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18 The Personal Law of Companies and the Freedom of Establishment under EU Law

The Enthronement of the Country-of-origin Principle and the Establishment of an Unregulated Right of Cross-Border Conversion

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18.1 Introduction

The hostility between the conflicts rules on the personal law of companies and EU free movement rights has a rather long, 24 years old history. The first case on this question was *Daily Mail*,[1] decided on 27 September 1988, while the saga seems to have found a berth on 12 July 2012 with the judgment of the Court of Justice of the European Union (hereinafter 'CJEU') in *VALE*.[2] During these 24 years, the case law has gradually, step-by-step, dismantled the 'real seat' theory (the concept that the personal law of the company is the law of the country where it has its real seat), and gave ground to the incorporation theory (that is, the company's personal law is the law of the country where it was established, *i.e.* registered).[3] The CJEU performed this with guarded wording and tacit language; however, in *VALE* the Court made this explicit and treated the death of the 'real seat' theory as an accomplished fact.[4]

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1 Judgment of 27 September 1988 in Case 81/87, *The Queen v. H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc [*1988] ECR 5483.

2 Judgment of 12 July 2012 in Case C-378/10, *VALE Építési Kft,* not yet published.

3 For a brief overview on the virtues and drawbacks of the incorporation and the 'real seat' theory *see* Ch.H.J.I. Panayi, 'Corporate Mobility in Private International Law and European Community Law: Debunking Some Myths', 28 *Oxford Journals Law Yearbook of European Law* 1, 2009, pp. 125-130.

4 Of course, this did not come as a surprise. *See* J. Armour, 'Who Should Make Corporate Law? EU Legislation versus Regulatory Competition', *in:* J. Holder & C. O'Cinneide (Eds.), *Current Legal Problems 2005*, Vol. 58, Oxford University Press 2006, p. 370 ("EU law is rapidly moving towards a framework within which companies will be both willing and able to locate their registered offices so as to secure a company law that is favourable to their requirements."); H.C. Hirt, 'Freedom of establishment, international company law and the comparison of European company law systems after the ECJ's decision in Inspire Art Ltd', 15 *European Business Law Review* 5, 2004, p. 1192.

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The CJEU's case law on the personal law of companies is part of a general trend of EU law whereby the country-of-origin principle is permeating into the domain of private law. Although at the outset this principle may have been considered as being applicable only to public law rules and requirements thwarting free movement (*e.g.* mutual recognition of technical standards),[5] it gradually found application also in the ambit of private law. Today, the country-of-origin principle may ensure the (mutual) recognition of civil law rights, obligations, statuses, such as legal personality,[6] surnames[7] and the lack of non-contractual liability,[8] acquired or gained in another member state. The country-of-origin principle gradually evolved from a public law connecting factor to a connecting factor under conflicts law.

Nonetheless, although the country-of-origin concept may be plausible in public law, its direct extrapolation to private law seems to be an unwelcome move, since it disregards the complexity of civil law matters. For instance, it is noteworthy that the CJEU's rulings on the personal law of companies apply only to intra-Union cases, and hence, cases involving a member state and a non-EU country are left untouched; that is, the 'real seat' theory may remain applicable regarding member state – non-member state relations. This bifurcation of the connecting factor is peculiar to the country-of-origin principle in conflicts law at large. The country-of-origin principle prevails only if the country of origin is a member state; if it is a non-EU country, the case does not come within the scope of the country-of-origin principle.[9] This bifurcation of the applicable law, while acceptable in relation to public law requirements such as technical and professional standards, seems to be very unwelcome in the realm of private international law.

This paper presents, from a critical perspective, the development of the CJEU's case law on the collision between the personal law of companies and the freedom of establishment with special emphasis on the CJEU's recent judgment in *VALE*.

It is argued that this ruling treats the incorporation theory as 'the law of the land', putting an end to the explanation that EU law does not establish a connecting factor, the determination of which is a member state competence, but simply precludes some plights that frustrate the freedom of establishment. Furthermore, the case law on the personal law of companies is put in the context of the country-of-origin concept as a general and fundamental principle of EU law. It is argued that although the incorporation theory fits

5 *See e.g.,* Judgment of 20 February 1979 *in* Case 120/78, *Rewe-Zentral AG v. Bundesmonopolverwaltung für Branntwein [*1979] ECR 649; Judgment of 26 June 1980 *in* Case 788/79, *Criminal proceedings against Herbert Gilli and Paul Andres* [1980] ECR 2071.

6 *See* "C. The CJEU's case law on the personal law of companies and free movement rights".

7 *See* Judgment of 2 October 2003 in Case C-148/02, *Carlos Garcia Avello* [2003] ECR I-11613; Judgment of 14 October 2008 in Case C-353/06, *Grunkin-Paul* [2008] ECR I-7639.

8 Judgment of 25 October 2011 in Joined Cases C-509/09 and C-161/10, *eDate/Martinez*. Not yet published.

9 *See* C.I. Nagy, 'The Word is a Dangerous Weapon: Jurisdiction, Applicable Law and Personality Rights in EU Law – Missed and New Opportunities', 8 *Journal of Private International Law* 2012, p. 293.

