAY'a Armağan, p. 469.
[110] Özel, "Avrupa Adalet Divanı'nın Inspire Art Kararı Üzerine Bir İnceleme", p. 469.

company's being pseudo or not with the determination of the real seat, the incorporation theory seems to loose its liberal essence completely.

1.3.3 RECONCILIATORY ATTEMPTS

Apart from the real seat theory and the incorporation theory, reconciliatory attempts have been made, which can be regarded, to a certain degree, as the modifications of the incorporation theory.

Some modifications to the incorporation theory derive from exercises of some particular countries. For example, the Nordic registration theory, which is another modified version of the incorporation theory employed by the Scandinavian countries, identifies the requirement for a foreign company to be registered as a distinguishing element.[111] Moreover, some countries alter the pure incorporation theory by additional legal acts applicable to the formal foreign companies and by doing so they "voluntarily correct their systems to take into account the potential danger to their reputation".[112] These modified incorporation theories can constitute obstacles for the cross-border movements of companies within the EC just like the real seat theory. However, this obstacle is not a result of a conflict of laws rule, but rather a result of domestic procedural and substantive law.[113]

On the other hand, attempts made by the German legal scholars have a rather theoretical basis. The main idea underlying these approaches was that one single legal system should not necessarily govern the matters relating to company law in case a foreign element is involved. The *Differenzierung* Theory and the *Überlagerung* theory were among ones, which have found the most repercussions.

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[111] Siems, p. 27.
[112] Wymeersch, p. 662.
[113] Martina Sever, "Company Mobility within the EC: Cross-border Transfer of the Real Seat of a Company", LL.M. Thesis, p.5.
http://www.llmebl.leidenuniv.nl/content_docs/Thesis/final_thesis_martina.pdf (01.10.2006)

1.3.3.1 *Differenzierung* Theory

Grasmann, the founder of the *Differenzierung* Theory, considers the *lex loci actus*[114]*, lex causae*[115] and *lex societatis* as to be constantly competing.[116] He asserts in his *Differenzierung* Theory that none of these conflict rules should be given decisive weight in advance and the applicable law should be determined in a case-by-case basis.[117] *Differenzierung* Theory determines the law applicable to a company by differentiating between the internal affairs and the external affairs of a company. The internal affairs are principally determined in accordance with the parties' duly declared intentions in the company contract.[118] These internal affairs are, for example, the company's formation, the rights and duties of the company's organs and its members, and the dissolution and winding up of the company and likely to fall within the scope of *lex societatis.*[119] One the other hand, external matters such as representation authorities of company organs, legal capacity of the company, liability, publicity and capital protection are subject to *lex loci actus.*

If it is not clear whether a topic should be regarded as internal or external, various interests at stake should be taken into consideration. This aspect of the *Differenzierung* Theory has been criticized as the distinction between internal affairs and external affairs might turn out to be artificial and cause arbitrariness in practice.[120]

1.3.3.2 *Überlagerung* Theory

Another theory developed by the German legal scholars is the *Überlagerung* theory. Sandrock considers the *Überlagerung* theory as a variant of the

[114] Law of the country, in which the company organs conducts its activities.
[115] Law governing the transactions between the company and the third parties.
[116] Rammeloo, p. 21.
[117] Rammeloo, p. 21.
[118] Brombach, p. 32.
[119] Rammeloo, p. 21; Brombach, p. 32.
[120] Rammeloo, p. 22.

incorporation theory, which should combine the liberal and competitive features thereof with the protection idea of the real seat theory.[121]

Like Grasmann, who developed the *Differenzierung* Theory, Sandrock refuses the idea of a single law governing all companies.[122] Under the model of *Überlagerung* theory, the incorporation criterion should be applied as the main principle. However, if the state, where the company has its de facto main seat, has binding company law rules, which provide better protection for third parties than the law of the state of incorporation, the rules providing better protection should be applied upon the request of an interested party with a legal claim.[123]

Sandrock makes a separation between the "incorporation and recognition problem" and the "personal statute" according to which the internal and external relations of the company should be judged.[124] The point that the *Überlagerung* Theory departs from the *Differenzierung* Theory is that the former prescribes the alternative application of the real seat theory and the incorporation theory in advance.[125] Formation and recognition matters are dealt with by the law of incorporation according to the *Überlagerung* theory.[126] As a consequence of this, a company that is duly formed under the law of another state should be recognized as an existent company. However, the creditors and the shareholders of the company and the third persons can rely on the mandatory law provisions of the country where the company has its real seat.[127]

Überlagerung Theory has is said to be based on the EC Convention on the Mutual Recognition of Companies, which provided the application of mandatory rules of the real seat country to a company formed under the law of a foreign

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[121] Brombach, p. 33.
[122] Rammeloo, p. 22.
[123] Erik Werlauff, "The Main Seat Criterion in a New Disguise- An Acceptable Version of the Classic Main Seat Criterion?", 2001, EBLR, p. 2.
[124]Norbert Horn, „Deutsches und europäisches Gesellschaftsrecht und die Niederlassungsfreiheit", NJW, 2004, Vol.13, p.896.
[125] Rammeloo, p. 22.
[126] Brombach, p. 33; Rammeloo, p.22.
[127] Rammeloo, p. 22.

company.[128] The legal rules of the real seat country and the incorporation country should not have cumulative, but alternative application.

Überlagerung theory has been criticized for lacking predictability and legal certainty and it has also been claimed that the judgment as to which substantive law provisions should be regarded as mandatory could be subject to arbitrariness.[129]

1.3.3.3 Other Reconciliatory Theories

Besides the *Differenzierung* Theory and the *Überlagerung* Theory, there have been other reconciliatory attempts which should be mentioned briefly. According to the *'Restricted Incorporation Theory'* of Behrens, the applicable law to a company should be determined principally in through the law of the state of incorporation. [130] However, in cases regarding the *ordre public*, the legal rules of the host can be applied alternatively if the law of incorporation does not include equivalent rules. [131]

According to the recognition conception of Beitzke, the recognition of a foreign company comprises the legal capacity, the earning capacity and the capacity to sue or be sued and all of the internal relations regarding the company management and the relations of the company members with the company should be dealt with in accordance with the law mentioned in the company statute.[132] However, according to Beitzke, the foreign company should comply with the company law of the host state through a re-incorporation, which encompasses the articles of association and a translation thereof, the modification of the structure of the company and its organs and the payment of a minimum capital complying with the appropriate company type in the country where the company has its real seat.[133]

Another reconciliatory theory, which the resolves the applicable law question principally by pointing out the law of incorporation, is the *'Kombinationtheorie'* of

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[128] Brombach, p. 35, Rammeloo, p. 23.
[129] Rammeloo, p. 23.
[130] Behrens, "Der Anerkennungsbegriff im Europaeische Gesellschaftsrecht', ZGR, 1978, p. 498.
[131] Behrens, p. 499.
[132] Brombach, p. 31.
[133] Brombach, , p. 31

Zimmers.[134] Zimmers avoids from a mixture of norms. In his view, the law applicable should be applied uniformly. The law of the country where the company has its real seat should only be applicable if the foreign company completely loses its connection with the state of incorporation.[135]

1.4 TRANSFER OF SEAT WITHIN THE FRAMEWORK OF COMPETING CONFLICT OF LAWS THEORIES

After seeing the main conflict of laws theories and the reconciliatory attempts thereto, the seat transfer of a company will be examined within the framework of the two mainstream theories.

It should be taken into consideration that in a case, where the statutory seat and the administrative seat fell apart as a result of seat transfer, there appears a divergence between the laws of the state of incorporation and the host state.[136] A company continues to be existent after the seat transfer without being subject to dissolution and re-incorporation in the host state only as long as the conflicts law rules of both states permits this.[137] In other words, this is only possible when both the state of origin and the host state adhere to the incorporation theory. It is also clear if both states adhere to the real seat theory; dissolution and re-incorporation are required. The question arises, however, when the states in question adhere to different conflict of laws theories. The situations, which might occur in such a

[134] Brombach, p. 35.
[135] Brombach, p. 35.
[136] From a wide point of view, the transfer of seat compromises the statutory seat, administrative seat or both of them at the same time. From a narrower perspective, on the other hand, the transfer of seat means the abandonment of the seat indicated in the statute of the company and formation in another state while maintaining its identity. The question in this case is whether the legal capacity of the company, which it acquired in the state of formation, can be transferred along with the seat. It must be mentioned that a situation where a company dissolves in the state of origin and incorporates itself in the host state cannot be regarded as a transfer of seat since there is no continuity between the two states.
[137] Brombach, p. 43.

setting, will be discussed under a distinction between the cases of moving out and moving in.[138]

1.4.1 MOVING-IN

Another distinction will be made between the situations of moving in while retaining the statutory seat and moving in while retaining the administrative seat.

1.4.1.1 Moving-in While Retaining the Statutory Seat

In accordance with the conflict of laws rules, the transfer of the administrative seat into territory of a state adhering to the real seat theory results in the change of the applicable law. When a company transfers its administrative seat from a country, under the law of which it acquired its legal personality, into another country, the real seat theory points out that this situation leads to the application of the conflict of laws rules of the host state.[139] As a matter of logic, since the host state referred to by the real seat theory is the state itself, which refers to the real seat theory, the substantive law of the host state will become applicable.

The consequences as regards substantive law differ depending on the state applying the real seat theory. In its German version, the real seat theory provides that a company transferring its administrative seat into another country adhering to the real seat theory is no longer recognized as a foreign company and loses it legal personality.[140] It is immaterial whether the state of origin applies the real seat theory or the incorporation theory.[141] The company in question will not *ex lege* be transformed into an equivalent company form under the law of the host state and is required to be re-incorporated under the law of the host state in order to gain legal personality again.[142] If the company fails to re-incorporate, the law of the host state

[138] This distinction has been expressed in different in a variety of terminology. Instead of moving-in and moving-out, also "entry and exit", and "immigration and immigration" has been used.
[139] Determination of the applicable law under the real seat theory also comprises the conflict of laws to be applied to the situation.
[140] Roth, 'From Centros to Überseering', p. 185.
[141] Brombach, p. 44.
[142] Roth, 'From Centros to Überseering', p. 185.

regards the company as have dissolved and gone into liquidation.[143] As regards the legal actions brought against such company, the *Bundesgerichtshof* tended to treat the company as a *Vorgesellschaft* (pre-incorporation company).[144]

On the other hand, other states adhering to the real seat theory may regard such a seat transfer in a different fashion. For instance, in France it may be possible for a company to transfer its administrative, thus changing its nationality but without loss of legal personality if the decision is taken unanimously by the shareholders and the company agrees to modify its constitution in conformity with the law of the host state.[145]

As far as the incorporation theory is concerned, moving-in of a foreign company while retaining the statutory seat has no conflict of laws consequences. The foreign company remains subject to the law of the state where it came from.

1.4.1.2 Moving-in While Retaining the Administrative Seat

When both the state of origin and the host state follow the real seat theory, the international transfer of the statutory seat does not have any consequences relating to the conflict of laws.[146] A change in the applicable law will not take place, since under the real seat theory a change in the applicable law is dependent on the transfer of the administrative seat.[147]

On the other hand, the transfer of the statutory seat while retaining the administrative seat leads to a change in the applicable law, in case the state of origin follows the incorporation theory and requires the existence of statutory seat of a company within its territory in order to consider it as subject to its law.[148] If the host state applies the real seat theory, its law will refer to the law of the state of origin,

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[143] Roussos, p. 9.
[144] Roth, 'From Centros to Überseering', p. 185.
[145] Roussos, p. 9.
[146] Stefan Leible, "Niederlassungsfreiheit und Sitzverlegungsrichtlinie", ZGR (2004), p. 531.
[147] Peter Behrens, "Die Umstrukturierung von Unternehmen durch Sitzverlegung oder Fusion über die Grenze im Licht der Niederlassungsfreiheit im Europäischen Binnenmarkt", ZGR (1994), p. 8.
[148] Behrens, "Die Umstruktirierung von Unternehmen", p. 8.

which will refer back to the law of the host state, as it regards the company as non-existent. Thus the law of the host state will be applicable.

1.4.2 MOVING-OUT

The situation of moving out, too, will be examined under distinction between the transfer of the administrative seat and the transfer of the statutory seat.

1.4.2.1 Moving-out While Retaining the Statutory Seat

The emigration of a company while retaining the statutory seat from a state adhering to the incorporation theory does not constitute any problems. The company remains subject to the law of state of incorporation and even if it exclusively operates abroad, it retains its legal personality in the state of incorporation.

The transfer of the administrative seat of a company from a real state country, on the other hand, leads to a change of the legal order governing the company. If the administrative seat is transferred from a real seat country to another, the legal personality of the company will be determined under the law of the host state. As regards the substantive law, the point to be examined is whether the company will be deemed to be dissolved in the state of origin. Under German law, according to which the real seat theory is by far strictest applied, transfer of real seat results in dissolution of the company.[149] According to the pre-dominant view, the resolution of the management of the company relating to the transfer of company's administrative seat must be regarded as a resolution for winding-up of the company.[150]

When the host state adheres to the real seat theory, re-incorporation of the company will be necessary regardless of the situation in the state of origin. If both of the states adhere to the real seat theory, the matter of legal personality will be dealt with in accordance with the internal laws of these states.

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[149] Wymeersch , p. 668.
[150] Brombach, p. 49.

This will not be the case, however, when a country adhering to the incorporation theory is involved as the host state. According to the real seat theory, in case of transfer of the administrative seat without the transfer of the statutory seat from the country applying the real seat theory to another country, the former country applies the legal order, including the conflict of laws rules, of the latter.[151] In such a setting, if the latter, *i.e.* the host state, adheres to the incorporation theory for determination of the applicable law, a *renvoi* takes place since the incorporation theory provides that the law of the country in which the company is incorporated shall apply. Consequently the substantive law of the former country will be applicable to the company. For example, if a company transfers its seat from Germany to England while retaining its registered office in Germany, German conflict rules would refer to English law and English law would refer back to German law (renvoi) as the state where the company has been incorporated. The matter becomes unclear at this stage.

The law of the host state recognizes the legal capacity of the company and does not require re-incorporation under its legal order. On the other hand German substantive law regards the transfer of the administrative seat outside Germany as the dissolution of the company.[152] There are two different approaches in the real seat doctrine at this point. According to one approach, the resolution for the transfer of the administrative seat leads to the dissolution and the liquidation of the company since the company is subject to a foreign legal order and it is not certain whether the German law will be referred to as the applicable law.[153] The other approach provides that the transfer of the administrative seat in such a case does not necessarily lead to the dissolution and the liquidation of the company if the company has not completely lost its relation with the state of origin.[154]

In the light of these approaches, it can be concluded that in a situation where a company transfers its administrative seat from Germany into an incorporation

[151] Roth: "From Centros to Ueberseering" p. 184.
[152] Brombach, p. 49.
[153] Brombach, p. 50.
[154] Brombach, p. 50.

theory jurisdiction, the outcomes of the situation remains subject to controversy as far as the substantive law is concerned.

In other countries adhering to the real seat theory, moving out of a company is made subject to certain condition, which impose a less rigid situation than the German version of the real seat theory. Italy, Spain and Portugal, for instance, hold the resolution for emigration subject to hardened majority rules.[155] Also in France the real seat can be transferred without dissolution[156], but subject to special voting quorum and treaties with the state of entry.[157]

1.4.2.2 Moving-out While Retaining the Administrative Seat

Since the real seat theory makes use of the centre of administration as the connecting factor, it is immaterial as regards the conflict of laws, that a company moves its statutory seat abroad, as long as the centre of administration remains within the territory. However, consequence of such a situation for the substantive law is disputed. The pre-dominant view in real seat theory assumes that a decision for moving-out while retaining the centre of administration amounts to dissolution, for as a matter of substantive law a company requires a statutory seat.[158] From the incorporation theory point of view, emigrating company may only be obliged first to settle its accounts with the tax authorities.[159]

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[155] Wymeersch, p. 669.
[156] In the view of some legal writers, however, transfer of the real seat is subject to dissolution in France as well as in Germany. See Wymeersch, p. 668.
[157] Wymeersch , p. 669.
[158] Brombach, p. 51.
[159] Wymeersch , p. 667.

