JURISDICTIONAL COMPETITION IN THE EUROPEAN COMMUNITY

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1. INTRODUCTION

In the United States, a company's internal affairs are governed by its state of incorporation without regard to where it actually conducts its affairs.¹ In addition, a company is free to select the state in which it incorporates. A company's free choice of jurisdictional incorporation, combined with the rule that the jurisdiction in which a company incorporates governs the company's internal affairs, underpins the regulatory competition² and de facto national convergence that exists in the United States through Delaware General Corporation Law.³ This general type of corporate law doctrine is known as "state of incorporation" theory.⁴

In the European Community ("EC"), however, neither regulatory competition nor convergence has traditionally existed, since a corporation's state of incorporation did not necessarily govern its internal affairs in other jurisdictions.⁵ Although certain EC Member States such as the United Kingdom and Denmark

¹ See Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329, 350 (2001) (stating that because in the United States a corporation's internal affairs is governed by its state of incorporation without regard to its principal place of business, a U.S. corporation can choose the state corporate law that governs its affairs by choosing its state of incorporation).

² For a discussion of regulatory competition in the United States and its positive or negative implications, see *infra* section 4.1.

³ See Gilson, *supra* note 1, at 350 (noting that the aggregated choices of a majority of publicly traded U.S. corporations have resulted in a convergence on the Delaware General Corporation Law as a de facto national corporate law).

⁴ *Id.*

⁵ See *id.* (stating that historically, convergence through regulatory competition was not available in Europe because the corporate law of the country in which the corporation's principal place of business was located governed its internal affairs regardless of the country of incorporation).

applied state of incorporation corporate law theory, most Member States such as France and Germany did not.⁶ Instead, they applied a doctrine that dictated that the law of a company's real seat governed a company's internal affairs.⁷ A company's real seat included either the jurisdiction where it had its principal place of business or its headquarters.⁸ This general type of corporate law doctrine is known as the "real seat doctrine."⁹

Until recently, the real seat doctrine has prevented jurisdictional competition in corporate law in the EC by restricting forum shopping.¹⁰ Hanne Birkmose, a noted European Union ("EU") scholar, suggests that this situation may have changed as a consequence of the judgment in the *Centros* case.¹¹ Two additional cases¹² after *Centros*, *Überseering*, and *Inspire Art*, also impact this

⁶ See P. John Kozyris, *Corporate Wars and Choice of Law*, 1985 Duke L.J. 1, 51 (1985) (noting that most countries in continental Europe use the real seat rule).

⁷ See Gilson, *supra* note 1, at 350 (explaining that convergence through regulatory competition was not available in Europe because the widespread application of the "real seat" doctrine dictated that the corporate law of the country in which the corporation's principal place of business was located governed its internal affairs regardless of the country of incorporation, a mandatory coincidence of a company's primary business location and the corporate law covering its governance).

⁸ For a brief summary of the real seat doctrine, see STEFANO LOMBARDO, REGULATORY COMPETITION IN COMPANY LAW IN THE EUROPEAN COMMUNITY: PREREQUISITES AND LIMITS 25-27 (2002) (noting that the real seat theory applies to a company the law of the country where the management has its stable seat or where the company has its major place of business independent of the law of the country where the company has its registered office).

⁹ Gilson, *supra* note 1, at 350.

¹⁰ See Hanne Sondergaard Birkmose, *The Fear of the Delaware-effect—The American Demon?*, in THE INTERNATIONALISATION OF COMPANIES AND COMPANY LAWS 244 (Mette Neville & Karsten Engsig Sorensen eds., 2001) ("As a result of the widespread application of the siege reel theory in the EU, forum shopping has been severely restricted.").

¹¹ *Id.* See also Case C-212/97, *Centros Ltd. v. Erhvervs-og Selskabsstyrelsen*, 1999 E.C.R. I-1459 (holding that it is contrary to Articles 43 and 48 of the Treaty for a Member State to refuse to register a branch of a company formed in accordance with the law of another Member State in which it has its registered office but in which it conducts no business where the branch is created for the purpose of evading application of more restrictive rules as regards the paying up of a minimum capital).

¹² See Case C-208/00, *Überseering BV v. Nordic Constr. Co. Baumanagement GmbH (NCC)*, 2002 E.C.R. I-9919 (holding that where 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

situation as they apply Articles 43¹³ and 48¹⁴ of the EC Treaty on the freedom of establishment to further limit the application of a host Member State's national law regarding companies that already have nationality, or legal personality,¹⁵ in another Member State. A case before *Centros*, *Daily Mail*¹⁶, also relates to this situation as *Überseering* and *Inspire Art* have affirmed that *Daily Mail* still limits the application of the freedom of establishment in Articles 43 and 48 of the EC Treaty.

This Article ultimately attempts to answer what effects *Daily Mail*, *Centros*, *Überseering*, and *Inspire Art*, in total, will have on jurisdictional competition in corporate law in the EC. Section 2 analyzes the evolving jurisprudence of these four cases. Its extensive analysis includes a discussion of the implications of these cases for jurisdictional competition and for the Member States with strict laws that have sought to block the importation of relaxed rules into their jurisdictions. It concludes, *inter alia*, that these decisions of the European Court of Justice ("ECJ") have altered the

company enjoys under the law of its state of incorporation ("A")); see also Case C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd.* 2003 E.C.R. I-10155 (holding that it is contrary to Articles 43 EC and 48 EC for national legislation 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).

¹³ Article 43 reads in relevant part:

Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

Treaty Establishing the European Community, Nov. 10, 1997, art. 43, 1997 O.J. (C 340) 195 (2002) [hereinafter EC Treaty].

¹⁴ Article 48 reads in relevant part: "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 . . . be treated in the same way as natural persons who are nationals of Member States." EC Treaty, art. 48.

¹⁵ See *infra* text accompanying notes 87–88.

¹⁶ See Case C-81/87, *The Queen v. HM Treasury and Comm'rs of Inland Revenue ex parte Daily Mail and General Trust plc*, 1988 E.C.R. 5483 (holding that Articles 43 and 48 of the EC Treaty 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).

real seat doctrine enough that, at a minimum, a partial jurisdictional competition regarding certain issues will be possible in the case of new incorporations. Section 3 then examines whether these cases will allow a full jurisdictional competition so as to lead to a race for laxity. It concludes that the reincorporation barriers are probably too high in the EC, given that *Daily Mail* still stands, and that the Tenth and Fourteenth Directives on Company Law have not yet been passed. Section 4 hypothetically accepts the possibility of a race in light of these four cases, but questions whether EC Member States will have the incentive to actually compete for incorporations, and if they do, whether a likely jurisdictional competition for only new incorporations would be efficient. Section 5 summarizes the relevance of the *Societas Europaea* ("SE") statute, which creates the possibility of having European corporations, with regard to the above jurisdictional competition analysis. It explores potential loopholes in the structure of the SE Statute that would possibly make jurisdictional competition even more likely, despite the fact that SE Statute generally threatens to foreclose it. Finally, Section 6 presents this Article's conclusions.

2. A DISCUSSION OF FOUR EC COMPANY LAW CASES: *DAILY MAIL*, *CENTROS*, *ÜBERSEERING*, AND *INSPIRE ART*

2.1. *Daily Mail*

Daily Mail and *General Trust plc* was an investment bank incorporated as a public limited company¹⁷ in the United Kingdom ("U.K.") that applied for consent under U.K. Section 482(1) (a)¹⁸ to transfer its central management and control to Holland.¹⁹ Its purpose in transferring its central management and control to Holland was to circumvent English tax law. Without waiting for consent, as required by Section 482(1)(a), *Daily Mail* opened an investment management office in Holland.

¹⁷ See A1 Company Services Limited, *Public Limited Company (PLC) Formation* <http://www.a1companies.com/plc/> (last visited April 13, 2006) (explaining what a limited company is in the United Kingdom).

¹⁸ Income and Corporation Taxes Act, 1970, § 482(1), Eng.

¹⁹ See *Daily Mail*, 1988 E.C.R. I-5483, para. 5 ("Section 482(1)(a) of the Income and Corporation Taxes Act 1970 prohibits companies resident for tax purposes in the United Kingdom from ceasing to be so resident without the consent of the Treasury.").

The United Kingdom objected to the circumvention of its national tax law. It argued that Daily Mail should sell at least part of its assets in order to reckon with British tax authorities before transferring its central management and control out of the United Kingdom.²⁰ Daily Mail, however, had other plans. It asserted that Articles 43 and 48 of the EC Treaty gave it the right to transfer its central management and control to another Member State either without consent at all, or with the right to obtain mandatory consent.²¹ The ECJ then phrased the issue of this case as follows: whether Articles 43 and 48 “preclude a Member State from prohibiting a body corporate with its central management and control in that Member State from transferring without prior consent that central management and control to another Member State”²²

In deciding this issue, the E.C.J. first concluded that the provisions of Articles 43 and 48 of the EC Treaty, which protect a company’s right of establishment, applied to the Member State of origin, or home Member State, despite the fact that Articles 43 and 48 were primarily directed to ensuring that foreign nationals and companies were treated in the host Member State in the same way as nationals of that state.²³ At the same time, the Court opined that the establishment rights under Articles 43 and 48 would be rendered “meaningless” if a home Member State could flat out prohibit corporations established under its laws from leaving in order to establish themselves in host Member States.²⁴

After deciding this issue, the Court noted that the freedom of establishment in Article 43 conferred the right upon companies

²⁰ Specifically, the court noted that transferring its residence for tax purposes would have enabled Daily Mail to:

sell a significant part of its non-permanent assets and to use the proceeds of that sale to buy its own shares, without having to pay the tax to which such transactions would make it liable under United Kingdom law, in regard in particular to the substantial capital gains on the assets which the applicant proposed to sell.

Daily Mail, 1988 E.C.R. I-5483, paras. 7-8. Although Daily Mail would have subsequently been subject to Dutch tax law, the aforementioned series of transactions would have been taxed only with regard to the capital gains that accrued after the transfer of its residence for tax purposes. *Id.*

²¹ *Id.*

²² *Id.* para. 9.

²³ *Id.* para. 16.

²⁴ *Id.*

established in a home Member State to set up “agencies, branches or subsidiaries” in host Member States.²⁵ Daily Mail’s management office fell within the definition of agencies, branches or subsidiaries.²⁶ However, the Court ultimately held that the U.K. tax law did not impinge on Daily Mail’s freedom of establishment because the United Kingdom merely limited Daily Mail from transferring its central management and control out of the United Kingdom while maintaining “its legal personality and its status as a United Kingdom company.”²⁷

2.1.1. *A critical analysis and exploration of Daily Mail*

Daily Mail’s holding suggested that if Daily Mail’s operation in the Netherlands was a branch and if Articles 43 and 48 granted a right of establishment to a company incorporated in home Member State A to set up a branch in a host Member State B, then it would seem that home Member State A could not have imposed any restrictions on Daily Mail’s movement without violating its establishment right.

In *Daily Mail*, however, the Court interestingly took the view that the freedom of establishment provisions never applied, since home Member State A law (U.K. law) did not actually prevent companies from setting up branches²⁸ as companies could wind-up.²⁹ This would allow a company to divest itself of legal personality under the home Member State’s law. Thus, in sum, although the *Daily Mail* court’s holding narrowly applied to home Member States, it potentially broadly implied that the confluence of two events would technically mean that a Member State’s restriction of a company’s movement would not be a specific limitation of that company’s freedom of establishment right. These two events were: 1) residence transfer or transferring management

²⁵ *Id.* para. 17.

²⁶ See *Daily Mail*, 1988 E.C.R., I-5483, para. 17 (“[T]hat is the form of establishment in which the applicant engaged in this case . . .”).

²⁷ *Id.*

²⁸ See *supra* text accompanying note 13; see also Werner F. Ebke, *Centros – Some Realities and Some Mysteries*, 48 AM. J. COMP. L. 623, 629 (2000) (noting that the right to set up branches, agencies, and subsidiaries is covered by the concept of secondary establishment).

²⁹ See *Daily Mail*, 1988 E.C.R. I-5483, para. 18 (suggesting that in the case of winding-up, a partial or total transfer of the activities of a company incorporated in the U.K. to a company newly incorporated in another Member State is not necessary).

and control; and 2) maintaining legal personality status in a Member State.³⁰

After *Daily Mail*, it appeared that a Member State's law could effectively interfere with the very purpose of Articles 43 and 48, the right of a company incorporated in one Member State to set up a branch in another Member State, without violating these provisions.³¹ This suggested that the right of secondary establishment which refers to the right to set up agencies, branches or subsidiaries, although recognized doctrinally as a full right, would yield to at least two conditions.