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better the system of the internal market characterised by free movement rights, as a general proposition, the categorical application of this principle to all fields of private law suppresses conflicts analysis and, as such, is a dubious development. Conflicts problems should receive a conflicts law answer. The oversimplified application of the country-of-origin principle, though certainly warranted in the field of public law, does away with private international law problems without carefully examining and adequately solving them. Furthermore, it is also argued that in *Cartesio*[10] and *VALE* the CJEU seems to have created an unregulated right of cross-border conversion. In *Cartesio*, the Court established a right of 'departure', *i.e.* companies have the right to move their seat to another member state in order to convert into the legal person of the receiving country, while losing their original legal personality. In *VALE*, the CJEU seems to have established a right of 'arrival', derived from the principle of non-discrimination. However, EU law prescribes only the theoretical possibility of conversion ('departure' and 'arrival'), and leaves the technicalities of this conversion to national law; the dissolution in the member state of origin remains governed by the latter's law. With this, the CJEU created an unregulated right of cross-border conversion, which, for the time being, operates largely in a legislative vacuum; hence, national courts bear a special responsibility. It is submitted that company conversions, especially cross-border conversions, raise complex issues to be settled in a complex legislative process and not in the courtroom. It would be welcome if the EU legislator could address the problem of cross-border conversions.

18.2 Extrapolating the EU Country-of-Origin Principle to Private Law

The traditional playing field of the country-of-origin principle (or better known as the principle of mutual recognition) has been the domain of public law, especially technical, professional and other legal standards.[11] However, this core principle of EU law has gradually permeated into the territory of private law and the concept of recognizing the country-of-origin's technical standards was extrapolated to the realm of private law, entailing the application of the civil law of the country of origin.

In *Carlos Garcia Avello*,[12] Belgium refused to change, in accordance with Spanish customs, the surnames of the two children of a Spanish father and a Belgian mother. The children had dual citizenship. Under Belgian law, the children get the surname of the father, while

10 Judgment of 16 December 2008 in Case C-210/06, *Cartesio Oktató és Szolgáltató Bt [*2008] ECR I-9641.

11 *See e.g.*, Judgment of 20 February 1979 *in Case 120/78, Rewe-Zentral AG v. Bundesmonopolverwaltung für Branntwein [*1979] ECR 649; Judgment of 26 June 1980 in Case *788/79, Criminal proceedings against Herbert Gilli and Paul Andres* [1980] ECR 2071. *See also,* European Commission, 'Communication from the Commission to the Council and the European Parliament on mutual recognition in the context of the follow-up to the action plan for the single market', COM (1999) 299 final, 16 June 1999.

12 Case C-148/02*, Carlos Garcia Avello*.

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under Spanish law the children obtain the first surnames of their parents. In essence, the CJEU, established that a dual citizen who is the national of two member states is entitled to choose a name that complies with the law or customs of either member state: the prohibition of discrimination based on nationality (Art. 18 TFEU) and the concept of Union citizenship (Art. 20 TFEU) preclude the member state from

> refusing to grant an application for a change of surname made on behalf of minor children resident in that State and having dual nationality of that State and of another Member State, in the case where the purpose of that application is to enable those children to bear the surname to which they are entitled according to the law and tradition of the second Member State.[13]

In *Grunkin and Paul*,[14] another case concerning the surname of a child, the application of the country-of-origin principle to the rules on surnames was more patent. The child was a German national and was born in Denmark. According to Danish conflicts rules, due to his habitual residence in Denmark, the question of the surname was governed by Danish law[15] and the name was registered in Denmark accordingly. Under Danish law, in case the parents did not have the same surnames, "an administrative change of [the] surname to one composed of the surnames of both parents joined by a hyphen" was allowed,[16] and the surname registered in Denmark was Grunkin-Paul. Afterwards, the German authority refused to recognize this surname: Germany follows the principle of nationality as to the name of natural persons;[17] as the child only possessed German citizenship, German law was applied, which provided that if "the parents do not share a married surname but have joint custody of the child, they shall, by declaration before a registrar, choose either the father's or the mother's surname".[18] The CJEU held that the German authorities have to recognize the surname (or to put it more generally: the civil status) acquired under the law of the country of origin (Danish law).

> In view of the foregoing considerations, the answer to the question referred to the Court must be that, in circumstances such as those of the case in the main proceedings, Article 18 EC [now Article 21 TFEU]precludes the authorities of a Member State, in applying national law, from refusing to recognise a child's surname, as determined and registered in a second Member State in which the child – who, like his parents, has only the nationality of the first Member State – was born and has been resident since birth.[19]

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13 Case C-148/02*, Carlos Garcia Avello*, para. 45.
14 Case C-353/06*, Grunkin-Paul.*
15 Case C-353/06*, Grunkin-Paul,* paras 11-14.
16 Case C-353/06*, Grunkin-Paul*, para. 13.
17 Section 10 EGBGB.
18 Section 1616 BGB.
19 Case C-353/06*, Grunkin-Paul,*para. 39.

