

Understanding Corporate Mobility in the EU
*Towards the Foundations of a European ‘Internal Affairs
Doctrine’*

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1. Introduction

This article seeks to understand the way we think about corporate mobility in the European Union (EU). It does so by tracing the developments in the area of corporate law back to the establishment of the EU in 1957. It appears that the member states have consistently attempted to block any intervention into their national legislation in this area which in turn has limited cross-border mobility of firms. This immobility has, however, been challenged by the European Court of Justice’s line of cases starting with *Centros*, which set in train the basis for cross-border movement of administrative headquarters and the migration of new firms to more favourable jurisdictions. In addition, the implementation of the *Societas Europaea* (European Company, SE) Statute in October 2004 created for the first time the possibility for reincorporation without liquidation of the old entity and the formation of an entirely new vehicle. The central question is whether these developments are sufficient to encourage cross-border activities, such as mergers, restructurings and re-incorporations. The analysis in this article makes it not only possible to identify the shortcomings of the current EU approach to corporate mobility, but also to design policies that can lead to a more efficient legal framework.

The starting point of the discussion is that corporate mobility yields a significant improvement in the performance of ‘European’ firms and hence boosts the confidence in the economic growth within the EU as depicted in the objectives of the Lisbon Strategy to create the most dynamic and competitive information-based economy by 2010. In the United States (US), the internal affairs doctrine arguably plays a crucial role in fueling economic growth, creating new jobs, and providing for innovative and new technologies. It ensured that firms of all sizes could operate throughout the nationwide market without being hampered by severe constraints resulting from the different corporate laws in each state. Under the internal affairs doctrine, courts will apply the law of the state of formation to the corporate affairs – the

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relationships among the directors, officers, and shareholders – even if the corporation in question has no other business in that state.¹

The internal affairs doctrine thus facilitates two main types of corporate mobility. The first type of corporate mobility refers to the choice of new firms to incorporate in whichever state offers the most attractive corporate law legislation. In this paper, this phenomenon is referred to as the ‘incorporation mobility’. Existing corporations that opt to reincorporate in another state fall under the second type of mobility, which we will call the ‘reincorporation mobility’. A firm can decide to reincorporate by merging with a company in another member state,² by converting to a different business form in a foreign member state or, simply, by transferring its statutory seat. In the latter case, the firm will change the legal regime applicable to its corporation.

Despite the fact that the US internal affairs doctrine is not constitutionally mandated and amendable to change by a particular jurisdiction, states generally adhere to it.³ It seems that most jurisdictions in the US historically tend to comply with a deeply ingrained comity principle that slowly but surely developed into an internal affairs doctrine. To be sure, section 302 of the Restatement (second) of Conflict of Laws codifies this doctrine, but this does not deprive a court or state legislature of the possibility to deny this doctrine by subjecting internal matters of foreign corporations to a different set of rules. Nevertheless, it is acknowledged that such a move would be onerous on the lawmakers as it could trigger federal intervention, retaliatory responses from other states and, more importantly, the relocation of operations by firms affected by a renouncement of the internal affairs doctrine.

In Europe, in contrast, the equilibrium is quite different. Upon the inception of the European Union, most member states followed the real seat doctrine, which ties a firm’s state of incorporation to its administrative seat. This limits choice of situs and forecloses corporate mobility. On the one hand, national legal regimes created barriers to mobility to preserve national lawmakers’ autonomy, while on the other hand preservation of national discretion reinforced the barriers. The member states looking toward preservation of national regulatory discretion have prevailed in the European corporate law setting for a long time, thereby setting the basis for a non-mobility equilibrium. Although we should emphasize that this was

¹ Under the Restatement (Second) of Conflict of Laws §294, general contract choice-of-law rules, rather than the internal affairs rule, apply to non-corporate business forms, such as general partnerships. The rights and duties owed by partners to each other are determined by the local law of the state which, with respect to the particular issue, has the most significant relationship to the partners, unless the parties have chosen the law of another state to govern their contractual rights and duties.

² Such a merger can take several different forms, for instance: (1) a company in member state A will be absorbed into a corporation in member state B or (2) the merger will result in the establishment of a new entity which will continue the operations of the merging companies.

³ See *The Internal Affairs Doctrine: Theoretical Justifications and Tentative Explanations For Its Continued Primacy*, Note, *Harvard Law Review*, vol. 115, 2002. See also Ribstein, L.E., *The Evolving Partnership*, *Journal of Corporation Law*, vol. 26, 2001, p. 825-827.

not intended with the creation of the EU,⁴ founding member states, such as France and West Germany, feared the consequences of an outbreak of a so-called ‘race-to-the-bottom’ in corporate lawmaking. This led to the introduction of top-down harmonization of national corporate law. Under this strategy, the member states entered into a cooperative game in which the parties agreed, in exchange for political benefits or rents, to desist from opportunism after attaining Community membership. The cooperative agreement among member states included another element; the member states would only agree to the harmonization of the national corporate laws if this could be achieved without the alteration of the core components of their laws.⁵

The legislative autonomy was also confirmed by the reluctance of member states to adopt EU level corporate law. While the EU continued to pursue its harmonization strategy, policymakers within the Commission had set out to design a more independent agenda on the basis of Article 308 (ex 235).⁶ The introduction of EU level business forms, such as the *Societas Europaea* (SE), was designed to stimulate cross-border mobility while, at the same time, covering the creation and conversion of undertakings. Despite the introduction of the European Economic Interest Grouping (EEIG) in 1985 and the SE in 2001, this strategy arguably failed to break down member states’ continued preference to retain legislative autonomy and control over core areas of corporate law.

Still, there is something to be said for the introduction of the SE. Although this EU-level business form, which entered into force in October 2004, is mainly viewed as a compromise legislation that offers a rigid and unattractive choice for firms to structure their internal affairs,⁷ the SE Statute at least allows these firms to merge across borders and transfer their seat from one member state to another. The internal governance structure of an SE continues to be governed largely by national legislation. It can be viewed as a first attempt to give firms a possibility to pursue the second type of corporate mobility. Since existing European firms may employ the SE to reincorporate in other member states, the Statute holds out a path around the obstacles surrounding the reincorporation process: a path which seems too narrow to lead to undisturbed choice of situs of incorporation. For instance, start-up firms

⁴ The Treaty of Rome (1957) provided for the right of establishment for foreign corporations to establish branches in another member state, without being subject to more restrictive corporate law provisions of the host state.

⁵ See Charny, D., Competition among Jurisdictions in Formulating Corporate Law Rules: An American Perspective on the ‘Race to the Bottom’ in the European Communities, *Harvard International Law Journal*, vol. 32, 1991.

⁶ Article 308 (ex 235) specifies two preconditions for unification: (1) action by the Community should prove necessary to attain, (2) the powers provided in the Treaty are insufficient. See Buxbaum, R.M. and Hopt, K.J., *Legal Harmonization and the Business Enterprise, Corporate and Capital Market Law Harmonization Policy in Europe and the United States (Volume 4)*, Berlin - New York: Walter de Gruyter, 1988, p. 210-12.

⁷ See McCahery, J.A. and Vermeulen, E.P.M., Does the European Company Prevent the ‘Delaware-effect’?, *European Law Journal*, Vol. 11, 2005, p. 785-801.

cannot establish an SE *ex novo* or *ex nihilo*.⁸ What is more, the provisions set forth in the Directive on Involvement of Employees detail the level of employee involvement in the formation and operation of an SE and, as a result, decrease rather than increase the SE's attractiveness.⁹

In recent years, a series of path-breaking decisions by the European Court of Justice (ECJ) involving the freedom of establishment of foreign corporations and the mutual recognition of corporations by the member states have also disturbed the EU non-mobility equilibrium. The rulings in *Centros*, *Überseeing* and *Inspire Art* make it possible for new firms to migrate to more favourable corporate law jurisdictions.¹⁰ However, these decisions do not explicitly introduce the possibility of free choice for *existing* firms that intend to migrate across borders. That is what they must mean if the EU is to approximate the freedom available to companies in the US where both types of corporate mobility are possible and acknowledged. It could therefore be argued that so long as that zone of discretion remains in place, the real seat doctrine has only been eradicated in part. Residual barriers to reincorporation, such as tax barriers, continue to make European firms highly immobile. The main types of corporate mobility are thus partially achieved by the introduction of the SE Statute and the triad of ECJ judgments.

New legislation may be required to invalidate member states' discretion to ignore the internal affairs doctrine. However, rapid developments in ECJ case law suggest that member states can also embrace a judge-made doctrine. For instance, the recent adoption of the Directive on Cross-Border Mergers certainly allows limited liability entities to merge and restructure themselves across borders within the EU.¹¹ In this respect, the implementation of the Directive will give an important impetus to the breakdown of the non-mobility equilibrium in the EU. It will help overcome some of the most important obstacles to cross-border mergers that still exist due to differences in national corporate laws. Particularly, it will give firms that are not able to seek incorporation under the SE Statute a legal instrument to merge with firms that operate in other member states. But here too the ECJ, forced to preempt defensive actions by member states in the *Sevic*-case,¹² arguably filled in the gaps in the legislation even before the actual implementation of the Directive in the member states. This

⁸ The significant amount of minimum capital that is required to form an SE is yet another dissuasive element in the SE Statute. The minimum capital requirement of €120.000 would certainly prevent start-up firms to opt for this EU-level business form. See section 4 of the Council Regulation (EC) No. 2157/2001 of 8 October 2001 on the Statute for a European company (SE), *OJ* 2001 L 294/1-21.

⁹ See Council Directive 2001/86/EC [2001] *OJ* L294/22.

¹⁰ See ECJ, Case C-212/97 *Centros Ltd and Erhvervs-og Selskabsstyrelsen* [1999] *ECR* I-1459; Case C-208/00 *Überseeing BV and Nordic Construction Company Baumanagement (NCC)* [2002] *ECR* I-9919; Case C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd* [2003] *ECR* I-10155.

¹¹ See Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies, *OJ* 2005 L 310/1-9.

