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Companies' Freedom of Establishment after the ECJ *Cartesio* Judgment

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Abstract
The ECJ's Cartesio judgment should be understood as overriding the Daily Mail *judgment of 1988. Under* Daily Mail*, Community rules governing freedom of establishment were waved away as not applicable, while in* Cartesio *they are merely not precluding national legislation controlling emigration. According to* Cartesio*, restrictions on transferring the centre of administration generally pass the test of compatibility. Nonetheless, in the authors' view, there should be no justification for sanctions of annulment or immediate dissolution of a company which has attempted to move its centre of administration to another Member State. In* Cartesio*, the ECJ proclaimed the right of companies to emigrate for the purpose of conversion into a company form of the host state. By analogy with* SEVIC Systems*, it seems that the host state may not refuse to give the immigré company permission to convert if similar conversion is open for local legal forms, unless justified by overriding requirements in the public interest. To sum up, the ECJ provides a complex method to determine and protect the freedom of companies to emigrate. Still, this method seems preferable to the other option: forcing Member States to tolerate emigration without regard to their legal tradition and the ensuing difficulties.*

Keywords: *Cartesio* judgment, freedom of establishment, freedom of emigration, cross-border transfer of a company's seat, cross-border transformation, 14th Company Law Directive, EC company law.

1. Introductory Remarks

1.1 Importance of the *Cartesio* judgment

The *Cartesio* judgment has probably been the most fervently debated ECJ ruling in the last months. It certainly represents the most important development in the application of the EC Treaty rules on freedom of establishment to companies since the *Überseering* judgment in 2002. The judgment of the ECJ has been received by European company law experts in different ways depending on their position in the ongoing discussion in this area, but usually with the same high level of emotion: either a feeling close to triumph (on the side of stubborn defenders of residual national competences in the matter of treatment of migrating companies) or deep disappointment (on the side of partisans of the uniformity achieved by giving clear and broad precedence to the Treaty's freedom of establishment rules).

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In our opinion, both views are too emotional and are justified only to a certain degree. As a deeper analysis will show, in *Cartesio* – as previously in *Überseering* – the ECJ has attempted to very subtly manoeuvre between Article 43 of the Treaty and the essential competence of national legislators to determine the incorporation and existence of companies. Whether this attempt has been fully successful is – once more – a matter open to debate. The real scope of the ruling in *Cartesio* is narrower and its reasons less conservative than frequently thought. In any case, it certainly does not relieve national legislators of serious concerns connected with the manner in which national laws limit companies' freedom to emigrate.

The *Cartesio* judgment also throws some light upon a more general problem: European company law has stopped at the crossroads between the Community freedom of establishment, on the one hand, and national legislators' discretion to determine the legal status of foreign companies and to exercise the power of life and death over local companies, on the other. To arrive somewhere, it must move sooner or later: either by force of secondary legislation,[1] or, lacking this, by judge-made law.

1.2 Vocabulary of international company law

For the sake of brevity and clarity, it may be useful to present, in advance, the authors' usage of certain terms connected with the movement of companies between different legal systems. A company can only come into being by means of a certain national legal system; this is the 'parent' or 'incorporation' ('formation') legal system of a 'parent' or 'incorporation' state. In the vocabulary of continental law, a company has its seat. This seat can be understood either as the 'real seat' (*siège réel*, usually corresponding to the centre of administration) or the 'statutory seat' (*siège statutaire*, 'formal seat', which is stipulated in the company's articles[2] and is a close equivalent of the English 'registered office'). In this paper, unless clearly specified otherwise, the company's seat shall be understood as its centre of administration (the 'real seat').

Each national law selects criteria through which it establishes the connection of companies with its own territory for the purpose of their regulation, or with the territory of another state for the purpose of the recognition of such companies, or with its own or the foreign territory in order to identify the law applicable to corporate relationships. For these purposes, national laws use various connecting factors, not necessarily identical for all three purposes in one legal system. Four of such factors are listed in Article 48 of the EC Treaty: formation (indicating the place of

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[1] Intervention by primary legislation is much less probable, and the opinion that it might have exclusive competence in matters of conflict of laws and treatment of foreign companies is clearly obsolete.

[2] In this paper, the term 'articles' is used as an equivalent of the French '*statute*' or the German '*Satzung*', thus encompassing both the memorandum of association and articles of association within the meaning of English company law.

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incorporation), registered office ('formal' or 'statutory seat'), central administration ('real seat') and principal place of business (an earlier version of 'real seat', now widely out of use, at least as a connecting factor in the conflict of laws context).

Some of these connecting factors are supported by legal theories explaining their predominance and their application, in particular in the field of conflict of laws. In the *Cartesio* judgment, the incorporation theory and the 'real seat' theory are mentioned. However, the 'statutory seat' theory still plays a role in some states (including Poland).

Under European Community law, a new connecting factor is proposed and a new theory seems to take over: the place of registration and the 'registration theory'. The registered office, as a connecting factor, differs from the place of registration only because of the context: the first factor is associated with the incorporation theory, which does not take into account any change of the law applicable to a company, while the other factor has been introduced precisely to make such a change possible.

When a company moves its seat (the 'real seat') from the incorporation state to another Member State (the 'host' or 'target' state), this is a cross-border seat transfer within the European Community. From the perspective of each of these states, the process may be called 'emigration' or 'immigration' and the company the 'émigré' or 'immigré'. Pursuant to the *Cartesio* judgment, a further distinction becomes necessary between emigration for the purpose of conversion into a company form under the law of the host state ('conversion emigration', which leads to 'cross-border conversion'), and emigration without such purpose, which presupposes the company's intention to stay governed by the law of incorporation ('simple emigration').

2. QUESTION SUBMITTED TO THE ECJ AND THE ECJ'S DECISION

2.1 **Facts**

The circumstances of the case are, as usual, extensively described in the judgment itself and, consequently, are generally known; only a brief repetition of the most essential facts will be given here.

CARTESIO[3] (*Cartesio Oktató és Szolgátató bt*), a Hungarian limited partnership,[4] wanted to transfer its administration centre (the 'real seat') from Hungary to Italy without any intention to accordingly change, at the same time or as an immediate consequence thereof, its status to one of Italian partnership or company.

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[3] Written in capitals to distinguish it from the reference to the ECJ case, *Cartesio.*

[4] Though only a partnership, as a commercial partnership CARTESIO has been subject to the registration requirement and has been treated essentially as a legal entity under Hungarian law. Consequently, it is a 'company' within the meaning of Article 48 of the EC Treaty and may be treated, in most regards, as a company for purposes of national conflict of laws rules and national regulations concerning incorporation and emigration of companies.

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Hungarian law, as analysed by the ECJ, follows – in the field of conflict of laws – the incorporation theory: companies are subject to the law under which they were registered. Still, the provisions of substantive company law unilaterally modify the effects of the incorporation theory for Hungarian entities. The seat of a company incorporated under Hungarian law (meaning its 'real seat' – centre of administration) must be located in Hungary, and this location is registered. As a result, transferring the seat to another country is not allowed. In this way, the Hungarian legislator has married, in a peculiar way, the general rule that the legal person is governed by the law of its incorporation with the practical application of the 'real seat' theory to Hungarian companies.[5]

CARTESIO's motion for registration of the new administration centre in Italy refused by the Hungarian registry court as being contrary to Hungarian law and, pursuant to CARTESIO's appeal, the Court of Second Instance (*Szegedi Ítélőtábla*), referred the matter to the ECJ in the form of a request for a preliminary ruling.

2.2 Question submitted to the ECJ

We will omit the interesting procedural problems which were the subject of the first three questions asked by the Court of Second Instance, and concentrate on the fourth question, which in turn is divided into four sub-questions. It is worth repeating the sub-questions word by word because they create the context without which the response cannot be properly understood:

> (a) If a company, [incorporated] in Hungary under Hungarian company law and entered in the Hungarian commercial register, wishes to transfer its seat to another Member State of the European Union, is the regulation of this field within the scope of Community law or, in the absence of the harmonisation of laws, is national law exclusively applicable?
> (b) May a Hungarian company request transfer of its seat to another Member State of the European Union relying directly on Community law (Articles 43 [EC] and 48 [EC])? If the answer is affirmative, may the transfer of the seat be made subject to any kind of condition or authorisation by the Member State of origin or the host Member State?
> (c) May Articles 43 and 48 of the Treaty of Rome be interpreted as meaning that national rules or national practices which differentiate between commercial companies with respect to the exercise of their rights, according to the Member State in which their seat is situated, are incompatible with Community law?

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[5] See paragraphs 11-20 of the *Cartesio* judgment. Compare the imprecise statement of the Advocate General, according to which Hungarian law follows the incorporation theory (paragraph 23 of the Advocate General's Opinion). The legal status under Hungarian law is presented by C.G. Beuerle and M. Schillig, *The Mysteries of Freedom of Establishment after Cartesio* (11.2.2009) p. 12 (note 70), available at: http://ssrn.com/abstract=1340964.