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In *eDate/Martinez*,[20] the CJEU applied the country-of-origin principle to the electronic (*i.e.* online) cross-border violations of privacy and personality rights. The judgment interpreted Article 3 of the E-Commerce Directive[21] and, to put it in its simplest form, ruled that, in principle, the law of the member state where the service provider is established (provided it is established in the EU) shall be applied if it is more favourable to the service provider. Although Article 1(4) of the Directive provides that the "Directive does not establish additional rules on private international law nor does it deal with the jurisdiction of Courts",[22] it also goes on to say that "the provisions of the applicable law designated by rules of private international law must not restrict the freedom to provide information society services as established in this Directive".[23] Article 3(2) of the Directive provides that "Member States may not, for reasons falling within the coordinated field, restrict the freedom to provide information society services from another Member State". The CJEU held that the coordinated field covers private law, including the civil liability of the provider of information society services,[24] and all measures that discourage the cross-border provision of the information society service qualify as a restriction. It amounts to such a discouragement if the service provider has to comply with stricter rules than in its country of establishment. The CJEU held that the free movement of services is not fully guaranteed

> if the service providers must ultimately comply, in the host Member State, with stricter requirements than those applicable to them in the Member State in which they are established. […] Article 3 of the Directive precludes, subject to derogations authorised in accordance with the conditions set out in Article 3(4), a provider of an electronic commerce service from being made subject to stricter requirements than those provided for by the substantive law in force in the Member State in which that service provider is established.[25]

The 'status' acquired under the country of origin was to be therefore recognised.

18.3 The CJEU's Case Law on the Personal Law of Companies and Free Movement Rights

In its country-of-origin case law, the CJEU advanced that it does not intrude into the domain of private international law, but in fact the country-of-origin principle, obviously

20 Joined Cases C-509/09 and C-161/10, *eDate/Martinez*. *See* Nagy, 2012, pp. 287-293.
21 Directive 2000/31/EC, *OJ 2000 L 178/1*.
22 Joined Cases C-509/09 and C-161/10, *eDate/Martinez*, para. 60.
23 Directive 2000/31/EC, Recital 23.
24 Joined Cases C-509/09 and C-161/10, *eDate/Martinez*, para. 58.
25 Joined Cases C-509/09 and C-161/10, *eDate/Martinez*, paras 66-67.

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and most cruelly devoured the choice-of-law problem. In the field of the *lex personae* of companies, the principle prevails that member states may adopt any approach as to the determination of the personal law of companies, as long as it is the incorporation theory. In these cases, at least until *VALE*, the CJEU expressly refused to intimate expectations as to choice-of-law rules; on the other hand, it was very categorical as to the plights it cannot tolerate:[26] while conflicts rules on the personal law of companies obviously come under the legislative competence of the member states, EU law cannot tolerate plights where a company lawfully founded in one member state cannot exercise or is discouraged from exercising the freedom of establishment, whatever conflicts law reasoning underpins this conclusion.

Conflicts rules on the legal person's personal law may collide with EU rules on the freedom of establishment. Although, as noted above, these provisions, especially Articles 49 and 54 TFEU, do not contain direct requirements related to conflicts rules, they determine certain intolerable plights and consequences and these expectations of EU law certainly trigger implications for conflicts norms. However, the requirements entailed by the free movement rules are so tight that they seem to stifle the national competence in conflicts law.

The cases that have reached the CJEU so far imply essentially two situations. In the first scenario, a company founded in one of the member states wishes to transfer its seat to another member state, while preserving its legal personality under the country of origin. Put more simply, in this scenario the company endeavours to 'leave' the country. The controversy arises from the decision of the member state of foundation to deprive the company of its legal personality (state of origin restrictions). In the second scenario, the company is established in one of the member states to which it has no real connection, whatever this may mean, and tries to operate in another country with which it – normally – has a close connection. Thus, in this scenario the company endeavours to 'enter' the country. Here, the controversy arises because the member state of recognition does not show too much hospitality; it does not recognize the legal personality of the company or restricts its recognition (host state restrictions).[27] *VALE* fits mainly the second category: an Italian company wanted to 'enter' Hungary through converting into a Hungarian company; Hungarian courts refused to register it as the legal successor of the Italian enterprise, albeit under the law of the country of origin it was alleged to be in the course of severing from Italian law and moving to Hungary.

26 *See* R. Michaels, 'EU law as private international law? Reconceptualising the country-of-origin principle as vested-rights theory', 2 *Journal of Private International Law* 2006, p. 205.

27 These two plights were clearly distinguished in Judgment of 2 November 2002, *in* Case C-208/00, *Überseering BV v. Nordic Construction Company Baumanagement GmbH (NCC)* [2002] ECR I-9919, paras 61-66, and in Judgment of 30 September 2003 in *Case C-167/01, Kamer van Koophandel en Fabriekenvoor Amsterdam v. Inspire Art Ltd* [2003] ECR I-10155, para. 103.

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18.3.1 State of Origin Restrictions: Transfer of Seat to Another Member State While Retaining the Original Legal Personality

The first case involving a state of origin restriction was *Daily Mail*,[28] where an English company intended to transfer its central management and control to the Netherlands due to tax considerations.[29] Under English law, this pre-supposed the permission of the English revenue service, which, nonetheless, denied to authorize the transfer. In the absence of the permission the seat could have been transferred to the Netherlands only in case the company had been wound-up in England and re-established in the Netherlands (here re-establishing, in fact, means that the shareholders could establish a new company in the Netherlands). The CJEU held in its preliminary ruling that the English revenue service's refusal to grant the permission was in compliance with EU law. Articles 49 and 54 TFEU,

> 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.[30]

The reasoning of the Court was twofold. First, it stressed that the provision of English law-making the consent of the revenue service a prerequisite of the central management's transfer imposes no restriction on the right of establishment, including the transaction contemplated by *Daily Mail*; the shareholders could still wind up the company in England and then re-establish it in the Netherlands.[31] Second, "unlike natural persons, companies are creatures of the law and (…) creatures of national law"[32] – this argument seems to suggest that legal personality is granted by national law and it is also the discretion of national law to revoke this status (*i.e.* national law determines the conditions that must be met in order to maintain such legal personality).