¹² See Case C-411/03 *Sevic Systems AG* [2005] *ECR* I-10805.

reinforces the question: what is the probability that member states are likely to accept the internal affairs justification without the promulgation of new EU legislation, such as Directives or EU-level regulations? Still, even if the member states accept the ECJ case law and do not challenge the creation of an internal affairs doctrine, a puzzle surely remains: will the cooperative equilibrium breakdown and lead to more corporate mobility? Can we expect mobility where the critical tax barriers remain in place limiting corporate migration? To answer these questions, this paper will critically assess the implications of the ECJ's statement in *Sevic* that EU-level legislation is not a precondition for corporate mobility. After all, harmonization Directives and ECJ case law could very well complement each other.¹³

This paper has four parts. Part 2 surveys the evolution of recent ECJ case law that may disrupt the corporate law equilibrium and also accentuate pressure on national tax systems. It sets out a detailed map of current and potential paths of cross border corporate mobility. We initially focus on the magnitude of mobility of start ups and closely held firms. Questions regarding the impact of the case law will also be addressed. In Part 3 we compare the corporate law routes opened by the ECJ with the additional opportunities for mobility imported by the EU level initiatives, such as the Merger Directive and the SE. The level of cross-border mobility is measured and considerations about extending EU level initiatives are analyzed in respect of their effect on legal mobility. Part 4 considers the residual barriers to corporate mobility. We inquire into the possibility of free choice of corporate situs and tax residence while considering the question as to which additional routes – whether judge-made or through legislative action – could improve and stimulate cross-border mobility in the EU. Part 5 concludes.

2. ECJ Case Law as the Foundation for an Internal Affairs Doctrine

2.1 The 'Incorporation Mobility' Case Law

Corporate mobility is, as we have seen, a complicated notion which can be broken down in two separate categories. Legal scholars generally distinguish between incorporation of start-up firms and the reincorporation of existing firms. As for the first type of corporate mobility, it is now generally accepted that the post-*Centros* decisions have made it possible that an entrepreneur in member state A, even if this is a classical real seat jurisdiction, wishes to incorporate their start up company in member state B, they can do so and later establish a branch in state A, which will contain all of the activities and assets of the business. Even if the establishment in state B serves the purpose of avoiding state A's rigid corporate law rules,

¹³ See also Hopt, K., Concluding Remarks 1st ECFR Symposium in Milan, 2006, *European Company and Financial Law Review*, Vol. 4, 2007.

such as minimum capital requirements, the organizers normally obtain full recognition in state A without application of any of its corporate law.

The *Centros*-case is an example of this scenario. *Centros* involved Danish nationals who, seeking to evade Danish minimum capital requirements, organized a close corporation in the United Kingdom. Then, seeking to establish the actual business in Denmark, the organizers sought Denmark's permission to register a branch. This permission was refused, and the ECJ decided that so doing was contrary to the freedom of establishment under Articles 43 and 48 of the Treaty. Denmark, like the UK, follows the theory of incorporation. The firm's primary establishment – its legal status as a corporation – was accordingly beyond dispute in Danish courts. The case solely concerned the 'secondary establishment' of a branch by an English private company in Denmark. Secondary establishment alludes to the setting up of agencies, branches or subsidiaries. The ECJ expanded the scope of the term 'branch', reducing the difference between primary and secondary establishment to a minimum and ruling that it was contrary to the Treaty for Denmark to refuse to register a branch of a firm organized as a private limited company in the United Kingdom solely to evade the application of Denmark's minimum capital requirements.¹⁴ To be sure, under the *Cassis de Dijon* decision,¹⁵ the Court does allow Treaty freedoms to be restricted when justified by the public interest, applying a multistep rule of reason test. But the ECJ rejected the Danish justification for minimum capital. Creditors of closely held firms, said the Court, could look to other protections than minimum capital requirements, and governments seeking to protect creditors could adopt measures less burdensome on fundamental freedoms.¹⁶

Centros did not involve a country of origin holding to the real seat doctrine, and thus did not explicitly rule the real seat doctrine contrary to community law. Nevertheless the judgment has important implications for corporate migration. The English private company in the case had been incorporated by Danes who at all times lacked any intention to conduct operations in the UK. Read broadly, the case shows that actors can situate their incorporations in countries offering internal processes and legal regimes that lower their costs regardless of where the firm's assets, employees and investors are located.¹⁷ But there may be limits on the

¹⁴ See Ebke, W.F., *Centros – Some Realities and Some Mysteries*, *American Journal of Comparative Law*, vol. 48, 2000, p. 961-986.

¹⁵ Case 120/78 (*Rewe Zentrale AG v. Bundesmonopolverwaltung für Branntwein*), [1979] ECR 649.

¹⁶ At the time of the *Centros*-decision, most member states viewed minimum capital requirements as essential to obtaining limited liability protection. However, these requirements do not pass the four factor test. See *Centros* §34: '[I]t should be borne in mind that, according to the Court's case law, national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfill four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary to attain it.'

¹⁷ This trend is far from new. In *Segers* (case 79/85 *Segers v Bedrijfsvereniging voor Bank- en Verzekeringwezen, Groothandel en Vrije Beroepen* [1986] ECR 2375), the court already decided that

privilege extended. *Centros* leaves open the parameters of the principle of mutual recognition. In a future case where a member state imposes higher minimum standards as a condition for recognition, said the ECJ, such measures must be proportional and non-discriminatory.¹⁸ It still remains to be seen which minimum standards will prove proportional and non-discriminatory, in particular minimum standards protecting stakeholders other than creditors.

The ECJ continued along the *Centros* path in *Überseering*, opening the door to transfer of the real seat. The case holds that where a firm incorporated in member state B, in which it has its initial registered office, is deemed to have moved its actual centre of administration to state A, Articles 43 and 48 preclude state A from applying its law so as to deny the capacity to bring legal proceedings before its national courts.¹⁹ As in *Centros*, refusal to recognize a firm's corporate status was held to be a disproportionate sanction for the mere transfer of the real seat. It could be argued that strictly speaking, the *Überseering*-judgment does not cover the incorporation process by a newly established firm in a member state different from its actual place of business. However, since the existing corporation did not move its statutory seat – and thus kept its corporate nationality – this case is considered to be a further clarification of *Centros* and not a different type of corporate mobility.

Both *Centros* and *Überseering* left open questions respecting the scope of a member state's privilege to apply national law to pseudo foreign companies. *Inspire Art* answered some of these questions, extending the rule beyond recognition and standing to cover application of a member state's broader system of corporate law. *Inspire Art* involved a Dutch enterprise organized in the UK solely for the purposes of avoiding stringent rules of Dutch company law. The organizers registered a branch in the *Handelregister* of the Chamber of Commerce in Amsterdam, but refused to register as a pseudo-foreign company. Two questions went to the ECJ: (1) whether Articles 43 and 48 preclude the Netherlands from setting additional demands such as those found in Articles 2-5 of the *Wet op de formeel buitenlandse vennootschappen (WFBV)*-Dutch law on pseudo-foreign companies); and (2) whether, if the provisions in the *WFBV* are found to be incompatible with European law, Article 46 must be interpreted so that Articles 43 and 48 do not preclude the Netherlands from applying rules such as those set forth in the *WFBV*, on grounds of creditor protection.

under Article 43 (ex 52) a Dutch sole proprietor could incorporate in England, because setting up a Dutch close corporation took considerably longer – even if he intended to continue to operate wholly in the Netherlands.

¹⁸ See *Centros* §§31-38.

¹⁹ The ECJ rejected German case law principles under which a Dutch corporation was denied legal entity status and, consequently, the right to bring an action in a German court. The ECJ took the view that since member states defer negotiating the mutual recognition of firms under Article 293, the denial to the Dutch corporation of the procedural right to bring an action fails to comply with Articles 43 and 48 of the Treaty.

The ECJ held that Article 1 of the *WFBV*, which required *Inspire Art* to register as a pseudo-foreign company, was contrary to Article 2 of the Eleventh Council Directive, which does not allow member states to impose disclosure requirements in addition to those provided by the Directive. In terms of the second issue before the ECJ, the Court referred to its earlier judgments and ruled that it was immaterial for the applicability of the freedom of establishment that a company, established in a certain member state, carries out its operations in another member state. Moreover, the ECJ held that the minimum capital requirements for pseudo-foreign companies mandated by the *WFBV* were in violation of the freedom of establishment, as they were not justified by the exception of Article 46 or any other requirement in the general interest.

Summing up, *Centros* introduced constitutionally mandated mutual recognition and constitutional review of minimum standards. It implied, contrary to the real seat doctrine, that incorporation in one member state cannot be called into question in another simply because the firm's central administration is not located in its state of incorporation. *Überseering* carries the line of reasoning to a transfer of real seat context. *Inspire Art* extends the ruling from mandated access to judicial process to substantive corporate law more broadly.

2.2 The 'Reincorporation Mobility' Case Law

The recent triad of ECJ decisions does not cover a reincorporation scenario, which could be achieved as follows: Company X that wishes to reincorporate in member state B. To this end, company X plans to organize a shell company X1 in state B and then merge company X into the shell. Company X will retain its administrative headquarters in State A and remain resident there for tax purposes. The company law of neither state A nor state B includes provisions that facilitate a merger of a company formed thereunder with a company formed under the laws of another state.

The lack of corporate law provisions to facilitate company X's planned transaction was the rule rather than exception in the EU. Mergers of this kind were only possible in a small number of member states, specifically, Greece, Italy, Portugal, and Luxembourg. The other member states lacked this enabling legislation. National policymakers, content to follow old patterns, have added few incentives for business parties to undertake cross-border combinations. Absent statutory recognition of the merger, company X literally must transfer its assets and liabilities to a new entity in state B, liquidating itself in state A prior to the transfer.

A robust freedom of establishment arguably should cover this type of cross-border merger. But also here, the ECJ comes close in its decision in respect of the merger between the *Security Vision Concept SA* and *Sevic Systems AG*. The case concerns a sale of all assets by a Luxembourg firm to a German firm in exchange for the German corporations's common

stock. The parties structured the transaction so that the Luxembourg transferor liquidated after the asset transfer. German corporate law recognized such mergers ‘by dissolution without liquidation’ only among domestic firms, and the German register of companies refused the registration of the merger. The ECJ held the refusal violates Articles 43 and 48 of the Treaty, citing cost savings and brushing aside concerns like fiscal supervision and protection of creditors and minority shareholders.

Note that the merger in the *Sevic*-case did not traverse the law of the transferor state, Luxembourg. The scenario we described above accordingly is not covered in all particulars – company X needs the right to exit state A’s corporate law regime in addition to recognition of the merger in state B while keeping its headquarters in state A. *Sevic*, however, covers a merger that results in both the transfer of the statutory seat and the real seat. Exit from state A becomes complete only if state A recognizes the state B incorporation of an entity with a local administrative seat. State A’s real seat doctrine could thus remain as an independent barrier.