2 CHAPTER: II - FREEDOM OF ESTABLISHMENT UNDER THE EC TREATY

2.1 INTRODUCTION

In respect of matter of recognition of foreign companies, there is a close relationship between the EC Law, particularly the freedom of establishment, and the private international law, which has been was explained in detail in the previous chapter. It has been subject to acute discussions whether the provisions on freedom of establishment included a *versteckte* (hidden) conflict of laws norm that undermined the application of the real seat theory and favored the incorporation theory, or, if the provisions on freedom of establishment are not understood to be including such a conflict of laws aspect, whether the application of national conflict of laws rules, particularly the real seat theory, constituted an impediment to the freedom of establishment, or, lastly whether the freedom of establishment had no relation at all with the national conflict laws as regards the recognition of foreign companies.

One of the main goals of the European Community is to create a Single Market by way of securing the fundamental freedoms. However, even though the other fundamental freedoms of the EC Law, namely the free movement of goods, the free movement of services and the free movement of workers, have all been completely safeguarded by both the European Court of Justice and the Community Institutions, it can be suggested that the freedom of establishment for companies has been afforded less favorable treatment.[160] So far, there has been no EC secondary legislation passed in respect of freedom of establishment. One single attempt in this regard was the 1968 Convention on the Mutual Recognition of Companies, which, however, as if to confirm this premise, has not been realized due to lack of

[160] Roussos, p. 7

ratification by the Netherlands.[161] This being so, the EC perception of the freedom of establishment was solely based on the ECJ decisions. Indeed, the ECJ seems to draw the framework of the freedom of establishment and with its decisions as from the beginning of nineties to provide an answer to the relation between the freedom of establishment and the private international law. Therefore, a proper study of the freedom of establishment requires a closer look at the decisions of the ECJ.

Having said these, in this chapter, the EC Treaty provisions on freedom of establishment, their scope of application including their exceptions will be examined under the interpretation of doctrine and the ECJ. The question as to the relation thereof with the private international law will be left to the following chapter.

2.2 EC TREATY PROVISIONS ON FREEDOM OF ESTABLISHMENT

The first paragraph of Article 43 of the EC Treaty provides *that the restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be abolished by progressive stages in the course of the transitional period.*[162] Since the expiry of the transitional period, the provisions on freedom of establishment are directly applicable.[163]

In the second paragraph of Article 43, a definition to the freedom of establishment is provided. Accordingly;

Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Art. 48, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital.

This definition in Article 43 can be broadened by way of comparison thereof with other fundamental freedoms laid down in the EC Treaty. Contrary to free movement of workers, application of the provisions on freedom of establishment requires the involvement of self-employed activities. As far as the companies are

[161] This Convention adopted the incorporation theory in principle. However, it included exceptions in favor of the real seat theory. See Sibel Özel, "Avrupa Adalet Divanı'nın Inspire Art Kararı Üzerine Bir İnceleme", Prof. Dr. Tuğrul ANSAY'a Armağan, p. 470.
[162] Art 43 EC Treaty.
[163] Case 2/74, Reyners [1974], para. 16, 20-32

concerned, the word self-employed comprises the members of the company organs, company's managers and the shareholders partaking in the company management.[164] Moreover, the activities of the self-employed persons must have a profit-making purpose, which needs not necessarily be the primary purpose of the establishment. However, pure charity activities do not fall within the ambit of the freedom of establishment.[165]

Moreover, as opposed to the freedom to provide services, freedom of establishment can be exercised through a fixed establishment and for an indefinite period. The ECJ in one of its landmark cases, which also verified the primacy of EU Law over the laws of the Member States, held that *it must be observed … that the concept of establishment within the meaning of Article 52 et seq*. (now Article 43) *of the Treaty involves the actual pursuit of an economic activity through a fixed establishment in another Member State for an indefinite period.*[166]

There is a limitation implied in the second paragraph of Article 43. Accordingly, the application of the right of establishment is limited to the nationals in a Member State other that of their nationality.[167] Consequently, the nationals cannot resort to the provisions on freedom of establishment against a Member State, which they are a national of.

The article, by referring to the conditions laid down by a Member State for its own nationals, provides another limit to the application of the right of establishment. This seems to suggest that the freedom of establishment cannot be invoked if the person is treated in the same way as a national.[168]

It was, in fact, unclear for a long period whether the EC Treaty provisions on freedom of establishment should be regarded solely as a prohibition of discriminatory measures based on nationality or they included at the same time the prohibition of restrictive measures which apply to both nationals and foreigners

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[164] Brombach, p. 54.
[165] Brombach, p. 53.
[166] Case 221/89 Factortame [1991] para 20
[167] Craig, Paul; de Búrca, Gráinne, "EU Law, Text, Cases and Materials", Oxford; New York: Oxford University Press, 2003, p. 772.
[168] Craig, Búrca, p. 772.

without distinction where they constitute an unjustified constraint for the latter.[169] The provisions on freedom of establishment have been interpreted as to be suggesting that the EC nationals did not have ground for complaint if the same measures of a Member State were applied to them as to nationals of that state.[170] The case law of the ECJ seemed to support this interpretation until the mid-eighties.[171] However, it is apparent that the ECJ, beginning from its *Kraus*[172] judgment, now understands the freedom of establishment likewise as prohibition of restriction.[173]

Today it is accepted that the freedom of establishment as provided in EC Treaty includes not only the equal treatment but also the prohibition of restrictive measures, which hamper this fundamental freedom and render it less attractive.[174]

2.2.1 Prohibition of Discrimination

The freedom of establishment provides that the prohibition of discrimination based on the general provision of Article 12 EC Treaty, which provides that any discrimination on grounds of nationality shall be prohibited.[175] The discrimination in sense of EC Law means a worse legal treatment on the grounds that a person possesses the nationality of another Member State than the treatment toward national of that Member State.[176] The ECJ in *Racke* case held that the discrimination exists solely in the application of different rules to comparable situations or in the application of the same rule to different situations.[177] The prohibition of discrimination in Article 43 comprises principally equal treatment and ranges to the discriminatory legal provisions and the discriminatory administrative practice. The

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[169] Brombach, p. 63.
[170] Craig/Burca,, p.783.
[171] Case 221/85, Commission v. Belgium [1984]
[172] Case 19/92, Kraus [1993], para.32
[173] This understanding of the ECJ was approved in the consequent judgments in *Gebhard* and *Überseering* cases.
[174] Eidenmüller, Horst ; Rehm, Gebhard M. "Niederlassungsfreiheit versus Schutz des inländischen Rechtsverkehrs: Konturen des Europäischen Internationalen Gesellschaftsrechts", ZGR, 2004, p. 159
[175] Case 2/74, Reyners [1974] para. 15,16.
[176] Brombach, p. 64.
[177] Case 283/83, Firma A. Racke v Hauptzollamt Mainz.

prohibition of discrimination also covers the indirect discrimination as well as direct discrimination.[178]

2.2.2 Prohibition of Restriction

Articles 43 and 48 of the EC Treaty preclude any national measure, where that measure, even though it is applicable without discrimination on grounds of nationality, is liable to hamper or to render less attractive the exercise by Community nationals, including those of the Member State which enacted the measure, of fundamental freedoms guaranteed by the Treaty.[179]

Article 48 is supplemented by article 294 EC. Article 294 provides that Member States should, 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 Art. 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.

National measures hampering the exercise of the freedom of establishment are subject to some exceptions, although to a limited extend. Pursuant to Article 46 of the EC Treaty, the national measures will not be regarded as hampering the exercise of freedom of establishment if they pursue a legitimate objective compatible with the Treaty and was justified by pressing reasons of public interest.[180] From this, it can be understood that the Member States are entitled to apply restrictions in particular situations, if they are justified by overriding reasons of general interest such as public policy, public security or public health. However, these restrictive measures that are justified by reason of general interest must be proportionate.

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[178] Laurence Gormley, "Introduction to the Law of the European Communities From Maastricht to Amsterdam", 1998, London: Kluwer Law, p. 737; Craig/Burca, p. 784; Brombach, p. 64, 65.
[179] Case 19/92, Kraus [1993], para.32
[180] Case 71/76, "Thieffry v Conseil de l' Ordre des Avocats à la Cour de Paris" [1977]ECR 765, para. 12, 15

Having explained the basic provisions on freedom of establishment, for this thesis mainly deals with the freedom of establishment of companies, I will focus on the scope of freedom of establishment of companies.

2.3 FREEDOM OF ESTABLISHMENT OF COMPANIES

Article 48 of the EC Treaty provides that '*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.'*

It is clear from this article that the EC Treaty grants the same freedom of establishment granted to the natural persons also to the companies or firms. However, the application to the companies is subject to some pre-conditions. Article 48 provides that in order to be treated in the same way with natural persons, a company must be formed under the law of a Member State and its registered office, central administration or principal place of business must be located within the Community. These criteria should be considered cumulatively. However, what should be alternatively considered is the registered office, central administration or principal place of business of the company.

2.3.1 Personal Scope of Freedom of Establishment of Companies

The second paragraph of this article defines the 'companies or firms' as the companies or firms constituted under civil or commercial law, including co-operative societies, and other legal persons governed by public or private law, save for those which are non-profit making.

A company, in order to be entitled to the right of establishment, must pursue a profit-making economic activity.[181] The non-profit-making companies are excluded from the freedom of establishment. Article 48 of the EC Treaty, when

[181] Craig/Burca, p, 784; Gülören Tekinalp, Ünal Tekinalp, Yeşim M. Atamer, Betil Emrah Oder, Gül Okutan, **"**Avrupa Birliği Hukuku", İstanbul: Beta Yayınları, 2000, p. 347; Gormley, p. 733.

defines the company, refers to the "legal persons governed by private or public law". Even though the non-profit making economic activities are within the ambit of Article 43 of the EC Treaty, non-profit-making companies are excluded from the freedom of establishment.[182]

A company must be established in conformity with the provisions of a Member State, in order to benefit from the freedom of establishment. Moreover, the company must have its statutory seat, its main administration or its main establishment within the Community.[183] The outcome of this pre-condition is that the companies (and other legal persons) from third countries are not entitled to the freedom of establishment within the meaning of the EC Treaty unless the Community enters into arrangements with third countries in this field.[184]

2.3.2 Material Scope of Freedom of Establishment of Freedom of Establishment of Companies

As was mentioned above, in respect of freedom of establishment Article 43 EC Treaty provides equal treatment to the natural persons and the legal persons. However, given the differences between natural and legal persons, this does not seem strictly possible.[185] The discrepancy between the natural persons and legal persons occurs particularly in the distinction between the right of primary establishment and secondary establishment.[186]

A natural person exercises the right of primary establishment either by carrying out economic activities for the first time in a Member State other than that

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[182]Burca also asserts that the exclusion of non-profit-making companies may to some extent be considered alongside the exclusion from the scope of the Treaty of workers who are not remunerated, and services which are not provided for remuneration.

[183] Basedow considers these as the two pre-conditions for a company to enjoy the freedom of establishment. See "Die Freizügigkeit für Handelsgesselschaften in Europa und das Internationale Privatrecht."

[184] Gormley, p. 733.

[185] Craig/Burca, p. 793.

[186] Despite the clear distinction in Article 43, the terms "primary" and secondary" establishment do not stem from the EC Treaty. In its first paragraph, the Article refers to setting up of agencies, branches and subsidiaries and in the second paragraph, a general right of establishment is referred to. The first is commonly referred to as secondary establishment and the latter as primary establishment. Both the primary and the secondary establishment benefit equally from the freedom of establishment provided under the EC Treaty.

of origin or by dislocating the existing activities into the other Member State.[187]. A primary establishment of a company, on the other hand, occurs in case of transfer of a company's central administration-the central management and control or registered office from the country of origin to the host country.[188] However, the situation is rather tricky when a company intends to carry out business activities starting from scratch in another Member State. The problem arises for the primary establishment of companies most of all when a pseudo company is in question. It has been debated whether a situation, where a pseudo company that conducts no business in its state of incorporation sets up a branch, agency or subsidiary in another Member State, constitutes a primary establishment or a secondary establishment. Even though the ECJ did not deal with this issue in *Centros* and *Inspire Art* cases, in which such companies were involved, it explicitly stated in both cases that the creation of a branch by a pseudo company amounted to the exercise of right of secondary establishment.[189] This attitude of the ECJ has drawn extensive criticisms from the legal scholars.[190] In the following part of my work, I will discuss the distinction between primary and secondary establishment under the light of the recent judgments of the ECJ by exposing the facts of these cases, findings of the ECJ and the relevant scholarly debate.

2.3.2.1 Primary Establishment

As was mentioned above, primary establishment of a company takes place when a company transfers its central administration or head office from its state of incorporation to another Member State. As a rule, companies exercise the right of primary establishment through transfer of their seat. Typical examples to the transfer of a company's central administration or head office from its state of incorporation

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[187] Brombach, p. 61.
[188] Roussoss, p. 9.
[189] Case C-212/97, para. 30 and C-167/01 "Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd.", para. 105. www.curia.eu.int (27.06.2006). See also Anne Looijestin- Clearie, "Have the Dikes Collapsed? Inspire Art a further breakthrough in the freedom of establishment of companies", EBLR, 5, 2004, p. 405.
[190] Looijestin-Clearie, p. 405, 406; Werner Ebke, "Centros- Some realities and Some Mysteries", American Journal of Comparative Law, v. 48, 2000, p. 631.

to another Member State were the well-known *Daily Mail* and *Überseering* judgments.

In *Überseering*, the most recent judgment concerning the primary establishment of companies, the ECJ held that the refusal by the authorities of a Member State to recognize the legal capacity of a company duly incorporated under the law of another Member State when the company transfers its real seat into the territory of former Member State amounted to an outright negation of the freedom of establishment and stated firmly that a necessary precondition for the exercise of the right of establishment is recognition of a company in the host Member State.[191] The contentious question was whether a company retains its legal personality after transferring its decision-making centre, its headquarters or its real seat into another Member State. As far as the primary establishment is concerned, the case law of the ECJ has been uncertain, since after a rather firm negation of it in the much criticized case *Daily Mail,* the consequences of the most recent primary establishment case *Überseering* seem to imply recognition of the primary form of the right of establishment.[192] This conclusion of the ECJ in *Überseering* greatly facilitates the exercise of the right of primary establishment by companies in the Community and further undermines the application of the real seat theory.[193] This aspect of the right of primary establishment, which undermines the application of the real seat theory, will be dealt with comprehensively in Chapter III.

The approach of the ECJ, which provoked the big debate as to what constitutes a primary establishment are seen in the *Centros* and *Inspire Art* judgments. The approach of the ECJ in *Centros* case was considered by some authors as to be suggesting a second way of exercising the right of primary establishment: "*That is by starting from the scratch, i.e. by pursuing economic activities for the first time, in a Member State other than the State in which it was incorporated".*[194] I consider it more appropriate to discuss this under the heading of

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[191] Case C-208/00 "Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC)", para. 50. www.curia.eu.int (30.04.2006)
[192] Vaccaro, p. 1352.
[193] Looijestijn-Clearie, p. 403.
[194] Anne Looijestijn-Clearie: "Centros Ltd- A Complete U-Turn in the Right of Establishment for Companies" ICLQ, v. 49, 2000, p. 625.

secondary establishment, since the *Centros* and *Überseering* cases in the view of the ECJ (and at least ostensibly) relate to the freedom of secondary establishment.