28 Case 81/87, *The Queen v. H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc.*

29 "[T]he principal reason for the proposed transfer of central management and control was to enable the applicant, after establishing its residence for tax purposes in the Netherlands, to sell a significant part of its non-permanent assets and to use the proceeds of that sale to buy its own shares, without having to pay the tax to which such transactions would make it liable under United Kingdom tax law, in regard in particular to the substantial capital gains on the assets which the applicant proposed to sell. After establishing its central management and control in the Netherlands the applicant would be subject to Netherlands corporation tax, but the transactions envisaged would be taxed only on the basis of any capital gains which accrued after the transfer of its residence for tax purposes." Para. 7.

30 Para. 25 and answer to question 2.

31 Para. 18.

32 Para. 19.

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The CJEU, 20 years after *Daily Mail*, faced another 'transfer of seat' case in *Cartesio*,[33] where it confirmed the old findings.[34] The Court re-affirmed that since legal persons are the creatures of law, it is the national law that creates and terminates them. "Naked I came from my mother's womb, and naked shall I return. The Lord gave, and the Lord has taken away; blessed be the name of the Lord."[35] This approach implies that if national law makes national legal personality conditional on certain requirements (for instance, it requires that the company has its central administration in the country), the member state acts within its powers; likewise, it is also the power of the member state to determine the conditions that must be met in order to preserve the company's legal personality under its own law.

> [Articles 49 and 54 TFEU]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.[36]

The Court advanced that EU law does not determine which companies are the holders of the freedom of establishment but leaves this question to national law, quite similarly to the question of citizenship. The holders of the freedom of establishment are, among others, member state companies, while it is national law that confers this quality upon them. Hence, before applying the corresponding EU rules, the preliminary question whether the company 'belongs' to a member state must be answered.[37]

> Thus a Member State has the power to define both the connecting factor required of a company if it is to be regarded as incorporated under the law of that Member State and, as such, capable of enjoying the right of establishment, and that required if the company is to be able subsequently to maintain that status. That power includes the possibility for that Member State not to permit a company governed by its law to retain that status if the company intends to reorganise itself in another Member State by moving its seat to the

33 C-210/06, *Cartesio Oktató és Szolgáltató Bt.*

34 On *Cartesio see e.g.,* V.E. Korom & P. Metzinger, 'Freedom of Establishment for Companies: The European Court of Justice Confirms and Refines its Daily Mail Decision in the Cartesio Case C-210/06', 6 *European Company and Financial Law Review* 1, 2009, pp. 125-160; P. Metzinger, 'A társaságok szabad letelepedése a Cartesio ügy után: Hogyan tovább nemzetközi székhelyáthelyezés?', 9 *Európai Jog* 2, 2009, pp. 8-15; J. Fazekas, 'Quo vadis Cartesio? – Gondolatok a székhelyáthelyezésrőlés a letelepedési szabadságról az Európai Bíróság Cartesio-döntése nyomán', 9 *Európai Jog* 2, 2009, pp. 16-25; A. Osztovits, 'Köddé fakult délibáb – a Cartesio ügyben hozott ítélet hatása a magyar polgári eljárásjogra', 9 *Európai Jog* 2, 2009, pp. 26-30; D. Deák, 'A Cartesio ügyben hozott döntés hatása a letelepedési szabadság értelmezésére: honosság és illetőség, tőkeexport semlegesség, székhelyáthelyezés', 9 *Európai Jog* 2, 2009, pp. 36-42.

35 Job 1:21.

36 Para. 124.

37 Para. 109.

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> territory of the latter, thereby breaking the connecting factor required under the national law of the Member State of incorporation.[38]

Interestingly, the CJEU rejected AG Maduro's proposal,[39] who considered the above Hungarian provision discriminatory, since it treated intra-state and cross-border transfers of seat differently.

> National rules that allow a company to transfer its operational headquarters only within the national territory clearly treat cross-border situations less favourably than purely national situations. In effect, such rules amount to discrimination against the exercise of freedom of movement.[40]

Nonetheless, the CJEU made it clear that although the company has no normative right to transfer its seat to another member state, while still retaining its legal personality under the law of the country of origin, it does have the right to do so if it is ready to lose its initial legal personality and to acquire a legal personality under the law of the target member state, provided the latter 'receives' the migrant company.

> Nevertheless, the situation where the seat of a company incorporated under the law of one Member State is transferred to another Member State with no change as regards the law which governs that company falls to be distinguished from the situation where a company governed by the law of one Member State moves to another Member State with an attendant change as regards the national law applicable, since in the latter situation the company is converted into a form of company which is governed by the law of the Member State to which it has moved.

In fact, in that latter case, the power referred to in paragraph 110 above, 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, cannot, in particular, justify the member state of incorporation, by requiring the winding-up or liquidation of the company, in preventing that company from converting itself into a company governed by the law of the other member state, to the extent that it is permitted under that law to do so.
Such a barrier to the actual conversion of such a company, without prior winding-up or liquidation, into a company governed by the law of the member state to which it wishes

38 Para. 110.
39 Opinion of AG Maduro in Case C-210/06, *CARTESIO Oktató és Szolgáltató Bt* [2008] ECR I-09641.
40 Para. 25.