2.3 The Practical Impact of the ECJ Case Law

The European Court of Justice decisions in the *Centros*, *Überseering* and *Inspire Art* cases only recently set in train the basis for the cross-border movement of administrative headquarters and the migration of new firms to more favourable jurisdictions. Recent empirical work shows that these decisions have improved incorporation mobility because a significant number of continental European privately held firms have been influenced by the absence of minimum capital requirements to establish as a private limited company in the UK. For example, Marco Becht, Colin Mayer and Hannes Wagner investigated new company formations in the UK between 1997 and 2005, revealing that the number of foreign private limited companies increased from 3,360 in the pre-*Centros* era to 19,860 post-*Centros*.²⁰ Moreover, they show that during this period 26,000 of the more than 70,000 private limited companies were located in Germany alone. They show that past 2002 increases in legal migrations from continental Europe to the UK averaged approximately 300 per year.

The resulting improvement of incorporation mobility allows the development of some arbitrage with respect to minimum capital rules. The mandatory capital maintenance rules with respect to the repurchase of issued shares, the reduction of capital, the issuance of new shares and the minimum capital requirements mandated firms to hold on their books accounts often in excess €8,000. The effect of these mandatory rules is to limit the flow of potential wealth-constrained entrepreneurs from starting-up a business. As a consequence, the demand for low-cost company law vehicles unhindered by capital maintenance requirements is relatively high across the EU. One would expect that the jurisdictions without minimum

²⁰ See Becht, M., Mayer, C., and Wagner, H.F (2006), Where Do Firms Incorporate? ECGI Law Working Paper No.70/2006, September 2006.

capital requirements are likely to attract more registrations of start-up companies. This finding is corroborated by the Germany Government's official data collection body (see *Table I*).

Table 1: Ratio of new incorporations GmbH – Limited (Private Company UK)

	01/2005	02/2005	03/2005	04/2005	05/2005	06/2005	07/2005	08/2005
GmbH	3115	3113	3216	3018	2675	3056	2637	2666
Limited	357	359	403	429	399	426	381	441

Source: Deutscher Bundestag (BT) – Drucksache 16/283 – 16.12.2005 – Auswirkungen und Probleme der Private Limited Companies in Deutschland.

We have to keep in mind, however, that those European firms incorporating in the UK are mostly 'round-trippers'.²¹ There are several reasons for this. Firstly, evidence indicates that lower costs are a main factor inducing especially small companies to incorporate in the UK. Economic work shows that in the pre-*Centros* era, forming a private company is rather expensive, as a percentage of GNI per capita, and involves many long and complex formalities in most member states.²² Secondly, the reason the UK is attractive is that it often takes some days rather than several weeks to actually establish a company. Thirdly, registration agents in continental Europe advertise and vigorously promote the UK as a major destination for small companies. It is common for agents to lure entrepreneurs by offering to create a company within 24 hours for insignificant sums. This trend provided incentives for lawmakers to reduce or eliminate outmoded minimum capital rules for private companies, which could be easily obtained by lowering the minimum capital requirements and providing simpler formation rules.²³ For instance, France already lowered its minimum capital requirement to €1 in 2003. Germany and the Netherlands will most likely continue to follow this trend.²⁴ In Germany, it is proposed to reduce the minimum capital from €25,000 to €10,000.²⁵ Dutch lawmakers seek to totally abolish the legal capital concept.²⁶

To the extent that small companies continue to select the UK private limited company to avoid costly and burdensome incorporation procedures, lawmakers will simply replicate the UK template to undermine the competitive advantage of the UK vehicle. Incorporation

²¹ See Becht, M., Mayer, C., and Wagner, H.F (2006), Where Do Firms Incorporate? ECGI Law Working Paper No.70/2006, September 2006.

²² See Djankov, S., La Porta, R, Lopez-de-Silanes, F., Shleifer, A., The Regulation of Entry, The Quarterly Journal of Economics, vol. 117, 2002.

²³ See Armour, J., Legal Capital: an Outdated Concept?, European Business Organization Law Review, vol. 7, 2006.

²⁴ In making this projection, we must acknowledge that the jurisdictions that are most affected by the UK private limited company, such as France, Germany and the Netherlands, take legislative actions.

²⁵ See Seibert, U., Close Corporations – Reforming Private Company Law: European and International Perspectives, European Business Organization Law Review, vol. 8, 2007.

²⁶ See Van Duuren, T.P., Portengen, H.J., Vermeulen E.P.M. and Bier, B., De vereenvoudigde BV, Preadvies van de Vereniging 'Handelsrecht' 2006, Deventer: Kluwer.

mobility is then only sustainable so long as there are sufficient other economic rents for small businesses and their agents. This suggests why it is so important for lawmakers to draft and modify their legislation to counter the forces stimulating the out-migration of smaller firms.

More importantly, the development of incorporation mobility reveals a number of important disadvantages to adopting a foreign corporate law regime. When a German company employs a UK limited, it might face more costs than initially expected due to the different business environment. These costs include loss of personal privacy, loss of competitive position, direct compliance costs, and administrative costs. Surprisingly, smaller firms in Germany rarely meet their disclosure obligations under the fourth and seventh EU Directives on the annual accounts and consolidated accounts of limited liability entities. From their viewpoint, they would prefer to pay a fine rather than reveal information that could be used against them by competitors.²⁷ In contrast, what usually occurs in the UK is that small businesses tend to make their financial disclosures in a timely and accurate manner. Although registration agents expect German companies to adapt to UK business practices, we would not predict that entrepreneurs continue in large numbers to opt for the UK limited when a cheaper and more competitive version of the GmbH becomes available.

This discussion brings out an important point about the incorporation mobility in the EU. It appears that mostly the smallest start-up firms – that are responsive to lower costs rather than to the actual corporation law provisions that deal with internal governance structures – are considering the adoption of a foreign corporate law system.²⁸ This makes the incorporation mobility resulting from the ECJ case law rather trivial and, because the costs of incorporation is the most important factor in ‘choice-of-business-form’ decisions, does not provide sufficient incentives for national legislatures to engage in regulatory competition.²⁹ Indeed, an analysis of the current corporate law reforms in the EU indicates that member states only respond by reducing the incorporation costs without changing the core elements of their corporation laws or introducing legislative innovations that enable firms to adopt the most effective governance structure.³⁰

Conversely, the *Sevic*-case raises the likelihood that medium-sized and large firms may relocate their seat based on the legal rules they prefer. As we will see in section 3.3 of this paper, this is the main reason why larger companies make use of the SE: it offers firms a legal

²⁷ See also the Financial Times (by Hugh Williamson), Germany’s love of the ‘Limited’, 3 October 2006.

²⁸ It should be noted however that large multinational firms could also use *Centros* and its progeny of cases to pursue specific restructuring strategies. For instance, Royal Dutch Shell plc is incorporated in the UK, but has its headquarters and tax residency in the Netherlands.

²⁹ Scholars have made a similar point for the US. See Ayres, I., Judging Close Corporations in the Age of Statutes, *Washington University Law Quarterly*, vol. 70, 1992; Bratton, W.W. and McCahery, J.A., The Equilibrium Content of Corporate Federalism, *Wake Forest Law Review*, vol. 41, 2006.

³⁰ See McCahery, J.A. and Vermeulen, E.P.M., Traditional and Innovative Approaches to Legal Reform: The ‘New Company Law’, *European Business Organization Law Review*, vol. 8, 2007.

form that allows them to pursue their corporate objectives. However, it will be impossible to conclude with any certainty whether the *Sevic*-case will lead to an increase in the reincorporation mobility and eventually to the acceptance of an internal affairs doctrine in the EU. Any increase in corporate mobility in the EU could also be due to the implementation of the Directive on cross-border mergers. In order to make an assessment whether ECJ case law will be able to break down the non-mobility equilibrium, we will discuss the effectiveness of EU legislation in limiting the barriers to corporate mobility in the next section. It should be noted in this respect that the ECJ explicitly stated in the *Sevic*-case that EU legislation must not be viewed as a prerequisite for cross-border mergers.

3. EU Legislation as the Foundation for an Internal Affairs Doctrine

3.1 EU Corporate Law Directives as an Impetus for Mobility

Under the historic pattern of corporate lawmaking at the EU level, national legislatures have had a virtual monopoly, supported by the twin pillars of the real seat doctrine in conflict of laws and national tax regimes. The real seat doctrine barred essential legal recognition to firms that attempt to relocate to another incorporation state. Moreover, firms that were termed ‘pseudo foreign corporations’ had to apply to the core rules of the home member state. Some member states did not follow the real seat doctrine. But even in these jurisdictions, national regulators have for long attempted to restrain local entrepreneurs from incorporating elsewhere by restricting reentry of their pseudo foreign corporations. And still now substantial exit taxes restrict an outbreak of corporate mobility. Together, the real seat doctrine, restrictions on pseudo foreign corporations, and exit taxes constituted the foundations of a stable, long-run non-mobility equilibrium that effectively barred the emergence of an internal affairs doctrine in the EU.

This equilibrium remained stable despite the appearance of the EC. Historically, Brussels has protected the member states’ control of the corporate lawmaking agenda and respected their implicit cooperative approach. To look at the evolution of EU corporation law is to see that from the inception of the harmonization program in 1957 through the modernization period of the High Level Group of Company Law Experts, the EU has not been able to stimulate the right of establishment of pseudo-foreign companies. The harmonization program has not produced the coveted effect of limiting the barriers to corporate mobility. In fact, the emergence of a non-intervention approach in EU lawmaking reinforced the tendency by discouraging disruption of regulatory settlements concluded among interest groups in the member states. The EU, acting in accordance with a perceived public interest, has deterred member states both from dismantling costly legal barriers to

reincorporation and from developing responsive measures aimed at encouraging corporate mobility. Let us look further into this to show how the harmonization program contributed to the non-mobility equilibrium in the EU.