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> (d) May Articles 43 [EC] and 48 [EC] be interpreted as meaning that, in accordance with those articles, national rules or practices which prevent a Hungarian company from transferring its seat to another Member State of the European Union, are incompatible with Community law?

2.3 **The ECJ's decision**

The ECJ responded to the entire fourth question with one sentence only:

> (4) As Community law now stands, Articles 43 EC and 48 EC are to be interpreted as not precluding legislation of a Member State under which a company incorporated under the law of that Member State may not transfer its seat to another Member State whilst retaining its status as a company governed by the law of the Member State of incorporation.

This conclusion cannot be properly understood without reviewing the detailed steps through which it was reached. On the face of it, it leaves any Member State free not only to prohibit its companies from transferring their administration centre to another Member State, but also to provide for any sanctions that correspond to a Member State's legislative policy regarding the crime, or even an attempt to commit the crime, of such transfer. Some authors have already concluded from the wording of this ruling that the state of incorporation can prohibit such a transfer under pain of dissolution.[6] If so, why not an immediate annulment in the style of the German lower instance courts in the *Überseering case*? If the state of incorporation is free to deal at will with its own corporate subjects, it should also be free to impose on them, in the reversed situation, the same 'real seat' philosophy, leading to the conclusion that, immediately after transferring its administration centre to a state under the law of which it is not registered and regulated, a company loses its corporate identity and becomes a non-entity. At first glance, it seems strange for a state to be required, by virtue of Article 43 of the Treaty, to abandon the most extreme consequences of the 'real seat' theory in order to 'recognise[7] the capacity', under its own law, of its own company which has emigrated in breach of a legal prohibition (such prohibition being, pursuant to the *Cartesio* judgment, unquestionably admissible).[8]

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[6] W. Meilicke, Der GmbHR-Kommentar [commentary on the *Cartesio* judgment], 2 *GmbH-Rundschau* (2009) pp. 92-94.

[7] In the German original, '*zu achten*' – to respect; there is a shade of difference between both language versions of the *Überseering* judgement. In our opinion, the German version better reflects the ECJ's idea of requesting respect for the acquired personality rather than its full recognition 'as granted' (under incorporation law).

[8] See S. Leible and J. Hoffmann, 'Cartesio – fortgeltende Sitztheorie, grenzüberschreitender Formwechsel und Verbot materiellrechtlicher Wegzugsbeschränkungen', 3 *Betriebs-Berater* (2009) p. 62; P. Kindler, 'Ende der Diskussion über die sogenannte Wegzugsfreiheit', 4 *Neue Zeitschrift für Gesellschaftsrecht* (2009) pp. 131-132.

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These seemingly logical conclusions, including that regarding the incorporation state's complete freedom to dissolve the émigré company, are too hasty though. A detailed analysis of the arguments upon which the ECJ based its judgment will show that the powers of the state of incorporation are in fact significantly restricted by the rule of freedom of establishment.

3. THE *CARTESIO* JUDGMENT AS A SUMMARY OF THE ECJ'S POSITION IN THE MATTER OF COMPANIES' FREEDOM OF ESTABLISHMENT

3.1 General remarks

By way of introduction it must be observed that the ECJ was not directly asked whether the incorporation state can treat its own companies that attempt to emigrate without the conversion purpose completely at will; however, without being asked, the Court, on its own initiative, explained that such freedom is not absolute. It must be remembered that the Hungarian courts merely refused to register and, consequently, recognise the transfer of CARTESIO's administration centre. They never attempted to treat CARTESIO as a non-entity because of the performed transfer, or even to threaten it with immediate compulsory dissolution. It is probable that, subsequently, CARTESIO would have been called upon to re-transfer its administration centre to Hungary under pain of dissolution but we do not know for sure. It results from paragraphs 102 and 103 of the *Cartesio* judgment that the perspective of dissolution (followed by reincorporation) has been merely pointed out by the Hungarian courts as the only viable way of transferring the company's seat to another state.[9]

As a result, the ECJ was called upon to rule upon the admissibility of restricting the companies' freedom of emigration within the Community, but not upon the admissibility of specific sanctions.

3.2 ***Daily Mail*: point of departure quickly left behind**

The crucial part of the ruling in the 1988 *Daily Mail* judgment[10] reads as follows:

> [I]n the present state of Community law, Articles 52 and 58[11] of the Treaty, properly construed, confer no right on a company incorporated under the legislation of a Member State and having its registered office there to transfer its central management and control to another Member State.

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[9] Quoting this position, the ECJ failed to mention that such a 'transfer' necessary involves sacrificing the present corporate identity for the sake of a new one; the evident purpose of CARTESIO was to avoid exactly this result.

[10] ECJ, Case C-81/87 *The Queen* v *H.M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc* [1988] *ECR* 5483.

[11] Now, Articles 43 and 48.

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Contrary to strong expectations, in the *Cartesio* judgment, the Court essentially followed the above ruling once more, after twenty years, even though in the wake of *Überseering* (2002)[12] and *SEVIC Systems* (2005)[13] it could have chosen another path, cleared by the Opinion of the Advocate General.[14]

However, the external similarity of both rulings is misleading. *Daily Mail* has been interpreted, almost unanimously and with good reasons, to hold that the freedom of establishment cannot interfere at all with the national legislation relating to the emigration of companies.[15] *Cartesio*, on the surface, could have been forcibly interpreted in the same way (and some authors indeed attempt to do so[16]) but in fact the wording of the ruling differs considerably from *Daily Mail*. Under *Daily Mail*, Community freedom of establishment rules were simply waved away as *not applicable*, while in *Cartesio*, *they are not precluding* national legislation controlling simple emigration. The obvious conclusion is that, this time, they were at least considered.

The ECJ's position in *Daily Mail* was significantly amended in *Cartesio*, which is more visible in the justification of the *Cartesio* ruling than in the ruling itself. The essence of that amendment is the implied requirement that national restrictions must pass the test of compatibility with the freedom of establishment. The Court declared that the power of a Member State to define the connecting factors required for the company to be incorporated under its law and to maintain that status is 'far from implying that national legislation on the incorporation and winding-up of companies enjoys any form of immunity from the rules of the EC Treaty on freedom of establishment' (*Cartesio*, paragraph 112). It is very important to note that *this conclusion has not been limited to the sphere of conversion emigration*: speaking in paragraph 112 about the power of a national legislator, the Court refers to paragraph 110 where, in the first place, simple emigration is discussed.

This is probably the most important part of the *Cartesio* judgment. Obviously, if there is no immunity, there must be a test for compliance. Admittedly, the Court barely hinted at the possibility of applying such a test, and only did so after hurrying, in paragraph 110, to declare that national laws can restrict simple emigration. Still, in the light of the quoted language of paragraph 112, this conclusion must result from the application of some test and cannot be the product of immunity from any control under Community law.

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12 ECJ, Case C-208/00 *Überseering BV* v *Nordic Construction Company Baumanagement GmbH* [2002] *ECR* I-9919.

13 ECJ, Case C-411/03 *SEVIC Systems AG* [2005] *ECR* I-10805.

14 Opinion of Advocate General Poiares Maduro in *Cartesio*, delivered on 22 May 2008.

15 M. Lutter, *Europäisches Gesellschaftsrecht*, 4th edn. (Berlin 1996) at pp. 41-42; W. Schön, 'The Mobility of Companies in Europe and the Organizational Freedom of Company Founders', 2 *European Company and Financial Law Review* (2006) p. 129, at p. 138; W.-H. Roth, 'From *Centros* to *Ueberseering*: Free Movement of Companies, Private International Law, and Community Law', 52 *International and Comparative Law Quarterly* (2003), at pp. 189-190.

16 Meilicke, *supra* n. 6, p. 93; Kindler, *supra* n. 8, p. 131.

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The criteria by which the ECJ has tested simple emigration restrictions are not reproduced in the judgment. However, a good example can be found in *SEVIC Systems*. In the words of the Court itself, any restriction imposed by national law 'can be permitted only if it pursues a legitimate objective compatible with the Treaty and is justified by imperative reasons in the public interest',[17] or otherwise it would be contrary to the right of establishment. The proper test for emigration restrictions consists in weighing freedom of establishment (which is a Community concern) against safety of business dealings (for which national jurisdictions are mainly responsible).

After *Cartesio*, the survival of national emigration restrictions is no longer abstractly guaranteed by the exclusive power of national jurisdictions; it must be based on substantive justification for the existence of the restrictions actually ordered. In the *Cartesio* ruling itself, the ECJ only determined that, in general, the prohibition of simple emigration has such justification. It never confirmed, neither in the ruling nor in the statement of reasons, the admissibility of immediate dissolution as a sanction for breach of this prohibition. As will be shown below, such a sanction does not pass the test of reasonability; and if it is not reasonable, it cannot be 'justified by imperative reasons in the public interest'.