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to relocate constitutes a restriction on the freedom of establishment of the company concerned which, unless it serves overriding requirements in the public interest, is prohibited under Article 43 EC (*see*, to that effect, *inter alia*, *CaixaBank France*, paras. 11 and 17).[41] The CJEU built upon the above *dicta* when establishing the right of cross-border conversion in *VALE*.[42]

18.3.2 Host State Restrictions: 'Entering' Another Member State

As to host state restrictions (*i.e.* in cases where a member state refused to fully recognize the personal status of a company incorporated in another member state on the basis that the law of incorporation is not the company's personal law and there is no genuine connection between the company and the country of incorporation), the CJEU held that the personal status acquired under the law of incorporation is to be fully recognized; the rules of the law of the real seat may be applied in so far as they are more favourable to the company or its members. This jurisprudence does not establish a right to choose the applicable law proper; however, it affords the parties the right to establish a company in any member state, even if this is clearly motivated by the purpose of circumventing the law of the real seat and even if the country of incorporation has no genuine link to the company (its shareholders, field of operation etc.), save the fact of incorporation.
The first case involving a host state restriction was *Centros*,[43] where a Danish couple (both of them Danish nationals residing in Denmark) established a private limited company in England in order to avoid the burdensome Danish rules on company formation, especially the minimum capital requirement.[44] It was common ground that the mail-box company established in England was meant to operate exclusively in Denmark, without any activity in England. The complications arose when the company tried to register a branch in Denmark: its application was refused, among others, on the grounds that it "was in fact

41 Paras 111-113.

42 *See* Opinion of AG Jääskinen *in* Case C-378/10, *VALE Építési Kft.*

43 Judgment of 9 March 1999 *in* Case C-212/97, *Centros Ltd v. Erhvervs- ogSelskabsstyrelsen [*1999] ECR I-1459. *See* Judgment of 10 July 1986 in Case 79/85, *D. H. M. Segers v. Bestuur van de Bedrijfsverenigingvoor Bank- en Verzekeringswezen, Groothandel en VrijeBeroepen [*1986] ECR 2375.

44 The minimum share capital under Danish law was 200,000 Danish Krone (DKK). On the day of the English company's foundation (18 May 1992) this was approximately 2.548.000 HUF (the Hungarian National Bank's DKK to HUF exchange rate on the relevant day was 12,74 HUF/DKK). The value of the minimum share capital may be demonstrated more plastically on the basis of current data. On 7 December 2012, the DKK to HUF exchange rate was 37,98 HUF/DKK (DKK 1 = HUF 37,98, official rate of the Hungarian National Bank, <www.mnb.hu/arfolyamok>) and the EUR to DKK exchange rate 7,4590 DKK/EUR (that is, EUR 1 = DKK 7.4590; *see* the euro exchange rates of the European Central Bank, <www.ecb.int/stats/exchange/eurofxref/html/eurofxref-graph-dkk.en.html>); accordingly, 200,000 DKK was approximately 7,596,000 HUF and 26,813 EUR.

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seeking to establish in Denmark, not a branch, but a principal establishment, by circumventing the national rules concerning, in particular, the paying-up of minimum capital".[45] The CJEU ruled that a member state has no power to question another member state's decision to grant legal personality to an entity. The Danish authority's arguments, namely, implied that England and Wales should not have registered the private limited company: this is a decision that, on the basis of mutual trust and recognition, cannot be reviewed by other member states.

> It is contrary to […] [Articles 49 and 54 TFEU]for a Member State to refuse to register a branch of a company formed in accordance with the law of another Member State in which it has its registered office but in which it conducts no business where the branch is intended to enable the company in question to carry on its entire business in the State in which that branch is to be created, while avoiding the need to form a company there, thus evading application of the rules governing the formation of companies which, in that State, are more restrictive as regards the paying up of a minimum share capital. That interpretation does not, however, prevent the authorities of the Member State concerned from adopting any appropriate measure for preventing or penalising fraud, either in relation to the company itself, if need be in cooperation with the Member State in which it was formed, or in relation to its members, where it has been established that they are in fact attempting, by means of the formation of a company, to evade their obligations towards private or public creditors established in the territory of the Member State concerned.[46]

Albeit the CJEU admitted that member states can, in certain cases, restrict the recognition of companies founded in other member states (in case there is a danger of 'fraud'), the clear and undisputed fact that establishing the company in England and Wales was motivated solely by the desire to avoid the Danish rules and that the company was intended to operate solely in Denmark were not sufficient to enable Denmark to resort to this exception. So the question arose: when is a conduct in the above context regarded as abusive or fraudulent?
The tension between conflicts law and the freedom of establishment was translated to the language of private international law in *Überseering*.[47] According to the fact pattern: Überseering was a Dutch company founded in the Netherlands, the shares of which were acquired by German citizens and the company's place of central management moved to Germany. In a lawsuit where Überseering sued for defective performance the defendant

45 Para. 7.
46 Para. 39.
47 Case C-208/00, *Überseering BV v. Nordic Construction Company Baumanagement GmbH (NCC).*

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raised the argument that Überseering is non-existent as it does not meet the conditions of legal personality under its personal law; consequently, it was considered not to have legal personality and as such incapable of becoming party to a legal procedure.