The first condition, residence transfer, was the very circumstance that would have allowed *Daily Mail* to evade U.K. tax law. As the Court noted, "only companies which are resident for tax purposes in the United Kingdom are as a rule liable to United Kingdom corporation tax."³² The cynic might have concluded that the Court was looking for a way to stop the circumvention of U.K. law. This is especially so considering that the opinion of the Advocate General to the Court stated: "As a general rule it appears that the national court may assess whether, in a specific case and having regard to the circumstances, there is a suggestion of abuse of a right or circumvention of the law and whether it should decide not to apply Community law."³³ Although the Court did not conclude that a state can refuse to apply EC law where there was intent to circumvent national law, it is clear that such reasoning may have been at the back of its mind.

The second condition, legal personality, was an attempt to reconcile freedom of establishment with the traditional notion that "unlike natural persons, companies are creatures of the law and, in the present state of Community law, creatures of national law."³⁴ This condition, combined with the residence transfer condition,

³⁰ See *id.* ("It requires Treasury consent only where such a company seeks to transfer its central management and control out of the United Kingdom while maintaining its legal personality and its status as a United Kingdom company."); see also Ebke, *supra* note 28, at 636 (noting that Member States generally give automatic recognition to companies that are formed under other Member States' national laws).

³¹ See *Daily Mail*, 1988 E.C.R. I-5483, para. 17 (suggesting a conflict between a company's primary establishment right to choose which legal regime applies and a Member State's right to control companies that come within its national law).

³² *Id.* para. 4.

³³ *Id.* para. 9 (opinion of the Advocate-General).

³⁴ *Id.* para. 19.

suggested that even *host* Member States who applied the real seat doctrine could perhaps restrict company immigration when a company's real seat residence was transferred, since the transfer might have created legal personality in the real seat state.³⁵

These implications were merely speculative because *Daily Mail* never stated a principle against circumvention. One might even see its failure to explicitly assert such a principle, which was stated in the Advocate General's opinion, as evidence that the Court never intended to wholly prevent circumvention of national law.

2.2. Centros

Centros Ltd. was a private limited company³⁶ incorporated in the U.K.³⁷ since its inception, Centros never traded in the U.K., but instead sought to establish a place of business in Denmark. Centros was owned by two Danish nationals domiciled in Denmark, whose intent was to use U.K. incorporation to circumvent Danish minimum capital requirements.³⁸

Danish law article 117(l),³⁹ in accord with Articles 43 and 48 of the EC Treaty, provided that foreign companies had a right to set up a branch.⁴⁰ Denmark, however, tried to refuse registration to Centros on the grounds that it had not established a branch. Denmark asserted that Centros's establishment in Denmark was a

³⁵ This also would have tacitly held back circumvention of national laws. For example, if company C, a new company, incorporated in home Member State A, decided to transfer its principal operations to host Member State B (a real seat doctrine state) in order to avoid B's stricter company law requirements, B, even though circumvention was not stated as contrary to Community law, could presumably have been able to not recognize A. For the resolution of this issue, see *infra* Section 2.3.

³⁶ See *A1 Company Services Limited*, *supra* note 17 (defining a limited company in the United Kingdom as a company whose liability is limited by English law or Scots law).

³⁷ See Case C-212/97, *Centros Ltd. v. Erhvervs-og Selskabsstyrelsen*, 1999 E.C.R. I-1459, para. 2 (explaining that a Ltd. is a private limited company in the U.K.); see also *LOMBARDO*, *supra* note 8, at 39 (noting that harmonization of capital requirements had not been achieved for the private limited company form).

³⁸ See *Centros*, 1999 E.C.R. I-1459, para. 2 (explaining the background of Centros ownership).

³⁹ *Anpartsselskabslov* art. 117(1).

⁴⁰ See *Centros*, 1999 E.C.R. I-1459, para. 5 ("Private limited companies and foreign companies having a similar legal form which are established in one Member State of the European Communities may do business in Denmark through a branch.") (internal quotations omitted).

"principal establishment"⁴¹ as it was established merely to circumvent the national law on minimum capital requirements and as it had never traded in the United Kingdom.⁴²

Centros contended that the establishment satisfied the conditions for a "branch" and that the right of establishment in Articles 43 and 48 of the EC Treaty allowed it, as a duly formed U.K. company, to set up a branch in Denmark.⁴³ It also asserted that the fact that it had not traded in the U.K. did not affect its freedom of establishment.⁴⁴

The Court first dismissed the relevance of Denmark's principal establishment argument,⁴⁵ thereby broadly construing "agencies, branches, or subsidiaries" in Article 43.⁴⁶ It then proceeded to phrase a broader more important issue, "whether or not a Member State may adopt measures in order to prevent attempts by certain of its nationals to evade domestic legislation by having recourse to the possibilities offered by the Treaty."⁴⁷

In answering this question, the Court first discussed Articles 43 and 48 and stated:

The immediate consequence of [Articles 43 and 48] is that . . . companies are entitled to carry on their business in another Member State through an agency, branch or subsidiary. The location of their registered office, central administration or principal place of business serves as the connecting factor with the legal system of a particular State in the same way as does nationality in the case of a natural person.⁴⁸

The Court then expressly noted the argument, previously discussed with regard to the *Daily Mail* opinion, that a Member State was entitled to take measures to prevent nationals from

⁴¹ *Id.* See also Ebke, *supra* note 28, at 632–33 (noting that some scholars have construed principal establishment to encompass primary establishment and presenting the foundations of the debate).

⁴² See *Centros*, 1999 E.C.R. I-1459, paras. 1–17 (detailing Denmark's attempt to merge the issues of circumvention and principal establishment).

⁴³ *Id.* para. 10.

⁴⁴ *Id.* para. 11.

⁴⁵ See *id.* para. 17 (citing Case 79/85, *Segers v. Berijtsvereniging voor Bank-en Verzekeringwegen, Groothandel en Vrije Beroepen*, 1986 E.C.R. 2375).

⁴⁶ EC Treaty, art. 43.

⁴⁷ *Centros*, 1999 E.C.R. I-1459, para. 18.

⁴⁸ *Id.* para. 20.

improperly circumventing national legislation.⁴⁹ It concluded that intentional circumvention itself did not constitute an "abuse" of the right of establishment.⁵⁰ The court's reason was as follows:

The provisions of the [EC] Treaty on freedom of establishment are intended specifically to enable companies formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community to pursue activities in other Member States through an agency, branch or subsidiary.⁵¹

Although the Court ruled that circumvention was not illegal, it simultaneously made a contrary suggestion by hinting at the possibility of a different outcome had the Danish law dealt with the "carrying on of certain trades, professions, or businesses" as opposed to denying registration.⁵²

After this holding, the Court proceeded to consider, "whether the national practice in question might not be justified."⁵³ Denmark asserted that its refusal to register Centros, which was incompatible with Articles 43 and 48, was justified because minimum capital requirements that prevented Centros' Danish registration protected creditors.⁵⁴ The Court rejected Denmark's

⁴⁹ See *id.* para. 24 (citing multiple cases for this proposition, including Case 115/78, *Knoors v. Secretary of State for Economic Affairs*, 1979 E.C.R. 399; Case 33/74, *van Binsbergen v. Bestuur van Bedrijfsvereniging voor de Metaalnijverheid*, 1974 E.C.R. 1299).

⁵⁰ *Id.* para. 27.

⁵¹ *Id.* For a further explanation, see Eddy Wymeersch saw this language as eliminating "the question whether the branch was not de facto a head office." Eddy Wymeersch, *Centros: A Landmark Decision in European Company Law*, in *CORPORATIONS, CAPITAL MARKETS AND BUSINESS IN THE LAW* 630, 632 (Th. Baums et al. eds., 1999).

⁵² This suggestion, however, was somewhat puzzling because it was inconsistent with the language of the Court that stated that the provisions were designed to ensure that companies could pursue activities in other Member States. See *supra* note 51 and accompanying text. See also EC Treaty, art. 43 ("Freedom of establishment shall include the right to . . . manage undertakings."). Ultimately, this hint became the basis of the strict Member States' argument in *Inspire Art.* See *infra* Section 2.4. (discussing how strict Member States argued that restrictive laws not affecting company registration would not conflict with Freedom of Establishment).

⁵³ *Centros*, 1999 E.C.R. I-1459, para. 31.

⁵⁴ See *id.* para. 32 (explaining the goal of protecting both public creditors as well as other creditors).

justification measures. It stated that these measures must be non-discriminatory, justified by imperative requirements in the general interest, suitable for securing the attainment of the objective, and necessary.⁵⁵ However, the Court implied that justifications would succeed when they were first less restrictive. As an example, it stated that Denmark could “mak[e] it possible in law for public creditors to obtain the necessary guarantees.”⁵⁶ It also suggested that measures would be justified when a company abused the freedom of establishment through fraudulent circumvention.⁵⁷

2.2.1. *A critical analysis and exploration of Centros*

Centros led to significant academic debate. Many scholars found the case surprising.⁵⁸ However, *Centros* is doctrinally consistent with the Court’s jurisprudence in *Daily Mail*. Under *Daily Mail*, one would have expected the Court to analyze the *Centros* situation as follows.

Centros, incorporated in home Member State A, has a right to establish a branch in host Member State B. *Centros* has such a right to establish a branch even though it is transferring its central management and control. This follows from the fact, as previously mentioned, that the *Daily Mail* Court acknowledged that *Daily Mail*’s establishment in the Netherlands constituted a transfer of central management and control. In *Centros*, host Member State B was not a real seat state, but a state of incorporation⁵⁹ state. As such, host Member State B had no argument, under *Daily Mail*, that it granted legal personality to *Centros*. Since legal personality was

⁵⁵ *Id.* para. 34.

⁵⁶ *Id.* para. 37. The Court stated that Denmark could adopt “any appropriate measure for preventing or penalising fraud . . . where it has been established that [manages] are in fact attempting, by means of the formation of the company, to evade their obligations towards private or public creditors established on the territory of a Member State concerned.” *Id.* para. 38.

⁵⁷ *Id.* para. 39.

⁵⁸ See Ebke, *supra* note 28, at 627 (noting that some scholars actually viewed this case as hailing the abolishment of the real seat theory.). Scholars of this sort often additionally maintained that the “Delaware rule in Europe would entail the much dreaded ‘race to the bottom.’” Wymeersch, *supra* note 51, at 631. *But cf.* Ebke, *supra* note 28, at 660 (taking the view that *Centros* only expanded the scope of the term “branch” in Article 43(1) and added little to the meaning of primary establishment or the abolishment of the real seat theory).

⁵⁹ See LOMBARDO, *supra* note 8, at 25–27 (explaining that under the traditional Anglo-Saxon state of incorporation theory, a company is viewed as a legal entity of the law of the country of incorporation and is subject to its law).

an additional condition for a Member State's restrictions not to conflict with freedom of establishment, Denmark would violate *Centros*'s freedom of establishment.

However, despite the doctrinal consistency, it could be believed that the Court in *Centros* was beginning to shift philosophical gears.⁶⁰ There are a number of arguments in support of this. First, the Court's decision in *Centros* came down in favor of the circumventing company, whereas the *Daily Mail* decision had come down in favor of the Member State protecting its national law.

Second, the Court in *Centros* specifically addressed whether circumventing national law would justify a Member State's refusal to give effect to EC law in the freedom of establishment context. As was previously mentioned, the *Daily Mail* Court steered around this issue even though it was addressed in the Advocate General's opinion.⁶¹ One might have therefore thought, after *Daily Mail*, that circumvention of national law was incompatible with the freedom of establishment. In *Centros*, there is a clear answer—it is not incompatible.

The *Centros* Court was interestingly almost forced into a position where it had to address the dreaded question of the relationship between circumvention of national law and the freedom of establishment. Under the *Daily Mail* standard, Denmark would have clearly infringed as there was no argument that *Centros* had legal personality in a state of incorporation nation. The Court therefore had two choices.

It could have held that legal personality was no longer necessary to avoid conflict with the freedom of establishment and eroded *Daily Mail*. This would have meant that a transfer of management and control was sufficient to avoid such a conflict.

The other option was to leave *Daily Mail* intact doctrinally, which meant deciding whether measures dealing with circumvention of national law by themselves conflicted with the freedom of establishment. Ironically, had the Court decided that these measures did not conflict with freedom of establishment, it would have eroded *Daily Mail*. Almost any transfer of central management and control would have been susceptible to being classified as an attempt to circumvent national law. This would

⁶⁰ But cf. Wymeersch, *supra* note 51, at 632 (discussing how some scholars took a more extreme view that *Centros* was a 'breakthrough' doctrine).

⁶¹ See *supra* text accompanying note 32.

have effectively dispensed with the legal personality requirement.

Thus, in essence, the result in *Centros* was the only way to maintain doctrinal consistency with *Daily Mail*. The price of this doctrinal consistency was a philosophical concession. If it is shocking, it is not because it is a major departure from *Daily Mail*. Instead, it is a departure from 1970s cases like *Knoors* and *Van Binsberg*.⁶² When the *Daily Mail* Court based its holding on the concurrence of a company's transfer of central management and a Member State conferring legal personality on a company, the E.C.J. had already taken a major step toward this jurisprudence.