3.3 *Daily Mail:* companies can only exist under national law (*Cartesio*: but the Community has a say in how they perish)

Neither *Daily Mail* nor *Cartesio* are directly concerned with the way in which some national legal systems have attempted to avoid the discussion of possible limitations of their power to nullify companies which they recognise as national entities. By drawing extreme consequences from the 'real seat' theory, presented as a part not of company law but of private international law (law of conflict of laws), some jurisdictions still attempt to avoid restrictions resulting from the freedom of establishment rule through a kind of 'disappearing trick'; from their perspective, a company which has – for whatever purpose – transferred its seat to another state immediately ceases to exist because it is now located in the 'wrong' territory: the territory of the state the law of which is recognised as being responsible for the functioning of the company but which refuses to regulate it.

In the *Daily Mail* judgment, the ECJ stressed that 'companies are creatures of national law and exist only by virtue of national legislation'. In *Cartesio*, the ECJ confirmed this rule and made it its point of departure in dealing with the question presented to it (paragraph 104).

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[17] These words have been taken from paragraph 21 of the *SEVIC Systems* judgment and are, of course, related to immigration restrictions. However, since in *Cartesio* the ECJ declared that emigration restrictions are not immune from control for conformity with the freedom of establishment, the phrase must be considered equally relevant for the latter, too.

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While the general truth of this conclusion cannot be denied, within the European Community the power of national law over the life of companies ceased to be an absolute one. Member States remain competent for determining the reasons for a local company's dissolution but, since 1968, their legislators cannot freely decide upon the manner in which such a company meets its end. Pursuant to Article 11 of the 1st Company Law Directive,[18] once a company is registered, national law can only punish exhaustively listed incorporation errors with annulment; it is certainly not free to order annulment for breaches of emigration restrictions committed at a later stage.

This rule did not apply directly to CARTESIO;[19] still, the ECJ's clear reluctance to recall it in the context of a more general discussion of the consequences of a cross-border seat transfer, not only in *Daily Mail* and *Cartesio* but also in *Überseering*, is puzzling. The fact that the opportunity to raise it in *Cartesio* was not seized could be explained by the fact that the power of the incorporation law to provide for restrictions against simple emigration was only confirmed by the ECJ in a general manner, while the admissibility of the most radical sanctions (annulment or immediate dissolution and winding-up) remained unexplored. However, there is another explanation, covering other judgments as well: Article 11 has always been omitted by the Court in the context of the freedom of establishment because of the traditional association of the problem of annulment of a company resulting from its cross-border seat transfer with conflict of laws rules rather than with substantive company law provisions. In our opinion, this association is simply wrong.

Upon closer analysis, the doctrine providing for the loss of the status of a legal entity as the result of seat transfer to another state cannot be based on conflict of laws rules properly understood and applied; such an analysis reveals the true character of this doctrine as proposing a concealed substantive norm protecting the territorial monopoly of national company law.[20] One can only wonder how the naïve conviction that this would-be conflict of laws rule is immune from the prohibition to cause immediate annulment of a company just because this prohibition is apparently 'linked to substantive company law', together with the resulting practice of refusing recognition of the existence of immigré companies, could survive as long as it has.[21]

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[18] First Council Directive 68/151/EEC of 9 March 1968 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community.

[19] The 1st Directive does not cover limited partnerships.

[20] Such analysis cannot be compressed into the framework of this paper; it has been presented by A.W. Wiśniewski, 'Statut personalny spółek kapitałowych i uznawanie spółek zagranicznych: orzecznictwo Trybunału Wspólnot a reforma polskiego prawa prywatnego międzynarodowego' [Personal law of companies: judgments of the ECJ and the reform of Polish private international law], in *Współczesne wyzwania europejskiej przestrzeni prawnej*, liber amicorum for Professor Eugeniusz Piontek (Cracow 2005) pp. 718-722.

[21] The basis for declaring that the immigré company is non-existent is predicated upon the assumption that, at the point of the seat transfer, it passes under the rule of the immigration state's

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After *Überseering*, it has become obvious that national laws are not free to decide upon the non-existence of a company without regard to Community law. In *Cartesio*, the Court developed particular restrictions regarding this freedom in the case of a cross-border transfer of the company's seat for purposes of conversion, and at least hinted at the possibility of the existence of some restrictions in the case of simple emigration.

3.4 *Daily Mail:* wrong approach to the Treaty definition of the company, still needs correction after *Cartesio*

The conclusion that 'companies are creatures of national law' must be followed by a simple question: which law? In the absence of a uniform rule, each Member State may attempt to provide its own response to this question. In *Cartesio*, the ECJ, still following *Daily Mail*, noted the variety of connecting factors concerning the admissibility of establishing a company under national laws and the possibility of a later amendment of such connection (paragraph 105). The Court concluded, invoking the arguments raised earlier in *Daily Mail* (paragraphs 21-23) and *Überseering* (paragraphs 69 and 70), that the question of whether a company may claim protection under Article 43 of the Treaty is a preliminary question which can only be resolved by the applicable national law.

In our opinion, this is a serious error of law. The grounds for this error can be tracked down to a popular oversimplification which assumes that the recognition of a foreign company as a legal entity and the determination of particulars of its corporate status are both conflict of laws problems which should be answered simultaneously on the basis of the law which is considered applicable to this company as a corporation (legal person). A more detailed analysis would show that the question of whether a legal system recognises a foreign company is a matter for a substantive and not a conflict of laws rule.[22] Similarly, the recognition of a company as belonging to the European Community is a substantive and not a conflict of laws problem.

The matter of a company's status as Community entity is directly regulated by Article 48 of the Treaty. Pursuant to this provision, which – again – is a substantive

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law, the incorporation conditions of which it does not meet. Leaving aside the simple counterargument that the company in question does not attempt to reincorporate at all and its existence is a product of a legal process completed under the incorporation law which at that time was undoubtedly applicable thereto, it should be pointed out that either the company has effectively passed under the rule of the host country's law and is then protected by Article 11 of the 1st Directive, or it has not, and then this law has nothing to say about its existence. That is why we call this product of the 'real seat' theory the 'disappearing trick': the company could be annulled neither before the seat transfer because there was as yet no ground for this (and it was not yet governed by the host state law anyway) nor after the seat transfer because this would be contrary to Community harmonisation measures. It seems to have evaporated into thin air *in the non-existent space of time between* being governed by the incorporation law and the host state's law.

[22] Wiśniewski, *supra* n. 20, pp. 712-717.

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and not a conflict rule, there are two premises for this qualification. Firstly, the company in question must be incorporated under the law of one of the Member States.[23] The respective national law only has to decide whether the company has ever come into being and has not been subsequently dissolved. It will be useful to recall in this context Article 11 of the 1st Company Law Directive, discussed above under section 3.4. It should be concluded that even in deciding whether a company incorporated under the given law still exists, the national legislator does not have complete freedom, being restricted to ordering the procedure of dissolution and winding-up as the ultimate sanction. Until dissolution leads to deregistration, the company must continue to be recognised as a national entity regulated by the law of the country of registration, irrespective of any change of connecting factors.

Secondly, the company in question must have either its registered office, centre of administration or principal establishment in the territory of the Community. Again, the fact that this provision is based on certain points of contact cannot qualify it as a conflict norm. Only one law can be the company's proper corporate law; the presence of three criteria to be applied concurrently shows that the question is not which law to apply; the question is whether the company is a Community entity, entitled to enjoy the right of establishment: a substantive problem. These three criteria undoubtedly represent the summary of points of contact important under legal systems of individual Member States. Once adopted in Article 48, however, they cease to represent any connection with the 'inventor' national legal systems. Their role is to establish the company's contact with the Community as a whole and their interpretation cannot follow national peculiarities, even of the parent legal system.

A company is located in the Community for purposes of enjoyment of freedom of establishment if the court (the ECJ or a national court) ruling on its treatment finds that it is connected to the Community by at least one of the three factors listed in Article 48. This finding is independent of whether, and on the basis of which particular factor, the national system to which this court assigns responsibility for the existence and regulation of the company, agrees or not. It must be remembered that this assignment is based on the conflict norm which the ruling court, and not the legal system indicated, considers applicable. It must also be noted that, as in *Überseering*, there may be more than one state ready to claim such responsibility, each having its own separate opinion on where the company belongs. In addition, different from national courts, the ECJ does not dispose of a uniform conflict rule by which it could select the national law to which the responsibility for the company could be unequivocally assigned. In this way, the ECJ has stepped exactly into the trap it wanted to circumvent: while stressing the lack of primary Community law regulating

[23] This is a substantive and not a conflict rule because it does not order the judge to apply a certain pre-determined national law to decide whether a company exists, but merely instructs him to take into account the certified result of an earlier application of any national law which considers itself applicable. The same reason prohibits qualification of the recognition of a company as a conflict of laws matter.

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conflict of laws in corporate matters, it has overlooked that precisely for this reason it cannot single out any particular national law to which it could exclusively entrust the qualification of a company as an EC entity: the necessary single connecting factor is nowhere to be found.