The argumentation was structured as follows. The forum shall apply its own conflicts rules to the question of personal law of legal persons. According to German conflicts rules, personal law, including the question of legal personality, is governed by the law of the country where the alleged legal person's real seat is located. Since the real seat, after the sale of the company's shares to German nationals, moved to Germany, the applicable law was German law and not Dutch law. Consequently, Überseering was expected to comply with the requirements of German company law, including the requirement of registration in Germany, which it, as a company with Dutch 'identity', neglected. Since Überseering did not meet the pre-conditions of legal personality laid down by German law (requirement of registration in Germany), it lacked legal personality, and as such it could not be party to a legal proceeding.

This was a conflict problem to the core and touched the nucleus of the tension between EU law and the conflicts question of the applicable law. The rules on the freedom of establishment and EU law in general do not establish expectations towards the conflicts rules on the personal laws of companies; this question obviously belongs to the competence of the member states. On the other hand, EU law cannot tolerate plights where a company lawfully founded in one member state cannot 'enter' another member state, whatever conflicts law reasoning underpins such a conclusion.

The CJEU ruled that

> 1.Where a company formed in accordance with the law of a Member State ('A') in which it has its registered office is deemed, under the law of another Member State ('B'), to have moved its actual centre of administration to Member State B, Articles 43 EC and 48 EC preclude Member State B from denying the company legal capacity and, consequently, the capacity to bring legal proceedings before its national courts for the purpose of enforcing rights under a contract with a company established in Member State B.
> 2.Where a company formed in accordance with the law of a Member State ('A') in which it has its registered office exercises its freedom of establishment in another Member State ('B'), Articles 43 EC and 48 EC require Member State B to recognise the legal capacity and, consequently, the capacity to be a party to legal proceedings which the company enjoys under the law of its State of incorporation ('A').[48]

48 Operative part.

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The CJEU gave no hints or suggestions as to how national conflicts rules should be designed;[49] or at least not directly. It was simply very categorical as to the situations it cannot tolerate.[50] At the same moment, the consequences of this ruling are rather clear for conflicts law. If a company is validly formed in one of the member states, *i.e.* it exists under the law of incorporation, it is the holder of the freedom of establishment;[51] hence, its existence granted by the law of incorporation cannot be questioned in any of the member states. In other words, EU law does not require member states to apply the law of incorporation; nevertheless, if under the applicable law the company has no legal personality, while it does have such a quality under the law of incorporation, the latter prevails. Taking this into account, the question emerges: what is the point in applying the law of the 'real seat' if the law of incorporation cannot be derogated from? After *Überseering*, the answer could have been that the CJEU ruled on a case where the company's legal personality was denied and it was questionable how it would decide if the member state refused to apply the law of incorporation to other issues coming under the notion of personal law.[52]

Nonetheless, the CJEU's ruling in *Inspire Art* made it highly doubtful whether any floor remained for a rule different from the law of incorporation, though the Court still refrained from explicitly establishing a connecting factor. In this case the Netherlands adopted a special piece of legislation on pseudo-foreign companies. While companies founded in another country were governed by the law of incorporation, if all the relevant connections bound them to the Netherlands, they were subjected to special rules: for instance, the minimum capital requirement of Dutch law applied and the directors had joint and several liability, if the company did not comply with the aforementioned Dutch rules. This approach could be conceptualized with conflicts terms as follows: the law applicable to the

49 AG Colomer was more explicit on this: "where the Member State where the company is incorporated is also that in which it has its registered office, one would be forcing the Court to opt for one of the connecting factors which, in the absence of any change in legislation, are of equal weight under Article 48 EC, namely, the factor consisting of the registered office of the entity in question, of its centre of administration or of its principal place of business. If the EC Treaty has not given preference to any one factor, it is not the place of the court to do so. In the absence of harmonization, Member States remain at liberty to organize their rules of private international law in that area, and the national courts to interpret those rules, which must nevertheless comply, in terms of their practical effects, with the requirements of Community law." Opinion of AG Colomer in Case C-208/00*, Überseering BV v. Nordic Construction Company Baumanagement GmbH (NCC,* para. 69.

50 Ch.H.J.I. Panayi, 'Corporate Mobility in Private International Law and European Community Law: Debunking Some Myths', 28 *Oxford Journals Law Yearbook of European Law* 1, 2009, pp. 155 ("The Court's answers to the questions referred were specific and targeted. To an extent, the Court simply disapproved of the refusal to recognize the legal capacity of Überseering which prevented it from bringing legal proceedings before German courts.")

51 Paras 81-82.

52 *See e.g.*, E. Micheler, 'Recognition of companies incorporated in other EU Member States', 52 *International and Comparative Law* Quarterly 2, 2003, p. 529.

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personal status of the company was the law of incorporation, while the imperative rules of the forum overrode some of the norms of the *lex causae*.

Nevertheless, the CJEU held that the special rules of Dutch law applicable to 'formally foreign companies' hindered the freedom of establishment because they could discourage companies lawfully founded in one of the member states from establishing a branch or other operation in another member state.[53]

> It is contrary to Articles 43 EC and 48 EC [now Article 49 and 54 TFEU]for national legislation (…) to impose on the exercise of freedom of secondary establishment in that State by a company formed in accordance with the law of another Member State certain conditions provided for in domestic company law in respect of company formation relating to minimum capital and directors' liability. The reasons for which the company was formed in that other Member State, and the fact that it carries on its activities exclusively or almost exclusively in the Member State of establishment, do not deprive it of the right to invoke the freedom of establishment guaranteed by the EC Treaty, save where the existence of an abuse is established on a case-by-case basis.[54]

The above judicial practice suggests that the law of incorporation shall be applied if it is more favourable to the company or its directors. The question emerges, though: if the law of the seat, notwithstanding it's imperative character, cannot be applied once it is more burdensome to the company or its directors than the law of incorporation, what remains in its purview? One may deny that the CJEU took a position as to the connecting factor to be adopted in private international law (as far as EU-matters are concerned, of course); however, that would disregard totally reality. The aftermath of the case law on the personal law of companies shows that the principle of 'real seat' was, in fact, replaced by the principle of incorporation: the supreme courts of Austria and Germany, the two citadels of the 'real seat' theory, moved towards the principle of incorporation.[55] Finally, in *VALE*, the CJEU made it explicit that the law of the land is the incorporation theory, treating it as an accomplished fact.