More important than what it doctrinally announced, the *Centros* decision showed that it would not stretch doctrine to satisfy a circumventive position. Since this case did not implicate the issue of legal personality, it did little to clarify the tension between companies as creatures of national law and beneficiaries of the freedom of establishment. This tension ran even deeper than circumvention issues.

2.3. Überseering

Überseering B.V.⁶³ was a limited company incorporated in the Netherlands, a state of incorporation Member State.⁶⁴ In 1990, Überseering contracted NCC GmbH,⁶⁵ a private limited company established in Germany (a real seat state), to perform work on property that it had acquired in Germany.⁶⁶ Überseering claimed that NCC's work was defective and brought an action before the Landgericht, the equivalent of a federal district court in Germany.⁶⁷ The action was dismissed.⁶⁸ German civil procedure⁶⁹ provided

⁶² See *supra* text accompanying note 59. It should, however, be noted that the 1970s precedent is not unequivocal. See *supra* text accompanying note 56.

⁶³ See *Limited v. BV: The Company Limited by Shares (Ltd.)*, [http://www.hjc.nl/follow "English Summary" hyperlink](http://www.hjc.nl/follow%20English%20Summary) (comparing the B.V. limited company structure in Holland to the U.K. limited company).

⁶⁴ See Case C-208/00, *Überseering BV v. Nordic Constr. Co. Baumanagement GmbH (NCC)*, 2002 E.C.R. I-9919, para. 2 (discussing generally Überseering BV and their business activities).

⁶⁵ See CHARLOTTE VILLIERS, *EUROPEAN COMPANY LAW – TOWARDS DEMOCRACY?* 25–26 (1998) (explaining that the GmbH is a German private limited company and describing its basic characteristics).

⁶⁶ See *Überseering*, 2002 E.C.R. I-9919, paras. 2, 6 (introducing the parties in the action and the project management contract they entered into).

⁶⁷ See Ebke, *supra* note 28, at 650 (explaining that the Landgericht is a German District Court).

⁶⁸ See *Überseering*, 2002 E.C.R. I-9919, para. 9 (noting that a higher regional

that an action brought by a party which does not have legal personality must be dismissed.⁷⁰ According to German law, a company's legal capacity was determined by reference to the applicable law in its "actual centre of administration."⁷¹ The Landgericht concluded that Überseering had transferred its actual center of administration to Dusseldorf merely because two German nationals had acquired all the shares in Überseering.⁷² Its own determination of a residence transfer was thus the basis for the dismissal.

Since the actual center of administration was transferred to Germany for purposes of German law, the Oberlandesgericht,⁷³ which is equivalent to a federal court of appeals in the United States, concluded on the basis of its national law that German law should apply. German law then required reincorporation in Germany in order to bring legal proceedings. Since Überseering did not reincorporate in Germany, it was found to lack standing and was denied the capacity to bring legal proceedings.⁷⁴

This case was later referred to the ECJ by the Bundesgerichtshof,⁷⁵ the German equivalent of the U.S. Supreme Court, under Article 234.⁷⁶ Article 234 is the EC statute that sets forth conditions under which the E.C.J. will have jurisdiction over matters relating to preliminary rulings by Member States.

court upheld the dismissal).

⁶⁹ See Zivilprozeßordnung [ZPO] [Civil Procedure Statute], Jan. 30, 1877 (stating that a party needs capacity to bring suit).

⁷⁰ See *Überseering*, 2002 E.C.R. I-9919, para. 3 (describing the possibility of allowing Germany to use the concept of legal personality to deny legal capacity).

⁷¹ *Id.* para. 4.

⁷² See *id.* para. 7 (stating that in December 1994 two German nationals residing in Dusseldorf acquired all the shares in Überseering).

⁷³ See *id.* para. 9 (stating that the Oberlandesgericht reviewed the Landgericht's initial dismissal decision); see also Ebke, *supra* note 28, at 652 (noting that the Oberlandesgericht is equivalent to the U.S. Court of Appeals).

⁷⁴ See *Überseering*, 2002 E.C.R. I-9919, para. 9 (arguing that as a company incorporated under Netherlands law, Überseering did not have legal capacity in Germany and, consequently, could not bring legal proceedings there).

⁷⁵ See Ebke, *supra* note 28, at 657 (explaining that the Bundesgerichtshof is equivalent to the U.S. Supreme Court).

⁷⁶ Article 234 provides in relevant part that "[t]he Court of Justice shall have jurisdiction to give preliminary rulings concerning: (a) the interpretation of this Treaty; (b) the validity and interpretation of acts of the institutions of the Community and of the ECB; (c) the interpretation of the statutes of bodies established by an act of Council, where those statutes so provide."

EC Treaty, art. 234.

Überseering then asserted that Germany violated its freedom of establishment by denying its legal capacity. Germany asserted that freedom of establishment did not apply at all in this context.⁷⁷ Germany invoked *Daily Mail* in particular.⁷⁸

The Court first distinguished *Überseering* from *Daily Mail* on the theory that the real seat doctrine did not confer “legal personality.”⁷⁹ Just because Germany determined that *Überseering* had made Germany its real seat, legal personality was not automatically conferred. The Court then proceeded to address whether Germany could find that *Überseering* had transferred its actual center of administration to Germany even though Holland, its ‘original’ home Member State and the state in which it was incorporated, had never called “[i]ts legal existence . . . in question.”⁸⁰

Transferring central administration was the other circumstance in *Daily Mail* that allowed a Member State to restrict companies, without violating Articles 43 and 48. The Court did not give any

⁷⁷ The court stated:

In limine and contrary to the submissions of both NCC and the German, Spanish and Italian Governments, the Court must make clear that where a company which is validly incorporated in one Member State (‘A’) in which it has its registered office is deemed, under the law of a second Member State (‘B’), to have moved its actual centre of administration to Member State B following the transfer of all its shares to nationals of that State residing there, the rules which Member State B applies to that company do not, as Community law now stands, fall outside the scope of the Community provisions on freedom of establishment.

Überseering, 2002 E.C.R. I-9919, para. 52.

⁷⁸ See *id.* para. 61 (noting that Germany tried to assimilate the *Daily Mail* situation to justify denying legal capacity to *Überseering*).

⁷⁹ The court specifically stated:

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, irrespective of whether in that regard the company actually intended to transfer its seat.

Id. para. 62.

⁸⁰ *Id.* para. 63.

definitive decision on whether Germany could so construe *Überseering*, but strongly implied that it could not.⁸¹ It then suggested that neither the existence of legal personality nor the transfer of the center of actual administration mattered. The Court simply refused to apply the *Daily Mail* circumstances that allowed Member State restrictions on immigrating companies by host Member States. Thus it stated that "unlike the case before the national court in this instance, *Daily Mail and General Trust* did not concern the way in which one Member State treats a company which is validly incorporated in another Member State and which is exercising its freedom of establishment in the first Member State."⁸²

This rationale had the effect of narrowly confining *Daily Mail* to its articulated conclusion in the context of company emigration.⁸³ The Court asserted that the rationale for its decision was consistent with that of *Daily Mail*, which had decided on the basis of the principle that the company is a "creature of national law."⁸⁴

It then held that *Überseering* had the right to rely on freedom of establishment to contest the German law that had denied it legal capacity as well as personality.⁸⁵

In its next increment, the Court considered whether Germany restricted *Überseering's* freedom of establishment.⁸⁶ It concluded

⁸¹ "[E]ven if the dispute . . . is seen as concerning a transfer of the actual centre of administration." *Id.* para. 64.

⁸² *Id.* para. 66.

⁸³ See Case C-81/87, *The Queen v. HM Treasury and Comm'rs of Inland Revenue ex parte Daily Mail and General Trust plc*, 1988 E.C.R. I-5483, para. 25 ("Articles 52 and 58 [now Articles 43 and 48] of the Treaty, properly construed, 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."). In the words of the *Überseering* Court, the *Daily Mail* Court

concluded that a Member State was able, in the case of a company incorporated under its law, to make the company's right to retain its legal personality under the law of that State subject to restrictions on the transfer of the company's actual centre of administration to a foreign country.

Überseering, 2002 E.C.R. I-9919, para. 70.

⁸⁴ *Überseering*, 2002 E.C.R. I-9919, para. 67.

⁸⁵ See *id.* para. 76 ("It follows . . . that *Überseering* is entitled to rely on the principle of freedom of establishment in order to contest the refusal of German law to regard it as a legal person with the capacity to be a party to legal proceedings.").

⁸⁶ See *id.* para. 77 (arguing that the company seat principle as applied by

that there was a restriction since the Netherlands, which was *Überseering's* initial home Member State, had continued to recognize *Überseering's* legal personality.⁸⁷ Moreover, it declared that the German reincorporation requirement was "tantamount to outright negation of freedom of establishment."⁸⁸ Its rationale was again that "a company exists only by virtue of the national legislation which determines its incorporation and functioning."⁸⁹

2.3.1. *A critical analysis and exploration of Überseering*

Überseering is significant in EC freedom of establishment jurisprudence for a number of reasons. Like the previous cases in this line, the effect of the German law in *Überseering* would have been to halt those companies trying to circumvent national law. After the decision in *Centros* held that circumvention by itself could not justify measures that restricted freedom of establishment, Germany was foreclosed from arguing that its national law was valid on this basis. As a result, Germany tried to see whether it could use *Daily Mail* to maneuver around *Centros*. This required placing the more fundamental issue of the bounds of national company law before the Court.

Since Germany was a real seat state, it had a strong argument that it could do so. This was in fact the first case in this line where a company incorporated in home Member State A had immigrated to host Member State B, a real seat state. In *Centros*, host Member State B was a state of incorporation state. As such, Denmark had no claim to conferring legal personality on *Centros*. Thus, the *Daily Mail* circumstances could have been of no use in that context. Nor could Germany's arguments have potentially availed it. A claim that *Centros* transferred its central administration would not have been enough, since the Court had already twice held that establishing central administration was not incompatible with the concept of a "branch"⁹⁰ that the Treaty had upheld. In the case of a

German law ensures that a company whose principal place of business is in Germany has a fixed minimum share capital, something which is instrumental in protecting parties with whom it enters into contracts and its creditors, and also prevents distortions of competition).

⁸⁷ See *id.* para. 80 (implying that a Member State's determination of legal personality should not conflict with a prior Member State's determination on this subject).

⁸⁸ *Id.* para. 81.

⁸⁹ *Id.*

⁹⁰ See EC Treaty, art. 43 (applying the freedom of establishment to "branches").

real seat state, however, it was at least arguable that a company's legal personality transferred with its real seat. If incorporation in a state of incorporation Member State conferred legal personality on a company, then it stood to reason that a company's seat would confer legal personality in a real seat Member State. This hypothetical can be illustrated visually as follows.

Figure 1: A Visualization of the Centros Case in Which There is No Potential Basis for Host Member State B to Assert Legal Personality

Figure 2: A Visualization of Uberseering's Failed Argument and How It Provided a Potential Basis for Host Member State B to Assert Legal Personality

If Germany had succeeded in obtaining its desired result, real seat Member States would have been armed against circumvention

of their national laws.⁹¹ For nearly all such circumventions would involve transfer of a company's central administration and, under the real seat rationale, transfer of its legal personality.

In addition, prevailing on this issue would have armed real seat Member States with an ex ante prophylactic measure. Germany claimed that it could decide whether a company had transferred its center of administration. Since it was a real seat Member State, any transfer of central administration would have given rise to legal personality.⁹² As a result, Germany and real seat Member States could have potentially fit almost anything into the *Daily Mail* circumstances, as Germany attempted to do by arguing that its nationals' acquiring all of Centros' shares constituted such a transfer.

This is significant because it would have allowed real seat Member States to block companies that they deemed de facto to have circumvented national law, while state of incorporation Member States would have had no such rights. Since a real seat Member State in this scenario would have the right to block companies incorporated in a state of incorporation Member State when it merely deemed a company to have established its central

⁹¹ This aspect in particular historically prevented the competition of jurisdictions in EC company law. Prior to this case, Garza noted that a real seat Member State could

"require another member state's corporation having its principal place of business ("seat," "siege," "[Sitz]") within its borders to incorporate under its own laws.

Indeed, several member states do impose such a choice-of-corporate-law requirement ("seat rule") to ensure that all corporations doing business within their boundaries are subject to the same rules of corporate law. As a result, the choice of corporate law is substantially restricted by these member states."

Danny Ray Garza, *Which Style Should Govern?*, 11 CURRENTS: INT'L TRADE L.J. 76, 78 (2002) (citation omitted).