Reliance upon national laws in order to clarify the status of a company as an EC entity leads into a quagmire. The only common denominator is Community law which provides for a set of connecting factors, each of them equally conclusive, and under which a Member State cannot attempt to consider a company extinct, if it has not yet been properly dissolved and wound up.

Incorporation of a company may be the exclusive product of national law but the loss of its personality is subject to certain common rules, and its qualification as a European Community entity is not subject to any national law at all.

3.5 ***Überseering*: a close parallel**

The problem to be resolved in *Cartesio* represented a mirror reflection of the problem decided in *Überseering*. In *Überseering*, a company transferred its seat without any opposition from the state of incorporation and met with restrictions from the host state; in *Cartesio*, the state of incorporation refused its company the right to move its seat (while the host state found no opportunity to take any position). This similarity has been the source of expectation that the ECJ will follow the same pattern, declaring such restrictions as excessive and as violating the freedom of establishment.

However, the similarity of reversed reflections has its limits; even in chess, one can 'reflect' the moves of the opponent only to a certain point. The similarity between *Überseering* and *Cartesio* is superficial and may be misleading; in fact, the incorporation state's interest in controlling the movements of 'its' company is quite different and much stronger than the interest of the host country in restricting immigration of companies. The latter has already, not only in *Überseering* but also in *SEVIC Systems*, been proved too weak to hold its ground in confrontation with the Community interest in promoting freedom of establishment.

Still, a certain continuation and parallel between *Überseering* and *Cartesio* is clearly visible. In *Überseering* (paragraph 70), before declaring that the existence of an immigré company must be respected by the host state, the ECJ confirmed its position taken in *Daily Mail* that the incorporation state can restrict the freedom of movement of its companies. The ECJ had no reason to develop this principle any further because the issue to solve in *Überseering* was the admissibility of immigration and not emigration restrictions. In *Cartesio*, it started from the same observation, but went much further: it distinguished between a simple transfer of the seat (which may remain restricted, but the need for a certain test for admissibility of the most severe sanctions can be seen to emerge) and a transfer with the purpose of conversion into a host state's company form (which should be permitted).

The most important feature of the ruling in *Überseering* is the prohibition of the use by the immigration state of the national conflict of laws rules (the 'real seat'

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doctrine) in order to ignore the existence of a foreign company which has transferred its seat to that state and has failed to reincorporate under its law. In the justification of *Cartesio* (paragraphs 112 and 113), the ECJ expressly declares that the incorporation state cannot order the dissolution and winding-up of a company attempting to emigrate for the purpose of conversion. Certainly, still less could it – presumably under the same 'real seat' doctrine – declare the annulment of the émigré company.

There are reasons to believe that the meaning of *Cartesio* regarding an EC company's right to existence is not limited to emigration for the purpose of conversion. As will be demonstrated in section 4.1 below, even in the case of a 'simple' transfer of the company's seat to another Member State (a transfer without declaration of intention to convert into a host state form) immediate annulment should be prohibited, while ordering the dissolution and winding-up should be subject to conditions.

3.6 ***SEVIC Systems:*** **fundamentally different or essentially similar?**

The problems on which the ECJ had to rule in *Überseering*, *SEVIC Systems* and *Cartesio* form a peculiar triangle along the sides of which important similarities and distinctions can be traced. The gist of *SEVIC Systems* was the declaration that the opportunity of a merger which a state offers to its local companies (in the wide meaning determined by Article 48 of the Treaty) cannot be denied to a foreign company wishing to take part. Similarly to *Überseering*, the treatment of an immigré company was at stake. Unlike *Überseering*, the company in question wished to merge into a local form. Similarly to *Überseering* and differently from *Cartesio*, the incorporation state raised no objections.

At first glance, it seems that the similarity between *SEVIC Systems* and *Überseering* is much closer than between *SEVIC Systems* and *Cartesio*. However, this conclusion is correct for the case before the Court and the Court's ruling, but not for the entire judgment. An important part of the *Cartesio* judgment is devoted to the discussion of the possibility of applying to a cross-border seat transfer the principle established in *SEVIC Systems* for cross-border mergers (paragraphs 121-123). In fact, in *Cartesio*, the ECJ uses *SEVIC Systems* as a trampoline to show what its decision could have been if only CARTESIO wished to become an Italian company instead of staying a Hungarian one, and if Italian law concurred.

Consequently, *SEVIC Systems* will also be crucial for determining what exactly the ECJ could have in mind when requiring the law of the host state to agree to the conversion of the immigré company.

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4. Scope of freedom of a company's emigration pursuant to the *Cartesio* judgment

4.1 **No justification for sanctions involving a company's annulment or immediate dissolution**

Pursuant to the ECJ's opinion, the EC Treaty does not prevent Member States from enacting legislation totally prohibiting a company's emigration if the company intends to continue to be governed by the law of the incorporation state after the cross-border seat transfer.[24] However, the Court had no opportunity to rule upon the admissibility of the most radical emigration restriction sanctioning such a transfer with cessation of the company's existence. Analogically to the application of the 'real seat' theory to immigré companies, in certain jurisdictions, in particular Germany,[25] such a consequence has also been drawn for émigré companies, although this time it was the product of the application of the foreign law of the new location of the company's seat.

Under the influence of the ECJ rulings, in particular *Überseering* and *Inspire Art*,[26] the German legislator recently abolished substantive law barriers preventing companies from transferring their seat out of Germany, leaving only the requirement that a correspondence address in Germany must be indicated.[27] However, conflict of laws problems remain unsolved for such émigré companies.[28]

In the absence of a direct opinion of the ECJ, it should however be concluded that the *negation of the existence of an émigré company is incompatible with freedom of establishment*. This conclusion is supported indirectly by both the *Überseering* and *Cartesio* judgment.

Similarly, as the host state is prohibited from refusing to recognise an immigré company's capability to act as a legal entity and appear before courts in order to protect the monopoly of its own company law, the parent state is prohibited from using this sanction as 'emigration repellent'. The function of this prohibition is not to protect the company's freedom of emigration, but to prevent damage resulting from the sudden annulment of a business entity operating in the Community area. In *Überseering*, the Court established that the respect of the company's legal capacity

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[24] The ECJ's ruling in *Cartesio*, item (4), and paragraph 110 of this judgement.

[25] See, e.g., H.-D. Assmann, in K.J. Hopt and H. Wiedemann, eds., *Aktiengesetz Großkommentar*, Vol. I (Berlin 2004) p. 243 et seq. The most conservative part of the German legal doctrine still attempts to defend this position. See Kindler, *supra* n. 8, p. 132.

[26] ECJ, Case C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd.* [2003] *ECR* I-10155.

[27] Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen (MoMiG), 23.10.2008.

[28] However, see the draft reform of the German private international law on legal persons: Referentenentwurf – Gesetz zum Internationalen Privatrecht der Gesellschaften, Vereine und juristischen Personen, 7.1.2008, available at: http://www.bmj.bund.de.

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enhances the protection of exactly those interests of creditors, minority shareholders and employees which allegedly justified the application of the 'real seat' as a connecting factor;[29] this relation does not change, irrespective of whether we consider it from the perspective of the immigration or emigration state.

In fact, the application of the sanction of annulment to the émigré company not only fails to effectively secure the interests at stake but also exposes all the stakeholders protected by the substantive company law to serious risks. *Firstly*, the company's contractual partners, allegedly primary beneficiaries of the 'real seat' doctrine, are inconvenienced. Creditors of a company incapable of acting in court have to sue former shareholders as co-owners of the assets, while the latter can raise the defence of invalidity of all transactions made after the seat transfer. The risk to the safety of trading is incalculable. *Secondly*, corporate rights of shareholders are annulled and they can only receive the value of their investments through the elaborate process of division of co-ownership. The operation of re-qualification of the émigré company as a partnership, suggested by some authors, does not eliminate those difficulties.[30]

Since in the *Cartesio* judgment the ECJ declared the requirement that a company intending to emigrate for the purpose of cross-border conversion must dissolve and re-incorporate to be incompatible with the freedom of establishment, it is even more difficult to agree with the opinion that annulment of a company which has made the first step in that direction may be permitted.

It should be added that annulment of the émigré company is clearly incompatible with Community secondary legislation. As has been pointed out above, the 1st Company Law Directive, in Articles 11-12, essentially prohibits the declaration of annulment of a company and only permits ordering its dissolution and winding-up. It should be noted that an analogical principle underlies the regulation of local and cross-border restructuring operations: a target company created in a faulty process of merger or division of local joint-stock companies validly exists until the transformation is nullified (Article 22 of the 3rd and Article 19 of the 6th Company Law Directive[31]). Additionally, once a cross-border merger is effective, it can never be invalidated (Article 17 of the 10th Company Law Directive[32]). In sum, Community law very strongly expresses the need to protect the continuity of companies' existence. It would be a gross inconsequence if the harmonised rules of European company law were applicable only to local relationships and devoid of any meaning in cross-border relationships where the need for their operation is visibly stronger.

[29] Paragraphs 92-93 of the *Überseering* judgment.

[30] Wiśniewski, *supra* n. 20, p. 717 et seq.