2.3.2.2 Secondary Establishment

Article 43 of the EC Treaty provides that the prohibition on restrictions on freedom of establishment shall also apply to the setting up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State. The right of a company to set up agencies, branches and subsidiaries in the host Member State is commonly referred to as the right of secondary establishment.[195]

2.3.2.2.1 Agencies, Branches or Subsidiaries

The list in Article 48 of the EC Treaty, which includes agencies, branches and subsidiaries, is not exhaustive[196] and these means of establishment serve as a collective term.[197] The ECJ in its judgment of *Commission v. Germany* stated that even the establishment of either a mere office managed by the undertaking's own staff, or of a person who is independent but authorized to act on a permanent basis for the undertaking as an agency is in the scope of the freedom of secondary establishment.[198]

Moreover one cannot come across a definition of the terms of agency, branch or subsidiary within the EC Treaty. In this respect, the case law of the ECJ once again gives a clue about the perception of these terms. In *Somafer v. Saar-Fernglas* the ECJ held that:

"the concept of branch, agency or other establishment implies a place of business which has the appearance of permanency, such as the extension of a parent body, has a management and is materially equipped to negotiate business with third parties. The latter, although knowing that there will if necessary be a legal link with the parent body, the head office of which is abroad, do not have to deal directly with

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[195] Ebke, "Centros- Some realities and Some Mysteries", p. 631.
[196] Norbert Kuehrer, "Cross-border Company Establishment", EBLR, 2001, p. 113.
[197] Brombach, p. 62.
[198] Case C-205/84, "Commission of the European Communities v Federal Republic of Germany", para. 21, www.curia.eu.int (22.07.2006)

such parent body but may transact business at the place of business constituting the extension."[199]

2.3.2.2.2 The Term 'Established'

Article 43 refers to the nationals of any Member State 'established' in the territory of any Member State; however the EC Treaty provides no definition of the term 'established'.[200] It has been debated whether having solely a registered office in a Member State suffices for a company in order to be deemed established and furthermore whether a company formed under the law of a Member State, where it only has its registered office but conducts no business activities there, benefits from the right of secondary establishment as it can be said to be 'established' in another Member State.[201] In order to discuss this matter accurately, one should comprehend the perception of the ECJ as regards the scope of secondary establishment.

2.3.2.2.3 Standpoint of the ECJ

The most significant judgments of the ECJ dealing with this matter are the *Centros*[202] and *Inspire Art*[203] judgments.

2.3.2.2.3.1 Centros

In its *Centros* decision of March 9, 1999, the ECJ held that it is contrary to the EC Treaty provisions for a Member State to refuse registration of 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.

As the subject matter of this case, the private limited liability company named Centros, which was established by a Danish couple in 1992 under the laws of the United Kingdom, intended to carry out its trade in Denmark through a branch. The Danish trade registry authority Erhvervs- og Selskabsstyrelsen (the Trade and

[199] C 33/78, "Somafer v. Saar-Fernglas" www.curia.eu.int (20.07.2006)
[200] Looijestijn-Clearie, "Have the dikes collapsed?", p. 406.
[201] Looijestijn-Clearie, "Have the dikes collapsed?", p. 406; Brombach, p. 62.
[202] Case C-212/97 Centros Ltd v Erhvervs- og Selskabsstyrelsen. www.curia.eu.int (19.08.2006)
[203] Case C-167/01 Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd. www.curia.eu.int (19.08.2006)

Companies Board, 'the Board'), however, refused to register Centros as a branch, on the grounds that the company's main aim was to establish in Denmark not as a branch but to set up its principle establishment in Denmark, and since it does not carry out any trade activities in the UK, where it is established, and this was done for avoiding the national rules of the Danish company law[204].

From the documents submitted in the main proceedings before the Danish national courts it was clear that Centros had never conducted any trade transactions in the United Kingdom ever since its formation[205]. Mr. and Mrs. Bryde, the founders of Centros Ltd. did not deny either that the formation of Centros in the United Kingdom under the law of United Kingdom was intentional, in order to avoid from the requirements of Danish Company law[206].

During the proceedings before the Højestret, the Centros claimed that it was duly formed in the United Kingdom and therefore has gained the right to set up a secondary establishment, i.e. a branch, in Denmark, since the Articles 52 and 58 (now 43 and 48) of the EC Treaty grants this freedom of secondary establishment to the companies, which are formed in accordance with the law of a Member State[207] and added that this point of view was confirmed by the ECJ in its judgment of *Segers*[208].

The Danish Board, on the other hand, submitted to the Højestret that the purpose of the establishment of a branch in Denmark was to avoid the national rules on the provision for and paying-up of minimum share capital, the idea behind the refusal was the protection of private or public creditors and other contracting parties and also by the need to endeavor to prevent fraudulent insolvencies[209].

The Højestret decided to stay proceedings and addressed the question as to whether it is compatible with Article 52 of the EC Treaty to refuse registration of a

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[204] Case C-212/97, para. 7.
[205] Case C-212/97, para. 3.
[206] Case C-212/97, para. 18.
[207] Case C-212/97, para. 10.
[208] In Segers Case the ECJ ruled that Articles 52 and 58 of the EC Treaty prohibited the competent authorities of a Member State from excluding the director of a company from a national sickness insurance scheme solely on the ground that the company had its registered office in another Member State, even though it did not conduct any business there. Case 79/85. "Segers v Bedrijfsvereiniging voor Bank- en Verzekeringswegen, Groothandel en Vrjie Beropon"
[209] Case C-212/97, para. 12.

branch of a company which has its registered office in another Member State and has been lawfully founded with company capital of GBP 100 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 .[210]

The Danish Government argued that the sole purpose of the company formation was the circumvention of the national rules governing the formation of the private limited companies and attitude of Centros constituted an abuse of the freedom of establishment[211]. The Danish Government also stressed that since the Member States are entitled to take necessary steps to prevent the nationals from circumventing their national legislation by using the Treaty provisions, the refusal of the Danish Board was justified. The argument of the Danish Government that the Member States could take necessary steps was not denied by the Court[212]. However, the Court held that the fact that a national of a Member State who wishes to set up a company chooses to form it in the Member State whose rules of company law seem to him the least restrictive and to set up branches in other Member States cannot, in itself, constitute an abuse of the right of establishment[213].

The Court by saying "*…the refusal of a Member State to register a branch of a company formed in accordance with the law of another Member State in which it has its registered office on the grounds that the branch is intended to enable the company to carry on all its economic activity in the host State…, in so far as it prevents any exercise of the right freely to set up a secondary establishment…"*, considered the situation in case as a secondary establishment.[214]

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[210] Case C-212/97 para. 13.
[211] Case C-212/97 para. 23.
[212] Case C-212/97 para. 24.
[213] Case C-212/97 para. 24.
[214] Case C-212/97, para. 30.

2.3.2.2.3.2 Inspire Art

The ECJ repeated this approach in a more recent judgment of *Inspire Art* of 2001. In *Inspire Art* case, once again, like in *Centros*, freedom of secondary establishment of a company that conducted no business activities in its home state was dealt with. However, this time the host Member State refused to register the branch of the company on the grounds that it did not comply with the requirements of the law on pseudo foreign companies.

Inspire Art Ltd was formed in July 2000 as a private limited liability company in accordance with the English law. Its registered office was in England and its only director was domiciled in The Hague and had the authority to act alone and independently in the name of the company. Moreover, Inspire Art Ltd carried out all of its business activities through a branch in Amsterdam.[215] Inspire Art Ltd was registered with the trade registry of the Amsterdam Chamber of Commerce; however, the registration did not bear any indication of the fact that it was a pseudo foreign company, which it was supposed to bear in accordance with the Article 1 of the WFBV.[216]

Article 1 of the WFBV defines a `formally foreign company'. According to this article, `a capital company formed under laws other than those of the Netherlands and having legal personality, which carries on its activities entirely or almost entirely in the Netherlands and also does not have any real connection with the State within which the law under which the company was formed applies ...'.[217] Articles 2 to 5 of the WFBV impose on such companies various obligations in respect of company's registration in the commercial register, an indication of that status in all the documents produced by it, the minimum share capital and the drawing-up, production and publication of the annual documents. If the formally

[215] Case C-167/01 para. 34.
[216] 'The Dutch Pro-Forma Foreign Companies Act of 1998' Reference was made to this act when discussing the additional requirements imposed by the states adhering to the incorporation theory. See footnote 111.
[217] Case C-167/01 para. 22.

foreign company does not comply with these obligations, WFBV also provides for penalties.[218]

In particular, Article 2 of the WFBV requires a company falling within the definition of a formally foreign company to be registered as such in the commercial register of the host State. An authentic copy in Dutch, French, German or English, or a copy certified by a director, of the instrument constituting the company must also be filed in the commercial register of the host State, and a copy of the memorandum and articles of association if they are contained in a separate instrument. The date of the first registration of that company, the national register in which and the number under which it is registered must also appear in the commercial register and, in the case of companies with a single member, certain information concerning that sole shareholder.

According to Article 4(4), directors are to be jointly and severally liable with the company for legal acts carried out in the name of the company during their directorship until the requirement of registration in the commercial register has been fulfilled.[219]

Chamber of Commerce submitted an application to the competent Dutch court and required that the fact that Inspire Art Ltd. has the status of pseudo-foreign company under Article 1 of the WFBV be added to the company's registration. This would, however, bring about the legal consequences provided for in Articles 2 et seq. of the WFBV. Claiming that the imposition of additional requirements with legal consequences was contrary to the Articles 43 and 48 EC Treaty, Inspire Art Ltd did not admit that its registration in the commercial register was not complete.

The Dutch court held that Inspire Art was a formally foreign company in accordance with the Dutch legislation. As regards the issue of the compatibility of the relevant Dutch legislation with Articles 43 and 48 EC Treaty, the court decided to stay the proceedings and it referred two questions to the ECJ for a preliminary ruling. The Dutch court asked whether Articles 43 and 48 prohibited the Netherlands from imposing additional requirements regarding the establishment of a

[218] Case C-167/01 para. 23.
[219] Case C-167/01 para. 24.

branch of a company which has been set up in the United Kingdom with the sole aim of securing the advantages which that offers compared to incorporation under Netherlands law, given that Netherlands law imposes stricter rules than those applying in the United Kingdom with regard to the setting-up of companies and payment for shares, and given that the Netherlands law infers that aim from the fact that the company carries on its activities entirely or almost entirely in the Netherlands and, furthermore, does not have any real connection with the State in which the law under which it was formed applieswhich was formed under the law of another Member State having the aim in accordance with its national legislation. [220]

The national court also asked whether, on a proper construction of those articles, it is held that the provisions of the *WFBV* are incompatible with them, must Article 46 EC be interpreted as meaning that the said Articles 43 EC and 48 EC do not affect the applicability of the Netherlands rules laid down in that law, on the ground that the provisions in question are justified for the reasons stated by the Netherlands legislature.[221]

The ECJ in its judgment stated that although the issue at the heart of the dispute was whether or not Inspire Art must be registered as a formally foreign company in the commercial register, such registration of Inspire Art automatically and inextricably entailed a number of legal consequences provided for by Articles 2 to 5 of the WFBV.[222] The national court considered that the question of compatibility with the EC Treaty arose particularly in respect of certain of the obligations under Articles 2 to 5 of the WFBV.[223]

The ECJ considered it necessary to examine the provisions of the Dutch legislation with regard to the freedom of establishment of companies guaranteed by the EC Treaty as well as the company law Directives in order to provide the national court with a helpful answer.[224]

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[220] C-167/01, para 39.
[221] C-167/01, para 39.
[222] C-167/01, para 49.
[223] C-167/01, para 50.
[224] C-167/01, para 51.

The ECJ concluded that Articles 43 EC and 48 EC preclude national legislations imposing on the exercise of freedom of secondary establishment certain conditions provided for in domestic law in respect of company formation relating to minimum capital and directors' liability. The reasons for which the company was formed in that other Member State, and the fact that it carries on its activities exclusively or almost exclusively in the Member State of establishment, do not deprive it of the right to invoke the freedom of establishment guaranteed by the Treaty, save where abuse is established on a case-by-case basis.[225]

Turning back to the secondary establishment, the Austrian, German and Italian governments submitted that a branch of a pseudo-foreign company should actually be regarded as the principal establishment of the company.[226] Setting up a branch in a Member State other than that of incorporation should be regarded as the exercise of the right of primary establishment. It has been argued that setting up branches in a Member State by a company which does not conduct any business in the state of incorporation falls within the scope of the right of primary establishment.[227] However, the ECJ did not consider the establishment of Inspire Art as a primary establishment and held that it was contrary to Articles 43 EC and 48 EC for national legislation such as the WFBV to impose on the exercise of freedom of secondary establishment in that State by a company formed in accordance with the law of another Member State certain conditions provided for in domestic company law in respect of company formation relating to minimum capital and directors' liability. The reasons for which the company was formed in that other Member State, and the fact that it carries on its activities exclusively or almost exclusively in the Member State of establishment, do not deprive it of the right to invoke the freedom of establishment guaranteed by the EC Treaty, save where the existence of an abuse is established on a case-by-case basis.

[225] Case C-167/01 para. 105.
[226] C-167/01 ,para. 85; see also Looijestijn-Clearie, “Have the dikes collapsed?”, p. 404.
[227] Looijestijn-Clearie, “Have the dikes collapsed?” p. 404.

It was apparent from the decisions of *Centros*[228] and *Segers*[229] that it was immaterial regarding the rules on the freedom of establishment that a company was formed in a particular Member State only for the purpose of establishing itself in another Member State, where the main or indeed entire business was to be conducted.[230]

Therefore, the ECJ considered the fact that the company was formed in a particular Member State for the sole purpose of enjoying the benefit of more favorable legislation did not constitute an abuse.[231]

In this respect, the fact that Inspire Art was formed in England for the purpose of circumventing Dutch company law, which had more stringent rules, did not mean that the company's establishment of a branch in the Netherlands was not covered by the freedom of establishment under Articles 43 and 48.

2.4 INTERFERENCE TO THE SCOPE OF PROTECTION

According to the case law of the ECJ, the freedom of establishment is interfered when a foreign company is hindered from entering into a Member State by denying its registration[232], by denying its legal capacity and the capacity to sue or to be sued[233], or by making the establishment of a secondary establishment subject to additional requirements[234].

2.4.1 Justification of Restrictions on Freedom of Establishment

The recent case law of the ECJ in *Centros*, *Überseering* and *Inspire Art* cases gives an idea about how a Member State can possibly restrict the freedom of

[228] Case C-212/97 Centros, para. 17.
[229] Case 79/85 Segers, para. 16.
[230] C-167/01, para 95.
[231] C-167/01, para 96.
[232] Case C-212/97 Centros.
[233] Case C-208/00 Überseering.
[234] Case C-167/01 Inspire Art.

establishment of a company; i.e. either by hindering a foreign company from entering into its territory by way of denying its registration on the grounds that it conducted no business activities in its state of incorporation (Centros), or by denying the legal capacity and the capacity to sue or to be sued of a foreign company when it transfers its real seat into its territory (Überseering), or by making the secondary establishment of a foreign company subject to additional requirements.[235]

However, national measures hampering the freedom of establishment or rendering its exercise less attractive can be subject to some exceptions. Those exceptions may either result from the Article 46 of the EC Treaty of from the case law of the ECJ.[236]

Article 46 EC Treaty provides that *'the provisions of this chapter and measures taken in pursuance thereof shall not prejudice the applicability of provisions laid down by law, regulation or administrative action providing for special treatment for foreign nationals on grounds of public policy, public security or public health.'*

In *Centros* and *Inspire Art* cases, the ECJ held that the motives that make a company prefer to be formed in a particular Member State are irrelevant with regard to the application of the rules on freedom of establishment, unless they amount to fraud.[237] A case dealing with a restriction justified on grounds of combating fraud has not yet been seen in the case law of the ECJ. Therefore we do not have any clues as regards what constitutes fraud in the view of the ECJ. In contrast, the case law reveals what does not constitute fraud in the view of the ECJ. It is clear in the light of the case law of the ECJ that the sole purpose of enjoying the benefit of more favorable legislation does not configure any abuse even if the company conducts its activities entirely or mainly in that second State.[238]

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[235] Eidenmüller/Rehm, "Niederlassungsfreiheit versus Schutz des inländischen Rechtsverkehrs: Konturen des Europäischen Internationalen Gesellschaftsrechts", ZGR, 2004, p. 168.
[236] Ebke, "Centros-Some Realities and Some Mysteries" , p. 642.
[237] Case C-212/97, para. 17, and Case C-167/01, para. 95.
[238] Case 79/85, para. 16; Case C-212/97, para. 18, and Case C-167/01, para. 96.

On the other and, the ECJ developed four criteria test based on reasonable requirements of public interest, which must be fulfilled for justification of the restrictions on the fundamental freedoms. [239] Accordingly:

(i) The restrictive measures must be applied in a non-discriminatory fashion,

(ii) They must be justified by imperative requirements in the general interest,

(iii) They must be suitable for securing the attainment of the objective which they pursue,

(iv) They must not go beyond what is necessary in order to attain it.