⁹² *Daily Mail* and *Centros* had essentially held, as previously noted, that the Member State could not determine on the basis of national law that an establishment was not a branch if it was duly formed in another Member State and fell within the scope of the Article 48 connecting factors. Eddy Wymeersch in 1999 had understandably assumed that *Centros* closed this issue. See Wymeersch, *supra* note 51, at 633 ("As far as the Treaty's freedoms are concerned, national bodies could not refuse to recognize foreign bodies on the basis that they do not have sufficient links with the Community, or that they do not meet the criteria for recognition under national law."). Germany's argument in *Überseering* would have effectively reversed this rule for real seat states.

administration in a real seat Member State, many companies would be forced to recognize their own incorporation in real seat Member States if they did not wish to paradoxically face the grave consequences of losing legal capacity and forced dissolution.⁹³

This could have had two important effects. First, it might have offset the benefits obtained by the more relaxed laws that Centros-like companies could obtain in certain state of incorporation Member States. Second, it might have made it wholly unfeasible for these and other companies with a remotely colorable central administration in a real seat Member State to not incorporate in real seat Member States.

In the first scenario, the effect would have been to preserve the existing real seat and state of incorporation framework in the EU. In the second scenario, it would have tended to either establish the dominance of, or export, the real seat doctrine at the expense of the incorporation doctrine.

Real seat Member States would have had the power to control which scenario obtained to some degree. If they imposed very harsh measures in the case of transfer, the second scenario would have been more likely to obtain. If the measures were less harsh, the first scenario would have been more likely to have obtained.

In addition, they could have further controlled this by having the power to decide when there was a transfer of central administration. They could have simply found such a transfer when they suspected circumvention. When they suspected circumvention, they could have imposed a measure that was sufficient to eliminate the foreign company's benefit from circumvention, without going further. Preserving the status quo, given the European fear of a race to laxity, is likely all that they would have intended. The chart on the following page presents an illustration of this scenario.

The Court's conclusion is not shocking, given the inherent danger of allowing real seat Member States to simply assert legal personality over companies and to require them to reincorporate. As a result, it is understandable that the Court forcefully declared that the German reincorporation rule was "tantamount" to the legal personality concept.⁹⁴ This was not truly inconsistent with *Daily Mail* to the extent that it could not resolve the eventual

⁹³ See *infra* Section 3.

⁹⁴ See *supra* text accompanying notes 77-81.

unavoidable conflict of two national legal personalities.⁹⁵

Figure 3: What if Real Seat Member States Could Have Determined Residence Transfer and Legal Personality so as to Deny Legal Capacity to Foreign Companies?

Situated in a netherworld between *Centros* and *Daily Mail*, the Court had two options in this regard. In the first case, it could have applied legal personality to uphold the German law. This would have resulted in the scenario described above where real seat doctrine would either prevail in the EU, or where the status quo would be maintained.⁹⁶ It also might have eroded an assumption already implicit in *Daily Mail* that the legal personality of the home Member State prevailed.

⁹⁵ See Eddy Wymeersch, *The Transfer of the Company's Seat in European Company Law* 18 (Eur. Corp. Governance Inst., Law Working Paper No. 08/2003, 2003), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=384802.

It is important to note—as [*Überseering*] recalls—that the court's holding in [*Daily Mail*] is framed in terms of a state's powers within its own jurisdiction, and not in terms of rules relating to a cross border relationship where the Treaty's freedom of establishment limits the powers of a member state vis-à-vis companies originating from another member state.

Id.

⁹⁶ See *supra* text accompanying Figure 3.

In the second case, it could have and did apply legal personality to find that the German law violated *Überseering's* freedom of establishment. The immediate result of its decision is that, at a minimum, host Member State anti-circumvention measures are severely limited where companies immigrate from state of incorporation Member States, since *Centros* further limits these measures in the context of a state of incorporation host Member State. This effectively cripples the real seat doctrine.

Moreover, the freedom of establishment will even apply in this context where there is a transfer of the central administration or management. This follows from the fact that in all three of these cases, the Court accepted that the transfer of the company's central administration did not affect its freedom of establishment or its status in the host state as a "branch."⁹⁷ This fully obfuscates the distinction between primary and secondary establishment.⁹⁸

Thus, companies that incorporate in state of incorporation Member States appear to have the carte blanche to transfer,⁹⁹ with minimal fear of anti-circumvention measures, into other Member States. The only limitations on their ability to transfer after this case were the justification doctrine in *Centros* and the emigration circumstances in *Daily Mail*. This allowed new companies who planned to do all or most of their business in a host Member State to take advantage of the more relaxed company laws of various other Member States. It is inevitable that certain incorporation Member States¹⁰⁰ like the U.K. with relaxed company laws will now export their standards through new incorporations.

⁹⁷ Although the Court in *Überseering* did not accept that its central administration had been transferred, it asserted that such a transfer would not have affected the decision outcome. See Case C-208/00, *Überseering BV v. Nordic Constr. Co. Baumanagement GmbH (NCC)*, 2002 E.C.R. I-9919, para. 64 (noting that even in this scenario the interpretation that the German government put forth of *Daily Mail* was incorrect).

⁹⁸ But see Ebke, *supra* note 28 (reserving considerable doubt as to whether *Centros* significantly abolished the distinction).

⁹⁹ See Garza, *supra* note 91, at 78 (noting that this brings the EU much closer to the "full faith and credit clause" scenario in the United States).

¹⁰⁰ Real seat states with lax laws should be able to export law as well. *Überseering* appears to consider the first Member State to grant legal personality as the Member State under whose law a company was duly formed and therefore as the state falling within the *Daily Mail* legal personality concept. See *supra* text accompanying note 88.

2.4. Inspire Art

Inspire Art Ltd.¹⁰¹ was a private limited company incorporated in the United Kingdom that established a branch in the Netherlands.¹⁰² Its sole director, who had independent decision making capacity, was located in the Netherlands.¹⁰³ In addition, Inspire Art Ltd. traded almost exclusively within the Netherlands.¹⁰⁴

The Netherlands imposed on it certain requirements by the WFBV.¹⁰⁵ The WFBV requirements were an attempt by the Netherlands, a state of incorporation Member State, to deal with the problem of formally foreign companies.¹⁰⁶ Various articles imposed obligations on these companies. Articles 2 to 5 of the WFBV impose on formally foreign companies various obligations concerning the 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. The WFBV also provides for penalties in case of noncompliance with those provisions.¹⁰⁷

Inspire Art Ltd. contended that it was not a formally foreign company. As a result, it never "registered as such in the commercial register of the host State"¹⁰⁸ as required by Article 2 of the WFBV. In addition, it contended that the WFBV provisions

¹⁰¹ See A1 Company Services Limited, *supra* note 17 (providing information about limited companies in the United Kingdom).

¹⁰² See Case C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd.*, 2003 E.C.R. I-10155, para. 2 (providing background information about the action).

¹⁰³ See *id.* para. 34 (stating that the company's sole director, whose domicile is in The Hague [Netherlands], is authorized to act alone and independently in the name of the company).

¹⁰⁴ See *id.* para. 36 (explaining that the Chamber of Commerce took the view that that indication was mandatory on the ground that Inspire Art Ltd. traded exclusively in the Netherlands).

¹⁰⁵ Wet op de Formeel Buitenlandse Vennootschappen ("WFBV") (Law on Formally Foreign Companies), Staatsblad 1997 No. 697 (Dec. 17, 1997).

¹⁰⁶ See *Inspire Art*, 2003 E.C.R. I-10155, para. 22 ("Article 1 of the WFBV defines a formally foreign company as 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 . . ."). "Formally foreign company" thus encompassed companies like Centros.

¹⁰⁷ *Id.* para. 23.

¹⁰⁸ *Id.* para. 24.

were contrary to Articles 43 and 48 of the EC Treaty.¹⁰⁹

The Kantongerecht,¹¹⁰ the lowest level court in a four-tiered Dutch hierarchy, held that Inspire Art was a formally foreign corporation, but refrained from ruling on the freedom of establishment issue. Instead, it referred this issue to the ECJ.¹¹¹ The ECJ interpreted this issue as whether Articles 43 and 48 of the EC Treaty precluded the WFBV from attaching additional conditions to establishment in a host Member State where a company had intent to circumvent stricter national company law requirements and where a company carried all or most of its activities on in the host state without a genuine connection to the Member State under whose law it was formed.¹¹²

The Court first did not consider the relation of certain WFBV disclosure provisions regarding branches opened in a Member State by companies covered by the First Directive and governed by the law of another Member State. This was because the Eleventh Directive,¹¹³ which subjects branches to disclosure requirements, preempted the field.¹¹⁴

The Court, however, did consider the WFBV provisions that did not fall within the scope of the Eleventh Directive.¹¹⁵ These were the minimum capital requirements rules.¹¹⁶ The Netherlands

¹⁰⁹ See *id.* para. 37 (stating that this was an argument in the alternative to its principal argument that it did not meet the conditions of Article 1 of the WFBV).

¹¹⁰ See Pieter Ruitinga & Anthony J. Mavronicolas, *Dutch Jurisdiction in Transportation Matters*, 28 J. MAR. L. & COM. 61, 61 (noting that the Dutch hierarchy consists of sixty-two cantonal courts).

¹¹¹ See *Inspire Art*, 2003 E.C.R. I-10155, para. 39 (stating the two questions referred to the ECJ for further review)

¹¹² See *id.* para. 52 (stating the issues the national court seeks in substance to ascertain).

¹¹³ See Council Directive 89/666, 1989 O.J. (L 395) 36 (outlining the provisions of the Eleventh Directive which discusses branch disclosures); see also VANESSA EDWARDS, *EC COMPANY LAW* 212-18 (1999) (providing an overview of the scope and major issues relating to the Eleventh Directive, which subjects branches to certain disclosure requirements).

¹¹⁴ See *Inspire Art*, 2003 E.C.R. I-10155, paras. 55, 69 ("It follows that, without affecting the information obligations imposed on branches under social or tax law, or in the field of statistics, harmonisation of the disclosure to be made by branches, as brought about by the Eleventh Directive, is exhaustive . . .").

¹¹⁵ See *id.* para. 73 (explaining that several provisions of the WFBV do not fall within the scope of the Eleventh Directive).

¹¹⁶ See *id.* (providing that those rules relate to the minimum capital required, both at the time of registration and for so long as a formally foreign company exists).

and Germany, *inter alia*, asserted that these WFBV provisions did not violate Articles 43 and 48.¹¹⁷ First, they argued that the WFBV dealt neither with company formation nor registration and thus did not implement the freedom of establishment.¹¹⁸ Rather, they maintained that the WFBV merely imposed additional obligations that related to a company's "business activities and the running of the company" ¹¹⁹ As such, the provisions fell outside of the scope of *Centros*, which had distinguished "rules governing the formation of companies"¹²⁰ from "rules concerning the carrying on of certain trades, professions, or businesses."¹²¹

Second, they stated that *Daily Mail* supported their position.¹²² They interpreted *Daily Mail* to stand for the proposition that Articles 43 and 48 of the EC Treaty did not restrict a host Member State's power to "determine the relevant factor connecting a company to their national legal order."¹²³ This echoed the aforementioned argument in *Überseering* that a Member State could determine when it conferred "legal personality"¹²⁴ on a company. They also asserted that they were free to apply national law as the rules relating to freedom of establishment had not led to harmonization.¹²⁵

Third, Germany and Austria argued that Articles 43 and 48 were not designed to enable the aforementioned undertakings of

¹¹⁷ See *id.* para. 74 (stating that the Chamber of Commerce and the Dutch, German, Italian, and Austrian Governments are of the view that application of provisions such as those of the WFBV is not contrary to Articles 43 EC and 48 EC).

¹¹⁸ See *id.* para. 75 (arguing that the validity of those companies is in fact recognized and they are not refused registration, with the result that freedom of establishment is not compromised).

¹¹⁹ *Id.* para. 81.

¹²⁰ Case C-212/97, *Centros Ltd. v. Erhvervs-og Selskabsstyrelsen*, 1999 E.C.R. I-1459, para. 26.

¹²¹ *Inspire Art*, 2003 E.C.R. I-10155, para. 76.

¹²² See *id.* para. 83 (pointing out that the Chamber of Commerce and the Dutch, German, and Austrian Governments refer to the judgment in *Daily Mail* and the relevant case law).

¹²³ *Id.*

¹²⁴ For a discussion of the relationship between a Member State conferring legal personality on a company and its ability to restrict a company without violating the freedom of establishment, see *supra* Sections 2.1.1 and 2.3.1.

¹²⁵ See *Inspire Art*, 2003 E.C.R. I-10155, para. 102 (arguing that in this respect the Member States retain the right to take action against "brass-plate companies," that classification being in the circumstances of the case inferred from the lack of any real connection with the State of formation).

"brass-plate companies."¹²⁶ They asserted that formally foreign companies should fall outside of the freedom of establishment because they were primary establishments.¹²⁷ This assertion went further than Denmark's assertion in *Centros*, which had then confined itself to contending that a "principal establishment"¹²⁸ fell outside of the right to set up "agencies, branches or subsidiaries," rather than that there was no primary establishment right under the freedom of establishment.