[31] Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54(3)(g) of the Treaty concerning mergers of public limited liability companies; Sixth Council Directive 82/891/EEC of 17 December 1982 concerning the division of public limited liability companies.

[32] Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies.

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The *Cartesio* judgment supplies new arguments in this context. It should be recalled that in *Cartesio* the ECJ dealt with the status of a company after the cross-border transfer of its seat and not of one just contemplating such a step. Consequently, the qualification of the transfer as made 'for purposes of conversion' cannot depend upon some uncertain declaration made to the parent state bodies before the transfer. In most cases, it will not even be quite clear in what legal form and to whom exactly such a declaration should be made if the parent state's law is generally silent about the existence of an opportunity of conversion emigration. Besides, the parent state cannot have the authority to finally conclude whether the host state's law is or is not willing to permit the conversion; as a result, the practical use of connecting decisive legal effects with a declaration made to the bodies of the parent state would be very limited. Rather, then, the declaration should be made to the bodies of the host state, and it logically follows that usually such a declaration can only effectively be made after the transfer of the seat. Application of the 'real seat' theory annulling the company at the point of the transfer just because it failed to declare its purpose beforehand, would prevent it from availing of the freedom which the Court has expressly admitted.

Interestingly, not only the annulment under pretence of the discussed peculiar application of the law of conflict of laws, but also *the substantive company law sanction of immediate dissolution and winding-up of the company at the point of the seat transfer would prevent the achievement of the conversion purpose.* Consequently, such immediate dissolution turns out to be incompatible with the freedom of establishment as well.

It stands to reason that during the conversion procedure, even if it is a prolonged one, the dissolution sanction should also be suspended. This creates a serious difficulty: in spite of its justified unwillingness, the parent system may be forced to regulate the expatriate company for a long period of time (unless the host state would accept responsibility even before finalising the conversion). Well, nobody has ever promised that cross-border transfers (just as cross-border mergers) would be an easy matter without supporting Community legislation. As in *SEVIC Systems*, however, it matters that such freedom is expressly confirmed as the prevailing rule.

Dissolution and winding-up remains a permitted sanction for breach of emigration restrictions, but not unconditionally: the company must have the opportunity to file for conversion, and sanctions in the incorporation state must be suspended until this motion is decided (with due reservation for exceptional cases where the motion is made in bad faith because it is established beyond doubt that the host state does not offer the conversion opportunity). It is therefore reasonable to conclude from the ECJ's position in *Cartesio* that *the farthest the national law can go in sanctioning emigration restrictions is to prescribe an adequate period of time during which a 'runaway' company can decide either to file for conversion or to repatriate its seat, under pain of dissolution if it fails to do either*. It is certainly not by accident that we are reminded of the system well known from the regulation of European entities.

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4.2 Justification for allowing simple emigration restrictions

There are strong arguments in favour of the state's freedom to prohibit emigration coupled with the intention of the company to stay regulated by its parent law, with the reservation that the non-obedient company's existence is protected at least provisionally.

Firstly, unlimited permission for companies to change the location of the seat while maintaining the ties with the parent substantive corporate law would make the control of observation of requirements of this law more difficult. The parent state should retain the ability to subject the companies appearing 'under the label' of that state to its own law. The application of that law across the border would necessarily be much less effective. The parent state cannot be forced to accept the possibility that a company which, after the transfer of its seat to another Member State, is formally still governed by its law, at the same time might successfully avoid application of this law's restrictions. The lack of effective control could particularly be harmful to the protection of the company's contractual partners and minority shareholders.[33]

Essentially, Community law guarantees that court decisions issued in the territory of one state are effective throughout the Community. However, the émigré company could oppose the coercive measures ordered by courts of the parent state by making use of the procedural measures under Articles 38-52 of Regulation No. 44/2001.[34] In order to create effective instruments for the execution of corporate obligations by companies domiciled in a state other than the parent state, intervention by the European legislator would be required.

Secondly, an unlimited right to emigrate would entail in itself negative consequences for the company's creditors and shareholders.[35] Usually, a cross-border seat transfer is expressly or impliedly approved by the majority of the shareholders; even then, though, for a minority opposing emigration it may lead to detrimental results. Such shareholders would, against their will, be exposed to increased costs and difficulties of cross-border exercise of corporate rights (e.g., participation in general meetings abroad). They will have to enforce, in a foreign state, sentences issued in corporate disputes by courts of, as it can be assumed, the parent state.

In this context it must be recalled that Article 22(2) of Regulation No. 44/2001 does not decide the matter of jurisdictions in corporate matters in a uniform manner. Exclusive jurisdiction belongs to the courts of the Member State on the territory of which the company has its seat; however, in determining the location of the seat, the courts of each Member State shall apply national conflict rules. In case of the separation of the statutory seat and the 'real seat' as a result of emigration, the Regulation

[33] See paragraph 33 of the Advocate General's Opinion; Meilicke, *supra* n. 6, p. 93.

[34] Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.

[35] See paragraph 32 of the Advocate General's Opinion.

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would justify the alternative jurisdiction of the courts of two Member States. This moreover complicates the ability of the parent state to subject the company to its law. The shareholders are exposed to claims brought in corporate law matters in the host state or the need to join proceedings they instituted against the company.

Creditors of the émigré company will encounter difficulties as well. Where the seat transfer entails transfer of assets, they will have to enforce their rights in the host state. Although under Article 60 of Regulation No. 44/2001 they may choose the court from which they would request legal protection among the states of a company's statutory seat, 'real seat' and principal place of business,[36] they may face abuse of freedom of establishment for the purpose of a specific kind of *forum shopping*: establishment under the most liberal bankruptcy law system. Regulation No. 1346/2000,[37] in Articles 3-4, makes bankruptcy subject to the law of the state in the territory of which the centre of a debtor's main interests is located. Disloyal managers and shareholders may be tempted to search for a system alleviating their liability, in particular in order to avoid severe consequences of non-performance of their obligations resulting from the bankruptcy law of the parent state.

The majority of Member States' legal systems fail to provide for any instruments protecting the interests of minority shareholders and creditors in case of a company's emigration. The instruments which can be mentioned are similar to those used to regulate other restructuring procedures such as cross-border mergers: e.g., the right to request a buyout of the shares of minority debtors by the company, or the creditors' right to request a suitable security from the company.

A cross-border transfer of the company's 'real seat' does not typically entail any amendment of the company's articles, making any shareholders' resolution or filing for registration unnecessary (such registration was required by the Hungarian law applicable to CARTESIO, but, e.g., under Polish law the 'real seat' is not registered and such filing would be neither required nor possible). This lack of required formalities also weakens the position of shareholders, who may face facts created by the management, influencing the very basis of corporate relationships, without being able to use their principal defence instrument, which is the request for court control of the shareholders' resolution. In this way, a transfer of the seat by the management leads to circumvention of the principle that all important amendments of corporate relationships require a decision by the owners of the company.

Thirdly, a cross-border seat transfer without conversion complicates the identification of the law applicable to the company. If the host state's conflicts law adopts the 'real seat' theory, this state's courts and other bodies will at least in part apply the host state's law to the company. Of course, in *Überseering*, the ECJ requested recognition of the capacity of such a company to act in law and in court; however, these

[36] This provision establishes the abovementioned three connecting factors for companies in such a manner that each is an equivalent of the domicile of a natural person.

[37] Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings.

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represent only the most important consequences of the legal personality and not the entire regulation thereof; the 'real seat' as a connecting factor has not been declared contrary to Community law as such. In *Inspire Art*, the Court further limited the application of the 'real seat' doctrine by prohibiting such effects which would discriminate against the immigré company or restrict its freedom of establishment to a disproportionate degree. Still, after a cross-border seat transfer without conversion a company must reckon with a number of practical complications resulting from an overlap of the personal laws of 'origin' and 'domicile' and from the natural tendency of the host state's bodies to favour the application of their own law and to interpret foreign law in a manner dictated by notions established under host state law.

4.3 Cross-border conversion: the *SEVIC Systems* ruling applies accordingly

In *Cartesio* (paragraph 112), the ECJ confirmed any Community company's right to emigrate for the purpose of conversion into a company form under the law of the emigration state 'to the extent that it is permitted under that law to do so'. At first glance, this might justify the position that the host state is free to decide whether or not it will welcome conversions of immigré companies. Paradoxically, the monopoly of controlling migration would not cease to exist but would pass again to the host state, a rather astonishing result after *Überseering*.

It will be useful to recall here the discussion underlying the ruling in *SEVIC Systems*. The ECJ declared the general refusal, by German courts, of admission of a foreign company to merger proceedings with its German counterpart to be contrary to the freedom of establishment guaranteed by Articles 43 and 48 of the EC Treaty. A different treatment of mergers depending on their local or cross-border dimension represents a restriction of this freedom. Such a restriction can only be admissible if there are overriding requirements in the public interest and if it is adequate for attaining its purpose and remains proportional thereto.[38] The Court, finally, arrived at the conclusion that the existence of harmonised regulation of cross-border mergers is not a necessary premise for exercising freedom of establishment in this form and a Member State which permits mergers of companies should make such procedures available also for cross-border transfers. In the Court's opinion, the public interest – represented by the need to protect creditors, minority shareholders and employees, the fiscal interest of the state and the safety of trading – can justify restrictions of the companies' freedom of establishment only in specific circumstances and within the limits of the proportionality test.[39]

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[38] Paragraph 23 of the *SEVIC Systems* judgment.