3.1.1 *Company Law Harmonization: The Establishment of the EU Company Law Regime and the First Generation of Company Law Directives*

Prior to the establishment of the EU, Europe amounted to a group of island jurisdictions, in which domestic lawmakers, each with different constituencies and political concerns, pursued their own policy agendas. Each jurisdictional island possessed an elite group of legislators, judges, regulatory agencies, professionals, and legal academics responsible for interpreting, preserving, and developing the law. They did so in conservative frameworks, undisturbed by and unresponsive to possible changes in the legal systems of surrounding islands. As jurisdictional islands, the states remained privileged to close their borders in response to exterior competitive threats. For example, in the 19th century, Belgium tried to play a non-cooperative corporate law game vis-à-vis France, encouraging French managers to change their jurisdictions of incorporation. France and other high cost jurisdictions responded to this opportunistic initiative by introducing the real seat doctrine, in effect closing their borders. It gets of course more difficult to keep the border closed when an island jurisdiction becomes part of a common market and national barriers to trade gradually dissipate. In such a market, corporate mobility is more likely to surface. At the same time, actions by a federal lawmaking body can help stimulate cross-border activities.

The Treaty of Rome (1957) established the European common market. It was designed to encourage the creation of an integrated market by assuring the free movement of goods, services, people and capital. The treaty provided foreign corporations the right to establish branches in another member state (host state) without being subject to more restrictive corporate law provisions. At that time, the real seat theory, which provides that the laws of the host state are applied if the actual center of the corporation's activities lies in the host state, remained dominant. But, in 1957, many feared it was losing ground. The Netherlands had recently abandoned the doctrine. Furthermore, provision 293 (ex 220) of the Treaty invited member states to enter into negotiations regarding the 1968 Brussels Convention on Mutual Recognition of Companies and Legal Entities, which would have abandoned the real seat in favour of the incorporation doctrine. For a while it looked like the Treaty could usher in a new era of corporate mobility. But reaction was split. Some founding member states feared an outbreak of a so-called 'race-to-the-bottom.' They had learned important lessons

about the effects of charter competition from the US experience.³¹ Competition was seen to entail substantial losses for domestic interest groups. France in particular was concerned that the Netherlands, which had a more flexible corporation law code and was playing non-cooperatively on corporate tax matters,³² would be able to attract a large number of pseudo-foreign companies.

Charter competition's opponents responded by using the lawmaking process, triggered by the Treaty and directed to elimination of disparities among the laws of EU member governments, to reduce potential benefits of competition. France and West Germany promoted top-down harmonization of national corporation laws as a EU agenda item. Existing members and new entrants went along, and the EU's mandatory corporate law Directives resulted. These sought to ensure compliance with a minimum level of regulation. With a common set of legal rules in each jurisdiction, no member state would have the zone of discretion needed to create law that attracted incorporations and hence no incentives to compete.

This first generation of corporate law Directives restated the existing content of the member states' national laws. Mandates resulted, such as minimum capital requirements and disclosure rules. At the same time, the Directives made no attempt to expand the zone of mutual recognition of firms. Even as EU lawmakers justified the harmonization Directives as measures to protect creditors and shareholders, their lawmaking scheme maintained special interest outcomes that had been reached in the respective member states prior to the elimination of trade barriers.³³ Incumbent management, for example, had every reason to support provisions that limit dividend payments and share repurchases so as to obtain more leeway to reinvest firm's profits.

To sum up, the early member states played a cooperative game respecting corporate law. They in effect agreed to desist from non-cooperative corporate lawmaking in exchange for membership in the Community. They negotiated and enforced a political agreement that protected their national stock markets and domestic labor settlements. Still small in number, they were concerned with political stability as well as economic integration. They valued political payoffs yielded by stable corporation law more highly than the chance for enhanced economic welfare held out by corporate mobility and competitive experimentation.

³¹ See Charny, D., Competition among Jurisdictions in Formulating Corporate Law Rules: An American Perspective on the 'Race to the Bottom' in the European Communities, *Harvard International Law Journal*, vol. 32, 1991.

³² See Bratton, W.W. and McCahery, J.A., Tax Coordination and Tax Competition in the European Union: Evaluating the Code of Conduct on Business Taxation, *Common Market Law Review*, vol. 38, 2001.

³³ See Carney, W.J., The Political Economy of Competition for Corporate Charters, *Journal of Legal Studies*, vol. 26, 1997.

3.1.2 *Later Harmonization and the adoption of the Directive on cross-border mergers*

The second wave of corporate law Directives was arguably more flexible, granting states options in respect of compliance. The change reflected added diversity of legal regimes due to the admission of the United Kingdom and other new member states. At the same time, an optional approach only ensured that the Directives did not interfere with core elements of given member states' national settlements. The move to flexibility thus followed from the cooperative agreement. Rigidity and top-down mandate remained the dominant theme, however.

The rigid approach eventually showed its limitations. Harmonization of core areas of corporate law, like the structure and responsibility of the board of directors and cross-border mergers, proved slow and ineffective.³⁴ This was no surprise: the member states valued the autonomy of their national legal regimes. They had fundamental disagreements regarding important issues, such as board structures and employee participation, and so proved reluctant to implement the harmonized rules. There being no politically acceptable consensus, regular vetoes of directive proposals under Article 100 of the EC Treaty (now Article 94) followed.

In 1985, the ECJ and the European Commission's responded to calls for greater flexibility by adopting a 'new approach' to harmonization based on minimum harmonization and mutual recognition.³⁵ The following year, the Single European Act (SEA) attempted to resolve possible veto blockages at Council level by providing for a consultation procedure and qualified majority voting. A number of corporate law Directives were promulgated between 1968 and 1989, removing a wide range of discrepancies between the European member states' rules with respect to the protection of stakeholders.³⁶

The EU reached another stage in the evolution of the harmonization program with the development of the subsidiarity principle, embraced by the member states in the 1992 Maastricht Treaty on the European Union.³⁷ The subsidiarity principle, embodied in Article 5

³⁴ See Woolcock, S., Competition among Rules in the Single European Market, in W.W. Bratton, J.A. McCahery, S. Picciotto, and C. Scott (eds.), *International Regulatory Competition and Coordination, Perspectives on Economic Regulation in Europe and the United States*, Oxford: Clarendon Press, 1996, p. 289-321.

³⁵ See Villiers, Ch., *European Company Law – Towards Democracy?*, Aldershot: Ashgate Dartmouth, 1998.

³⁶ The European Community has adopted an array of directives (First, Second, Third, Fourth, Sixth, Seventh, Eighth, Eleventh, Twelfth, and the Securities Directives), which regulate disclosure and *ultra vires*, capital requirements of public corporations, mergers and divisions of public corporations, corporations' annual and consolidated accounts, the qualification of accountants, disclosure of branches, formation of single member corporations, admissions to stock exchange listing, public offers of listed and unlisted securities, acquisitions and sales of major holdings, and insider trading. See Edwards, V., *EC Company Law*, Oxford: Clarendon Press, 1999.

³⁷ Besides constraining the Commission's role through the subsidiarity principle, the Maastricht Treaty also introduced the co-decision procedure. As a consequence, the European Union's decision-making structure closely resembles the constitutional form of *democratic federalism* in which central

of the Treaty, concerns areas that are not within the exclusive competence of the European Union.³⁸ It commands the location of competence at the EU level or at the member state level, and, rather than listing the respective competencies, provides for an efficiency test to determine local decisions.³⁹

The European Commission, building on the principles of subsidiarity and proportionality, has introduced a new, more flexible type of Directive. This moves away from the provision of minimum standards to a framework model. Despite the new approach, the EU has enjoyed only limited success in the area of corporate law. The 2003 passage of a significantly weakened Directive on Takeovers exemplifies the persistence of deeply rooted conflict among the member states over the direction and pace of the Directives.

The Commission's current efforts to reform the regulatory framework for corporate law are largely inspired by recommendations made by a group of experts commissioned by the EU.⁴⁰ These measures were designed to simplify existing rules and improve freedom of choice between alternative forms of organization. The program looked toward reform at four levels. First, the Commission proposed to modernize corporate law by further harmonizing corporate disclosure, board structure, and director liability requirements, and by amending capital rules. Secondly, it planned to adopt rules facilitating corporate restructuring and mobility. Thirdly, it proposed the establishment of a permanent coordination structure, the European Corporate Governance Forum, to work along with member state agencies to sanction unfit directors. Fourthly, it proposed to strengthen the supervision of auditors and to adopt comprehensive rules on the conduct of audits. This initiative largely retraced the terrain covered by previous harmonization attempts and therefore its prospects for success were not too optimistic.

However, the High Level Group's call for an urgent submission of a revised Directive on cross-border mergers obviously bore fruit. On 15 December 2005, Directive 2005/56/EC entered into force. This Directive further facilitates the merger of corporations that have their statutory and business seat in one of the member states. Its provisions, which should be implemented in national corporation laws before 15 December 2007, apply to mergers where

government policies are agreed to by a simple majority of elected representatives from lower-tier governments. See Inman, R.P. and Rubinfeld, D.L., *Rethinking Federalism*, *Journal of Economic Perspectives*, vol. 11, 1997.

³⁸ Areas within the exclusive competence of the Union are subject to the proportionality test of Article 5 §3 of the Treaty, which provides that 'action by the Community shall not go beyond what is necessary to achieve objectives of the Treaty;' proportionality and subsidiarity both apply to nonexclusive areas.

³⁹ First of all, it has to be determined whether there is a power under the Treaty to take action. The subsidiarity principle then determines whether and how the Community may act. It must be shown that the objectives of the proposed action cannot be sufficiently achieved by the member states. The finding must then justify the further conclusion that in view of the measure the objective can be better achieved at Community level. The proportionality test as defined in §3 of Article 5 still has to be satisfied.

⁴⁰ See Report of the High Level Group of Company Law Experts on A Modern Regulatory Framework for Company Law in Europe, Brussels, 4 November 2002.

at least two corporations are governed by the laws of different member states. It took more than twenty years of negotiation before the EU legislature could obtain approval for the adoption of this Directive.⁴¹ Since a cross-border merger results in the ceasing of the acquired and absorbed companies, a member state's corporation law could lose its application to the protection of shareholders, creditors, employees and other stakeholders. Indeed, the adoption of the Directive on cross-border mergers could be viewed as another disturbance of the EU's non-mobility equilibrium.