Fourth, the Netherlands and Germany, *inter alia*, asserted the abusive or fraudulent improper circumvention justification measure that *Centros* implied was allowed under the freedom of establishment.¹²⁹ They broadly interpreted the holding in *Centros*, which did not allow a host Member State to refuse registration to a company having legal personality under another home Member State, and found it to not apply. This was because the host Member State, unlike in *Centros*, did not refuse to register or recognize a company, but only provided for limited "preventive measures and penalties."¹³⁰

The Court rejected the host Member States' first argument that the WFBV merely dealt with the carrying on of business and thus did not violate the freedom of establishment. It concluded that the WFBV, even though it dealt with the day-to-day operations of existing companies, adversely impacted the formation of companies to the extent that formally foreign companies like Inspire Art Ltd. carried on their activities "exclusively, or almost exclusively, in the Netherlands."¹³¹

It then rejected their argument that *Daily Mail* permitted Member States to assert legal personality over companies, or to

¹²⁶ *Id.* para. 84.

¹²⁷ See *id.* para. 85 (arguing that by placing the sole center of its activities in a State other than that to which it formally belongs, a company must be considered to be primarily established in that first State).

¹²⁸ See Ebke, *supra* note 28, at 629 (noting a debate that existed as to whether primary establishment was encompassed by principal establishment at the time of *Centros*).

¹²⁹ See *Inspire Art*, 2003 E.C.R. I-10155, para. 86 (acknowledging that the Dutch and German case law allows governments to prevent a party from "improperly or fraudulently taking advantage of provisions of Community Law"); see also Case C-212/97, *Centros Ltd. v. Erhvervs-og Selskabsstyrelsen*, 1999 E.C.R. I-1496 (stating refusal to register the branch of a company formed in another Member State violates Articles 43 and 48 of the Treaty for Member States).

¹³⁰ *Inspire Art*, 2003 E.C.R. at I-10155, para. 88.

¹³¹ *Id.* para. 100.

determine the connecting factor to national origin. It stated:

[U]nlike the case at issue in the main proceedings, *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.¹³²

Finally, based on the above, the Court concluded that the WFBV restricted freedom of establishment under Articles 43 and 48.¹³³ It then turned to the question of justification for the minimum capital and directors' liability provisions contained within the WFBV.

The Netherlands argued that the provisions regarding the paying-up and maintenance of minimum capital were justified by both Article 46¹³⁴ and by "overriding reasons relating to the public interest."¹³⁵ It asserted that they protected creditors and others against the risk of fraudulent insolvency.¹³⁶ In addition, it argued that the directors' liability provisions were justified by the fact that Member States, absent harmonization, had broad discretion in applying penalties for noncompliance of national law.¹³⁷ They also argued that they were justified because directors were responsible for the proper conduct of company matters.¹³⁸

The Court summarily dismissed any justifications under Article 46.¹³⁹ It classified the justifications as "aims of protecting

¹³² *Id.* para. 103.

¹³³ *See id.* para. 104 (concluding that the provisions of the WFBV relating to minimum capital and to directors' liability constitute restrictions on freedom of establishment as guaranteed by Articles 43 and 48 of the EC Treaty).

¹³⁴ Article 46 reads in relevant part "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." EC Treaty, art. 46.

¹³⁵ *Inspire Art*, 2003 E.C.R. I-10155, para. 108.

¹³⁶ *Id.* para. 110.

¹³⁷ *See id.* para. 111 (explaining that directors' liability constitutes an appropriate sanction for noncompliance with the provisions of the WFBV).

¹³⁸ *See id.* para. 112 (arguing that directors are to be expected to incur liability if the company does not comply with the provisions of the WFBV).

¹³⁹ *See id.* para. 131 (stating that none of the arguments put forward by the Netherlands Government with a view to justifying the legislation at issue in the

creditors, combating improper recourse to freedom of establishment, and protecting both effective tax inspections and fairness in business dealings"¹⁴⁰ These had to be evaluated on the basis of overriding reasons.¹⁴¹

Second, it considered the above justifications. Protecting creditors failed because creditors were already put on notice that they were dealing with U.K. companies.¹⁴² Combating improper recourse to freedom of establishment failed as *Centros* had affirmed that a company not conducting any business in the Member State of its formation could circumvent a host Member State's national law to take advantage of more relaxed rules.¹⁴³ The Court in *Centros* had thus already held that circumvention did not constitute abuse or fraud.¹⁴⁴

However, the Court took an ambiguous position with regard to fairness in business dealings and the efficiency of tax inspections. It implied, without stating anything affirmatively, that these might be justifications, but dismissed them in the absence of evidence as to "efficacy, proportionality and non-discrimination."¹⁴⁵

Finally, the Court never considered the independent legality of the directors' liability provisions. Since the minimum capital provisions were incompatible with the freedom of establishment, the Court held that its penalties were incompatible as well.¹⁴⁶ Thus, it remained unclear whether director liability could be used as a means to discourage circumvention in the proper context.

main proceedings falls within the ambit of Article 46 of the EC Treaty).

¹⁴⁰ *Id.* para. 132.

¹⁴¹ The court earlier noted that the criteria for evaluating justifications on the basis of overriding reasons: "[T]hey must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the public interest; they must be suitable for securing the attainment of the objective which they pursue, and they must not go beyond what is necessary in order to attain it" *Inspire Art*, 2003 E.C.R. I-10155, para. 133.

¹⁴² *See id.* para. 135 (pointing out that *Inspire Art* clearly holds itself out as a company governed by the law of England and Wales and not as a Netherlands company).

¹⁴³ *See id.* paras. 137-39 (discussing treatment of similar issues in *Centros* and other settled case law).

¹⁴⁴ *See Case C-212/97, Centros Ltd. v. Erhvervs-og Selskabsstyrelsen*, 1999 E.C.R. I-1459, para. 27 (holding that circumvention by itself was not an abuse of the freedom of establishment).

¹⁴⁵ *Inspire Art*, 2003 E.C.R. I-10155, para. 140.

¹⁴⁶ *Id.* para. 141.

2.4.1. Analysis and exploration of Inspire Art

Some lawyers in the EC have hailed this case as opening the path to a competition of jurisdictions.¹⁴⁷ However, in many respects, there is nothing particularly new or significant at work in this decision. First, *Überseering* would seem to have clearly already refuted the Member States' primary establishment argument.¹⁴⁸ At the same time, *Inspire Art* is the first case where the Court explicitly recognized that the freedom of establishment entailed a right of primary establishment.

Second, the Court refuted Germany's and Denmark's argument that a Member State could assert legal personality over a company. Nothing is factually new in this respect. Rather, it appears as if certain Member States merely attempted to bypass *Überseering's* decision that a Member State could not determine legal personality when a company was already a creature of another Member State by shifting terms to the "connecting factor" language left outstanding from *Daily Mail*.

In addition, the company's transfer was more legitimate in this case than in *Überseering*, where Germany had found transfer on the mere basis of share acquisition. However, *Überseering* never rested on whether there was an actual transfer.¹⁴⁹ It held that even if there had been a transfer, *Daily Mail* was essentially limited to the emigration context. Thus, the connecting factor argument was

¹⁴⁷ Matthias Hirschmann and Dirk Ellerkmann, two practitioners in the EC at the law firm Lovells, wrote:

In its *Inspire Art* decision of 30 September 2003, it held that a corporate entity validly established in one member state may transfer its administrative seat to another member state without having to comply with the second member state's stricter corporate legislation. The decision is expected to increase competition between legal types of company [sic] throughout Europe and puts further strain on the minimum capitalisation and strict capital maintenance rules of German company law.

Matthias Hirschmann & Dirk Ellerkmann, *Inspire Art: End of German GmbH?*, Practical Law Company (2003), available at <http://www.practicallaw.com/4-107-1754>.

¹⁴⁸ Even *Daily Mail* had implied that transferring the central administration to a non-set state was a protected form of establishment. After *Überseering*, where the "transfer" was to a seat state, the primary establishment argument is extremely weak.

¹⁴⁹ See Case C-208/00, *Überseering BV v. Nordic Constr. Co. Baumanagement GmbH (NCC)*, 2002 E.C.R. I-9919, para. 64 (refusing to base its holding on a transfer situation).

clearly stale from the outset.

The argument that national anti-circumvention measures could be applied under the abuse exception to freedom of establishment also is not novel. *Centros* previously held that a company not having carried on any business in the Member State under whose law it was formed that intended to circumvent a host Member State's national law did not per se fall within the scope of the abuse exception.¹⁵⁰

However, Germany and Denmark's argument did present one important issue. *Centros* had left open the possibility that the abuse exception to freedom of establishment would apply when carrying on trades, professions, or businesses as opposed to the company registration scenario.¹⁵¹

The Netherlands in *Inspire Art* tried to capitalize on this opening to argue that Inspire Art Ltd.'s failure to comply with the WFBV was abusive because the WFBV didn't concern the registration scenario, but only related to carrying on trades, professions, or businesses as the WFBV never required registration or refused recognition. Since the penalty for noncompliance was merely joint and several director liability, with the company itself not incurring any penalty, the Netherlands could strongly argue that the WFBV in this respect merely imposed additional "administrative" obligations.¹⁵² This was clearly a very strong argument from a technical point of view, especially since the Court in *Centros* had suggested that less restrictive measures than denial of registration would be permitted in order to allow creditors to obtain the necessary guarantees.¹⁵³ The *Inspire Art* decision, which rejected the creditor argument, thus reduced the protecting creditor justification to meaninglessness since creditors would be considered protected when they were merely put on notice that they were dealing with U.K. companies.¹⁵⁴

If the argument had succeeded, the impact with regard to jurisdictional competition in the EU would have surely been

¹⁵⁰ See *supra* text accompanying note 51.

¹⁵¹ See *supra* text accompanying note 52.

¹⁵² See Case C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd.*, 2003 E.C.R. I-10155, para. 99 (opinion of the Advocate-General) (explaining how the WFBV is in effect making it "necessary to satisfy the requirements imposed on the formation of a limited liability company in the Netherlands" by refusing to recognize companies established under foreign law).

¹⁵³ See *supra* text accompanying note 57.

¹⁵⁴ See *supra* text accompanying note 143.

severe. Before analyzing the precise implications of this argument, it is worthwhile to note that the goal of the anti-competition Member States following *Centros* was to find a way of preventing state of incorporation Member States with relaxed laws from exporting their rules.

Überseering was the first attempt. Rather than run head on into existing circumvention jurisprudence, the anti-competition Member States were forced to run backwards to *Daily Mail* in an attempt to capitalize on the more fundamental tension between national company law and freedom of establishment. This was staged through the technicalities of the real seat doctrine.

After the effort to use *Daily Mail* failed, the anti-competition Member States were effectively pinned against the wall. Their only judicial recourse to the problem was to take the dangerous path toward the quintessence of *Centros* itself. If they succeeded, *Centros* and jurisdictional competition would be severely crippled. This attempt was reflected in *Inspire Art*.

If these Member States had prevailed, it would have meant that minimum capital requirements would have fallen within the scope of carrying on trades, professions, or businesses. The penalty for noncompliance was director liability, provided that there was no refusal of recognition or registration. This, in turn, would have meant, namely, two things.

First, it virtually would have ensured that codetermination requirements¹⁵⁵ could be required with a similar penalty. This is because codetermination¹⁵⁶ more clearly would fall within the scope of carrying on trades, professions, or businesses, since it relates to day-to-day employee participation. Second, more importantly, it would have generally tended to allow Member States to export stricter national law rules.

In this respect, there were two possible scenarios. To illustrate this, consider the minimum capital requirements. First, a formally foreign company could comply. To do so, it would have to

¹⁵⁵ For a discussion of a German codetermination law, see Peter E. Quint, *The Constitutional Guarantees of Social Welfare in the Process of German Unification*, 47 AM. J. COMP. L. 303, 307 (1999) (explaining that codetermination grants employees significant representation on boards of major companies). *But cf.* LOMBARDO, *supra* note 8, at 40 (noting that codetermination differs significantly among European states as some workers enjoy protection in the context of company law instead of labor law).

¹⁵⁶ See LOMBARDO, *supra* note 8, at 129-33 (describing the evolution of codetermination following the Second World War).

maintain the requisite level of minimum capital in the Member State where it incorporated to take advantage of more relaxed legislation. This would have had the effect not only of imposing the stricter rule on the company when it does business in the host Member State, as the *Centros* requirement would have done, but in the home Member State of incorporation as well.¹⁵⁷ As a result, strict law would in certain issues get exported when companies sought to circumvent other issues. This would have resulted in a two-way exportation, which the real seat Member States might have found marginally equitable.

Second, a formally foreign company could choose not to comply. In this case, directors would face liability. Although the company would then take advantage of the upside of the relaxed legislation, its directors would face the risk. Since directors would tend not to want personal downside for the company's upside, they would be less likely to choose noncompliance. As a result, there would be no incentive to form formally foreign companies for the purposes of circumvention.

If they did choose noncompliance, companies could attempt to offset director risk. This could be accomplished namely through option compensation or indemnification. These mechanisms might, however, have been met with substantial opposition on the part of the anti-competition Member States. Since the justification for interfering with freedom of establishment would be fraud in this scenario, it seems unlikely that their opposition would prevail as offsetting director risk would not decrease creditor payment. Moreover, since companies are anyhow liable, it is not clear that they would incur significantly greater risk. This might have led to a situation where anti-competition Member States ensured that creditors got paid, while companies still could take advantage of more relaxed rules.¹⁵⁸ However, the increased agency costs would still tend to maintain the status quo.