However, all the restrictive measures adopted by Member States as yet, such as conditioning the recognition of legal capacity to the paying up of a minimum capital or the reincorporation in another Member State, have consistently failed to comply with the proportionality test.[240] The ECJ implied in *Centros* case that measures that are less restrictive, or that interfere less with fundamental freedoms than the refusal of registration or of recognition of legal capacity could be implemented to attain the purpose of protection of creditors.[241] The ECJ also set forth that the creditors of a company are supposedly on notice that the company is subject to foreign laws and a Community protection under company law directives like the fourth directive and the eleventh directive is always available.[242]Besides, once creditors have been duly informed that they are dealing with a foreign company subject to foreign laws, they are in a good commercial position to negotiate whatever protection.[243]

2.4.2 The Disclosure Requirements in WFBV and Eleventh Directive

According to the ECJ, several of the provisions of the WFBV fell within the scope of the Eleventh Directive, which concerned disclosure requirements in respect

[239] Case C-19/92, para. 32, Gebhard, para. 37 , Case C-212/97, para. 34
[240] Vaccaro, p. 1355.
[241] Case C-212/97, para. 37.
[242] Case C-212/97, para. 36.
[243] Vaccaro, p. 1355.

of branches opened in a Member State by companies covered by the First Directive[244] and governed by the law of another Member State.[245] The Court also added that those provisions, the compatibility of which with the Eleventh Directive had not been called into question, could not be considered as constituting any impediment to the freedom of establishment of companies.[246] But the compatibility of these provisions with Community law, according to the ECJ, did not mean that the sanctions attached by the WFBV for non-compliance with the measures must also be compatible.[247]

According to Article 4 (4) WFBV, directors are jointly and severally liable with the company for legal acts adopted in the name of the company during their directorship for so long as the requirements concerning disclosure in the business register had not been met.[248] The ECJ pointed out that the Eleventh Directive required the Member States to provide for appropriate penalties where branches of companies failed to make the required disclosures in the host Member States[249] and where a Community regulation did not specifically provide any penalty for an infringement or referred for that purpose to national laws, regulations and provisions, the Member States were required under Article 10 to take all measures necessary to guarantee the application and effectiveness of Community law.[250] For that purpose, while the choice of penalties remained within the discretion of the Member States, the penalties had to be analogous to those applicable for similar infringements of national law.[251] Therefore the ECJ held that it was for the national court to determine whether the penalty provided for by Article 4 (4) WFBV met those conditions and whether it did not put formally foreign companies at a disadvantage in comparison with Dutch companies where there was an infringement of the disclosure requirements.[252] In case the national court reaches the conclusion

[244] Directive 68/151/EEC.
[245] C-167/01, para 55.
[246] C-167/01, para 58.
[247] C-167/01, para 59.
[248] C-167/01, para 60.
[249] C-167/01, para 61.
[250] C-167/01, para 62.
[251] C-167/01, para 62.
[252] C-167/01, para 63.

that Article 4(4) of the WFBV treats formally foreign companies differently from national companies, it must be concluded that that provision is contrary to Community law.[253]

The ECJ pointed out that such a disclosure requirement provided for by the WFBV as the requirement to indicate the fact that the company is a formally foreign company is not provided for in Article 2[254] of the Eleventh Directive.[255] For this reason, the ECJ held that the disclosure requirements imposed by the WFBV were contrary to Community law.[256]

It is clear that the ECJ does not consider the restriction on grounds of application of national conflict of laws norms as a reason of justification. This attitude of the ECJ forms the subject of the following chapter. More clearly, the application of conflict of laws theories, which present a protective strategy by simply applying the states own law rather than enacting particular protective measures, seem, in the ultimate analysis, to be incompatible with the justification test developed by the ECJ. In Chapter III, the downfall process of the real seat theory will be examined in a case by case basis.

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[253] C-167/01, para 64.
[254] The compulsory disclosure according to Article 2 of the Directive shall cover only the address of the branch, the activities of the branch, the register in which the company file mentioned in Article 3 of Council Directive 68/151/EEC is kept, together with the registration number in that register, the name and legal form of the company and the name of the branch if that is different from the name of the company, the appointment, termination of office and particulars of the persons who are authorized to represent the company in dealings with third parties and in legal proceedings, the winding-up of the company, the appointment of liquidators, particulars concerning them and their powers and the termination of the liquidation in accordance with disclosure by the company as provided for in Article 2 (1) (h), (j) and (k) of Directive 68/151/EEC, the accounting documents in accordance with Article 3 and the closure of the branch.
[255] C-167/01, para 65.
[256] C-167/01, para 71-72.

3 CHAPTER: III - RELATIONSHIP BETWEEN LEX SOCIETATIS AND THE FREEDOM OF ESTABLISHMENT

3.1 CONFLICT OF LAWS ASPECT OF ARTICLE 48

3.1.1 General

The meaning of the freedom of establishment for the international company law has constantly been controversial in the EC law literature. As was seen in Chapter I, there are two mainstream private international law theories in respect of determination of law applicable to a foreign company: the real seat theory and the incorporation theory. The real theory subjects a company to the law of the country, in which it has its centre of administration, while according to the incorporation theory the company remains subject to the law of place of incorporation irrespective of the location of company's centre of administration.

On the other hand, as was stated in Chapter II of this research, the companies formed under the law of an EU Member State are entitled to the freedom of establishment in accordance with Articles 43-48 EC Treaty. Such companies can make use of this freedom either by transferring their centre of administration or head office into another Member State, i.e. primary establishment, or by setting up agencies, branches or subsidiaries in another Member State, i.e. secondary establishment. However, problems occur when the Member State, in which a company intends to set up a secondary establishment, adopts the real seat theory.[257] Likewise, a Member State adhering to the real seat theory can stipulate reincorporation under its own law when a company intends to transfer its centre of administration into its territory.[258]

As things stand, it is of remarkable significance to determine whether the real seat theory, with all its requirements and legal consequences, could still be

[257] Sibel Özel, "Avrupa Birliğinde Şirketlerin Yerleşim Serbestisinin Lex Societatis ile Olan İlişkisi".
[258] Özel, op cit.

applied, or the application thereof constituted a hindrance against the freedom of establishment of companies. In academic circles, it is asserted by some legal scholars that the EC Treaty provisions on freedom of establishment were irrelevant of the national conflict of laws rules of the Member States and that the Article 48 EC Treaty did not have a conflict of laws dimension.[259]

According to another group of authors, Article 48 EC Treaty included (at least a hidden)[260] conflict of laws norm, which set forth the application of the incorporation theory.[261] This conflict of laws norm was directly applicable for it is clear and unconditional.[262] Therefore it does not need to be implemented in domestic law. At the same time, a reference to the conflict of laws norms of the host Member State can exceptionally be permissible just in case this can be justified by general interest or if the laws of the state of incorporation are more stringent than those of the host Member State.[263]

The European institutions provided answers as regards this debate, however in a somewhat paradoxical fashion. On the one hand, the ECJ granted wide cross-border mobility to companies by excluding the application of the real seat theory, at least for the so-called entry situations. On the other hand, the Council in its Regulation on the Statute for a European Company[264] adopted an approach, which has been defined as a more flexible version of the real seat theory.[265]

In order to be able to investigate the cross-border mobility of companies formed under the law of a Member State, it must be clarified painstakingly whether the requirements of Article 48 should be regarded as having a conflict of laws aspect, and if so, to what extent, or the national conflict of laws theories of the Member States can still be applied in respect of ascertaining the law applicable to companies.

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[259] Roth, 'Viel Lärm um Nichts?', p. 327
[260] German commentators express this as a "versteckte Kollionsnorm", which can be translated as a "hidden conflict of laws norm".
[261] Norbert Horn, „Deutsches und europäisches Gesellschaftsrecht und die EuGH-Rechtsprechung zur Niederlassungfreiheit- Inspire Art", NJW, 2004, p.896.
[262] Brombach, p. 105.
[263] Horn, p. 896.
[264] Council Regulation (EC) 2157/2001 on the Statute for a European Company (SE)
[265] Vaccaro, p. 1348.

3.1.2 VALIDITY OF THE REAL SEAT THEORY

In fact, the view asserting that a company formed under the law of a Member State should be recognized as having legal capacity as long as it has its statutory seat and centre of administration within the European Community, has been represented by some authors ever since the direct applicability of the EC Treaty provision on freedom of establishment.[266] It was asserted that in respect of companies from other Member States, the application of the real seat theory was implicitly excluded and incorporation theory was taken as the basic.[267] However, the common view, for a long period, was that the freedom of establishment was irrelevant of the conflict of laws. The commentators assumed that the Treaty of Rome could not have intended to outlaw the real seat theory, as all of the Founder Member States followed the real seat theory and otherwise would have run against the intention of the framers.[268] However, this view seems to contradict with the fact that the mutual recognition of foreign companies was on the agenda of the EC legislators as of mid-fifties, and furthermore, even though the founder Member States adhered to the real seat theory, it would not be wise to assume that the negotiators of the Rome Treaty overlooked the potential implications of Article 48 for issue.[269]

In the meantime, the conformity of the real seat theory with the freedom of establishment was questioned for the first time by the German Courts in *Druckhaus Landshut* case of 1985.[270] The German Court did not decide on the matter due to procedural reasons, however emphasized that if it were to decide on the case, it would have submitted it to the ECJ and asked whether the *Sitztheorie* could be

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[266] For this view see Werner Ebke, 'Ausländische Kapitalgesellschaft &Co. KG', ZGR, p.249.
[267] Ebke, 'Ausländische Kapitalgesellschaft &Co. KG', ZGR, p. 249.
[268] Luca Cerioni, 'A Possible Turning Point in the Development of EC Company Law: The Centros Case', ICLLJ, 2000, p. 166; Eva Maria Kieninger, 'Niederlassungsfreiheit als Rechtswahlfreiheit', ZGR,1999, p. 733.
[269] Harald Halbhuber, 'National Doctrinal Structures and European Company Law', CMLR, 2001, p. 1401.
[270]The Case before the German Court concerned an English private limited company which intended to acquire the shares of a German limited partnership and participate in this German company as a partner with limited liability. See Ebke, 'Ausländische Kapitalgesellschaft &Co. KG', p. 248.

applied to the matter of recognition of the English private limited company in question. Apart from that, there had been no serious threats toward the national conflict of laws policies of the Member States.

Moreover, after the *Daily Mail*[271] decision, the supporters of the real seat theory were at ease, as the decision of the ECJ seemed to support the view that private international law rules relating to the company law are not to be measured under the freedom of establishment.[272] This decision was generally viewed as the recognition of the priority of the real seat theory, which supports the conflict of laws rules of many Member States, vis-à-vis the freedom of establishment under EC Treaty.[273]

In the *Daily Mail* case, the English company Daily Mail sought to transfer its headquarters from London to Amsterdam for the purpose of avoiding the relevant taxes in the UK. According to English tax law, which aimed at preventing tax evasion, such a transfer is subject to government approval.[274] The Court stated that it was apparent that under United Kingdom company legislation a company incorporated under that legislation and having its registered office in the UK, might establish its central management and control outside the United Kingdom without losing legal personality or ceasing to be a company incorporated in the United Kingdom.[275] The relevant United Kingdom tax legislation provided that only companies which are resident for tax purposes in the UK are as a rule liable to United Kingdom corporation tax and company is to be considered as resident for tax purposes in the place in which its central management and control is located.[276]
Daily Mail plc. argued before the ECJ that an approval of the government for a seat transfer constituted a restriction against the freedom of establishment granted by Articles 43 and 48 EC. Daily Mail claimed essentially that the EC Treaty expressly confers on the companies the same right of primary establishment in another

[271] Case C-81/87. The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc.
[272] See Horn, p. 896; Stefan Leible & Jochen Hoffmann, 'Wie Inspriert ist Inspire Art?', ZGR, 2004, p. 677.
[273] Grossfeld/ Lutterman, "Anmerkungen zu EuGH v. 27.09.1988", JZ, 1989, p. 386.
[274] Case C-81/87, para. 2.
[275] Case C-81/87, para. 3.
[276] Case C-81/87, para. 4.

Member State as is conferred on natural persons. The transfer of the central management and control of a company to another Member State amounted, in the view of Daily Mail, to the establishment of the company in that Member State because the company is locating its centre of decision-making there, which constitutes genuine and effective economic activity .[277] The UK argued that the Treaty provisions do not give companies a general right to move their central management and control from one Member State to another . The fact that the central management and control of a company is located in a Member State does not itself necessarily imply any genuine and effective economic activity on the territory of that Member State and cannot therefore be regarded as establishment within the meaning of the EC Treaty.[278] Furthermore, the Commission emphasized that in the present state of Community law, the conditions under which a company may transfer its central management and control from one Member State to another are still governed by the national law of the State in which it is incorporated and of the State to which it wishes to move.[279]

The ECJ upheld the decision of the British fiscal authority and set forth that those treaty provisions *"confer no right on a company incorporated under the legislation of a Member State and having its registered office there to transfer its central management and control to another Member State."*[280]

The ECJ reached this conclusion by way of a detour through comparative company law.[281] First, it brought to mind that companies *"exist only by virtue of the varying legislation which determines their incorporation and functioning"*[282] and then went on to discuss the disparities between the approaches of the Member State by saying:

"Certain States require that not merely the registered office but the central administration of the company should be situated on their territory, and the removal of the central administration from that territory thus presupposes the winding-up of the company with all the consequences that winding-up entails in company and tax

[277] Case C-81/87, para.12.
[278] Case C-81/87, para. 13.
[279] Case C-81/87, para. 14.
[280] Case C-81/87 , para.25.
[281] Halbhuber, p. 1390.
[282] Case C- 81/87, Para 19.

law. The legislation of other States permits companies to transfer their central administration to a foreign country but certain of them, such as the United Kingdom, make that right subject to certain restrictions... "[283]

The ECJ based its conclusion on the fact that Article 48 EC Treaty *"places on the same footing, as connecting factors, the registered office, central administration and principal place of business."*[284] This has been interpreted as if the Treaty recognized that the company laws of the Member States differ in the connection to "*their territory*" required for incorporation of their own companies.[285]

This judgment of the ECJ was of material meaning within the framework of conflict of laws rules in respect of recognition of foreign companies and found an extensive resonance particularly in German legal literature.[286] The ECJ, in an *obiter dictum*, stated that Articles 43 and 48 of the EC Treaty could 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.[287] It added that in the present state of Community law relevant articles of the Treaty, properly construed, conferred no right on a company incorporated under the legislation of a Member State and having its registered office there to transfer its central management and control to another Member State.[288] This attitude of the ECJ in Daily Mail case was interpreted by the legal scholars as to be acknowledging that the conflict of laws rules of the Member States have resistance against the freedom of establishment.[289]

The Daily Mail judgment of the ECJ was characterized by German commentators as confirming German *Sitztheorie* practice of not recognizing companies formally incorporated in other Member States, but not doing any

[283] Case C-81/87, Para 20.
[284] Case C-81/87, Para 21.
[285] Halbhuber, p. 1391.
[286] Brommbach, p. 74,75.
[287] Case C-81/87, para. 24.
[288] Case C-81/87, para. 25.
[289] Ebke, "Centros- Some realities and Some Mysteries", p. 637.

business there.[290] It was concluded from the statements of the ECJ that the national laws, consequently the conflict of laws rules, of Member States had priority before the primary European law in the field of freedom of establishment of companies.[291] In spite of some highly EC-Law spirited approaches[292], it was commonly accepted after the Daily Mail decision that there was no such thing as a 'European' conflict of laws rule.[293] According to this view, the EC Treaty did not set out a conflict of laws norm and the ECJ clearly did not want to get mixed up with the tricky matter of the relationship between traditional conflict of laws rules and freedom of establishment, leaving this matter to a future convention under Article 293 or to a harmonization effort based on Article 44(2)(g).[294]

3.1.3 ELIMINATION OF THE REAL SEAT THEORY IN COMPANY IMMIGRATION

The ease of the scholars on the real seat theory side of the picture left its place to unease after the Centros decision of the ECJ. This decision was described as the beginning of the downfall of the real seat theory by a number of authors. Centros decision was followed by Überseering and Inspire Art, which gave the freedom of establishment of companies its final shape, as far as the entry of a company into the territory of a Member State is concerned. Each of these three judgments should be examined thoroughly as each one is of remarkable significance for the abolition of the real seat theory. As will be examined hereinafter, Centros case implied that the real seat criterion cannot be applied against the pseudo foreign companies, which intends to get established in another Member State by making use of secondary establishment. Überseering set forth that the legal personality of a company from

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[290] Halbhuber, p. 1391.
[291] Brommbach, p. 76.
[292] Drobnig, even after Daily Mail, asserted that the EC Treaty contained a hidden conflict norm presciribed the incorporation theory. For this, see Rammeloo, op cit, foot note 178 and Ebke, 'Ausländische Kapitalgesellschaft &Co. KG', p. 249.
[293] Rammeloo, p. 54, foot note 179.
[294] Wulf-Henning Roth, 'Case C-212/97, Centros Ltd v. Erhvervs- og Selskabsstyrelsen, Judgment of 9 March 1999', CMLR, 2000, p. 153.

another Member State is to be recognized when such company transfers its real seat in form of primary establishment. Finally with the Inspire Art decision of the ECJ, it was clear that the matters other than recognition are to be dealt with under the law of the state of incorporation.