[39] Paragraphs 26 and 28-29 of the *SEVIC Systems* judgment. See also, e.g., ECJ judgments in Case C-12/92 *Kraus* [1993] *ECR* I-1663, paragraph 32; Case C-55/94 *Gebhard* [1995] *ECR* I-4165, paragraph 37; and Case C-212/97 *Centros* [1999] ECR I-1459, paragraph 34.

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There are no serious arguments against the application, *mutatis mutandis*, of the *SEVIC Systems* principles to cross-border seat transfers. Conversion does not entail greater risks than merger; on the contrary, usually it is a much more simple operation. There is only one participant in the conversion, so that complex coordination of parallel restructuring processes under more than one national law is not required. What needs coordination is the application of two legal systems to one company, or, more strictly speaking, the determination of the time of replacing one corporate law with the other and the manner of accounting for differences.

It follows from the above analysis that specific permission for conversion into a given foreign company form, or even generally permission for conversion into a foreign company, which presently cannot be expected from the majority of Member States at all,[40] does not have to be a necessary prerequisite for conversion emigration.[41] Unless in *Cartesio* the Court wanted to play hide and seek with business entities, it must have had in mind a more broadly understood right of conversion. It should be assumed that the requirement should be similar to that established for cross-border mergers.

Following the logic of *SEVIC Systems* one must agree that, on the one hand, the ECJ rulings cannot replace harmonisation measures and dictate to national legislators conversion provisions to be introduced into their company laws; on the other hand, where such transformation possibilities are present, discrimination against foreign companies would violate the freedom of establishment. Consequently, it should suffice for local law to offer a reasonably viable transformation procedure essentially meant for other local forms of business entities.

This means that a potentially prolonged procedure before the courts of the emigration state may be necessary, typically taking place after the transfer of the company's seat to that state. In any case, even if we were to assume that an express opportunity for foreign companies to convert is required, it would be for the courts of the host state, not the incorporation state, to decide whether or not the company qualifies for such conversion. Consequently, the incorporation state must be prohibited from declaring the annulment of the company at the point of the transfer of its seat to another state. Essentially, it cannot, as well, order dissolution and winding-up with the purpose of re-incorporation in the host state. Such restrictions can only operate in exceptional cases where they would be justified by 'overriding requirements in the public interest' (*Cartesio*, paragraphs 111-113).

The opinion expressed in some commentaries on the *Cartesio* judgment, i.e., that – in case of a lack, in the host state, of provisions on cross-border conversion – the

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[40] Presently, only some Member States have or contemplate having regulations regarding cross-border conversions.

[41] M. Szydło, Commentary on the *Cartesio* judgment, 46 *Common Market Law Review* (2009) p. 721.

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émigré company is automatically transformed into a partnership,[42] must be rejected. Such an effect would mean negation and not promotion of the freedom of establishment; the company would in fact be refused its original capacity, to be replaced by only a relative ('crippled') personality, and by a new legal regime completely deforming its previous corporate relationships.

The doctrine of such 're-classification', based on the 'real seat' theory and treated as a 'mild' version thereof (when compared to the 'harsh' version providing for the total annulment of the immigré company) has been proposed and applied earlier, in particular in Germany, to Community companies[43] and met with deserved criticism that it is harmful and discriminatory. German courts still attempt to revive it, though, to use it in the field of emigration restrictions.[44]

In the *Inspire Art* judgment, the ECJ qualified a much less harsh intervention by the host state (Dutch) law in the corporate relationships shaped by the law of incorporation as being contrary to the freedom of establishment. Re-classification as a partnership cannot satisfy the requirements formulated in the *Überseering* judgment either, because it demonstrates disregard of the legal capacity acquired under the law of incorporation. It cannot be rationally expected that the company and its shareholders would agree to such a transformation, which would result in their personal liability for company debts and destabilisation of corporate relationships. It would be more reasonable to avoid cross-border restructuring and use the opportunity to form a branch office instead.

In addition, some (e.g., Polish) legal systems make a clear distinction between commercial partnership and simple ('civil') partnership. Conversion into a commercial partnership encounters similar difficulties as conversion into a company: the need to pursue the required procedure and to file for registration (in this context one may well recall that CARTESIO was itself such a partnership!). On the other hand, conversion *ex lege* into a civil partnership means complete disregard of the *Überseering* principle because such partnerships are not considered legal entities at all; they have no personality of their own and exist only on the basis of the legal capacity of partners.

Re-classification of companies migrating to Germany has been prohibited by the *Überseering* and *Inspire Art* judgments. There are no arguments justifying the comeback of this doctrine, compromised as it is, in the European area, by cross-border conversion. The conclusion from the above judgments, reinforced by *Cartesio*, is that a company's freedom of establishment in its primary dimension includes the right of

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[42] D. Zimmer and Ch. Naendrup, 'Das Cartesio-Urteil des EuGH: Rück- oder Fortschritt für das internationale Gesellschaftsrecht?', 9 *Neue Juristische Wochenschrift* (2009) p. 547 et seq.; Leible and Hoffmann, *supra* n. 8, pp. 58, 60 et seq.

[43] German courts continue the practice of reclassification of immigré companies from non-Member States into German partnerships.

[44] See the decision of the German Bundesgerichtshof of 27.10.2008, II ZR 158/06, Betriebs-Berater 2009, No. 1, p. 14, related to a Swiss company.

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direct access to the market of a Member State after conversion into a local form. Such conversion, however, cannot take place *ex lege* into a form ill-adapted to the business purposes of such a company and deforming its internal relationships. The basis for a conversion must be an application from the company pursuant to a corporate decision of its shareholders.

4.4 To what extent can the country of incorporation restrict a company's emigration for conversion purposes?

In paragraphs 110-112 of the *Cartesio* judgment, the ECJ distinguishes between the transfer of a company's seat (in the meaning of administrative centre) with the purpose of conversion into a host state company and such a transfer with the purpose of continuing as a company subject to the corporate law of incorporation. The admissibility of the first purpose of emigration is expressly confirmed: the state of incorporation cannot prevent emigration with a conversion purpose, in particular provide for dissolution or winding-up, to the extent that the company is permitted to convert by the new host state law.

There are two main aspects of emigration of a company; its relationships with the parent state and with the host state. The ECJ concentrated on the first aspect because it was the parent state court that inquired how it should treat CARTESIO's application for registration of its new seat in Italy. In the opinion of the Court, the parent state can only apply restrictions which are justified by overriding requirements in the public interest.[45] Essentially, this power does not include the right to require that the company dissolves and re-incorporates under the law of the host state. Thus, the Court expressly confirmed that the freedom of establishment binds the state of incorporation to its own companies as well.

This position corresponds to earlier ECJ judgments concerning natural persons. First of all, the case *Hughes de Lasteyrie du Saillant*[46] should be mentioned. In this case, the Court found that French regulations governing capital gains tax which required French residents to pay tax on hidden increases in the value of securities pursuant to a change of residence for tax purposes constitute a restriction which is not proportional and, as such, is contrary to the freedom of establishment.

Even before C*artesio*, the majority of authors were of the opinion that a company's right to emigrate fell within the scope of freedom of establishment protected by Community law. The argument most frequently used was the need to broaden the scope of the rules established in the *Centros*, *Überseering*, *Inspire Art* and *SEVIC Systems* judgments to the emigration of companies.[47]

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[45] Paragraph 113 of the *Cartesio* judgment.

[46] ECJ, Case C-9/02 *Hughes de Lasteyrie du Saillant and Ministère de l'Économie, des Finances et de l'Industrie* [2004] *ECR* I-2431.

[47] W.-G. Ringe, 'No Freedom of Emigration for Companies?', 16 *European Business Law Review* (2005) pp. 621, 624 et seq.; F.M. Mucciarelli, *Companies' Emigration and EC Freedom of*

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It has already been pointed out above that the opportunity to transfer a company's seat with the purpose of conversion into a host state company might be, practically speaking, a very weak offer because the legal systems of the Member States do not contain provisions dealing with such conversion, and the ECJ has stressed that agreement from the host state's law is a necessary prerequisite.[48] However, at least in those legal systems which provide for developed regulation regarding conversion of corporate forms, the necessary adjustment is not more difficult than in the case of a cross-border merger before the 10th Directive.[49] There is only one short step between the ECJ's discussion of the matter in *Cartesio* and the conclusion that any Member State which provides for conversion of certain entities into one of its corporate forms should not refuse a foreign company's application for such a conversion if only its form is reasonably comparable. Therefore, the legal framework for such conversion should be analysed more closely.