¹⁵⁷ Of course, in the case of purely intrastate companies, this scenario would have had no import. Although this would not have affected purely intrastate companies, most multinational companies would have been impacted, thereby at least tending to substantially export strict law.

¹⁵⁸ This outcome would clearly have been much less effective for anti-competition Member States in codetermination, where protection of creditors is not at stake. As such, it would have only partially met their expectations. On the other hand, they could have more easily opposed option compensation and indemnification on this ground. This would have led toward retaining the status quo.

It is anybody's guess which of these two scenarios would have obtained. At a minimum, this would have maintained the status quo, or a compromise situation. If fully successful, anti-competition Member States would have sometimes exported¹⁵⁹ strict rules throughout the EC. In this respect, the potential outcomes were very similar to those in *Überseering*.

Figure 4: What if the WFBV Provisions on Minimum Capital Requirements Had Fallen within Centros's Exception Relating to the Carrying on of Trades?

One impact then of the Court's decision in *Inspire Art* is that it again avoided a possible exporting of strict law, or at a minimum, avoided retaining the status quo. This is particularly significant because the anti-competition Member States may have finally exhausted their roads for accomplishing either of these purposes, at least as far as current jurisprudential doctrine is concerned. This is visually illustrated below.

2.4.2. *The aftermath of Inspire Art: Jurisdictional competition in the EC?*

Despite the lack of major published analyses, many practitioners have therefore assumed that *Inspire Art* will definitely

¹⁵⁹ Most likely, it would not have exported strict rules very often as Member States would have no incentive to incorporate in one Member State only to transfer central administration to another Member State.

open the road to jurisdictional competition in Europe.¹⁶⁰ This is probably true, at least, with regard to allowing the possibility of competition over minimum capital requirements in the case of new incorporations. This is so for two reasons.

First, two major cases are now on point holding that neither *Daily Mail's* legal personality circumstance nor the freedom of establishment abuse exception (even when the circumvention measure appears to relate to the carrying on of trades, professions, or businesses) allow anti-circumvention measures in minimum capital requirements cases in immigrations. Thus, anti-competition Member States in this regard have come close to running out of doctrinal options.

Second, the Court appears to have held in *Inspire Art* that requirements "mandatorily"¹⁶¹ applied to formally foreign companies that have the "effect of impeding the exercise by those companies of the freedom of establishment"¹⁶² fall within the scope of registration requirements, not within carrying on trades, professions, or businesses. This tautologically means that minimum capital requirements fall within the registration requirements' scope.

However, *Centros* and *Überseering* merely construe one area of the controversy relating to relaxed rules. Most major areas, such as codetermination,¹⁶³ have yet to be construed. Clearly, the anti-competition Member States after beginning the fight in the area of minimum capital in *Centros* were not going to fight off *Centros* by putting codetermination at stake. A victory in minimum capital requirements in *Inspire Art* would have effectively protected codetermination whereas a defeat would not have explicitly

¹⁶⁰ See, e.g., Hirschmann & Ellerkmann, *supra* note 147 (suggesting that *Inspire Art* is expected to lead to jurisdictional competition).

¹⁶¹ Case C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd.*, 2003 E.C.R. I-10155, para. 100.

¹⁶² *Id.* para. 101.

¹⁶³ See Gilson, *supra* note 1, at 353 (presenting a theoretical discussion regarding the future of codetermination). Part of why codetermination has not yet been construed is because the application of codetermination rules to a branch of a foreign company is contrary to German law. In addition, codetermination is currently linked to the company statute itself. See Wymeersch, *supra* note 51, at 639 (stating that Germany could alternatively apply a comparable measure at the branch level). However, this does not mean that Germany would not in the future try to change the structure of codetermination, particularly as it can clearly no longer, after *Überseering*, require incorporation of a company's central administration in its state.

destroyed it.

The anti-competition Member States in *Inspire Art* clearly suffered a very serious defeat. One of the major issues in the jurisdictional competition is now lost to these Member States. However, they have cleverly and craftily proceeded in their quest thus far, slowly yielding one piece at a time.

In the hypothetical codetermination situation, one possibility would be a challenge based on *Daily Mail's* notion that a Member State can determine whether companies possess legal personality under its national law. This would clearly fail after *Überseering*, which was not based in minimum capital and which anyhow very firmly limited the use of *Daily Mail*.

The other possibility would be to lodge an abuse exception challenge under *Centros*. This clearly has a better chance of success than the *Daily Mail* challenge. However, the Court in *Inspire Art* gave some indications that such a challenge would fail in the case of codetermination. This is because a national law that seemed to *prima facie* be concerned with the carrying on of trades, professions, or businesses was held to anyhow restrict freedom of establishment because it was mandatorily applied, and its effect was to harm formation of companies.¹⁶⁴

On the other hand, all codetermination requirements that didn't refuse registration or recognition to companies would seem to be concerned with the carrying on of trades, professions, or businesses. This is because codetermination applies in the day-to-day life of workers in companies. As such, it is more properly within the scope of the "carrying on" exception.

It is unclear how the Court would resolve this conflict. The new "effects" doctrine suggests that it would be resolved against the anti-competition Member States. Under *Inspire Art*, it appears that mandatory requirements that affect formation simply do not fall within the scope of "carrying on." On the other hand, the Court might logically limit this doctrine as it previously limited *Daily Mail*.

This could be done by simply deciding that mandatory codetermination requirements, absent registration requirements or

¹⁶⁴ See *Inspire Art*, 2003 E.C.R. I-10155, para. 100 ("The effect of the WFBV is, in fact, that the Netherlands company law rules on minimum capital and directors' liability are applied mandatorily to foreign companies such as *Inspire Art* when they carry on their activities exclusively, or almost exclusively, in the Netherlands.").

denial of recognition, do not per se affect company formation. Certainly, there is a case to be made that they don't impact initial capital investment to the same degree. Such a decision cannot be ruled out as codetermination requirements seem to philosophically fit more properly in the "carrying on" exception that the Court might stretch in this direction. This would be especially true if it felt that labor were a more important "stakeholder"¹⁶⁵ interest than creditors.

If it did so, limiting the effects doctrine in some way or other would have interesting effects on jurisdictional competition. Once again, in a WFBV-like scenario, the formally foreign company could choose to comply with the requirement. A company that complied would have to adopt codetermination in the Member State under whose law it was formed. This would actually produce partial laxity, in addition to an exportation of certain strict laws, since companies would have some incentive to actually incorporate in order to take advantage of favorable minimum capital requirements. Once again, the strict Member States would have likely found this situation marginally equitable.

On the other hand, a company could also not comply with the codetermination requirement. In this event, the anti-competition Member State would seek director liability. The company would again try to counter by providing indemnification. However, indemnification would possibly fail in this scenario as Member States could employ consistent arguments to block it.

Assuming that they could not block it or that option compensation could be sufficiently employed to offset director risk, noncompliance may obtain. If the penalty imposed were director liability, as in *Inspire Art*, anti-competition Member States might fail to force companies to adopt codetermination requirements. However, noncompliance would obtain only at the price of increased agency costs. These costs could very well

¹⁶⁵ See Katharina Pistor, *The Standardization of Law and Its Effect on Developing Economies*, 50 AM. J. COMP. L. 97, 123 (2002) ("This term loosely refers to all parties with a stake in the firm who are not shareholders and includes investors, employees, creditors, and suppliers."). See generally THE CORPORATION AND ITS STAKEHOLDERS: CLASSIC AND CONTEMPORARY READINGS (Max B.E. Clarkson ed., 1998) (presenting collected essays on stakeholder theory); Jeswald W. Salacuse, *Corporate Governance, Culture and Convergence: Corporations American Style or With a European Touch?*, 9 NAFTA: L. & BUS. REV. OF THE AM. 33, 46 (2003) (noting that stakeholder theory is recognized in Europe, excepting the U.K.); LOMBARDO, *supra* note 8, at 79 (noting that stakeholder theory in strong stakeholder states even takes into account the interest of the State).

countervail any resultant benefit from relaxed law.

If the Court limits the effects doctrine at codetermination, a full race for laxity would thus not ensue, since compliance would result in a two-way exporting of law, while noncompliance would likely result in no exporting of law. This is visually illustrated below.

Figure 5: What if Strict Member States Were to Successfully Argue that the Effects Doctrine Does not Extend to Co-Determination?

3. FACTORS LIMITING JURISDICTIONAL COMPETITION

Although Member States with strict rules clearly have no power to restrict newly formed companies from becoming formed under the law of a Member State with relaxed rules and exporting those rules, a full jurisdictional competition scenario would require that long established companies in the strict Member States also have the possibility of changing jurisdictions.¹⁶⁶

Company law rules regarding dissolution might effectively prevent a company's ability to change jurisdictions. One possibility for restricting emigration establishments is for strict

¹⁶⁶ See Wymeersch, *supra* note 51, at 637 (noting that cross-border mergers are an effective tool, without a comparable European instrument, for accomplishing jurisdictional transfers in the United States).

Member States to impose dissolution on the emigrating company. A strict Member State would thus withdraw its legal personality where a company formed under its laws wished to emigrate.¹⁶⁷ Existing companies would have to either dissolve and reincorporate at a prohibitively high cost or not establish branches. This is so for the following reasons.

Dissolutions are not financially feasible for companies. First, Ronald Gilson notes that under Germany's real seat law, a company's changing of jurisdiction of incorporation is treated as liquidation and results in corporate level capital gains tax on the appreciation in assets. Thus, for large corporations, the added value of relaxed law in another Member State would most likely not be worth the tax cost.¹⁶⁸ In addition, three Danish scholars point out:

A change of nationality requiring dissolution in the state of origin, whereby assets are transferred to the shareholders, and re-incorporation in the receiving state, involving a transfer of assets to the newly formed company, is costly and not a feasible method. The company law rules will treat it as a different company, and therefore, contracts, loans, etc. cannot be assigned to the new company without the consent of the creditors, or contracting parties.¹⁶⁹

As a result, companies who were formed under the laws of a strict Member State could not change their jurisdiction. First, this could prevent jurisdictional competition in the case of new companies, as the *Centros* connecting factor requires that a company be duly formed in the home Member State. It is doubtful that all Member States would restrict emigration. Presumably, at least one Member State would seek to become the Delaware of Europe.¹⁷⁰

More likely, the *Daily Mail* emigration scenario would bar only existing companies from exiting. Wymeersch, however, questions

¹⁶⁷ See *id.* at 645 (asserting that so restricting emigration could lead to an immigration jurisprudence that was purposeless).

¹⁶⁸ Gilson, *supra* note 1, at 356.

¹⁶⁹ Mette Neville et al., *Free Movement of Companies under Company Law, Tax Law and EU Law*, in THE INTERNATIONALISATION OF COMPANIES AND COMPANY LAWS, *supra*, note 10, at 197.

¹⁷⁰ But see *infra* text accompanying notes 177–79.

whether *Daily Mail* would ever extend beyond the tax context.¹⁷¹ If it did not extend beyond the tax context, then it might not bar existing companies. Such an argument fails for two reasons.

First, not allowing an antecedent home Member State to deny legal personality would run against *Überseering*, which based its holding on the fact that the German rule would violate the company's Dutch legal personality.¹⁷²

Second, as things stand, companies would have to dissolve and reincorporate to take advantage of a host Member State's law. This strategy, as discussed above, is not economically viable. As a result, existing companies would not change their home jurisdictions.

They may nevertheless have an incentive to anyhow export law, perhaps by transferring their seat to take advantage of a more relaxed tax regime,¹⁷³ but this would not lead to a true jurisdictional competition as these companies could not effectively choose what state's law they were exporting. Thus, whether or not a Member State requires dissolution after primary establishment in emigration, a jurisdictional competition will not ensue for already existing companies.

In the tax context, however, there is a greater possibility that existing companies in strict Member States could jurisdictionally shop. This is because in some cases transferring effective management, without dissolution, is enough to ensure that a company is no longer fully under the tax regime of its state of origin.¹⁷⁴ However, *Daily Mail* would allow the Member State of origin to impose taxation in this event.¹⁷⁵ Such taxation may be enough to prevent well-established companies from jurisdictionally shopping for tax law.

If Wymeersch is incorrect, the decisions in *Centros*, *Überseering*, and *Inspire Art* suggest a different strategy for Member States seeking to limit the possibility of jurisdictional competition. Before considering such a strategy, one must note two points.

¹⁷¹ See Wymeersch, *supra* note 51, at 645 (expressing a concern that withdrawing legal personality would undercut the purposes of immigration that the Court had upheld).

¹⁷² See *supra* Section 2.3.