A foreign company can enter into the territory of a Member State in two different ways. It can either transfer its real seat (primary establishment) or set up agencies, branches or subsidiaries (secondary establishment).[295] The validity and the elimination of the real seat should be examined under this distinction.

3.1.3.1 Primary Establishment in Secondary Establishment's Disguise

As was thoroughly discussed in Chapter II, the Centros case concerned a pseudo foreign company incorporated in England, where it carried out no business. Therefore its registration was denied by the Danish authorities on the grounds that the reason of incorporation in England was solely circumventing the Danish company law rules. In its judgment the ECJ repeated its view in *Segers* judgment[296] and held that a situation in which a company formed in accordance with the law of a Member State in which it has its registered office desires to set up a branch in another Member State falls within the scope of Community law and consequently it is immaterial that the company was formed in the first Member State only for the purpose of establishing itself in the second, where its main, or indeed entire, business is to be conducted.[297] Accordingly, a formal establishment would be sufficient to enjoy the right of secondary establishment.

Other than the duty for a company to move its registered office into the country, into which the company has already moved its de facto main seat, the real seat theory implies another duty for a company; to make a primary establishment in a situation where the company merely wants to have operate through a secondary

[295] Kuehrer, p.113.
[296] Case 79/85, para. 16.
[297] Case C-212/97 para.17.

establishment in the other country.[298] This was the crucial point that provoked the academic debate, as Centros wanted merely to operate through a secondary establishment in Denmark. It was question after this decision whether the ECJ's decision meant the elimination of the real seat theory. Was the Daily Mail judgment overruled by the Centros judgment or not? Did the ECJ abolish the real seat theory?[299]

The Centros case had clearly displayed the tendency of the ECJ against the real seat theory and for the incorporation theory in the view of some authors.[300] The reason for this was that the ECJ in this judgment did not regard the real seat of the company as a legally decisive factor and in its decision it took as the basis the place of incorporation for the recognition of Centros. The decision of the ECJ was considered as to be overruling the Daily Mail judgment and preparing the end of the real seat theory in the field of application of freedom of establishment.[301] It was even suggested that *'what Cassis de Dijon did for the free movement of goods, Centros would do for the free establishment of companies.'*[302] The reason for greeting the decision as a rejection of the real seat principle was that the real seat theory contradicted with the general policy of freedom of establishment under the EC Treaty.[303]

On the other hand, another group of writers set forth that *Centros* decision was only relevant for the Member States that adhered to the incorporation theory, while for those Member States that adhere to the real-seat theory nothing would change.[304] In the view of these scholars, a closer look at *Centros* revealed that the

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[298]Erik Werlauff, 'The Main Seat Criterion in a New Disguise', EBLR, 2001, p. 3.

[299] For comments see J Lau Hansen 'A New Look at Centros – From a Danish Point of View', EBLR, 2002, p. 85; Looijestijn-Clearie 'Centros Ltd – A Complete U-Turn in the Right of Establishment for Companies?', ICLQ, 2000, p. 622; Roth 'From *Centros* to *Ueberseering',* p. 177; Halbhuber, p. 1392.

[300] Horn, p. 896; Kieninger, „Niederlassungsfreiheit als Rechtswahlfreiheit", p. 745; Leible, „Anmerkungen zu EuGH Rs. C-212/97 (Centros)", NZG, 1999, p. 300.

[301]Freitag, "Der Wettbewerb der Rechtsordnungen im Internationalen Gesellschaftsrecht.", EuZW, 1999, p. 267.

[302] Werlauff, 'Using A Foreign Copany For Domestic Activities', http://www.rws-verlag.de/volltext/centros4.htm (last accessed on 24.09.2006)

[303] Erik Werlauff "Using a Foreign Company for Domestic Activities"

[304] Hanno Merkt, ' Centros and its Consequences for Member State Legislatures', ICCLJ, 2001, p. 120; Roth, 'Viel Lärm um Nichts'; Ebke, "Das Centros Urteil und seine Relevanz für das deutsche

decision did not go much beyond the *Segers*[305] judgment, leaving the conflict of laws issue untouched[306] and the judgment had no relevance for Member States that apply the real seat theory.[307] The decision seemed consistent since Centros would be recognized as having legal capacity in Denmark if it conducted business activities in its state of incorporation, *i.e* England.[308] The reason of the refusal by Denmark was not that it followed the real seat theory[309]. The Danish authorities refused such registration on the grounds that Centros did not conduct any business in its state of incorporation and that the aim of such establishment was circumventing the national Danish regulations regarding the payment of a minimum capital. It was also clear from the facts of Centros that Denmark regarded Centros as a foreign limited liability company.[310] Consequently there were no problems of recognition involved and the EJC did not examine any problems of conflict of laws theories in regard to the freedom of establishment.[311] Accordingly, since Denmark applied the incorporation theory, the Centros case did not have any such consequences relating to the application of the real seat theory.[312] In the view of these authors, the majority of whom stem, not surprisingly, from Germany, the Centros decision did not have any outcomes in respect of the treatment of the foreign capital companies that transfer their principal seat into a Member State applying the real seat theory.

The matter as to whether a company is properly formed does not result from the Community law, but from the internal laws of Member States according to the German understanding.[313] It is clearly stated in Daily Mail decision that unlike natural persons, companies are creatures of the national law and they exist only by

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Internationale Gesellschaftsrecht", JZ, 1999, p. 656; Kindler, 'Niederlassungsfreiheit für Scheinauslandsgesellschaften?' NJW, 1999, p. 1993.

[305] Case 79/85, D.H.M.Segers v. Bestuur van de Bedrijfsvereniging voor Banken Verzekeringswezen, Groothandel en Vrije Beroepen.

[306] Roth, 'Case Law', CMLR, p. 153.

[307] Kindler, ‚Niederlassungsfreiheit für Scheinauslandsgesellschaften', NJW, p. 1996.

[308] Ebke, 'Das Schicksal der Sitztheorie nach dem Centros-Urteil des EuGH', JZ, 1999, p. 656; Kindler, 'Niederlassungsfreiheit für Scheinauslandsgesellschaften? ', p. 1996; Brombach, p. 87.

[309] In fact some commentators consider Denmark as adhering to the real seat theory; see Freitag

[310] Case C-212/97, para.4.

[311] Kuehrer, "Cross-Border Company Establishment", EBLR, 2001, p. 115.

[312] Ebke, 'Das Schicksal der Sitztheorie', p. 627; Kindler, ‚Niederlassungsfreiheit für Scheinauslandsgesellschaften', p. 1996; Kuehrer; p. 115.

[313] Kindler, ‚Niederlassungsfreiheit für Scheinauslandsgesellschaften', p. 1997.

virtue of the varying national legislation which determines their incorporation and functioning.[314] It was also asserted that the EC Treaty accepts the divergence regarding the conflict of laws rules of Member States and leaves the choice of the criterion to the Member States.[315] This understanding finds its basis once again in the Daily Mail decision. The ECJ in its judgment states that;

"The Treaty has taken account of that variety in national legislation. In defining, in Article 58, the companies which enjoy the right of establishment, the Treaty places on the same footing, as connecting factors, the registered office, central administration and principal place of business of a company. Moreover, Article 220 of the Treaty provides for the conclusion, so far as is necessary, of agreements between the Member States with a view to securing inter alia the retention of legal personality in the event of transfer of the registered office of companies from one country to another. No convention in this area has yet come into force."[316]

The ECJ indeed accepted in Daily Mail decision that the EC Treaty regards the differences in national legislation concerning the required connecting factor and the question as to 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 but must be dealt with by future legislation or conventions.[317] Such legislation or conventions have not yet come into reality. The EC law scholars formulated this attitude of the EC Treaty in field of international company law as follows: "The international company law and consequently the real seat theory are *niederlassungsfreiheitresistent*[318] and the international company law comes before the freedom of establishment."[319]

What the advocates of the real seat theory tried to get at was that Centros decision is inconsistent, as the ECJ, supposedly, took account of the fact that Denmark adopts the incorporation theory and there considered Centros as a

[314] Case 81/87, para.19.
[315] Kindler, ‚Niederlassungsfreiheit für Scheinauslandsgesellschaften?', p. 1997.
[316] Case 81/87para. 21.
[317] Case 81/87para. 23.
[318] This German word indicates the resistance against the freedom of establishment.
[319] Ulrich Klinke, ' Europäisches Unternehmensrecht und EuGH', ZGR, 2002, p. 168.

company of English law.[320] According to those scholars, if Centros desired to open a branch in Germany without conducting any business activities in the state of incorporation, the ECJ would take account of the fact that Germany adheres to the real seat theory and consequently a refusal of registration would not result in a breach of the freedom of establishment since German law regards such a company as non-existent.

The advocates of real seat theory who claimed that the Centros decision had no outcomes in respect of conflict of laws further argued that the subsidiarity-principle provision in Art. 5 EC Treaty, introduced through the Maastricht Treaty, which is also referred to by the Commission in a proposal for the 14th Directive could be taken into consideration.[321] Even if the Centros case had the intention to overrule the Daily Mail decision, it should have stated that also in the context of the subsidiarity principle.[322]

3.1.3.2 Recognition in Narrow Sense

The view that the national conflict of laws are not under the regime of Community had to be reviewed once again as a result of the ECJ's following decision of *Überseering*. This judgment proved the view wrong, which explained the situation in Centros by the fact that Denmark adopts the incorporation theory. As a result of the *Überseering* decision, Member States became bound to recognize the legal capacity and the capacity to sue and be sued of a company, which has been properly incorporated in a Member State, where it has its statutory seat.[323]

3.1.3.2.1 The Facts of the Überseering Case

The Überseering Case concerned damages for defective work carried out in Germany by Nordic Construction Baumanagement GmbH (NCC) on behalf of

[320] Kindler, "Niederlassungsfreiheit für Scheinauslandsgesellschaften?" , p. 1997.
[321] Kindler, "Niederlassungsfreiheit für Scheinauslandsgesellschaften?", p. 1997; Kuehrer, p. 116.
[322] Kuehrer, p. 115.
[323] Martin Schulz, "(Schein-)Auslandgesellschaften in Europa – Ein Schein- Problem?" NJW, 2003, p. 2705.

Überseering BV.[324] Überseering BV, a Dutch company, incorporated and established in the Netherlands owned property in Germany and was registered as the owner of that property in the German register. Überseering BV entered into a contract with a German construction firm, Nordic Construction Baumanagement GmbH (NCC) in 1992. This contract concerned the renovation of one of the buildings of Überseering. After the completion of the work subject to the contract, Überseering claimed that the the paint work was defective.[325] In 1994, two German nationals acquired all of the shares of the company.[326] Überseering BV failed to obtain compensation from NCC for the defective work and therefore brought proceedings against NCC on the basis of its project-management contract with NCC.[327] The German Courts held in the proceedings that, Überseering had transferred its actual centre of administration to Düsseldorf once its shares had been acquired by two German nationals and consequently, as a company incorporated under Netherlands law, Überseering did not have legal capacity in Germany and, thus, could not bring legal proceedings in Germany.[328] Thereupon, Überseering appealed to the Bundesgerichtshof [329] along with the observation that in parallel with the proceedings currently pending before the Bundesgerichtshof, an action was brought against Überseering before another German court based on certain unspecified provisions of German law[330]. The prevailing case law of the *Bundesgerichtshof* at the time denied legal capacity, and consequently the capacity to sue or be sued before German courts, to companies incorporated under foreign law and thereafter moved their real seats into Germany, unless these companies reincorporated under German law.[331]

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[324] Case C-208/00, para. 2.
[325] Case C-208/00, para. 6.
[326] Case C-208/00, para. 7.
[327] Case C-208/00, para. 8.
[328] Case C-208/00, para. 9.
[329] Case C-208/00, para. 11.
[330] Case C-208/00, para. 12.
[331] Kilian Baelz and Teresa Baldwin, "The End of the Real Seat Theory: the ECJ Decision in Ueberseering and its Impact on German and European Company Law", German Law Journal, 2002, para 5.

Bundesgerichtshof stayed proceedings and referred two questions concerning the interpretation of Articles 43 and Articles 48 and the implications of the *Centros* judgment to the ECJ for a preliminary ruling.[332]

Are Articles 43 EC and 48 EC to be interpreted as meaning that the freedom of establishment of companies precludes the legal capacity, and capacity to be a party to legal proceedings, of a company validly incorporated under the law of one Member State from being determined according to the law of another State to which the company has moved its actual centre of administration, where, under the law of that second State, the company may no longer bring legal proceedings there in respect of claims under a contract?

If the Court's answer to that question is affirmative:

Does the freedom of establishment of companies (Articles 43 EC and 48 EC) require that a company's legal capacity and capacity to be a party to legal proceedings is to be determined according to the law of the State where the company is incorporated?'[333]

3.1.3.2.2 Decision of the ECJ

The main finding of the ECJ in Überseering case appears to be of considerable significance although, given the special nature of the relevant German rules, scarcely unexpected.[334] The German version of the *Sitztheorie*, which refused to grant legal capacity and the capacity to sue and be sued to a company which

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[332] Case C-208/00 para. 21.

[333] *VII. Zivilsenat's* submission of these questions to the European Court of Justice for a preliminary ruling met a considerable opposition. The most criticized point was the formulization of the second preliminary question referred to the ECJ.[333] This question was criticized to be 'superfluous' as the previous decision of the Bundesgerichtshof in *Jersey* judgment dealt explicitly with the same matter. In Jersey Decision of 1 July 2002, II Zivilsenat held that a limited company formed under the law of the Channel Island of Jersey having its centre of administration in Germany should be recognized not as an incorporation but as an unincorporated private association, i.e. a BGB company. A BGB company has the capacity to sue and be sued under its own name. However, the point missed by the legal writers criticizing the question of the *VII. Zivilsenat* was '*that the companies formed under the law of the Channel Island of Jersey, cannot invoke the benefits of the freedom of establishment guaranteed by Articles 43 and 48 of the EC Treaty because of a reservation filed by the United Kingdom in connection with its accession to the EU*'. For further details see Ebke, "The European Conflict-of-Corporate-Laws Revolution", p. 16; Ebke, "Überseering: "Die wahre Liberalität ist Anerkennung", p. 927.

[334] Frank Wooldridge, 'Freedom of Establishment of Companies Affirmed', EBLR, 2003, pg. 233.

transferred its centre of administration to Germany, seemed to the ECJ to be particularly rigid.