Of course, cross-border conversion carried out on the basis of the provisions regulating transformation of local entities is a difficult operation. The principal obstacle is the lack of uniform European rules concerning the determination of the law applicable to companies. It should be recalled, without entering into particulars, that from the perspective of a legal system relying without any reservations on incorporation as the connecting factor, a cross-border conversion is out of question as a matter of principle: the company is sentenced, for its entire life, to allegiance to the law which granted it its personality.

Moreover, a cross-border conversion requires a detailed separation in terms of scope between both applicable laws involved: of the parent state and of the host state. Even the general principle adopted in the law of conflict of laws of some Member States, namely that conditions provided for by both legal systems must be met, does not clear all doubts. Only some Member States have enacted clear conflict rules to regulate cross-border conversion.[50] Further difficulties result from discrepancies between national substantive law rules concerning conversions. Other than in the case of merger and division of companies (3rd and 6th Company Law Directive), no harmonisation directive removes these discrepancies.

In addition, the ascertainment by the host state's responsible bodies of the fulfilment of preconditions required by the parent legal system turns out to be a problem: there is no uniform mechanism for the issuance of certificates, such as that which the

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Establishment (15.10.2007), available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1078407, p. 26 et seq.

48 Zimmer and Naendrup, *supra* n. 42, pp. 547-548; Kindler, *supra* n. 8, p. 131.

49 Declared admissible by the ECJ in *SEVIC Systems*.

50 Outside the EU, see Articles 161-163 of the Swiss Act on Private International Law of 18.12.1987, which provide for delimitation of Swiss and foreign law in the process of cross-border transformation. See F. Vischer, in D. Girsberger, et al., *Zürcher Kommentar zum IPRG*, 2nd edn. (Zürich 2004) p. 1800 et seq.

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Community law provides in relation to cross-border mergers or to a transfer of the seat of a *societas europaea.*[51]

Essentially, the ECJ proposes a system of 'emigration for conversion' under which a company may freely transfer its seat to another Member State for that purpose and the incorporation state has to suspend sanctions for such period of time as is required to finalise the conversion. During this period, the company must be governed by the 'old' incorporation law because the target legal system cannot yet assume control.

This procedure is well known in European company law and the ECJ expressly refers to it in paragraphs 115-118: it has been used for European entities, including the *societas europaea.*[52] The rule is that one can freely transfer the centre of administration to another Member State on condition that, within the period of time specified, the registered office (*Satzungssitz*, *siége statutaire*) will also be transferred. The ECJ is approving it now as a general rule for any cross-border transfer of a company's seat. This rule was not applicable to CARTESIO only because it had never expressed any intention to convert.

It should be reminded that in *Cartesio* the European Commission suggested that it is possible, or maybe even necessary, to accordingly apply the provisions regulating transnational entities, such as the European Economic Interest Grouping, European Company and European Cooperative,[53] to cross-border seat transfers. These provisions govern the transfer of the real seat, necessarily followed by a cross-border transformation (limited to the change of the national law applied to fill gaps in Community regulations). Formally, the ECJ rejected this position arguing that the application *mutatis mutandis* of these rules to CARTESIO could not help as CARTESIO wished to remain a Hungarian company even after the transfer.[54] However, within the scope of the conversion emigration discussed as a kind of *obiter dicta*, the system resulting from a closer analysis of the Court's position is very similar.

Obviously, there are no grounds for the direct application to national companies of the norms introduced for transnational entities. Such an attempt would violate national conflict of laws as well as substantive rules. However, certain basic principles which can be abstracted from the regulation of cross-border transformation of European entities may be relied upon in order to resolve conflicts between national laws of Member States.

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[51] See Articles 8 and 17-31 of the Regulation on the Statute for a European Company, and Articles 10-11 of the 10th Directive on cross-border merger of limited liability companies.

[52] See Articles 8 and 17-31 of the Regulation on the Statute for a European Company.

[53] Paragraphs 115-116 of the *Cartesio* judgment.

[54] Paragraphs 119-120 of the *Cartesio* judgment.

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5. THE CONSEQUENCES FOR THE FUTURE DEVELOPMENT OF EUROPEAN COMPANY LAW

5.1 The case for adoption of the 14th Directive

The *Cartesio* judgment and its implications very clearly lead to the conclusion that a combined legislative effort at Community level is necessary for the further development of companies' freedom of establishment. Such effort should be composed of two elements, both of crucial importance: uniform regulation of mutual recognition of companies and of the law applicable to them, and harmonisation of substantive company law rules regulating enjoyment of this freedom.

In this context, the decision of the European Commission to suspend, in 2007, the work on the 14th Company Law Directive concerning cross-border seat transfer must be assessed critically.[55] This decision, conflicting with declarations in the 2003 Action Plan,[56] lacked convincing justification. The Commission argued that the question of whether the 14th Directive could effectively improve the position of European business entities remained unsolved. Member States taking different positions in matters of cross-border seat transfers would make the Directive difficult to adopt. An effect of transferring the statutory seat could be achieved by a cross-border merger. The Commission concluded that therefore, in the nearest future, it would be necessary to gain experience concerning the practical influence of the new merger regulations. Besides, the Commission wanted to wait for new incentives from the ECJ, expected from the judgment in the *Cartesio* case, already pending.[57]

Even before the *Cartesio* judgment, the Commission's position was vulnerable.[58] Whatever the expectations about the final ruling, it had been obvious beforehand that it could not replace harmonisation of national laws. A judgment in an individual case confirming the essential existence of a certain freedom cannot replace transparent substantive and procedural rules regarding the cross-border operation or remove

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[55] Underlying the decision itself was the Commission Staff Working Document: Impact assessment on the Directive on the cross-border transfer of registered office, 12.12.2007, SEC (2007) 1707.

[56] Communication from the Commission to the Council and the European Parliament: Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward, 21.5.2003, COM (2003) 284, sec. 3.4.

[57] Ch. McCreevy, Speech at the 5th European Corporate Governance and Company Law Conference, Berlin, 28.6.2007, available at: http://www.bdi.eu; Speech by Commissioner McCreevy at the European Parliament's Legal Affairs Committee, 3.10.2007, pp. 3-4.

[58] E. Wymeersch, 'Is a Directive on Corporate Mobility Needed?', 8 *European Business Organization Law Review* (2007) p. 161; G.-J. Vossestein, 'Transfer of the Registered Office. The European Commission's Decision Not to Submit a Proposal for a Directive', 4(1)*Utrecht Law Review* (2008) p. 53; A. Opalski, 'Stan i perspektywy europejskiego prawa spółek a rozwój polskiego prawa spółek' [The state and prospects of European company law and the evolution of Polish company law], 1(8) *Studia Prawa Prywatnego* [Private Law Studies] (2008) p. 96.

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obstacles resulting from different approaches to conflict of laws problems. The employee participation problems could not have been resolved by the ECJ judgment either. We have experienced this already after the *SEVIC Systems*, before the entry into force of the 10th Directive effectively permitted the practical enforcement of the freedom to carry out cross-border mergers.

Similarly, the lack of transparent substantive, procedural and conflict of laws rules makes a cross-border conversion very difficult to process. Interpretation of primary law is not a handy instrument: without harmonised regulation one has to put each individual restriction established by a Member State law to the proportionality test developed by ECJ practice, which is decisive for the restriction's survival after being confronted with the freedom of establishment.

After *Cartesio*, the importance of cross-border conversion increased. It has been demonstrated to constitute the only viable way for those companies which are incorporated under a national law prohibiting the transfer of the real seat to another state to enjoy freedom of establishment. For other companies, it is a useful supplement to the right to move their centre of administration, allowing them to more freely select the most convenient legal system and stimulating competition between Member States' company law systems. In the future, the decisive incentive for a cross-border conversion could be the search for the most effective internal organisation (which will lower the costs of capital accumulation), attracting strategic investors, going public on the selected securities exchange and working on image building by assuming an internationally renowned legal form, etc.

The need for recommencing the work on the 14th Directive is a frequent conclusion drawn by commentators on the *Cartesio* judgment.[59] Since the ECJ has declared that the possibility of cross-border conversion is open to national companies, the European legislator really has no other choice but to provide adequate regulating mechanisms.

5.2 The case for adoption of the regulation on the law applicable to companies

Competition between national systems of conflict of laws and substantive rules concerning international movement of companies causes the regulation of cross-border activities to be extremely non-transparent and the predictability of a final outcome of an attempted operation very low. The particular differences are many and cannot be reduced only to the schematic distinction between incorporation, 'real seat' and statutory seat theories. In fact, each individual national system pursues its own

[59] Zimmer and Naendrup, *supra* n. 42, p. 549 et seq.; Leible and Hoffmann, *supra* n. 8, p. 63; J. Napierała, 'Transgraniczne przeniesienie siedziby spółki w świetle wyroku Trybunału Sprawiedliwości w sprawie Cartesio' [Cross-border transfer of a company's seat in the light of the ECJ *Cartesio* judgment], *Kwartalnik Prawa Prywatnego* (Private Law Quarterly) (forthcoming, 2009).