Still, the Directive does not allow merging firms to unlimitedly adopt a legal system that presents them with the most efficient governance structure and board composition. The strict principles and arrangements relating to employee participation – as set out in the Council Directive No 2001/86/EC of October 2001 with regard to the involvement of employees in the SE – apply when the corporation law of the absorbing company does not provide for at least the same employment participation regime as is applicable in one of the merging and disappearing companies. In order to ensure the working of the Directive on the involvement of employees, the merging companies must have an average of more than five hundred employees in the six months preceding the publication of the draft terms of the merger. The Directive on cross-border mergers is largely based on the provisions of the SE Statute. It could be argued in this respect that EU Level business forms paved the way for more cross-border mobility. The next section will take a closer look at the emergence of the SE and its impact on corporate mobility in the EU.

3.2 EU Level Business Forms as an Impetus for Corporate Mobility⁴²

First generation EU lawmakers were convinced that a SE statute could create an economic environment through which firms could reach their full development and more crucially to promote cooperation among firms located in different regions of the EU.⁴³ In line with the first harmonization Directives, the Commission initially aimed to create a uniform and

⁴¹ A first draft of the Directive on cross-border mergers was presented in 1984 [COM(1984) 727 final, *OJ* 1985 C 23/11].

⁴² Because of the special nature of the European Economic Interest Grouping (EEIG) and the European Cooperative Society (SCE), sections 3.2 and 3.3 of this paper only highlights the development and use of the SE. The EEIG is adopted in 1985 (Council Regulation (EEC) 2137/85 on the European Economic Interest Grouping (EEIG) [1985] *OJ* L199/1). The reason for the relatively early adoption of the EEIG was that this EU level initiative was not detrimental to national doctrines and usages and hardly competed against national-oriented business forms. The EEIG is too limited in scope. Its activities must be related to the economic activities of its members. Unlike a corporation, which generally aspire to profits for itself, the nature of an EEIG is primarily aimed at facilitating or developing the economic activities and own results of its members. The SCE Regulation (Regulation (EC) No 1435/2003 *OJ* L 207 of 18 August 2003) entered into force on 21 August 2003 and aims to provide independent associations of individuals with a legal business form to satisfy their common economic, social and cultural aspirations. On 2 May 2007, more than 1500 EEIGs were established (see www.libertas-institut.com).

⁴³ See Leleux P. Corporation Law in the United States and in the E.E.C., Some Comments on the Present Situation and the Future Prospects, *Common Market law Review*, vol. 6, 1968.

comprehensive legislative proposal that served as a basis for a truly genuine European business form. This led to a first proposal in 1970. Since its approach would threaten the member states' lawmaking autonomy, it came as no surprise that this proposal did not obtain the countries approval. It took until 1989 before the Commission published a new draft Statute. In order to expedite its adoption, it was decided to address the employee participation in a different Directive. A report – produced by a group of experts chaired by former Commission President Etienne Davignon – outlining a compromise solution regarding labour participation, opened the door for a compromise legislation that resolved political difficulties by referring extensively to the national corporation law of the member state where the SE would have its administrative seat.⁴⁴ Only in December 2000 did the Council adopt the SE Statute, which entered into force in October 2004.

The SE Statute makes it possible for a firm to effect reincorporation from one member state to another by reorganizing as an SE and transferring the administrative seat. Under the Statute, legal persons may form an SE through (1) merger of two or more existing companies that are governed by the laws of at least two different member states (cross-border merger); (2) formation of a holding company promoted by public or private limited companies; (3) formation of a jointly held subsidiary; or (4) conversion of an existing public limited company.⁴⁵ Some governance matters are determined under the SE Statute. But most matters are determined by a renvoi to the national company law of the member state where the SE has its seat. However, the Statute explicitly allows firms to select a one-tier system in which the SE comprises a general meeting of shareholders and a board of directors. If the SE prefers to have a supervisory board that monitors the board of directors, the Statute provides for the implementation of a two-tier system.

Significantly, the Statute does open a door for a German AG to escape the strict German rules on labor codetermination, but not a basis for doing so based on a unilateral management decision. A special negotiation procedure for worker participation must be followed upon the creation of an SE.⁴⁶ The Directive distinguishes between information and consultation on the one hand and participation on the other hand. The employee representatives must in all cases be informed about material decisions and given the opportunity to influence the deliberation and decision-making process. In addition, where twenty five percent of the originating firm's employees have a right to participate in management, the employees' representatives must consent to the planned composition of the supervisory board (two-tier) or board of management (one-tier). Thus, a German AG whose

⁴⁴ Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE) OJ L 294, 10/11/2001, 0001-21.

⁴⁵ See Art 2 and Title II of the Regulation.

⁴⁶ Section II of the Regulation.

unions agree to give up all or part of their supervisory board representation can reorganize as an SE with whatever governance structure agreed to by the unions. No movement of the administrative seat to another member state need occur.

The statute holds out three advantages. Firstly, it is the first piece of European level legislation that allows for cross-border mergers. It provides for a relatively easy possibility to alter the location of the administrative seat.⁴⁷ The Statute accordingly could stimulate some regulatory arbitrage across the EU,⁴⁸ provided the firm in question otherwise moves its seat. Secondly, the Statute holds out cost advantages for a firm not seeking to change its seat but seeking to consolidate operations in multiple member states. A firm, even if it plans no change of seat, can merge its various subsidiaries into the SE. The SE emerges as a unitary entity organized in one member state and operating branches in other states across the EU. The difference is that all companies in the group now follow a single body of corporate law. The recent conversion of *Alliance AG* into an SE suggests that firms do see cost advantages in operating under a single set of rules. Thirdly, the Statute makes it possible for a parent to merge out a minority shareholder interest in a subsidiary without having to take the potentially costly step of making a tender offer for the minority shares.⁴⁹

Despite its advantages and possibilities to encourage corporate mobility, the practical usage of the SE is often called into question. Many practitioners have expressed skepticism about whether the EU level legislative measures would lead to significant changes in corporate practice. They point at the lack of statutory guidance to incorporate and operate as an SE. Moreover, they expect that firms would be deterred by the complexity of the process of setting up an SE. In particular, the need to enter into negotiations with employee representatives is believed to be a bottleneck. Lastly, the absence of a specific tax regime, particularly with regard to cross-border seat transfers, is likely to be a significant impediment to the use of the SE. Although to date (April 2007) fewer than eighty SEs have been incorporated – of which one is liquidated and two Dutch SEs have been converted into limited companies residing on the Cayman Islands – we can already draw some preliminary conclusions about the SE's role in stimulating corporate mobility.

⁴⁷ The registered office of an SE may be transferred to another member state. Such a transfer shall not result in the winding up of the SE or in the creation of a new legal person. Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE) OJ L 294, 10/11/2001, 0001-21. Art 8 paragraph 1.

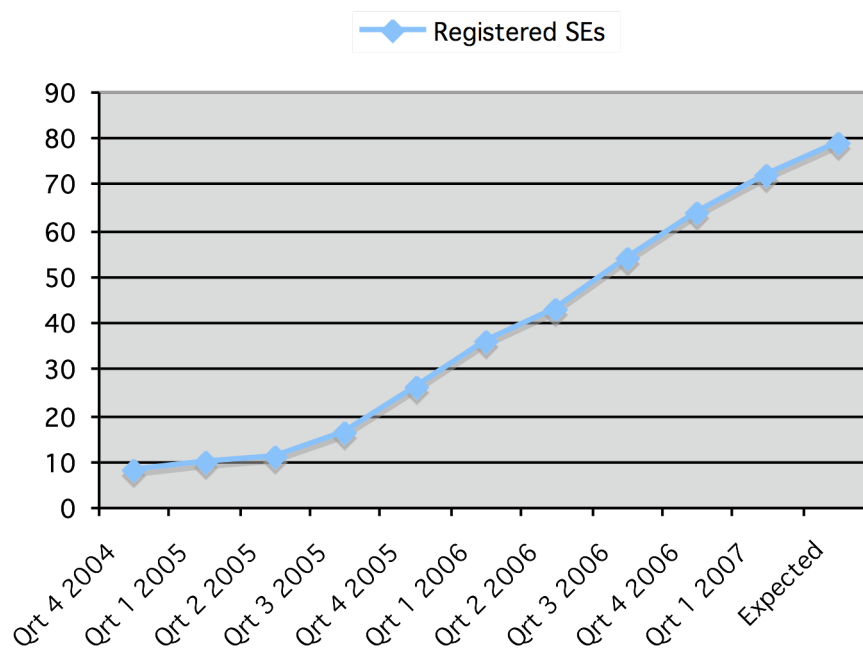
⁴⁸ See Enriques, L., *Silence Is Golden: The European Company Statute as a Catalyst for Company Law Arbitrage*, *Journal of Corporate Law Studies*, vol. 4, 2004.

⁴⁹ Allianz bought out minority shares of RAS, an Italian insurer, in connection with its conversion to SE status. See *Financial Times* (by P. Jenkins & T. Buck), *Corporate Governance: Why European Companies May See Benefits in a Company Statute with Fewer Limitations*, 11 October 2005.

3.3 The Practical Impact of the SE

When we look at the number of SEs that were formed in each quarter since its introduction in October 2004, it would seem that this EU level initiative is still an unattractive alternative for firms seeking to pursue cross-border activities or migration strategies (see *Figure 1*). However, an average of almost eight SE incorporations per quarter could indicate there is a demand for EU-level business forms to pursue cross-border movements. In particular, if we take the time-consuming formation procedures and legal advisors' unfamiliarity with this new business form into account,⁵⁰ it should come as no surprise that 'only' seventy-seven SEs were incorporated so far. Indeed, in an environment where a non-mobility equilibrium prevails, the SE should already be considered successful if it not only enables more cross-border mergers and activities, but also offers firms across jurisdictions a cost-effective means of pursuing inter-jurisdictional strategies.

Figure 1: Total number of SEs registered (October 2004 to April 2007)⁵¹



Source: adapted from information available at www.seeurope-network.org

In order to give a more complete picture of the effect of the SE on corporate mobility, we will categorize the main determinants of SE formations. If we look at the available data at www.seeurope-network.org, we can draw some interesting, although not surprising, conclusions. Firstly, it appears that mainly in jurisdictions with widespread participation

⁵⁰ A feasibility study of a European Statute for SMEs (financed by the European Commission) shows that business practice, especially in the area of small and medium-sized enterprises, is not familiar with the possibility of forming an SE. 91.3% were not familiar with this EU level business form. See AETS, *Etude de faisabilité d'un statut européen de la PME*, July 2005.