The ECJ held that Überseering was validly incorporated in the Netherlands and as a company incorporated under the law of the Netherlands was entitled under Articles 43 and 48 to exercise its freedom of establishment in Germany and thus, it was of little significance that all of its shares had been transferred to German nationals residing in Germany after the formation of the company, as that had not caused Überseering to cease to be a legal person under the law of the Netherlands.[335]

The reasoning of this, according to the ECJ, was that the company's existence was inseparable from its status as a company incorporated under the law of the Netherlands, since a company existed only by virtue of the national legislation which determined its incorporation and functioning.[336] The ECJ considered a requirement of reincorporation of the same company in Germany[337] as tantamount to outright negation of freedom of establishment.[338]

It was claimed by German and Spanish Governments during the proceedings, by reference to the Daily Mail judgment, that Article 293 EC had priority against the Articles 43 and 48 EC Treaty and the freedom of establishment did not deal with the case of cross-border seat transfer of a company. The advocates of the real seat doctrine set forth that the seat transfer of companies within the EU required a separate Convention based on the Article 293 EC Treaty. So long as no such convention exists, the matter of legal capacity and capacity to sue and be sued of a company is dependent on the current law of the moving-in Member State. The ECJ denied this view explicitly and said that it did not intend to recognize in Daily Mail judgment a Member State as having the authority to subject such companies' effective exercise in its territory of the freedom of establishment to compliance with

[335] Case C-208/00, para. 80.
[336] Case C-208/00, para. 81.
[337] German law does not recognize the legal capacity of a company incorporated in a foreign country if it had its central administration in Germany, unless it is reincorporated under German law.
[338] Case C-208/00, para. 81.

its domestic company law.[339] The recognition of a company's legal capacity and its capacity to be a party to legal proceedings in the Member State of establishment could not be made dependent on the national law of a Member State.[340] According to the ECJ, Article 293 EC Treaty did not constitute any reservations of legislative competence in the Member States and this norm only gave the Member States the opportunity to enter into negotiations so long as it is necessary.[341]

It is apparent that in the absence of such a convention under Article 293 EC Treaty, the conflict of laws rules and substantive laws of the Member States cannot enjoy a priority against the EC Law and the regulation of companies' seat transfer cannot be subject to the national laws of the Member States.[342] The provision of Article 293 EC Treaty does not constitute a particular regulation for the freedom of establishment of companies and has a subsidiary meaning in relation to Articles 43 and 48 EC Treaty.[343]

Furthermore the ECJ added that the principles mentioned in the Daily Mail decision are only applicable in the case of moving-out and a Member State was able to make the company's right to retain its legal personality subject to restrictions on the transfer of the company's actual centre of administration to a foreign country.[344] This separation of the ECJ between moving-in and moving-out also explains why it did not mention the Daily Mail case in its judgment of Centros.[345]

3.1.3.2.3 The Outcomes of the Judgment

The case-law of the ECJ leads to the understanding that the real seat theory lost its validity as a conflict of laws rule within the ambit of the EC Treaty for the so-called company immigration.[346] In fact, the decision did not include a

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[339] Case C-208/00, para. 72.
[340] Case C-208/00, para. 73.
[341] Case C-208/00, para. 54.
[342] Brombach, p. 94.
[343] Ebke, "Die 'ausländische Kapitalgesellschaft & Co. KG'", p. 252.
[344] Case C-208/00, para. 70.
[345] This attitude of the ECJ seemed, in the opinion of some authors, to be a contradiction.
[346] Horn, p.896.

fundamental stance for or against the real seat theory. But the decision set out two consequences in respect of conflict of laws. According to the first, the situation of moving-in of companies falls within the scope of freedom of establishment.[347] This means that the restrictions on moving-in must be measured in accordance with Articles 43 and 48 EC Treaty but not internal conflict of laws rules of Member States. It is immaterial that such restrictions are based upon a decision of the ECJ concerning a moving out situation, *i.e*. Daily Mail.[348] The second consequence is that a Member State cannot require under reference to the real seat theory the compliance with its company law regulations of a company, which is formed under another law system.[349] Taking these into consideration, some commentators consider the decision of the ECJ in Überseering as a total rejection of the real seat theory.[350]

On the other hand, a number of German commentators still asserted that the validity of the real seat theory was not affected by the Überseering judgment.[351] The proponents of the real seat theory argued that the real seat principle could still be applied as long as the legal capacity of a pseudo-foreign company, but not limited liability, was recognized, which was possible when a foreign company was treated as a *Gesellschaft bürgerlichen Rechts* (*GbR*).[352]

This situation deprived the real seat theory, which implied an obstacle within the internal market for the cross-border mobility of the companies since a long time, of its basis.[353]

3.1.3.2.4 The Consequences for the Member States

As a result of the preliminary ruling of the ECJ, the German judiciary had to abandon its old real seat theory oriented perspective. For the determination of the

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[347] Case C-208/00, para. 52.
[348] Case C-208/00, para. 62.
[349] Horn, p. 896.
[350] Horn, p. 896.
[351] Peter Kindler, "Auf dem Weg zur europäischen Briefkastengesellschaft", NJW, 2003, p. 1089; Daniel Zimmer, "Nach "Inspire Art": Grenzlose Gestaltungsfreiheit für die deutsche Unternehmen?", NJW, 2003, p.3585.
[352] Kindler, "Auf dem Weg zur Europaeischen Briefkastengesellschaft?", p. 1073, 1076.
[353] Schulz, p. 2705.

legal capacity of a company incorporated within the EU, from now on the place of incorporation would be taken as the decisive connecting factor. The *VII. Zivilsenat* with its decision of 13.03.2003[354] abandoned the real seat theory in respect of a company from a Member State and treated Überseering BV as a company having legal capacity and capacity to sue and be sued. According to some authors, this decision acknowledged the beginning of end for the real seat theory as far as the companies from Member States are concerned.[355]

Following the judgment of 13.03.2003, several German courts applied the incorporation theory relating to the legal capacity and capacity to sue and be sued of companies from other EU Member States.[356]

The decision leaves the application of the real seat theory in respect of companies from non-EU countries untouched. It is apparent that, unless otherwise provided through bilateral agreements[357], the real seat theory is still applicable in relation to the companies from non-EU states.[358]

Advocate General Colomer stated that Article 48 EC Treaty did not impose any conflict of laws requirements in respect of determination of the law applicable to a foreign company in case of a seat transfer. Colomer pointed out that it is immaterial how a Member State comes to the conclusion of non-recognition of legal capacity.[359] It was clear, in the view of the Advocate General, that Member States were bound to reach a result in conformity with the Community Law. However, it was up to the Member States how to do that, as long as no harmonization in this field took place.[360] Therefore, the Advocate General considered it appropriate not to answer the second question of the Bundesgerichtshof.[361] The ECJ answered the question notwithstanding the opinion of the Advocate General. Accordingly, the legal capacity of a company duly formed under the law of incorporation is to be

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[354] BGH, NJW 2003, 1461.
[355] Schulz, p. 2705.
[356] See Ebke, 'Überseering: Die Wahre Liberalität ist Anerkennung', p. 930.
[357] Germany has concluded such agreement with the USA and accordingly the real seat is not applicable to the companies from the USA either.
[358] Ebke, 'Überseering: Die Wahre Liberalität ist Anerkennung', p. 930.
[359] Colomer; no 64.
[360] Colomer, no 69.
[361] Colomer, no 66.

recognized and the moving-in Member State is to refer to the law of the State of incorporation for the matter of legal capacity.[362]

From all these, it can be concluded that the Advocate General did not interpret the Article 48 EC Treaty as including a conflict of laws norm and the ECJ, by affirmatively answering the second question of the Bundesgerichtshof clearly set forth its opposed view and interpreted the Article 48 EC Treaty as having a conflict of laws meaning.

3.1.3.2.5 Provisional Conclusion

After the Überseering decision, it was generally accepted that the EC Treaty articles on freedom of establishment included a hidden conflict of laws norm and this decision of the ECJ was a further nail in the coffin of the real seat theory.[363] However, this general agreement was limited to the recognition in a narrow sense. Furthermore, in the Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe, it was almost unanimously agreed that the denial of the recognition of a company which has its real seat in another country was a disproportioned measure, which can never be justified.[364] For a clear statement as to the recognition in wide sense, namely the recognition of the entire legal system a company is subject to, the Inspire Art judgment was to be awaited.

3.1.3.3 Recognition in Broad Sense

The decisions of Daily Mail, Centros and Überseering drew a framework for the relation between the freedom of establishment as provided under the EC Treaty and the national conflict of laws rules of the Member States. One final question remained, however, which concerned the extent of this interference of the EC Law.

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[362] Brombach, p. 197.
[363] Hirt, p 1191; Eidenmüller, JZ 1/2004, pg. 25; Horn NJW 2004, pg. 896; for contrary see Kindler NJW 2003, p. 1073,1078; Altmeppen, 'Schutz vor "europäischen" Kapitalgeselschaften', NJW 2004, p. 99.
[364] Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe, pg. 102.

The ECJ in Überseering did not point to whether any or all features of internal and external relations of a company remained subject to the original law of incorporation or became subject to the new seat.[365] When and to what extent could the Member States subject a foreign company to their national legislation? Could a Member State apply additional measures to companies that was formed under the law of another Member state and has moved its centre of administration into its territory, in order to protect the interests of particular persons such as creditors and the employees dealing with the company?[366]

According to the previous case-law and Inspire Art it could. However, the scope of such protection was very limited.

The ECJ in its *Inspire Ar*[367]*t* decision set out a broader scope of rights, which a company can resort to against a host Member State. As was mentioned before, the *Kantongerecht Amsterdam* (Amsterdam District Court) in its decision of 2001 considered Inspire Art Ltd as a pseudo-foreign company in accordance with Article 1 *WFBV* and referred the case to the ECJ for a preliminary ruling on whether the *WFBV* regulations were consistent with the EC Treaty.[368]

The ECJ set forth in its judgment that disclosure requirements provided in the Formal Foreign Companies Act had to be measured in accordance with the provisions of the Eleventh Company Law Directive, while the minimum capital requirement and director's liability had to be measured under Articles 43 and 48 EC Treaty, since there is no secondary Community legislation in this field.[369]

The ECJ held that all the additional requirements should be considered incompatible with Community law and there were two separate breaches of Community law: provisions on disclosure requirements of the WFBV were contrary to Article 2 of the Eleventh Directive[370], whilst provisions on the share capital and

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[365] Lipstein, p. 531.
[366] Hirt, p.1208.
[367] The facts of this case were displayed in Chapter II, when dealing with the secondary establishment.
[368] Christian Kersting and Clemens P Schindler, "The ECJ's Inspire Art Decision of 30 September 2003 and its Effects on Practice", German Law Journal, 2003, para. 4.
[369] Case C-167/01. para. 55-56.
[370] Case C-208/00, para. 72.

director's liability constituted restrictions on the exercise of freedom of establishment as guaranteed by Articles 43 EC and 48 EC Treaty.[371]

In the first place, it was certain, in the opinion of the ECJ, that national legislations like WFBV cannot impose disclosure requirements on the branch of a company incorporated under the laws of a Member State, because this is contrary to Article 2 of the Eleventh Directive.

The second infringement of the Community law was that the provisions on the share capital and director's liability constituted restrictions on the exercise of freedom of establishment. The respective provisions of the WFBV could not be justified under the justification grounds in Article 46 of the Treaty and overriding reasons related to the public interest, the four-prong test developed in *Gebhard*[372] and confirmed in Centros.[373]

The ECJ in its Inspire Art decision clarified that '*foreign company is not only to be respected as a legal entity having the right to be a party to legal proceedings, but rather has to be respected as such, i.e. as a foreign company that is subject to the company law of its state of incorporation. Any adjustment to the company law of the host state is, hence, not compatible with European law'*. [374]

After the *Inspire Art* decision of the ECJ, at least wide consensus appeared providing that the real seat principle could no longer be applied in cases where companies moved their real seats into another Member State. Legal scholars realized that as far as the freedom of establishment is concerned, whether the legal consequence of unlimited liability arises *ipso jure*, like in German approach, or it arises due to requirement to registration as a pseudo-foreign company under Dutch law makes no difference.[375]

With the Inspire Art case, the conflict of laws function of the freedom of establishment emerged obviously. Accordingly, the company law under which a company is formed has standing in the new Member State of establishment. Thereby, the reconciliatory theories like *Überlagerungstheorie* were refused.[376]

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[371] Case C-167/01, para. 104.
[372] Case C-55/94 Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano.
[373] Case C-212/97, para. 34.
[374] Kersting & Schindler.
[375] Zimmer, " Grenzenlose Gestaltungsfreiheit für deutsche Unternehmen?", p. 3586.
[376] Horn, p. 896.

However, even after the Inspire Art decision, it has set forth that qualification of Article 48 EC Treaty as a hidden conflict of laws norm should not lead to the mistake of putting the scope of the freedom of establishment on equal footing with the applicable law determined in accordance with the national law of the Member States.[377]

Sure enough, Article 48 as a conflict of laws norm merely functions when the Member State in which the company is incorporated pursues the incorporation theory. Otherwise, namely when the Member State in which the company is formed adheres to the real seat theory, then the company will lose its legal personality by transferring its real seat abroad.[378] Hence, the EC Treaty articles do not have a conflict of laws aspect as far as the exit situations are concerned.

This clear attitude of the ECJ, however, still found discrepant interpretations in the academic circles. According to the pre-dominant interpretation, [379] the recognition of a foreign company requires a Member State to recognize the company in question as governed by *"the entire legal system of the state of incorporation"*[380] and companies of other Member States have to be acknowledged as "a whole", not just in their legal capacity.[381] Accordingly, limited application for pseudo-foreign companies is not possible and "the same must, a fortiori, be true for real foreign companies."[382]

By contrast, another group of commentators claimed that the decision does not provide that a foreign company is governed by the law of incorporation in every respect. Accordingly it is still arguable that a foreign remains subject to company law of its state of incorporation *"only in relation to its formation and certain fundamental decisions, such as the company's dissolution and a change of its constitution."*[383] According to this view, *"only certain parts of and not the entire*

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[377] Eidenmüller& Rehm, p. 166.
[378] Horn, p. 897.
[379] Hirt, p. 1211.
[380] Kersting & Schindler; the same is argued also by Daniel Zimmer, Case C-167/01,Kamer Van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd., judgement of 30 September 2003.
[381] Zimmer, "Grenzlose Gestaltungsfreiheit für die deutsche Unternehmen?'", p. 3591.
[382] Zimmer, "Grenzlose Gestaltungsfreiheit für die deutsche Unternehmen?'", p. 3591.
[383] Hirt, p. 1210.

company law of the Member State, where the foreign company was formed, regulated the operation of such a company".[384]

3.1.4 COMPANY EMIGRATION AND THE REAL SEAT THEORY

3.1.4.1 Concept of Emigration

The emigration of a company can be depicted as a situation where a company faces in relation to its Member State of origin, *i.e.* the Member State in which it is incorporated, when executing a resolution to transfer its real seat into the jurisdiction of another Member State.

A Member State of origin can hinder the transfer company's real seat to another jurisdiction in two ways. First of all, hindrances to emigration arise from the fact that the Member State of origin adheres to the real seat theory. The real seat principle in its most strict appearance denies legal personality to a company when the company's transfers its real seat out of territory of the state.[385]

Other than the obstacle arising out of the application of the real seat theory, tax legislations of the Member States can possibly cause impediments to the moving out of the companies. Because of the transfer of a company's real seat into another Member State, the Member State of origin loses a taxpayer and this State makes such a transfer conditional upon the consent of the national tax authorities.[386]

3.1.4.2 Dichotomy between Emigration and Immigration in the Judgments of the ECJ

Daily Mail, which is referred to as *"an outbound case"*[387], is the only judgment where the ECJ addressed the company's cross-border emigration. As was explained above, *Daily Mail* concerned an English company wishing to transfer its

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[384] Hirt, p. 1210.
[385] Looijestijn-Clearie, "Centros Ltd – A Complete U-turn", p.633; see also Roth, "From Centros to Überseering"p. 184 and 185.
[386] Wolf-Georg Ringe, No Freedom of Emigration for Companies?, EBLR, 2005, p. 622.
[387] Christian Kersting and Clemens Philipp Schindler, The ECJ's Inspire Art Decision of 30 September 2003 and its Effects on Practice, (2003) 4 (12) German Law Journal, at 1277

central management and control to the Netherlands, in actual fact for the purpose of avoiding corporation taxes that a company would be liable to pay in the United Kingdom upon the selling off of a substantial part of its non-permanent assets.[388]

The UK tax legislation provides that the place of central management and control is decisive for determining the residence of a company for tax purposes.[389] The consent of the British Treasury was required for the transfer of a company's real seat outside the United Kingdom, for due to such transfer, the company ceases to be resident for tax purpose.[390]

The Treasury did not issue consent and the ECJ, upon a preliminary question held that the United Kingdom tax legislation requiring consent of the Treasury for the transfer of *Daily Mail*'s central management and control to the Netherlands is *not* incompatible with Articles 43 and 48 (then 53 and 58) of the Treaty as the latter Articles *confer no right on a company incorporated under the legislation of a Member State and having its registered office there to transfer its central management and control to another Member State.*[391]

Centros, *Überseering* and *Inspire Art,* three illustrious decisions of the ECJ, however, totally concerned situations where the host Member States brought about impediments to the exercise of freedom of establishment. This has lead to the understanding that the ECJ differentiates between the situations of emigration and immigration, and the elimination of the real seat theory was only said for the immigration of a company. As far as the emigration of a company is concerned, the approach taken in Daily Mail still maintained its validity.