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particular variation of one of those theories or a combination thereof, additionally complicated by a variety of rules concerning the admissibility of *renvoi*. ECJ judgments cannot go beyond formulating certain restrictions for the operation of national legal constructions; what is required is a positive regulation. No fragmentary solution of particular problems will ever produce generally satisfactory results. There is a clear need for a uniform core of European international company law.

Assuming that a primary law regulation (an international convention) is neither a necessary nor preferable solution, a Community regulation unifying conflict of laws rules in the field of company law, coordinated with substantive solutions resulting from the 14th Directive, should be promulgated. A draft of such a regulation was proposed in 2006 by the International Company Law Commission created by the German Council of Private International Law.[60] Influenced by ECJ practice, the draft provides for companies to be 'subject to the law of the state in whose public register they are entered'. Companies or partnerships which are not subject to the registration duty or are not yet registered, are to be regulated by the law under which they are organised. Entities for which the above rules are not conclusive (partnerships without a permanent organisation) are subject to conflict rules relating to contractual obligations.

Under Article 7 of the draft, a company registered under the law of one Member State can change the applicable law through a cross-border registration transfer without being obliged to make a parallel change in the location of its 'actual seat' ('real seat', centre of administration). Deregistration is subject to the parent law, while a new registration takes place pursuant to the law of the host state. Registration transfer is subject to the parent law where it concerns the fulfilment of conditions aimed at the protection of third persons and shareholders.

As can be seen, the draft rejects any application of the 'real seat' as the connecting factor, thus breaking links between the seat and the applicable law. In this respect, it is more radical than the *Cartesio* judgment which leaves the matter of such links to be decided by the incorporating state. Even though certain individual solutions provided for in the draft may be debatable, the proposal for uniform corporate conflicts law permitting full enjoyment of the freedom of establishment by companies, resolving major disputes and filling gaps in progressive rules promoted, case by case, by the ECJ, is certainly welcome.

The distinctive feature of the draft proposal is its preference for the founders' will. The original applicable law is the legal system to which the founders referred when forming the company. However, this decision can be changed later in the company's life. This means a fundamental change from a protectionist approach shielding a country's territory from foreign infiltration or preventing the escape of companies from national jurisdiction. The function of private international law is not

[60] H.J. Sonnenberger, ed., *Vorschläge und Berichte zur Reform des europäischen und deutschen internationalen Gesellschaftsrechts* (Tübingen, Mohr Siebeck 2007).

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to block such changes but to work out rules delimiting the scope of regulation of the involved legal systems on the basis of the founders' will as the decisive factor. It can be hoped that, in the long run, the Community will enforce uniform legislation based on the principles presented in the draft.

It is possible that the most important achievement of the *Cartesio* judgment will be its role as a strong incentive for undertaking work on such uniform regulation.

6. Conclusions

6.1 The status quo: freedom of establishment after the *Cartesio* judgment

After *Cartesio*, the scope of companies' freedom of establishment as determined by the ECJ has two aspects.

Firstly, a company can transfer its seat to another Member State if it is permitted by the law of incorporation (*Daily Mail*, *Überseering* and *Cartesio* judgments). The parent state can restrict such a transfer in any way, including through outright prohibition; however, the sanctions for breaching this prohibition are already, to a certain extent, determined by the freedom of establishment rule. The parent state cannot annul the company attempting emigration (*Cartesio*). Arguably, an immediate declaration that the company is dissolved is also ruled out; instead, the company should be allowed a grace period to opt for conversion (again, *Cartesio*). In turn, the host state must recognise the capacity of the immigré company (*Überseering*) and should refrain from imposing restrictions or duties which are not proportional and not justified by overriding requirements in the public interest (*Centros* and *Inspire Art*).

Secondly, a company can emigrate without looking for any permission, on condition that its purpose is to convert into a company form under the law of the host state. The parent legal system cannot restrict this freedom; in particular, the requirement to dissolve the company and reincorporate it under the host state law is not compatible with the freedom of establishment (*Cartesio*). Even though this question is not discussed by the ECJ in *Cartesio*, by means of analogy with *SEVIC Systems* it seems that the host state may not refuse to give the immigré company permission to convert if its company law offers this opportunity to similar local entities, unless justified by overriding requirements in the public interest and unless the restrictions pass the test of proportionality.

In *Cartesio*, the ECJ opted for the more complex method of protection of the freedom of companies to emigrate. A cross-border conversion affects the rights of shareholders, creditors and employees far more strongly than the mere transfer of the centre of administration. Still, this solution is preferable to the other option: forcing Member States to tolerate simple emigration without regard to their legal tradition and – what is more important – without any possibility to solve the ensuing difficulties (which only harmonisation or unification measures could).

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In sum, and with the reservations expressed above, companies' freedom of establishment after *Cartesio* does include emigration from the state of incorporation (and, consequently, from a subsequent state of registration, too).

6.2 The ECJ's judgment and the Opinion of the Advocate General

The first reactions to the *Cartesio* judgment tended to concentrate on the disagreement between the ruling of the ECJ and the Opinion of the Advocate General. Contrary to such superficial observations, a deeper analysis shows that the views of the Advocate General and the Court's position are essentially compatible, even though the order of arguments and the final response to the Hungarian court's question are different. The Advocate General discovered a basic incompatibility between *Daily Mail* and the later judgments (*Centros*, *Überseering*, *Inspire Art* and *SEVIC Systems*) and urged the Court to finally break with *Daily Mail* and take from the Member States their uncontrolled 'power of life and death' over companies. The Court, rather expectedly, attempted to find basic agreement and continuity between its judgments. However, under cover of confirmation of the *Daily Mail* principle as a starting point, the Court added a significant qualification: that the Member States' power does not enjoy immunity from the rules of the EC Treaty on freedom of establishment.

There is an internal incompatibility between at least a part of the content of the Advocate General's Opinion and the conclusion submitted to the ECJ as proposal for its ruling in response to question (4). On the one hand, the Advocate General essentially agrees with the treatment of cross-border conversion as the only unrestricted form of emigration of companies (although he outlines a strange form of partial conversion, see paragraph 33 of the Opinion); on the other hand, he proposes to determine that Articles 43 and 48 of the EC Treaty should prohibit national regulations preventing companies from transferring their 'operational headquarters' (centre of administration, 'real seat') (paragraph 36 of the Opinion).[61] The Advocate General's radical conclusion lacks coordination with the less radical part of his Opinion and, in this context, the Court's choice of a more conciliatory option is understandable.

The result of the *Cartesio* judgment can be interpreted both ways: as the preservation of the state's power as long as the company is governed by its law (because restrictions on simple emigration generally pass the test of compatibility with the freedom of establishment), or as the withdrawal of absolute power from the state of incorporation (because it cannot prevent conversion emigration or annul the company at the point of simple emigration). Although the authors are of the opinion that

[61] See paragraph 36 of the Advocate General's Opinion: 'Articles 43 EC and 48 EC preclude national rules which make it impossible for a company constituted under national law to transfer its operational headquarters to another Member State.'

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the second interpretation corresponds better with the ECJ's intentions, this controversy will have no major practical importance for the enjoyment of the freedom of establishment by companies operating in the European economic space.

6.3 Perspectives for a new conflict of laws approach

The *Cartesio* judgment is, in fact, a *coup de grâce* for the 'real seat' theory already unsaddled by *Überseering*. This doctrine has been considered still valid by some authors, even after *Überseering*, although its scope of application is limited to the parent state's own companies attempting to emigrate. Under this doctrine, the state of the new seat must take control of the émigré company immediately, or, from the perspective of its own state of incorporation, it will cease to exist. One may encounter the opinion that this doctrine has been 'upheld' by *Cartesio*;[62] its partisans, however, fail to draw elementary conclusions from those parts of the judgment which are inconvenient for their position. It should be obvious that, for the conversion emigration to be practicable at all, *the parent state must agree that its law will govern the company for some time after the cross-border transfer* of its centre of administration.

Still, the fall of the 'real seat' theory does not automatically mean that its old rival, the incorporation theory, will be the new champion. *Everything speaks for a newcomer as the winner: the registration theory*, a modernised version of the earlier statutory seat (registered office) theory using the place (or rather: state) of registration as a connecting factor. The distinction in relation with the statutory seat theory is that the place of registration is more universal because it is independent of the company's articles which may or may not, under the applicable law, specify any particular address or locality to which the company is linked in its corporate relationships. The registration theory relies upon the public act of registration by which a certain state assumes responsibility for the existence of the company; still, in most cases the company will also be required to choose its statutory seat on the territory of this state.

In its basic aspects, the registration theory is similar to the incorporation theory, with one important difference: it expressly recognises the possibility of changing the company's state of registration and, consequently, the law governing the company. In fact, it has been created exactly for the purpose of making such a change possible.

[62] Kindler, *supra* n. 8, p. 131; Leible and Hoffmann, *supra* n. 8, p. 62.

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