53 Paras 99-101.

54 Para. 143 and answer to question 2.

55 For Austria *see* Case 6Ob124/99z OGH (Austria), decision of 15 July 1999, *ÖsterreichischesRecht der Wirtschaft*, No. 11, 1999, p. 719. For a case-note *see* Ch. Nowotny, 'OGH anerkennt Niederlassungsfreiheit für EU-/EWR-Gesellschaften. Die Centros-Entscheidung des EuGH zwingt zur Abkehr von der Sitztheorie', *Österreichisches Recht der Wirtschaft* 11, 1999, p. 697. For Germany *see* Case II ZR 5/03 BGH (Germany), decision of 14 March 2005. For a case-note *see* H. Eidenmüller, 'Geschäftsleiter- und Gesellschafterhaftung bei europäischen Auslandsgesellschaften mit tatsächlichem Inlandssitz', 58 *Neue Juristische Wochenschrift* 23, 2005, pp. 1618-1621. *See also,* W. Goette, 'Zu den Folgen der Anerkennung ausländischer Gesellschaften mit tatsächlichem Sitz im Inland für die Haftung ihrer Gesellschafter und Organe', 27 *Zeitschrift für Wirtschafts-recht* 12, 2006, pp. 541-546.

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18.4 The State of the Law after the CJEU's Judgment in Vale

The case law on the personal law of companies culminated in the CJEU's judgment in *VALE Építési Kft.*[56] The controversy emerged from an Italian company's transfer of seat from Italy to Hungary and the submission of an application for registration in Hungary. However, in this case, the cross-border transfer of the seat, at the same moment, implied the company's conversion, since it (voluntarily) lost its initial legal status and wished to become a Hungarian company. Accordingly, the case centred around a cross-border conversion and not a cross-border transfer of seat.[57] This circumstance distinguishes *VALE* from *Daily Mail* and *Cartesio*, where the company wished to transfer its seat to the target member state (Netherlands, Italy), while preserving the legal personality acquired under the law of the country of origin (English law, Hungarian law).

The country of origin (Italy) recognized (or at least enabled) the company's universal succession, while the host member state (Hungary) did not. The Italian registry, under the heading "Removal and transfer of seat", indicated that "the company has moved to Hungary"; the company gave an address in Budapest designated as its new seat.[58] Nonetheless, the Hungarian company court (which runs the commercial register) refused to indicate in the registry that the Hungarian company was the legal successor of the Italian company. Of course, the shareholders were not deprived of the possibility to establish a company in Hungary that takes over the operations of the terminated Italian enterprise; however, this would have been a new company and not the legal successor of the Italian one.

The CJEU held that although in case of cross-border company conversions

> the host Member State is entitled to determine the national law applicable to such operations and thus to apply the provisions of its national law on the conversion of national companies governing the incorporation and functioning of companies.[59]

The principle of equivalence precludes host member states from refusing, in cross-border conversions, to register that the new company's 'predecessor in law' was the

56 Case C-378/10, *VALE Építési kft.* For an early note on the case (before the adoption of the CJEU's ruling but after the publication of AG Jääskinen's opinion) *see* D.M. Şandru, 'Libertatea de stabilire a societăţilor comerciale. Posibile efecte ale cauzei VALE, C-378/10, pendinte, asupra practicii instanţelor române', *Revista Română de Drept European* 3, 2012, pp. 124-130. For a case-note on the judgment in *VALE see* N.N. Orosz, 'Az Európai Bíróság ítélete a VALE Építési Kft. ügyében. Az EUMSZ 49. és 54. cikkéből eredő tagállami kötelezettségszegés kérdése', *Jogesetek Magyarázata* 3, 2012, pp. 66-73.

57 *See* Panayi 2009, p. 165 (Distinguishing between transfer without reincorporation and transfer with reincorporation).

58 Case C-378/10, *VALE Építési Kft,* para. 11.

59 Case C-378/10, *VALE Építési Kft,* para. 62.

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company established in the member state of origin, provided this is possible in the case of domestic conversions. Furthermore, the principle of effectiveness precludes the host member state from "refusing to take due account, when examining a company's application for registration, of documents obtained from the authorities of the Member State of origin".[60]

Although the judgment does not make it explicit, from a private international law perspective, it seems to have been decisive that in this case the country of origin (the Italian registry), in its "graceful message of dismissal",[61] made it expressly clear that according to its law (the initial *lex personae*) the company converted (or was in the process of being converted) into a Hungarian company via legal succession; that is, when refusing to register the Hungarian company as the legal successor of the Italian enterprise, the Hungarian company court in fact refused to recognize the status acquired under the country of origin (Italy).