3.1.4.3 (Re)Interpretations of the *Daily Mail* and Company Emigration

Following the *Daily Mail* judgment of the ECJ, it was commonly concluded that transfer of a real seat from one Member State to another, simply did not fall within the scope of freedom of establishment. However, as the consequent

[388] Case 81/87para. 7.
[389] Case 81/87para. 4.
[390] Case 81/87para. 5.
[391] Case 81/87para. 25.

judgments of the ECJ proved this point of view wrong, the *Daily Mail* judgment had to be reinterpreted in the light of the fact that the ECJ considered any obstacle – regardless from whether it arises out of conflict norms and substantive law provisions- toward the transfer of the seat of a company into another Member State to be contrary to the freedom of establishment provided under the EC Treaty.

Initially, it is concluded from this reinterpretation that the so-called emigration situations did not fall within the ambit of freedom of establishment.[392] According to this view, a Member State was not obliged to continue to respect the legal personality it had granted before the relocation of the company's seat.[393] This view found its basis on the reiterating of the ECJ in *Überseering,* which provided that *a company, which is a creature of national law, exists only by virtue of national legislation which determines its incorporation and functioning.*[394]

In Überseering case, the ECJ explained the difference between Überseering and Daily Mail by saying:

> *It must be stressed that, unlike Daily Mail and General Trust, which concerned relations between a company and the Member State under whose laws 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, the present case concerns the recognition by one Member State of a company incorporated under the law of another Member State, such a company being denied all legal capacity in the host Member State where it takes the view that the company has moved its actual centre of administration to its territory .*[395]

Furthermore, the ECJ added that unlike *Überseering*, *Daily Mail* did not concern the way in which one Member State treats a company validly incorporated in another Member State and exercising its freedom of establishment in the first Member State.[396]

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[392] Wymeersch, p. 677; Ringe, p. 623 ; Jonathan Rickford, "Current Developments in European Law on the Restructuring of Companies: An Introduction", EBLR, 2004, p. 1231.
[393] Kersting and Schindler, op cit, at 1283.
[394]Case C-167/01, para. 67.
[395] Case C-167/01, para. 62
[396] Case C-167/01, para.66.

The ECJ repeated this approach in Inspire Art case by stressing that *Daily Mail and General Trust* concerned 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.[397]

Some authors on the other hand did not accept such a distinction between the immigration and emigration of a company. By interpretation in the light of the following judgments, it has been considered that it was implausible that the ECJ would take a company's freedom of establishment in an emigration situation more restrictively than in an immigration situation.[398] The denial by a Member State of company's right to a cross-border transfer of the actual centre of administration, principal place of business or real seat and imposing a condition to reincorporate in the other Member State should be considered as equivalent to an *outright negation* of freedom of establishment provided under Articles 43 and 48 of the EC Treaty.[399]

It has been stated that differentiation of the ECJ would lead to a 'partial' freedom of establishment, since the right to decide on the place of business anywhere within the EC would be limited to a right that can be claimed against a host State that refuses to recognize a foreign company.[400]

In the first place, such a contrast in treatment toward the emigration and immigration of a company has been criticized for being contrary to the clear provision of Article 48 EC Treaty, which sets out that companies are to '*be treated the same way as natural persons'*.[401] The ECJ in *Daily Mail* based its judgment on the substantial dissimilarity between natural and legal persons when they want to make use of the freedom of establishment. However, this viewpoint has been judged to be incompatible with the clear wording of the Article 48 EC Treaty, which foresees equal treatment of both legal persons and real persons.[402]

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[397] Case C-167/01, para. 103.
[398] Ebke; "Die Wahre Liberalität ist Anerkennung", p. 932.
[399] Ebke; "Die Wahre Liberalität ist Anerkennung", p. 932.
[400] Ringe, p. 632.
[401] Case 81/87.
[402] Wymeersch , p.677.

Furthermore, in case the State of origin intends to disable a company from transferring its seat into country, the freedom of establishment will not function as it is supposed to. This situation has been criticized for it could possibly lead to a certain degree of arbitrariness.[403] It is a logical consequence that a situation of entry can only take place when the emigration of a company is allowed by the State of origin and therefore by making the emigration of a company dependent on permission of a Member State, the freedom of establishment remains under the discretion of the Member States, maybe not on the immigration side of the picture but on the emigration side. It has been asserted that this situation does not comply with the freedom of establishment for its objective '*is to confer rights against the Member States; more precisely, these rights should not be dependent on the Member States' discretion but give individuals a claim against the State that can only be interpreted by the European Court of Justice'*.[404]

It has been claimed that the obstacles to ' company emigration' can have more devastating outcomes than obstacles to 'company immigration', by giving the following example; if an English company is hindered to move its real to Germany because the German law forbids it, the English company still has the chance to choose another Member States to move its seat to, but when German law hinders German companies' from moving out[405], German companies are not allowed to transfer their seat to any Member State.[406]

3.2 SEAT TRANSFER OF COMPANIES IN THE LIGHT OF FREEDOM OF ESTABLISHMENT

In the wake of the judgments of the ECJ in *Centros*, *Überseering* and *Inspire Art* cases, the principles of the seat transfer of companies were set clearly, at least for the so-called company immigration. In this part of my research, I will scrutinize

[403] Wooldrige, p. 227, 232.
[404] Ringe, p. 633.
[405] As was mentioned in Chapter I, under German law for transferring the real seat is equivalent to a decision of going into liquidation.
[406] Ringe, p. 633.

the seat transfer of and law applicable to companies on a situation-by-situation basis. Taking the approach of the ECJ into consideration, it is necessary to make a basic distinction between immigration and emigration once again. Transfer of the *de facto* seat while retaining the statutory seat and transfer of the statutory seat will be examined under this distinction.

3.2.1 CROSS-BORDER IMMIGRATION

The company can transfer its *de facto* real seat either while retaining its statutory seat in its place of incorporation or it can transfer its statutory seat along with its real seat. This would lead to different consequences. Therefore, the seat transfers in form of immigration will be examined under this distinction.

3.2.1.1 Transfer of the *de facto* Real Seat while Retaining the Statutory Seat

3.2.1.1.1 General

A company, which falls within the scope of Articles 43 and 48 EC Treaty, retains their legal personality and remains subject to the law of its place of incorporation when it transfers its real seat into another Member State. The real seat theory cannot be applied for determining for the applicable law to the legal status of a foreign company. In the so-called company immigration, the incorporation theory should be applied. This was an apparent result of the *Überseering* judgment of the ECJ. In Überseering, the ECJ explicitly stated that a company formed in accordance with the law of a Member State A in which it has its registered office exercises its freedom of establishment in another Member State B, Articles 43 EC and 48 EC require Member State B to recognize the legal capacity and, consequently, the capacity to be a party to legal proceedings which the company enjoys under the law of its State of incorporation A.

In the light of the principle set forth in the ECJ judgments, a company formed under the law of Member State A will be continue to be governed by the law of Member State A, even when it transfers its *de facto* real seat into the territory of

Member State B. The fact that Member State B adheres to the real seat theory is of no consequence.[407] Since the company in question continues to exist under the law of Member State A, it cannot be held subject to any requirements arising from the law of Member State B. The only exception to this can be the mandatory requirements of Member State B, which fulfill the conditions of the *Gebhard* test.

And the *Inspire Art* judgment revealed that the incorporation theory should be applied for determination of the entire legal system a foreign company is subject to. Namely, this has also consequences for the Member States which apply the real seat criterion not to the recognition of a foreign company, but only for the operations of the company in its territory. The Member States are now obliged to apply to a foreign company which moved its real seat into their territory the entire legal system of the place of incorporation.

3.2.1.1.2 Secondary Establishment-Pseudo Foreign Companies

Other than the transfer of the real seat into another Member State without a change in the applicable law, the companies validly formed under the law of a Member State also enjoy the freedom of establishment, even if they do not pursue any business activities in their place of incorporation. This can be achieved by setting up branches, agencies or subsidiaries. As regards the right of secondary establishment, Inspire Art decision of the ECJ confirms the principles set out by *Segers* and *Centros* cases.[408] Carrying out economic activities in the state of incorporation cannot be stipulated for the exercise of secondary establishment. The company remains subject to the law of place of incorporation.

The fact that a national of a Member State who wishes to set up a company chooses to form it in the Member State whose rules of company law seem to him the least restrictive and to set up branches in other Member States cannot, in itself, constitute an abuse of the right of establishment and the right to form a company in accordance with the law of a Member State and to set up branches in other Member States is inherent in the exercise, in a single market, of the freedom of establishment

[407] Looijestin-Clearie, "Have the Dikes Collapsed?", p.417.
[408] Looijestin-Clearie, "Have the Dikes Collapsed?", p.417.

guaranteed by the Treaty.[409] The fact that a company does not carry out any economic activities in its state of incorporation and intends to pursue its activities only in the Member State where its branch is established is not sufficient to prove the existence of abuse or fraudulent conduct which would entitle the latter Member State to deny that company the benefit of the provisions of Community law relating to the right of establishment.[410] The creditors of such company are excepted to be on notice that the company is governed by another legal system and they can refer to certain rules of Community law which protect them, such as the Fourth Council Directive[411] on the annual accounts of certain types of companies, and the Eleventh Council Directive[412] concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State.[413] Furthermore, combating fraud cannot justify a practice of refusing to register a branch of a company which has its registered office in another Member State.[414]

Prior to the *Centros* decision of the ECJ, Member States that apply the real seat criterion considered companies like *Centros* as not formed properly. The attitude of the German courts in a very similar case had showed that Centros would not have been qualified as having legal capacity for it did not satisfy the provisions of German company law.[415] In this judgment before the German court, German law had been applied to a private limited company incorporated under English law since it only had its statutory seat in England and carried out the whole of its activities in Munich.[416] The registration of the secondary establishment of the company had been refused on the grounds that the German provisions on incorporation of a company were not fulfilled, so that the company could not be recognized as having legal capacity.[417] Consequently it can be accepted that a German Court would have

[409] Case C-212/97. Para. 27.
[410] Case C-212/97. Para. 29.
[411] 78/660/EEC of 25 July 1978.
[412] 89/666/EEC of 21 December 1989.
[413] Case C-212/97. Para. 36.
[414] Case C-212/97. Para. 38.
[415] Kindler, "Niederlassungsfreiheit für Scheinauslandsgesellschaften", p. 1993 ; Brommbach, p. 88.
[416] For further information on this judgment, see Brombach, p. 88.
[417] Brommbach, p.88.

classified Centros as a company governed by German substantive law, as an *offene Handelsgesellschaft* or *Gesellschaft bürgerlichen Rechts*[418], whereas the Danish Court regarded Centros as a foreign limited company.[419]

The judgments in *Centros* and *Inspire Art* showed that this German practice can no longer be pursued. In the light of these decisions, Member States are obliged to recognize a foreign company formed under the law of another Member State, even when the company in question solely sought the formation under the law of another Member state in order to circumvent the law of the Member State, in which it is intending to transact. It can be concluded that a choice between corporate laws of the Member States is possible.

The debate as to the companies' usage of secondary establishment was firstly called into discussion by Austrian Supreme Court (Oberster Gerichtshof, OGH) in a judgment having similar facts to those in Centros.[420] The OGH considered the Austrian company law provisions, which require documentation for the existence of a *de facto* main seat in the claimed home state, and thus the main seat criterion under Austrian company law, to be incompatible with the right of secondary establishment as provided in the EC Treaty.[421]

Furthermore, a second respective development was seen in Denmark, however this time at a legislative level. Following the Centros decision, the registration authority in Denmark abandoned its view denying such registration, however some significant changes in tax law were introduced by the Danish government and tax obligations, which in reality amounted to the payment of the same amount of the minimum capital, were imposed to foreign companies.[422] This was referred to by Werlauff as *"the main seat criterion in a new disguise",* because

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[418] Commercial partnership or civil partnership.
[419] Roth, "From Centros to Überseering", p.179,180.
[420] Kristin Nemeth, 'Case Law-National Courts', CMLR, 2000, p. 1278, Werlauff, 'The Main Seat Criterion in a New Disguise', p. 3.
[421] Werlauff, "Main Seat Criterion in a New Disguise", p. 3; Mathias Siems, "Convergence, Competition, Centros and the Conflicts of Law: European Company Law in the 21st Century", European Law Review, 2002, p. 2.
[422] Werlauff, p. 4.

the Danish government aimed at constitution a minimum capital rule through the back door.[423]

Briefly, companies formed in accordance with the law of a Member State and having their registered office, centre of administration or principal place of business within the Community can make use of secondary establishment and remain subject to the law of place of incorporation, even if they conduct no business activities there.

3.2.1.2 Transfer of the Statutory Seat

The recent decisions of the ECJ do not provide any statement as to whether in situations of the transfer of the statutory seat the incorporation theory should be applied. It must be pointed out that the transfer of the statutory seat into a Member State applying the real seat theory is immaterial.[424] When a company transfers its statutory seat in, say for instance, Germany, this situation would have neither conflict of laws consequences nor substantive law consequence.

3.2.1.3 Companies from Third Countries:

The principles established in *Centros*, *Überseering*, and *Inspire Art* do not have any direct consequences towards the companies that are formed outside the EC and the real seat theory continues to have effect for such companies.[425] Moreover, the German Courts held that the constitutional equal treatment principle clearly does not exclude the treatment of companies from non-Member States in a different fashion than the companies from the Member States and there was no such international law obligation as to the recognition of the legal capacity of companies from other states.[426] However, it is clear that there would still occur problems for the countries adhering to the real seat theory in cases where a company from a non-EU

[423] Werlauff, p .4.
[424] Brombach, p.115.
[425] Ebke, 'Überseering: Die Wahre Liberalität ist Anerkennung', p. 930.
[426] Ebke, 'Bürgerliches Recht. Gesellschaftsrecht: Anmerkung', p. 300.

country transfers it real seat into a EU country that adheres to the incorporation theory in order to move later into the country adhering to the real seat theory.[427]

The Member States adhering to the real seat theory now need to come to a decision as to whether they incline to continue to make use of the connecting factor of real seat towards the companies formed in non-EU member countries or whether they should rotate to the incorporation theory, perhaps still applying the overriding principles of national laws in case of pseudo-foreign corporations.[428]

Application of the incorporation theory may also arise from the provisions of international treaties. In the example of Germany, due to the provisions of the 'Treaty of Friendship, Commerce, and Navigation' of 29 October 1954 with the USA, it has been widely discussed since a long time whether the provisions of this treaty provided a requirement to recognize the legal capacity of a company from one of the more than 50 jurisdictions of the USA, even when it centre of administration (real seat) is located within Germany.[429] The *XI. Zivilsenat* of the *Bundesgerichtshof* in its judgment of 29 January 2003, held that under this treaty, a corporation that is duly incorporated in the State of Florida, and exists in accordance with the law of Florida, benefits from the status of a legal person under the law of Florida as the applicable law regardless of the location of its real seat and the reasoning of this was that according to its Friendship Treaty with the United States, Germany was under the obligation to provide 'national treatment', 'most-favored-nation treatment', and 'the right of establishment' to companies validly formed in the United States.[430]

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[427] Franz Wassermayer, 'Überseering aus der Sicht des Steuerrechts', EuZW 2003, p. 257.
[428] Ebke, 'The European Conflict of Laws Revolution', p. 46.
[429] Ebke, 'Bürgerliches Recht. Gesellschaftsrecht: Anmerkung', p. 300.
[430] Ebke, 'Bürgerliches Recht. Gesellschaftsrecht: Anmerkung', p.300; Ebke, 'The European Conflict of Laws Revolution', p. 47.