⁵¹ This figure depicts the information available on 72 registered SEs.

rights, the benefits of establishing an SE outweigh its considerable formation costs. For instance, German *BASF AG* estimated an amount of €5,000,000 to convert to an SE. This amount includes the costs of compliance with the necessary legal and accounting requirements as well as registration and disclosure costs.⁵² The fact that 78% of the SEs are established in countries with strict regulations, particularly in the area of formation and employee participation (see *Table 2*), indicates that there are other important reasons that make it cost-effective to go through the cumbersome formation requirements than the importance of the adoption of a genuine European structure. Indeed, contrary to the incorporation mobility that merely involves the avoidance of formation costs,⁵³ firms contemplating the establishment of an SE find the flexibility with respect to corporate governance and participation rights the main attraction of this EU-level business form.

Table 2: The relation between participation rights and number of registered SEs

Countries with widespread participation rights	
Germany	29 SEs ⁵⁴ registered
Finland	1 SE registered
Hungary	2 SEs registered
Luxembourg	2 SEs registered
The Netherlands	9 SEs ⁵⁵ registered
Norway	2 SEs registered
Austria	8 SEs registered
Slovakia	2 SEs registered
Sweden	5 SEs registered
Countries with limited participation rights	
Belgium	7 SEs registered
Cyprus	1 SE registered
Estonia	1 SE registered
France	2 SEs registered
Latvia	2 SEs registered
Countries with no (or very limited) participation rights	
Liechtenstein	1 SE registered
The UK	3 SEs registered

Source: adapted from information available at www.seeurope-network.org

However, while the SE allows firms to voluntarily adopt the corporation law of a more flexible and liberal jurisdiction, firms tend not to change the administrative seat for practical and psychological reasons. If we only take the ‘normal’ SEs with operations and employees into account, we see that 65% of the existing SEs is formed by the conversion of national

⁵² See Conversion Documentation, Conversion of BASF Aktengesellschaft into a European Company (Societas Europaea, SE) with the company name BASF SE (available on the company website).

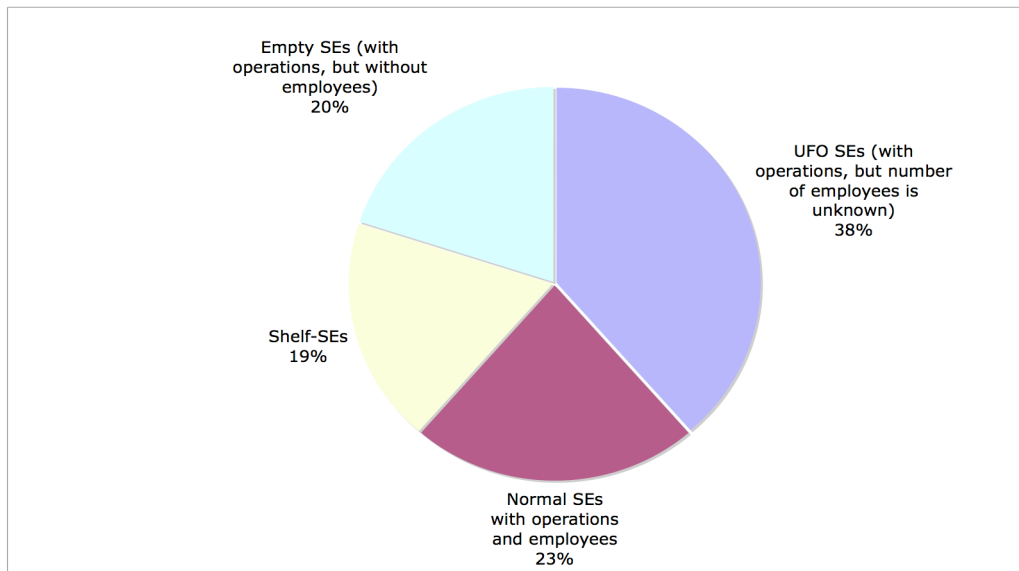
⁵³ See Section 2.3 of this paper.

⁵⁴ One SE is liquidated.

⁵⁵ Two SEs are converted to private limited companies residing on the Cayman Islands.

corporations that had one or more subsidiaries in other member states (see *Figure 2*). Instead of stimulating reincorporation mobility, the SE competes with national business forms, such as for instance the *Aktiengesellschaft* in Germany. The following business cases exemplify the advantages of the SE.

Figure 2: SEs per category



Source: adapted from information available at www.seeurope-network.org⁵⁶

In August 2006, *MAN B&W Diesel AG*, a German market leader in the world of two- and four-stroke engines,⁵⁷ converted to an SE. Significantly, it was the first German company that successfully concluded an agreement with the employee representatives of different European business divisions. Even though Augsburg remained the administrative and statutory seat of *MAN Diesel SE*, the conversion offered the possibility to deviate from the rigid co-determination provisions that apply to the *Aktiengesellschaft* by reducing the number of supervisory board members from twelve to ten as well as giving its board (*Aufsichtsrat*) a more international composition (through reducing the influence of German workers on the board).⁵⁸ The intended conversions by *Fresenius AG*, a German Healthcare company, and *BASF AG* shows that this is the prime motivator for German companies to switch to a EU-

⁵⁶ Most of the so-called UFO SEs operate in the financial service sector.

⁵⁷ See www.manbw.com.

⁵⁸ This explains the specificity of the SE and its virtual absence in jurisdiction without stringent participation rights. For German companies, the SE could be a relatively quick and efficient means to transform their board structure to meet international standards, whereas for other firms it constitutes a burdensome and costly alternative.

level business form. Both companies attempt to involve all European employees in the appointment procedure of the members of the supervisory board.⁵⁹

Other companies in strict regulation jurisdictions, such as Germany and Austria, go a step further and also take the opportunity to choose a one-tier board structure. A recent example is *Mensch und Maschine Software SE*, a high-tech company that focuses on Computer Aided Design and Manufacturing (CAD/CAM) solutions. This German-based firm converted into an SE adopting the one-tier system because it is the preferable corporate governance structure for listed high-tech companies in which management holds a significant number of the outstanding shares. A single tier board makes prompt and flexible decision-making possible. This is viewed as a substantive benefit for firms that operate in a fast-growing and ever-changing business environment and explains why 71% of the ‘normal’ SEs opted into the one-tier system offered by the SE Statute.

It should come as no surprise, moreover, that 19% of the SEs are established as ready-made shelf companies. A shelf company can be a convenient option when firms promptly require to set up a EU-level business form without going through the complex and costly formation requirements. Like we have seen with *Centros* and its progeny of cases, here too ‘registration agents’ play an important role in promoting new developments. For instance, the German *Foratis AG*, which according to its website is a market leader in shelf companies,⁶⁰ offers SEs for a purchase price of €132,000. With such an SE, buyers acquire a EU-level entity with a share capital of €120,000. Because the majority of SEs that are offered off the shelf by this agent are structured as a one-tier board, it could be concluded that corporate governance rather than mobility considerations are responsible for the creation of a niche market for shelf SEs.⁶¹ The fact that *Foratis AG* focuses on the German market reinforces the conclusion that the SE is generally viewed as an additional ‘national’ business form which, besides the international allure, offers mainly advantages in the area of corporate governance.

Two and half years after the introduction of the SE we can draw the tentative conclusion that this EU-level initiative has not resulted in the hoped-for increase of reincorporation mobility. Although we can foresee a trend that companies that are located in

⁵⁹ See Financial Times (by G. Wiesmann en I. Simensen), German blue chips ponder switch to SE format, 12 April 2007; Financial Times (by R. Milne), Porsche’s designs on VW lead it to steer to a different company structure, 12 April 2007; Financial Times (by I. Simensen en G. Wiesmann), Unions weakened on supervisory board, 12 April 2007; Financial Times (by R. Hönighaus en I. Simensen), Allianz plans to raise €3.5bn in German property sale, 4 May 2007.

⁶⁰ See www.foratis.com.

⁶¹ It follows from the available data that two companies purchased a shelf SE at Foratis AG: (1) Atrium Erste Europäische VV SE was renamed into Convergence CT SE in January 2006 and (2) Donata Holding SE was before the acquisition called Atrium Fünfte Europäische VV SE. Both companies have a one-tier board structure. In the first months of 2006, Foratis registered four new SEs. Atrium Achte Europäische VV SE and Atrium Neunte Europäische VV SE were registered in April 2006. Atrium Dritte Europäische VV SE and Atrium Vierte Europäische VV SE were established in March and February 2006 respectively.

the new member states of the EU will value the European label of the SE more than companies in other member states,⁶² it is obvious that both the case law and legislative developments are insufficient to break down the strong non-mobility equilibrium that prevails in the EU. Since it is generally accepted that corporate mobility should be a priority item on the political agenda of the EU commission, the question is which alternative measures could eventually lead to the adoption of an internal affairs doctrine which has comparable effects as the judge-made doctrine in the US. In the next section, we will analyze barriers to corporate mobility. We will then be able to assess the possible alternatives that are currently considered by policymakers, lawmakers, academics and alike.

4. Barriers to Corporate Mobility in the EU

Under the internal affairs doctrine, US corporations are able to do business outside their state of incorporation with the certainty that the corporation law of the formation state will apply. This doctrine arguably leads to more efficiency as it could decrease transaction costs and stimulate transfers of the statutory and/or administrative seat, mergers among firms of different member states, the use of branches, and cross-border cooperation in general. However, US law does not offer constitutional protection for ‘foreign’ corporations. It is therefore no wonder that US scholars find it remarkable that corporate mobility is still so underdeveloped in the EU. The absence of a common history, culture and language may, of course, prevent the emergence of US-style corporate mobility in the EU.⁶³ But European case-law and legislative measures, such as the harmonization Directives and the introduction of genuine European business forms, offer a constitutional internal affairs doctrine which is more conducive to corporate mobility than the doctrine in the United States.⁶⁴

Two barriers could explain the inertia of European firms to jump on the corporate mobility bandwagon. Firstly, lawmakers and powerful interest groups are very successful in defending the strong non-mobility equilibrium. Professor Gilson, for example, explains that ‘some European lawyers have read *Centros* narrowly, “merely referring to a case of abuse, without general significance. From the perspective of an American, and therefore of an amateur at parsing the opinions of the European Court of Justice, so narrow an interpretation

⁶² See for similar conclusions AETS, Etude de faisabilite d’un statut européen de la PME, July 2005. An unnoted, but equally important, development is the leading role played by registration agents in the market for shelf-SEs.