¹⁷³ See Neville et al., *supra* note 169, at 200–12, 224–26 (providing a detailed discussion why a company could change, at least to some extent, the tax regime to which it was subject without changing its company law jurisdiction).

¹⁷⁴ *Id.* at 224.

¹⁷⁵ See *id.* (stating that such a view is a basic assumption of *Daily Mail*).

First, these cases require formation "in accordance with the legislation of a Member State."¹⁷⁶ Second, a Member State's legal personality that is first-in-time (the home state) should not be interfered with except by the Member State under whose law that company was formed:

[Überseering's] very existence is inseparable from its status as a company incorporated under Netherlands law since, as the Court has observed, a company exists only by virtue of the national legislation which determines its incorporation and functioning. The requirement of reincorporation of the same company in Germany is therefore tantamount to outright negation of freedom of establishment.¹⁷⁷

A strategy in this regard, in the event that tax consequences were insufficient to control reincorporation, would be for strict Member States to alter their legislation to incorporate permanence into the attributes of their national companies so as to prevent existing companies from terminating their personality.¹⁷⁸ Such a modification would ensure that existing companies duly formed in strict real seat Member States are always subject to the strict laws.

If this modification happened, strict real seat Member States as well as state of incorporation Member States could stop companies from dissolving and reincorporating in more relaxed Member States. The question is whether they could get away with it, or whether the ECJ would extend *Überseering* to decide that a primary establishment in another Member State would offend the legal personality of the Member State under whose law a company was formed even when that company wanted to wrap up its affairs?¹⁷⁹ If a company is really a creature of national legislation, then why

¹⁷⁶ Case C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd.*, 2003 E.C.R. I-10155, para. 101.

¹⁷⁷ Case C-208/00, *Überseering BV v. Nordic Constr. Co. Baumanagement GmbH (NCC)*, 2002 E.C.R. I-9919, para. 81.

¹⁷⁸ See Wymeersch, *supra* note 95, at 18 (stating that it is not clear "[w]hether that [*Daily Mail*] may lead to fully denying companies the right to emigrate, or merely allows member states to impose certain conditions . . ."). *But cf.* Neville et al., *supra* note 170, at 224-25 (taking the view that even tax rights would not be unfettered and would be subject to the proportionality principle).

¹⁷⁹ Clearly, the ECJ didn't contemplate this situation, since it stated in *Daily Mail* that "all the systems permit the winding-up of a company in one Member State and its reincorporation in another." Case C-81/87, *The Queen v. H.M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust PLC*, 1988 E.C.R. I-5483, para. 14.

couldn't a Member State under whose law a company was formed deny dissolution?

In any event, the following are extremely likely: first, the freedom of establishment jurisprudence will lead to at least a possibility of partial jurisdictional competition¹⁸⁰ in the case of new companies; second, the competition will be averted in the case of existing companies.¹⁸¹

4. JURISDICTIONAL COMPETITION—INCENTIVE AND ASSESSMENT

The above discussion has so far mainly gone to the question of

¹⁸⁰ Harmonization through Article 44(2)(g) of the EC Treaty could potentially prevent a jurisdictional competition. Article 44(2)(g) provides in pertinent part:

The Council and the Commission shall carry out the duties devolving upon them under the preceding provisions, in particular:

...

(g) by coordinating to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or firms within the meaning of the second paragraph of Article 48 with a view to making such safeguards equivalent through the Community.

EC Treaty, art. 42(2)(g). See also LOMBARDO, *supra* note 8, at 43 (explaining that harmonization was susceptible to an alternative construction that would not allow free establishment). For an evaluation of harmonization, see Wymeersch, *supra* note 95, at 19 (noting that "harmonization has sometimes been used to achieve this type of anti-competitive conduct" and that harmonization has a poor record and would be unlikely to succeed); see also LOMBARDO, *supra* note 8, at 66 (noting that harmonization may have disadvantages in terms of regulatory failure, regulatory capture and innovative ability as well as advantages by achieving economies of scale). But cf. Christian Kersting, *Corporate Choice of Law—A Comparison of the United States and European Systems and a Proposal for a European Directive*, 28 BROOK. J. INT'L L. 1, 51–61 (2002) (providing a very detailed account of how specifically harmonization might be achieved); LOMBARDO, *supra* note 8, at 47–54 (explaining and discussing nine directives and two regulations that have been successfully adopted with respect to company law harmonization).

¹⁸¹ The jurisdictional competition for reincorporation could change if the Fourteenth Company Law Directive passes. This would allow "companies to change their [nationality] without having to be dissolved in the state of origin and re-incorporated in the receiving state." Neville et al., *supra* note 170, at 227. It could also change with the passage of the Tenth Directive on cross-border mergers. See Birkmose, *supra* note 10, at 255 (noting that this directive would make mergers between companies from several different states possible). See generally EDWARDS, *supra* note 113, at 391–393 (explaining that the Tenth Directive has not passed due to a controversial article that allows Member States to not apply workers' participation rules when an undertaking would result in not meeting the conditions required for being a representative in an undertaking's organs).

the possibility of a jurisdictional competition. However, this does not address whether Member States would actually have an incentive to compete, or whether jurisdictional competition in the case of newly formed companies would be positive. In order to ascertain the answer to these questions, this Article will take a brief look at the incentives for jurisdictional competition in the United States, and whether these incentives have positively affected U.S. corporate law. Finally, we will consider what implications these answers have for the EC.

4.1. *The U.S. Example*

A significant incentive for Delaware to be seriously interested in attracting incorporations is the franchise fee. "That this can be a considerable source of revenue may be illustrated by the fact that, in 1998, franchise tax revenue in Delaware amounted to \$400m, corresponding to more than 19% of Delaware's total tax receipts."¹⁸²

In order to get franchise fees, Delaware has led a race in the United States that has ended in increasingly relaxed corporate regulation. "Through countless adaptations of company laws, the states have tried to make the law so attractive for the companies that they choose to incorporate in their jurisdictions."¹⁸³ These adaptations have led to the seminal scholarly debate in U.S. corporate law as to whether Delaware has led corporate law in the United States in a race to the top or a race to the bottom.¹⁸⁴ This debate hinges on whether the relaxed regulation benefits

¹⁸² Birkmose, *supra* note 10, at 246.

¹⁸³ *Id.* at 245.

¹⁸⁴ For the origins of the debate, see generally William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 665-66 (1974) (noting jurisdictional competition leads to a race to the bottom); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J.L. STUD. 251, 257-60 (1977) (noting jurisdictional competition leads to a race to the top); ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* (1993) (describing the market for corporations and praising the genius of jurisdictional competition); Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1985) (documenting the importance of the franchise fee in American jurisdictional competition theory); Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469 (1987) (showing the application of interest-group theory on the race to the top or race to the bottom debate); Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435 (1992) (presenting an empirical analysis of the dynamics and effects of state competition).

management at the expense of shareholders, or whether it optimizes shareholder investments.¹⁸⁵

The race to the top argument has become dominant in U.S. corporate law scholarship.¹⁸⁶ Its proponents argue that company directors will choose to reincorporate in a state whose company law will maximize values for both shareholders and directors because their freedom is limited by market forces.¹⁸⁷ As a result, directors will maximize shareholder earnings in order to keep their positions.¹⁸⁸ The other major disciplining force is the fact that shareholders can exert a disciplinary effect on directors by withdrawing their investments.¹⁸⁹

4.2. Existing and Newly Formed Companies in the E.C.

Birkmose asserts that the EC will not have any incentive to race toward laxity for two reasons. First, the same fiscal incentives do not exist for EC Member States.¹⁹⁰ There is no equivalent to the franchise tax and the potential revenues from company income tax "will usually be regarded as being resident in the state in which the company has its seat of management according to the provisions of a double taxation convention; accordingly, that State generally has the right to tax the company's income."¹⁹¹

¹⁸⁵ See Birkmose, *supra* note 10, at 246-47 ("[T]his disagreement centers on whether the fact that the individual states periodically adapt their law to the 'needs' of the companies results in legislation enabling companies to optimise shareholder investments . . . or whether the result is legislation that favours company management . . .").

¹⁸⁶ In Europe, however, race to the top arguments have not historically been dominant. See Clive M. Schmitthoff, *The Future of the European Company Law*, in *THE HARMONIZATION OF EUROPEAN COMPANY LAW 3* (Clive M. Schmitthoff ed., 1973) (providing an example of the traditional European view on jurisdictional competition). See also Stefan Grundman, *Regulatory Competition in European Company Law – Some Different Genius?*, in *CAPITAL MARKETS IN THE AGE OF THE EURO* 561 (Guido Ferrarini et al. eds., 2002) (noting that many authors in Europe still regard jurisdictional competition as both unadvisable and not transposable). Cf. *supra* text accompanying notes 166 and 195.

¹⁸⁷ See Birkmose, *supra* note 10, at 249 (noting that the most importance of these disciplining forces is the market for corporate control and the risk of hostile takeover).

¹⁸⁸ See *id.* at 249 (explaining how the threat of a hostile takeover provides incentives for directors to act in the best interests of shareholders).

¹⁸⁹ See *id.* at 250 (stating that shareholders might decide to re-invest their money in a state with more efficient legislation).

¹⁹⁰ See *id.* at 265 (explaining that fiscal factors have been given priority by U.S. states).

¹⁹¹ *Id.* at 266. For a detailed discussion of the double taxation convention, see

This argument assumes that Member States would not race, but for an immediate fiscal tax incentive. However, it could also be argued that "countries have sought to improve their chances for corporate success by implementing the best practices from around the world. The competition among corporations in product, labor, and capital markets is thought of as being matched by competition among corporate governance models."¹⁹² Thus, if racing is the most efficient system, efficiency itself would seem to create a sufficient incentive, particularly in a global world.

Second, Birkmose argues that even if the U.S. example of the race leads to legislation that maximizes shareholder wealth, "the objective of [EC] company law is not only to regulate the relations between the company and its shareholders but also between the company and its other stakeholders."¹⁹³ Since maximizing shareholder wealth is not the only goal of EC Member States, they will be less likely to race toward laxity even if Member States are really trying to come up with the most efficient system. Birkmose thus essentially argues that efficiency is normative, and that U.S. standards will not transpose onto European standards.

Third, Birkmose suggests that under prevailing European stakeholder normative standards, a race would not be efficient. Although shareholders¹⁹⁴ would undoubtedly be protected in a competition for new incorporations, other stakeholders such as creditors and employees of a company would potentially not be protected.¹⁹⁵ In addition, he asserts that the relaxed regulation that resulted from attracting new incorporations would have a secondary effect on shareholders of existing companies.¹⁹⁶

This assertion creates two questions: (1) would the secondary effect on existing companies give rise to investment inefficiency for

Neville et al., *supra* note 170, at 200-26.

¹⁹² Garza, *supra* note 92, at 82-83 (citations omitted).

¹⁹³ Birkmose, *supra* note 10, at 251.

¹⁹⁴ See *id.* at 252 (stating that shareholders would be protected as they would "know under which conditions the company is to be operated and thus the risks involved at the time they subscribe for the shares").

¹⁹⁵ *Id.*

¹⁹⁶ See *id.* ("This danger is present because the existing companies in a Member State are subject to the same law as the new companies, and if the rules are made more lenient in order to attract new companies, these lenient rules will also become applicable to the existing companies."). Such an argument actually understates the potential secondary effect. Newly formed companies in relaxed states could export their law to strict Member States, while existing companies in strict Member States would be subject to strict rules.

shareholders; and (2) even if there is no inefficiency for shareholders, would there anyhow be stakeholder inefficiency?¹⁹⁷

Newly incorporated companies may have very different interests from existing companies. In any one Member State, each company would seem to equally bear the costs of regulation, but this is not so.

Certain newly formed companies can export law to other Member States. Existing companies will thus be at a competitive disadvantage if they are unable to change nationality. If the EC Member States decide to race—which they would do most likely out of a belief that it would at least maximize shareholder investment, as the U.S. example¹⁹⁸ strongly indicates—it is essential that the interests of shareholders in newly formed companies do not diverge too much from those of existing companies. If they diverge, then there will be no incentive to race.

5. AFTERWARD: THE EFFECT OF THE SE STATUTE

On October 8, 2004, the Statute of the European Corporation or *Societas Europaea* ("SE")¹⁹⁹ became effective.²⁰⁰ The SE Statute²⁰¹ allows companies to be established "in the form of a European public limited-liability company"²⁰² In addition, the SE Statute is relevant to a number of aforementioned important controversial issues. Among these issues are codetermination, minimum capital

¹⁹⁷ This question is so broad that it is difficult to conclusively address. However, it does seem to risk losing features such as minimum capital requirements and codetermination, which relate to the interests of creditors and employees. For example, if the ECJ rules that codetermination falls within the scope of "carrying on trades, professions or businesses," the stakeholder efficiency problem might be somewhat mitigated. See *supra* text accompanying note 41.

¹⁹⁸ See Birkmose, *supra* note 10, at 246 (suggesting that in the U.S. example uneven application would not be a concern as companies can freely reincorporate, without tax implications).