3.2.2 CROSS-BORDER EMIGRATION

3.2.2.1 Moving-out of the *de facto* Real Seat while Retaining the Statutory Seat

Centros, Überseering and Inspire Art cases deal solely with the entry of foreign companies into the territories of another Member State. It cannot be concluded from these decisions that the Member States are obliged to apply the incorporation theory in respect of companies leaving their territories. Moreover, in *Überseering*, the ECJ stressed that, unlike *Daily Mail*, which concerned relations between a company and the Member State under whose laws 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, the present case concerns the recognition by one Member State of a company incorporated under the law of another Member State, such a company being denied all legal capacity in the host Member State where it takes the view that the company has moved its actual centre of administration to its territory .[431] Apparently, the ECJ draws a distinction between moving-in and moving-out situations.

Consequently, Member States can still apply the real seat theory in order to determine the legal capacity of the companies leaving their territories. Consequently, the transfer of the real seat of a company from a Member State applying the real state theory may lead to a change of the legal order governing the company in the host Member State. As was mentioned above, the real seat in its strictest form considers the decision of a company to move its head office outside of the jurisdiction in which it was formed as equivalent to a decision for winding-up.

3.2.2.2 Moving-out of the Statutory Seat

The recent decisions of the ECJ do not have consequences in respect of conflict of laws for a company moving its statutory seat out of a Member State, either. Since the real seat theory makes use of the centre of administration as the

[431] Case C-167/01, para. 62

connecting factor, it is immaterial as regards the conflict of laws, that a company moves its statutory seat abroad, as long as the centre of administration remains within the territory.

3.2.3 THE EUROPEAN COMPANY (SE)

3.2.3.1 General

The ECJ is not the only actor who undertakes to give the European Company Law its shape. Evidently, the Community legislator has the same ambition, even though it pursues a different path in respect of realizing the internal market as far as the free movement of companies is concerned.[432] These two actors attribute different levels of significance to choice of law as regards the determination of the proper law of a company.

While the former evidently opts for the freedom of choice of law in its recent case law, the latter attaches a limited importance to the choice of corporate laws, which reveals itself in the SE statute.[433] Indeed, the formers of a SE do not seem to have an unlimited freedom of choice and contrary to the ECJ, the EU legislation on SE seems to have chosen the real seat doctrine as the theoretic background for the transfer of seat.

The SE was designed as a company type unique to the EC law and independent from the laws of Member States.[434] However, the ratified text of the Regulation, which is composed of 70 Articles and does not regulate incorporation of a SE in detail, reflects this intention to a very limited extent and for a detailed regulation, the laws of the Member States are referred to.[435] The Regulation leaves

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[432] Horst Eidenmüller, 'Mobilität und Restrukturierung von Unternehmen im Binnenmarkt', JZ, p. 24.
[433] Eidenmüller, p. 24.
[434] Fatih Bilgili, "Avrupa Anonim Ortaklığı". Elektronik Sosyal Bilimler Dergisi, 2003, p. 21. World Wide Web: http://www.e-sosder.com/dergi/4FBLGLavr_6.doc (10.08.2006)
[435] Bilgili, p.21.

the matters such as share capital and maintenance of the share capital to the particular laws of the Member States.

The statutory seat and the centre of administration of a SE are both to be located within the same Member State in accordance with the Regulation.[436] In case the head office is no longer in the same Member State as its registered office then the Member State in which the registered office is situated is to ensure the SE adjusts its situation within a specified period. Consequently, European Companies are not able to establish a mailbox company in order to choose a more beneficial legal regime.[437]

3.2.3.2 The Seat Transfer of the SE

The seat transfer rules of an SE are set forth in Article 8 of the Regulation. Accordingly, the transfer of the registered office of an SE does not result in the winding up of the SE or in the creation of a new legal person. This was considered as a major opening for the first time in this field: a company may transfer its seat to another jurisdiction, and this will not affect the continuity of its legal personality.[438]

On the other hand, what makes the SE Regulation seem to adopt the real seat approach is the obligation for a SE to have its registered office and head office in the same place. A Member State can assure the enforcement of this requirement either by mandating the company to re-transfer the head office back in it territory, of by forcing a transfer of the registered office. If the company fails to comply with these requirements, it may then be liquidated.

The European Company (SE) Regulation caused a doctrinal debate, mainly based on the legislative technique of *renvoi*, which may allegedly lead to great dissimilarity as to the way the Directive is concretely implemented in each Member State and it has been set forth that this would most presumably result in many different models of European Companies to be created.[439]

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[436] See Art 7 SE Statute.
[437] Martin Ebers, 'Company Law in Member States against the Background of Legal Harmonisation and Competition between Legal Systems', European Review of Private Law, 2003, p.510.
[438] Wymeersch, p. 690.
[439] Vaccaro, p. 1359.

3.3 A COMPROMISE BETWEEN TWO THEORIES

3.3.1 PROPOSAL FOR A FOURTEENTH DIRECTIVE ON THE TRANSFER OF THE REGISTERED OFFICE

The transferability of a company's centre of administration from one Member State to another was made subject to an analysis by the Commission following the rigid criticisms after the *Daily Mail* case. As a result of this analysis, the Commission attempted to mingle the real seat theory and the incorporation theory.[440] The aim was attaining a result, which would be proper for all the Member States at the same time, while permitting companies to transfer their registered office or head office without requiring liquidation in the Member State of incorporation and reincorporation in the host Member State. However the Proposal foresaw a change in the applicable law. Following the transfer, the company would be subject to the law of the host Member State.

In the preamble of the Proposal, the undeniable necessity to ensure the cross-border mobility of companies within a single market was mentioned. Furthermore, the difficulties arising from the diversity among the Member States' national conflict of laws was referred to. By referring to the judgment in *Daily Mail* case, it was stated that making companies equivalent to natural persons for the purposes of freedom of establishment cannot be achieved simply by applying the EC Treaty articles because of the dissimilarities between Member States' laws and that a legislative effort was needed in order to implement freedom of establishment in the way intended by the Treaty.

With this intention, the Commission drafted a Proposal for a Fourteenth Directive on the transfer of the registered office or the *de facto* head office of a company from one Member State to another with a change of applicable law.[441]

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[440] Vaccaro, p. 1361.

[441] Proposal for the Fourteenth Council Directive on the transfer of the registered office of a company from one Member State to another with a change of applicable law. (1997) XV/D2/ 6002/97-EN REV2.

3.3.1.1 Provisions of the Proposal

The Proposal comprises the companies with share capital as the companies with share capital are the only type of companies that have legal personality in all Member States.[442] Moreover, it was provided that a company could not transfer its registered office under the directive if it was subject to proceedings of winding-up, liquidation, insolvency or suspension of payments.[443]

Article 2 of the Proposal defines the registered office of a company. Accordingly, the registered office means the place where the company is registered, or the place where the company has its central administration and is registered.[444]

Article 3, which sets out the basic principle of the Directive, envisaged that the Member States should take necessary measures in order to allow a company to transfer its registered office or *de facto* head office without a subsequent liquidation and reincorporation. On the other hand, the law applicable to the company subject to the seat transfer changed as of the date of the registration in accordance with the Directive.[445]

The following articles of the proposal deal with the rights of the shareholders, registration, publications and the resolutions of the companies subject to the Directive.

3.3.1.2 Inconsistency with the Case Law

The Commission rejected the premise of allowing a transfer of the real seat of a company without a change in its governing law and this revealed itself as the fundamental characteristic of the proposal. However, as to the matter of recognition, the Directive required the Member States to recognize a company, which has

[442] Article 1.
[443] Article 1.
[444] Article 2.
[445] Article 3

transferred its registered office or *de facto* office. Other than the matter of recognition, though, the conflicts of laws rules of the Member States remain untouched.[446] This seems to be a compromise between the real seat theory and the incorporation theory.

The proposal addressed the problem of existence of the two divergent theories by way of a rather reasonable compromise; however, it still did not go as far as the ECJ case law in the recognition of freedom of establishment.[447] Taking the principles set forth by the ECJ in *Centros, Überseering* and *Inspire Art* into account, a directive on the transfer of a company's real seat may seem unnecessary. The decisions in the recent judgments seem to offer companies a more favorable possibility to move the *de facto* head office – under the form of a branch – without a change of the applicable law.

3.3.2 A COMBINATION OF THE REAL SEAT THEORY AND THE INCORPORATION THEORY

Instead of elimination the real seat theory completely and adopting the incorporation theory, a strict system of disclosure information requirements and a minimum set of standard rules may constitute the basis for the mutual recognition of companies, and better maintain the evolution of a European company law state competition.[448]

The modifications of the incorporation theory were mentioned in Chapter I of this research. The *Differenzierung* Theory, which proposes that none of the conflict rules should be given decisive weight in advance and the applicable law should be determined in a case-by-case basis, and the *Überlagerung* theory, which combines the liberal and competitive features of the incorporation theory with the protection idea of the real seat theory, can be offered instead of adopting the incorporation theory and eliminating the real seat theory.

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[446] Roussos, p. 18.
[447] Vaccaro, p. 1362.
[448] Vaccaro, p.1364.

The *'Restricted Incorporation Theory'* of Behrens provides that the applicable law to a company should be determined principally in through the law of the state of incorporation. However, in cases regarding the *ordre public*, the legal rules of the host can be applied alternatively if the law of incorporation does not include equivalent rules. By determining the company statute under the incorporation theory, the protection original identity of a foreign company after the transfer of the centre of administration will be safeguarded and the legal capacity of this company will be recognized.[449] The national company law rules will only be applicable insofar as the laws of the state of incorporation include no equivalent rules and the particular interests of certain persons will be left unprotected in lack of such laws.[450] This seems to be appropriate, necessary and adequate for the limitation of the freedom of establishment of companies.

Furthermore, the approaches taken in the Draft Proposal and the Statute for SE also provide an appropriate compromise between the two theories. The Member States should allow a company to transfer its registered office or *de facto* head office into their territories without a subsequent liquidation and reincorporation. On the other hand, the law applicable to the company subject to the seat transfer may change following the seat transfer.

This sounds familiar to the main idea of the *Überlagerung* Theory, which is also said to be based on the EC Convention on the Mutual Recognition of Companies. This theory also makes a separation between the "incorporation and recognition problem" and the "personal statute" according to which the internal and external relations of the company should be judged. Formation and recognition matters are dealt with by the law of incorporation, while the creditors and the shareholders of the company and the third persons can rely on the mandatory law provisions of the country where the company has its real seat. This formulation can provide a solution where the mobility of companies is guaranteed and the interests aimed to be safeguarded by the real seat theory are assured at the same time.

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[449] Behrens, "Der Anerkennungsbegriff des Internationalen Gesellschaftsrechts", p. 499.
[450] Brombach, p.166.

CONCLUSIONS

This research sets forth how the European Court of Justice has essentially changed the conflict of laws rules for determination of a company's governing law. In the light of the "legislative" activity of the ECJ, the transfer of the real seat of a company from one Member State to another cannot be obstructed with non-recognition of the legal personality or a change in the applicable law. No matter it arises from substantive law or from conflict of laws rules, any legal provision, which restricts the right of establishment (primary or secondary), was held incompatible with the EC Law.

Its rulings in *Centros, Überseering* and *Inspire Art* laid the groundwork for the way for both primary establishment and secondary establishment to be in the same way recognized. The judgments in these three cases disclose a certain stance to abolish the remaining restraints to the free movement of companies.

Although some legal commentators claimed the otherwise, in the view of the ECJ *Centros* case concerned a secondary establishment rather than a primary establishment. As a result of this case, it was certain that the European companies would have no further interest in the formal recognition of primary establishment in order to transfer their centre of administration from one Member State to another. This could be achieved simply by making use of secondary establishment. This being so, it was completely up to the founders of a company to choose any legal system among the legal systems existing within the EU. The very difference between primary and secondary establishment becomes pointless when the ECJ places on the same footing the three connecting factors set out in Article 48 EC Treaty, i.e. registered office, central administration and principal place of business. However, the advocates of the real seat theory expected the ECJ to take account of the conflict of laws norms of the Member States, as in Centros judgment two Member States adhering to the incorporation theory were involved.

Überseering case showed that it was only a coincidence that the actors of *Centros* both adhered to the incorporation theory. In this judgment, the ECJ

explicitly expressed that the Member States were obliged to recognize the legal personality of a foreign company transferring its real seat into their territories. It was then certain that the application of the real seat theory was not compatible with the freedom of establishment provided by the EC Treaty so far as the immigration of a company falling within the scope of Article 48 into a Member State was concerned. The last question as to whether the real seat theory could be applied to company matters other than legal personality and the capacity to be a party to legal proceedings was answered by Inspire Art judgment. Accordingly, the matters such as limited liability of the shareholders were also governed by the law of state of incorporation so far as the immigration of a company falling within the scope of Article 48 into a Member State was concerned.

This is an explicit farewell to real seat theory for the so-called immigration situations. The restrictions on the freedom of establishment of companies can only arise from public interest. A four-prong test must be fulfilled. Accordingly, the restrictive measures must be applied in a non-discriminatory fashion, 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 lastly they must not go beyond what is necessary in order to attain it.

However, a company can still be subject to restrictions holding it back from moving-out from the Member State, in which it was incorporated. A Member State is still capable of obstructing a company from leaving its territory. Indeed, the *Centros*, *Überseering* and *Inspire Art* cases all concerned companies, which were confronted with obstacles when entering into other Member States, while the situation in Daily Mail concerned moving-out of a company. This was interpreted as that the ECJ makes a difference between the immigration and emigration of a company. The real seat theory was eliminated only so-called the immigration situations and the approach taken in Daily Mail still maintained its validity for company emigrations.

Paradoxically, the obstacles to ‘emigration’ of a company can have more devastating consequences for a company than obstacles to ‘immigration’. The

companies are still dependent on an approval of the Member State to leave its territory while they are granted a broad freedom to enter into the territory of another Member State without a change in the applicable law. When the German practice of considering the resolution of a company to move out as equal to a resolution for dissolution is taken into account, the devastating consequences for a company becomes clearer. This seems to be somewhat contradictory when the realization of a competitive single market is set out as an aim.

On the other hand, the so-called pseudo foreign companies, or, as some German commentators put it *billige Gesellschaften* (cheap companies), seem to have the opportunity to enter into any Member State, without facing requirements to re-incorporate or even to comply with the mandatory requirements in the host Member State, insofar as the Member State of incorporation allows to leave its territory. This will apparently create a certain level of competition between the legal systems of the Member States. When the present state of the EC law is taken into account, whether such a competition can be exercised soundly is a matter of discussion. Many commentators doubt that this situation could result in, in American words, a "race to the bottom" and freedom of establishment could be abused. Companies would be supported to shop around in search of a company law system they identify as the faultiest.

At this point, instead of a radical approach of eliminating the real seat theory completely, maybe a compromise between the real seat theory and the incorporation theory should have been thought of. At this level, the clear contradiction between the approaches of the Community legislator and the ECJ should not be eluded observation. While the ECJ grants an extremely broad freedom of establishment to the company immigration, Regulation for Statute for a European Company holds the SE subject to a change in the applicable law when it transfers its seat into another Member State. The Draft Proposal for the Fourteenth Council Directive on the transfer of the registered office of a company from one Member State to another with a change of applicable law, as its name clearly emphasizes, also envisages a change in the applicable law in case of seat transfers. The approach of the

Community legislator seems to present a compromise between the incorporation theory and the real seat theory. The only point common between the approaches of the ECJ and the Community legislator seems to be that, they both provide that a company should retain its legal personality when it transfers its real seat into another Member State.

In my view, the cross-border mobility of companies is a key element for a functioning single market. The non-recognition of foreign companies and the requirement of re-incorporation of the real seat theory clearly contradict with this cross-border mobility. However, this is not to say that the real seat theory should be held completely incompatible with freedom of establishment. Requirement of a Member State to apply to a foreign company its mandatory company law requirements makes sense when the dissimilarities of the company laws of the Member States are taken into consideration. This can be achieved by way of compromise between the incorporation theory and the real seat theory, more precisely, a modified version of the incorporation theory.

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