⁶³ See Kirchner, C., Painter, R.W. and Kaal, W., Regulatory Competition in EU Corporate Law after Inspire Art: Unbundling Delaware’s Product for Europe, European Company and Financial Law Review, vol. 2, 2005.

⁶⁴ See Ribstein, L.E., The Evolving Partnership, Journal of Corporation Law, vol. 26, 2001, p. 825-827 (arguing that the internal affairs doctrine, together with cultural and institutional factors as well as the ‘dormant commerce clause’, provide an environment conducive to corporate mobility and free choice of law).

seems like wishful thinking.” For better or worse, the Court explicitly ruled that denying branch registration to a company whose foreign incorporation has the sole purpose of “evading application of the rules governing the formation of companies” in the nation in which the company's principal place of business will be located, “is contrary to Articles 43 and 48”.⁶⁵ Secondly, even if corporate mobility enjoys a constitutional mandate in the EU, member states can cheaply put up effective exit tax barriers that limit freedom of establishment. Hence, so long as member states retain any discretion they will not easily be confronted with out of equilibrium threats that force them to reassess their cooperative strategy to limit corporate mobility.

4.1 The Status Quo Barrier

It follows from the above discussion that corporate mobility in the EU is constrained by factors other than language and cultural differences. Even though the ECJ opened the door to increased corporate mobility by requiring the removal of national measures that impede cross-border market access and free choice of legal regime, defenders of the status quo are very inventive in finding ways to circumvent any disturbance of the non-mobility equilibrium.⁶⁶ As we have seen, the EU harmonization program itself retards the scope of diversity among the member states and thus lessens the salience of free choice. EU Directives have given the substantive corporate law of the member states a mandatory and petrified quality,⁶⁷ insulating them from evolutionary pressures at home, much less from competition from abroad. Indeed, the harmonization program has created legal and institutional barriers to corporate mobility. This ‘petrification externality’ is evidenced by statements made by the German and Dutch Governments in the *Sevic*-case in which they argue that corporate mobility, in particular in the context of cross-border mergers, requires specific rules designed to protect stakeholders’ interest. They were of the opinion that these protective rules could only be promulgated through a harmonization Directive. In this view, harmonization measures with respect to, for instance, cross-border mergers and cross-border seat transfers are a prerequisite of a fully-fledged internal affairs doctrine in Europe. This would severely minimize the prospects for changing the status quo in the EU. Moreover, even if a harmonization Directive is adopted, the implementation could be hampered by a member state’s possibility of undermining the Directives. The ECJ’s response that harmonization rules are not necessary to accept cross-border movement initiatives by European firms is therefore a leap in the right direction.

⁶⁵ See Gilson, R.J., Globalizing Corporate Governance: Convergence of Form or Function, *American Journal of Comparative Law*, vol. 49, 2001, p. 353.

⁶⁶ See also Halbhuber, H., National Doctrinal Structures and European Company Law, *Common Market Law Review*, vol. 38, 2001.

⁶⁷ See Wouters, J., European Company Law: *Quo Vadis?*, *Common Market Law Review*, vol. 37, 2000.

4.2 The Exit Tax Barrier

Reincorporation costs make European firms highly immobile. Reorganizing under a foreign corporate law statute often triggers taxes on hidden reserves, effectively restricting the demand for firms to opt into different national governance systems. If the tax burden exceeds the expected cost savings held out by the alternative legal regime, migration has no point even if there is a complete and consistent set of harmonization Directives in place. Indeed, the still current ECJ's decision in *Daily Mail* on hidden reserves will do little to stimulate demand for reincorporation.⁶⁸

Daily Mail concerned a UK company that wished to transfer its administrative seat to the Netherlands. Its purpose was tax avoidance. The company planned to dispose of a large capital asset. The transfer of its central office to the Netherlands implied a transfer of its tax residence. Dutch tax residence in turn meant a stepped up tax basis on assets, averting a substantial UK capital gains tax on the planned asset sale. Meanwhile, no transfer of the firm's UK domicile of incorporation was contemplated. Since both the Netherlands and the United Kingdom followed the incorporation doctrine, transferring the administrative seat raised no questions concerning the governing corporation law. On the other hand, UK tax law⁶⁹ required the Treasury to consent to the transfer of the company's seat and tax residence abroad. *Daily Mail* argued that the UK consent provision was contrary to Articles 43 and 48 of the Treaty.

The ECJ treated the claim as a corporate law matter, holding that Art 43 of the Treaty does not grant a company the right to transfer the administrative seat while retaining corporate status under the law of the jurisdiction of origin unless that jurisdiction's law allows for the transfer.⁷⁰ The ECJ underscored, however, that 'the rights guaranteed by [the Treaty] would be rendered meaningless if the member state of origin could prohibit undertakings from leaving in order to establish themselves in another Member State.'⁷¹ The key point on the facts of the case, stressed the ECJ, was that the UK exit regulation applied in cases where the company wished to transfer its seat while maintaining UK corporate status. In such cases, it held, the national legislation may freely impose conditions, such as obtaining consent of the Treasury.

Interestingly, the ECJ has revised the issue of the permissibility of exit taxes in the context of the transfer of residence by an individual, self-employed person. In *Lasteyrie du*

⁶⁸ See Case 81/87 *The Queen v Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust* [1988] ECR 5483.

⁶⁹ Section 482 (1) (a) of the Income and Corporation Taxes Act 1970.

⁷⁰ The more particular ground was that no agreement on the mutual recognition of companies or firms within the meaning of Article 293 (ex 220) had been reached. See *Daily Mail* (§21-25).

⁷¹ See *Daily Mail* paragraph 16.

Saillant,⁷² the ECJ prohibited discriminatory taxation of an exiting taxpayer. Mr. de Lasteyrie left France in 1998 to settle in Belgium, transferring both his professional practice and tax residence. At that time, he held securities that exceeded 25% of the profits of a company subject to corporation tax in France, securities whose market value exceeded their acquisition price. The Code Général des Impôts includes a provision that prescribes a levy of income taxes on such differences in value of securities when a French resident leaves the country. The plaintiff challenged this provision and the case was referred to the ECJ, which held that the legislation in question impeded the exercise of free establishment. The Court reasoned that the rule was discriminatory because taxpayers who transfer their residence abroad are taxed on latent increases in value, while taxpayers remaining in France are taxed only on increase in value after they have actually realized such gains. Thus, *Lasteyrie du Saillant* provides that exit taxes cannot hinder the exercise of the free establishment exercised by a natural person and that exit tax regimes must comply with the criteria established in *Centros*.⁷³

Clearly the case is important because it challenges the discretion of member states to use of exit taxes on the basis of freedom of establishment, if only in relation to individual taxpayers. But the ECJ in *Lasteyrie du Saillant* distinguished between natural persons and corporate residents and therefore left untouched its judgment in *Daily Mail*. It is difficult to assess whether the ECJ will extend its freedom of establishment jurisprudence to legislation hindering corporate emigration, such as seat transfers and mergers. Because the ECJ has accepted exit taxes as a central defense in restricting firm mobility and free choice, few expect that the ECJ will issue a judgment that disrupts the regulatory structure of company law in the EU.

Indeed, in cases where taxes have inhibited or traversed Treaty freedoms, the ECJ has recognized three justifications under the rule of reason: (1) the protection of fiscal cohesion of the national tax system; (2) the need for effective fiscal supervision; and (3) the prevention of abuse of law. It has been suggested that exit taxation should be permitted, despite its deterrent effect on migration, on fiscal cohesion grounds. But the fiscal cohesion defense, while it has proved successful in a few ECJ tax cases, has most often been applied very restrictively.⁷⁴

To be sure, the Council Directive on the Common System of Taxation applicable to Mergers, Divisions, Transfer of Assets and Exchanges of Shares concerning Companies of

⁷² See Case C-9/02 *Hughes de Lasteyrie du Saillant v. Ministerie de l'Economie, des Finances et de l'Industrie* [2004] ECR I-2409.

⁷³ See the four-factor test described in footnote 17.

⁷⁴ See Gammie, M., *The Role of the European Court of Justice in the Development of Direct Taxation in the European Union*, *Bulletin for International Fiscal Documentation*, vol. 57, 2003.

Different Member States, adopted in 1990,⁷⁵ covers a range of cross-border transactions that do not trigger any tax issues. These include (1) legal mergers, which can involve either (a) two or more existing companies merging into one with the original companies ceasing to exist; (b) a merger of one company into a second company that carries on the business; or (c) the merger of a wholly owned subsidiary into a parent company; (2) the direct acquisition by an acquiring company of voting control of a transferor company through acquisition of shares from the shareholders of the transferor in exchange for shares of the acquirer;⁷⁶ and (3) transfers of the assets of one or more branches of a firm in exchange for firm stock followed by dissolution of the transferor company.⁷⁷ Two important conditions apply respecting the assets in the transferor state. Firstly, the acquiring company must continue to use the same tax base and depreciation method, and, secondly, the assets must be ‘effectively connected with a permanent establishment of the receiving company’ within the state of the transferor.⁷⁸ In other words, the assets of the transferor firm must be left in place by the merger. The conditions follow from the fact that the resident state of the transferor company needs to be able to collect the previously deferred capital gains tax in the future when the receiving company disposes of the assets. Note, however, that the second condition implies a limitation on mobility – the capital gains deferral is available only if the state of the transferor retains its tax jurisdiction over the assets in the form of a permanent establishment. The Directive does thus not deal with all possible exit tax questions. Also, because the Directive does not provide explicitly for free emigration of companies, it is likely, given the preference to defend the status quo, that member states impose exit taxes for transactions the Directive does not cover.

⁷⁵ Directive on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different member states, Council Directive 90/434/EEC.

⁷⁶ A share merger occurs when a company acquires a holding in the capital of another company obtaining a majority of voting rights and in exchange it issues securities to the shareholders of the company in which it acquired majority holding. The Directive does not, however, indicate which share acquisitions qualify for tax benefits. There are at least two competing views: (1) where there are several connected share acquisitions in a company for the purpose of reaching majority as a result of the separate purchases, the Directive should apply to even the first package of shares purchased; or (2) the Directive could be applied restrictively only to the acquisition of one share that provides actual majority (50% plus one share). Naturally, the Directive covers public takeover bids, as well as any further acquisitions above 50%. See Terra, B. and Wattel, P., *European Tax Law*, The Hague: Kluwer Law International, 2005. Unsurprisingly, the Directive does not include corporation tax provisions for share mergers. It only regulates the taxation of shareholders, including both corporations and individuals.