¹⁹⁹ See generally CARLA TAVARES DE COSTA & ALEXANDRA DE MEESTER BILREIRO, *THE EUROPEAN COMPANY STATUTE* (2003) (providing a broad overview of the SE Statute regime).

²⁰⁰ Friedrich Kubler, *The Societas Europaea—Implementation and Perspectives 1* (2003) (on file with author).

²⁰¹ See Robert Drury, *The European Private Company*, in *THE INTERNATIONALISATION OF COMPANIES AND COMPANY LAWS*, *supra* note 10, at 57 (noting some basic features of the SE Statute such as limited liability, close company form, legal personality from the moment of registration, and real seat theory).

²⁰² Council Regulation 2157/2001, art. 1, 2001 O.J. (L 294) 3 [hereinafter SE Statute].

requirements, and the real seat theory.

The SE Statute deals with codetermination by requiring companies to "retain or adopt the codetermination regime of the participating companies which gives the highest degree of participation to the workers."²⁰³ This means that SEs with establishments in multiple Member States will have to adopt the laws of strict Member States such as Germany in this regard.²⁰⁴

The SE Statute deals with minimum capital requirements primarily through Article 4. Article 4²⁰⁵ requires subscribed capital in excess of 120,000 Euros and allows a Member State to impose greater capital requirements on companies carrying on certain types of activities with registered offices in its Member State. This figure is substantially in excess of the minimum capital requirements of typical national companies.²⁰⁶

Articles 7 and 64 of the SE Statute deal with the real seat theory by reaching "the conclusion that SEs must have their real seat and seat of incorporation in the same state."²⁰⁷ These provisions appear

²⁰³ Kubler, *supra* note 200, at 3.

²⁰⁴ See *Euro Rules for Companies*, BELFAST NEWS LETTER, Dec. 20, 2003, at 22 ("The new laws could lead to workers' representatives sitting on boards of major companies.")

²⁰⁵ SE Statute, *supra* note 202, arts. 4(2)-(3).

²⁰⁶ See Gilson, *supra* note 1, at 351 (noting that the Danish minimum capital requirements that Centros had sought to avoid were only \$27,000, or 200,000 Danish Crowns); see also Walter D. Schwidetzky, *A Comparison of Corporate Taxation in the United States and Germany: Different Ways Up the Mountain*, 28 GA. J. INT'L & COMP. L. 217, 218 n.7 (2000) (noting that German AG minimum capital requirements of 5000 are relatively high) citing § 7 AKTIENGESETZ. An *Aktiengesellschaft* ("AG") is a German stock corporation. See generally, William J. Carney, *Limited Liability Companies: Origins and Antecedents*, 66 U. COLO. L. REV. 855, 866 (1995) (distinguishing the German GmbH, or limited liability company, from the German AG).

²⁰⁷ *The Jurisdiction Competition and the European Company*, http://www.juridix.net/eu_soc/essay4_se.htm (last visited Apr. 7, 2006) [hereinafter *Jurisdiction Competition*]. Article 7 states: "The registered office of an SE shall be located within the community, in the same Member State as its head office." SE Statute, *supra* note 202, art. 7. Article 64 states:

When an SE no longer complies with the requirement laid down in Article 7, the Member State in which the SE's registered office is situated shall take appropriate measures to oblige the SE to regularize its position within a specified period either:

a) by re-establishing its head office in the Member State in which its registered office is situated or

b) by transferring the registered office by means of the procedure laid

to retreat from the national company law cases that had the effect of nearly abolishing the real seat doctrine.

The result of these provisions is that the new European Company case law, which potentially lays the path towards a limited jurisdictional competition, may find itself wholly eroded. This is because the SE Statute threatens to impose uniformly strict standards²⁰⁸ on controversial areas that would mark a retreat from the position that will likely obtain as a result of *Daily Mail*, *Centros*, *Überseering*, and *Inspire Art*. However, a few different circumstances would likely prevent this result.

First, the SE Statute in codetermination matters could be manipulated by an SE setting up a foreign subsidiary in another Member State and then merging into it. Article 66 of the SE Statute, in turn, allows companies registered in one state, after a two year period, to transform itself into a public, limited-liability company governed by national law.²⁰⁹ Thus, Professor Kubler notes:

[A] German corporation will be able to merge with a much smaller foreign company, which may be its subsidiary, into an SE under British, Dutch or Luxemburg law. But after two years . . . the company would no longer be determined by German law, but by the legal system of its registered office.²¹⁰

Although companies can currently, after the expansive interpretation of the term “branch”, establish their seats in host Member States, this technique would allow existing companies to go one step further. They could export relaxed laws by changing a host Member State into a home Member State without the expense of setting up a network of subsidiaries.²¹¹ This, of course, assumes

down in Article 8.

Id. art. 64.

²⁰⁸ This possibility marks a significant contrast from the popular viewpoints expressed in the European press. See, e.g., John Plender, *Continental Capitalism à la Carte*, FIN. TIMES, Feb. 21, 2003, at 17 (discussing fears that the SE Statute will lead to a *la carte* capitalism); *Glass is 5% Full – Or 95% Empty*, FIN. TIMES BUS. L. EUR., Sept. 30, 1997, at 8 (noting that the SE Statute will be an invitation to shop for accounting, auditing, and tax treatment)

²⁰⁹ See Kubler, *supra* note 200, at 7 (pointing out a potential loophole in the statute).

²¹⁰ *Id.*

²¹¹ See Press Release, European Commission, European Company Statute:

that such a technique would not incur additional offsetting expenses.

Whether such a strategy would incur tax consequences is not yet concrete.²¹² If the SE merger technique did incur tax consequences, then SEs would be unable to avoid strict requirements. In addition, it is highly likely that company emigration will carry other costs in certain Member States, such as Germany. These additional potential costs will likely include appraisal rights, even though such rights are considered to be at odds with the SE-Regulation.²¹³

In any case, the SE-Regulation may have only a limited effect on jurisdictional competition since new companies will likely not decide to form as SEs at all. Such companies have nothing to be gained from a potential conversion to another national law at the expense of more stringent initial requirements, particularly in the case of minimum capital requirements.

Existing companies, however, will probably become SEs, even though existing companies registered in non-codetermination Member States might fear the added costs of subjecting themselves to a strict codetermination regime by merging with a company in such a Member State.²¹⁴ The possibility of merging and subsequently becoming national companies of another Member State with less strict law should induce existing companies to form as SEs, with the exception of Germany and other countries where the costs would be too severe. The emigration obstacles that existed under *Daily Mail* will thus be lifted, and, in the longer run, such restrictions will ultimately be lifted even in the most obstinate

Commission Welcomes Formal Adoption (Oct. 8, 2001), available at <http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/01/1376&format=HTML&aged=1&language=en&guiLanguage=en> (last visited Apr. 7, 2006) ("The European Company will enable companies to expand and restructure their cross-border operations without the costly and time-consuming red tape of having to set up a network of subsidiaries.").

²¹² See *Jurisdiction Competition*, *supra* note 207 (noting that it is uncertain what the tax consequences of SE mergers will be); HM Treasury, *A Competitive and Modern Business Tax System: Pre-Budget Report 2003* 5 (Dec. 10, 2003) (noting that the SE STATUTE does not mention tax law).

²¹³ Friedrich Kubler, *A Shifting Paradigm of European Company Law?*, 11 COLUM. J. EUR. L. 15. (2005).

²¹⁴ A merger of this type would dilute shareholder rights regarding control of the Board. See Plender, *supra* note 208, at 17 ("But . . . under the new legal regime such a merger decision could only be taken by statutory majority and with specific protections for minority shareholders.").

Member States, or German corporations will miss out on the "reorganization of European industries across the traditional borderlines" and valuable merger opportunities.²¹⁵ The result will inevitably be a full jurisdictional race in the long run, and an almost complete jurisdictional race in the short run. This will effectively crush the real seat doctrine and, for better or worse, will supplant the invisible hand of the indirect efficiency of laxness with the stakeholder theory and its ostensible virtues.

6. CONCLUSION

The four company law cases considered here have progressively eroded the ability of strict Member States to prevent jurisdictional competition. *Daily Mail* took the first modest step in this course by declining to announce an anti-circumvention principle. Instead, it contemplated that freedom of establishment would conflict with national company law, namely when a Member State could assert that a company was a creature of its law. Although effectively anti-circumventionist in the singular factual situation which it narrowly contemplated, it served as the basis for holdings that would severely limit a state's ability to restrict jurisdictional competition.

Daily Mail should therefore not be viewed as a guise to subvert the freedom of establishment. Instead, *Daily Mail* was the beginning of an attempt to carefully reconcile vestiges of previously existing notions of company national law with Articles 43 and 48 of the EC Treaty.

Centros took another step towards permitting jurisdictional competition. It explicitly stated that circumvention in itself was not contrary to the freedom of establishment. Instead, it rearticulated *Daily Mail*'s basic contention that a Member State had no power over a company, unless that company was a creature of its law. In so doing, it announced that the ECJ would not stretch *Daily Mail* to advance the anti-circumventionist cause. At the same time, it suggested that Member States might nevertheless be free to restrict companies that carry on trades, professions, or businesses without violating the freedom of establishment.

Überseering was the first and only case that made the EC directly confront the tension between traditional national company law and the freedom of establishment. *Daily Mail* had held that a

²¹⁵ Kubler, *supra* note 213, at 17.

Member State having legal personality was sufficient to lift Articles 43 and 48 impediments to restrictions, despite a transfer of the management office. *Überseering* forced the Court to answer whether real seat Member States could simply assert that a company became a creature of its national law, even when another Member State had not ceased to confer legal personality. No matter what the Court's answer is, some traditional notion of what it had meant to be a company under national law would have fallen.

At the end of the day, the Court concluded either (1) that the real seat's notion of legal personality would yield to the state of incorporation's notion, or (2) that a second Member State cannot assert legal personality to the detriment of another State. In any event, the Court's decision further prevented Member States from restricting the exportation of national laws.

Inspire Art was a perhaps a final attempt to obtain the power to prevent jurisdictional competition in company law. Strict Member States sought to favorably apply the unfavorable after their legal personality attempt failed in *Überseering*. With few avenues left, strict Member States sought to favorably apply the unfavorable by basing its minimum capital requirements on *Centros*. Although this case had held such requirements contrary to the freedom of establishment, it asserted a potential exception for restrictions that dealt with the carrying on of trades, professions, or businesses.

The Court, however, had other plans. The carrying on exception was not applied, even though the Danish law in question did not deal with registration requirements. The Court concluded that it was sufficient that the restrictions were mandatorily applied and had the effect of creating a heavy burden for companies seeking to form.

Inspire Art seems to all but close the strict Member States' final door for obtaining further power to prevent jurisdictional competition with regard to certain issues. The fate of codetermination in freedom of establishment jurisprudence will likely still have to be determined. This is because codetermination may not sufficiently affect company formation in the same way as minimum capital requirements do. In addition, codetermination more properly may have been what the Court contemplated in *Centros* when it announced the carrying on exception.

Case analysis of the most recent freedom of establishment company law cases demonstrates that it is unlikely that Member States will have power beyond *Daily Mail's* emigration scenario to

limit jurisdictional competition. This power, even if no other measures are possible, will likely prove to be sufficient for preventing existing companies from jurisdiction shopping because the tax burden will outweigh any conceivable legal advantage. Such barriers, however, are not applicable to new company formation. In new company formation, jurisdictional shopping will remain a strong possibility.

Jurisdictional shopping does not necessarily imply a race to laxity. A Member State must have an incentive to develop relaxed laws, or such a race will not obtain. EC Member States, unlike Delaware, do not have adequate tax fiscal incentives.

However, the current body of U.S. scholarship suggests that a race to laxity is naturally, albeit indirectly, efficient. Economic efficiency in itself might thus be an adequate financial incentive. This naturally depends on whether EC Member States progressively come to accept this body of U.S. scholarship. Under the currently dominant stakeholder theory in the EC, a race would not be efficient because it would adversely affect the rights of creditors and workers. In addition, a race might not be efficient in the EC even under a shareholder theory. This is because shareholders of existing companies would be at a disadvantage to take advantage of relaxed rules vis-à-vis shareholders of new companies.

On October 8, 2004, the SE Statute was enacted, which governed specifically the formation of EC companies. This statute, by imposing codetermination and minimum capital requirements on SE companies, threatened to effectively undo the results of the ECJ's recent case law, opening the way to a possibility of jurisdictional competition. However, as Professor Kubler discovered, a potential exists for SE companies to merge with subsidiaries and to subsequently become governed by national company law after a two-year period. This would effectively allow existing companies to export the law of a new home state without the expense of setting up subsidiaries. In the short run, certain Member States, such as Germany, may evade the SE Statute by imposing costs on dissolution, but such Member States will miss out on the internationalization and reorganization of European industry. In the long run, it appears clear that such Member States will be forced to accept the full implications of the SE Statute and, to the detriment of stakeholder theory values, full jurisdictional competition will ensue.