⁷⁷ It is unclear whether the Directive under ‘branches of activity’ covers all types of activities or whether the case law of the ECJ on the interpretation of the Directive on the taxation of capital raising, Council Directive 69/335/EEC concerning indirect taxes on the raising of capital, in the *Muwi* case Case C-164/90 *Muwi Bouwgroep BV v Staatssecretaris van Financiën* [1991] ECR I-06049, applies here as well, and the term ‘branch of activities’ should be interpreted similarly to that of the Capital Raising Directive.

⁷⁸ The acquiring firm need not become resident in the transferor state, but the state maintains its right to tax any profits created by the remaining establishment as a tax at the source of income. It also maintains the right to tax the assets upon exiting the state in the future.

4.3 Possible Solutions to the Barriers

4.3.1 EU-level Legislative Measures

At the outset, we would like to emphasize that, while the formal and de facto seat transfer lie at the heart of the corporate mobility discussion in the EU, the need for a Fourteenth Company Law Directive on the transfer of seat from one member state to another seems more acute than ever.⁷⁹ The European Commission's Action Plan on 'Modernising Company Law and Enhancing Corporate Governance in the EU' acknowledges the importance of both a Directive on cross-border mergers and a Directive on the transfer of seat.⁸⁰ The introduction of the SE offered acceptable solutions for the issues relating to board structures and employee participation. While, as we have seen, the SE gave the necessary impetus to the approval of the Directive on cross-border mergers, the seat transfer Directive is still in the drafting phase. Under the existing equilibrium, however, the deadlock situation is not likely to be solved easily.⁸¹

An earlier draft version of the Fourteenth Directive dealing with the transfer of a firm's seat intended to reconcile the real seat and incorporation doctrines by providing that member states shall take all measures necessary to allow firms to transfer their registered office or *de facto* head office, together or separately, to another member state. According to Article 3 of this draft proposal, such a transfer will involve a change in the law applicable to the firm. Even so, this draft proposal refrains from eliminating the real seat doctrine: Employee rights will be governed, where they are more firmly enshrined, in the home state.

However, the earlier draft is not in line with the post-*Centros* view that firms should be allowed to incorporate as foreign business forms.⁸² In this context, a recent corporate mobility proposal drafted by the German Council for International Private Law could serve as an

⁷⁹ See Wymeersch, E., *Is a Directive of Corporate Mobility Needed?*, European Business Organization Law Review, vol. 8, 2007.

⁸⁰ See Commission of the European Communities, *Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward*, COM (2003) 284 final, Brussels, 21 May 2003. In this respect, we should also mention the need for the introduction of a European Private Company. However, proponents claim that it is needed for the creation of companies and conversion purposes rather than enhancing corporate mobility. See Eurochambres en BusinessEurope, Document prepared for the symposium organised by EUROCHAMBRES and BUSINESSEUROPE under the auspices of the European Economic and Social Committee, *The European Private Company – EPC – A European Structure Intended for SMEs*, Brussels, 15 May 2007.

⁸¹ See Ventoruzzo, M., *Cross-border Mergers, Change of Applicable Corporate Laws and Protection of Dissenting Shareholders: Withdrawal Rights under Italian Law*, European Company and Financial Law Review, vol. 4, 2007.

⁸² See Vermeulen, E.P.M., *The Evolution of Legal Business Forms in Europe and the United States, Venture Capital, Joint Venture and Partnership Structures*, The Hague: Kluwer Law International, 2003.

alternative basis for the adoption of the internal affairs rule as a whole.⁸³ The incorporation doctrine is the starting point of this proposal. Under this principle, a corporation as well as a partnership will be governed by the formation state's law. This includes rules regarding the legal nature, the internal governance structure, legal representation and limited liability. A host state can only apply its corporate law rules if a legal system is chosen abusively. According to the proposal, it is necessary to follow the respective legal rules for all companies involved in a cross-border reorganization, such as mergers and legal splits, which is more or less a codification of the *Sevic*-case. The proposal offers a simple principle for voluntary migration to a foreign legal regime. First, it should comply with the corporate law rules of the new regime. In addition, it is obvious that the transferring company should regard the laws of the departing state with respect to the rights of shareholders, creditors, employees and other stakeholders.

This proposal could be compared to the US Restatement of Conflicts Law. Recall however that model measures are not widely accepted in the EU despite their apparent positive benefits. At first blush, the German initiative could offer focal point solutions to the coordination problems among states. It purports to codify and summarize the ECJ case law, but also attempts to fill the gaps with respect to the scope of corporate mobility and the type of business forms eligible for cross-border incorporations and reincorporations. If accepted, it could be cited by lawmakers and judges as if it were authoritative, representing each member state's expectations of what states should do when dealing with corporate mobility issues. When more states have adopted the solution, it becomes increasingly difficult for a dissenting member states to lag behind. As we have seen in other contexts, voluntary and codified standards are considered an effective means for implementing better practices by European businesses.⁸⁴

4.3.2 *ECJ Case Law*

Although legislative measures would directly facilitate corporate mobility, these reforms are not presently the leading techniques in challenging the EU non-mobility equilibrium.⁸⁵

⁸³ See Sonnenberger, H.J. and Bauer, F., *Proposal of the Deutscher Rat für Internationales Privatrecht for European and National Legislation in the Field of International Company Law*.

⁸⁴ Well-considered guidelines for practical use by business parties and legal professionals arguably create standards and best-practices that are attractive enough to serve as a focal point. See McCahery, J.A. and Vermeulen, E.P.M., *Corporate Governance and Innovation*, ECGI – Law Working Paper No. 65/2006. Voluntary and codified standards are increasingly viewed as a viable solution when regulation is needed, but difficult to introduce given the different views of the parties involved in the lawmaking process. This explains why the 'soft law' approach is tested in the sometimes controversial hedge fund and private equity industry.

⁸⁵ It should be noted, however, that EU Commission's SLIM (Simpler Legislation in the Internal Market) Initiative is also aimed at improving cross-border mobility in the EU. This Initiative, which

Therefore as long as most member states gain few significant advantages from increasing mobility, fiscal barriers and national vested interest are likely to remain significant impediments. Under existing arrangements, challenges to the dominant equilibrium are still defeated by policy preferences that allow few alternatives, leading either to deadlocks or compromise legislation that yields few political gains. This article has suggested that alternative measures are a prerequisite for introducing US-type mobility.

In the context of these circumstances, it is important to recognize two issues. Firstly, the ECJ has clearly resolved in the *Centros* triad of cases difficult questions regarding incorporation mobility. Secondly, the ECJ's interpretation in the *Sevic*-case is an important first step towards bringing forward the arrangements needed to support a reincorporation regime. Therefore, this suggests that the ECJ's role is likely to be crucial in altering the dominant preferences of member states through new decisions that provide the key mechanisms for instituting an internal affairs doctrine in the EU.⁸⁶ To be sure, the ECJ is constrained in pursuing its own agenda within carefully reasoned legal analysis in order to avoid member state criticism.⁸⁷

With regard to the reincorporation mobility, it is worth noting that there is a referral Case pending.⁸⁸ The Court of Appeal Szeged (Hungary) seeks, among other things, answer to the following three questions. Firstly, what is the applicable law, if a company, organized under the corporate law of member state and entered in its commercial register, wishes to transfer its seat to another member state? Secondly, can such a company transfer its registered office under articles 43 and 48 of the Treaty? Thirdly, is it possible to subject such a transfer to conditions and approvals by either the state of incorporation or by the host member state?

In this case, *Cartesio*, a Hungarian legal entity, requested the Court of Registration to register the transfer of its registered office to Italy. *Cartesio* wishes to remain registered in Hungary. The Court rejected this request holding that *Cartesio* should follow the Hungarian corporate law procedures. If the ECJ confirms this view, *Cartesio* must first be dissolved and liquidated and then again be incorporated in Italy. The new Italian company must register as a branch in Hungary. The questions in this case could give the ECJ an opportunity to clarify its position on both the statutory seat transfers (which entails the application of a different legal

was launched in May 1996, resulted in the adoption of Directive 2003/58/EC of the European Parliament and of the Council of 15 July 2003 amending Council Directive 68/151/EEC, as regards disclosure requirement in respect of certain types of companies. This amendment gives companies the option to voluntarily file their documents and particulars in other EU languages so as to improve cross-border access.

⁸⁶ See Schön, W., The Mobility of Companies in Europe and the Organizational Freedom of Company Founders, *European Company and Financial Law Review*, vol. 4, 2007.

⁸⁷ See Pollack, M.A., *The Engines of European Integration: Delegation, Agency and Agenda Setting in the EU*, New York: Oxford University Press, 2003 (explaining the slow pace of institutional change by the ECJ).

⁸⁸ See Case C-210/06 *OJ C* 165 of 15 July 2006 – *Cartesio*.

regime) and de facto seat transfers (which do not affect the applicable corporation law) before the adoption of the Fourteenth Directive. Following the development of the ECJ's new jurisprudence, the court may well extend the decision in *Lasteyrie du Saillant* to legal entities.⁸⁹ We put this forward as merely a possible trajectory of ECJ doctrine and leave the detailed examination of whether and how such a decision could resolve the complexities of exit taxes to future work.

5. Conclusion

Corporate mobility is still largely constrained by member state discretion. Even though the ECJ has reduced the scope of the real seat doctrine and its barriers to the freedom of establishment, the Court has not explicitly eliminated it. ECJ case law does not explicitly resolve matters involving a domestic company wishing to exit its state of incorporation. There are also serious obstacles, such as the absence of a reincorporation procedure and exit taxes that continue to block freedom of establishment and restrict cross-border mobility. To unblock the obstacles to cross-border mobility, this Article has suggested that the ECJ will inevitably have to follow through on its new line of reasoning. We predict that a new threat of ECJ interventionism, perhaps complemented by legislative measures, would only make domestic lawmakers more responsive, reacting by adjusting their regulatory and fiscal strategies in order to avoid losing domestic firms. Such developments would benefit firms seeking to migrate to company law regimes they prefer.

⁸⁹ See Hopt, K., Concluding Remarks 1st ECFR Symposium in Milan, 2006, *European Company and Financial Law Review*, Vol. 4, 2007 (arguing that the ECJ should 'issue a clear statement that it is doing away with the specter of *Daily Mail*, maybe when it decides the recent Hungarian referral case').