The CJEU also confirmed that companies (and presumably legal persons in general) "are creatures of national law and exist only by virtue of the national legislation which determines their incorporation and functioning,"[62] and, in consequence, it is the national law that determines who the holders of the free movement rights may be.[63]

> [A] Member State thus unquestionably has the power to define both the connecting factor required of a company if it is to be regarded as incorporated under its national law and as such capable of enjoying the right of establishment, and the connecting factor required if the company is to be able subsequently to maintain that status […].[64]

In para 31 of the ruling, the CJEU seems to have made clear what has been an accomplished fact: (in intra-Union matters) the personal status of companies is governed by the law of incorporation; "such a company is necessarily governed solely by the national law of the host member state, which determines the connecting factor required and the rules governing its incorporation and functioning."

Due to the incorporation theory, the member state of origin has the power to determine the pre-conditions of legal personality. Accordingly, *VALE* – in accordance with *Daily Mail* and *Cartesio* – had no right to preserve its Italian legal personality after moving its

60 *Ibid.*
61 Borrowed from the title of one of the poems by Endre Ady, a renowned Hungarian poet; title in Hungarian: '*Elbocsátó, szép üzenet*'.
62 Para. 27.
63 Para. 28.
64 Para. 29.

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seat to Hungary, and to claim Hungarian legal personality before establishing a seat in Hungary. The CJEU put this very unequivocally:

> in the present case, the application by Hungary of the provisions of its national law on domestic conversions governing the incorporation and functioning of companies, such as the requirements to draw up lists of assets and liabilities and property inventories, cannot be called into question.[65]

The main concern against Hungarian law was not that it prescribed certain requirements against the acquisition of Hungarian legal personality. The main objection was that these requirements were not in conformity with the principle of equal treatment, since they treated domestic and cross-border conversions differently.

> The Court consider[ed] that, in so far as the national legislation at issue in the case in the main proceedings provides only for conversion of companies which already have their seat in the Member State concerned, that legislation treats companies differently according to whether the conversion is domestic or of a cross-border nature, which is likely to deter companies which have their seat in another Member State from exercising the freedom of establishment laid down by the Treaty and, therefore, amounts to a restriction within the meaning of Articles 49 TFEU and 54 TFEU […].[66]

The application of the requirement of equal treatment as to conversions (domestic and cross-border) did not come out of the blue. In *SEVIC Systems*,[67] the CJEU held that national law may not discriminate between domestic and cross-border mergers, ruling that

> [Articles 49 and 54 TFEU] preclude registration in the national commercial register of the merger by dissolution without liquidation of one company and transfer of the whole of its assets to another company from being refused in general in a Member State where one of the two companies is established in another Member State, whereas such registration is possible, on compliance with certain conditions, where the two companies participating in the merger are both established in the territory of the first Member State.[68]

The Court extended the findings on cross-border mergers to cross-border conversions as well.

65 Para. 52.
66 Para. 36.
67 Judgment of 13 December 2005 in Case C-411/03, *SEVIC Systems* [2005] ECR I-10805.
68 Operative part.

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Since the above Hungarian rules were considered unjustifiable by imperative reasons of overriding public interest, the CJEU held that they fell afoul of the freedom of establishment.[69]
The language of the CJEU's ruling in *VALE* bases the condemnation of Hungarian law on the principle of equivalence, in other words, cross-border conversions should not be precluded if domestic ones are not. Although the ruling did not treat the right of 'arrival' as an autonomous right but deduced it from the requirement of equal treatment, as member states normally do enable domestic conversions, the requirement of equal treatment seems to entail that this right should be *de facto* available throughout the EU.
The ruling also suggests that cross-border conversions are governed by the law of the state of origin and subsequently by that of the host state. As to the role of the law of the country of origin, the Court noted that the examination of the fact

> whether VALE Costruzioni dissociated itself from Italian law, in accordance with the conditions laid down there under, while retaining its legal personality, thereby enabling it to convert into a company governed by Hungarian law […]constitutes the indispensable link between the registration procedure in the Member State of origin and that in the host Member State.[70]

The requirement that the cross-border conversion is feasible only if the law of the country of origin enables this appears also in the opinion of AG Jääskinen. He considered the question whether VALE existed at the time of lodging the application for registration in Hungary as a "crucial preliminary issue".[71] AG Jääskinen advanced that legal succession can occur only if

> universal transmission is not possible if the predecessor company has already lost its legal personality when the successor company is registered. In that situation, the holder of the rights and obligations of the predecessor company would be either a company which de facto has no legal personality or the shareholders, taken collectively or even individually. A situation of that kind does not permit universal legal succession between the two companies.[72]

AG Jääskinen arrived at the conclusion that Hungarian courts are required to recognize the legal succession of VALE (that is, to register it as the legal successor of the Italian company) only if the removal of VALE from the Italian commercial register was cancelled; otherwise VALE would have no legal personality at the moment of lodging the application for registration in Hungary.

69 Paras 38-40.
70 Paras 58-59.
71 Para. 23.
72 Para. 79.

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The most important novelty in *VALE* is the establishment of an autonomous (though unregulated) right of cross-border conversion. Namely, the combined effect of the CJEU's rulings in *VALE* and *Cartesio* entail that European companies have an autonomous right of cross-border conversion under EU law. In the *dicta* of *Cartesio*, the CJEU considered that a company has a right of 'departure' in order to convert into the legal person of another member state (to move its seat to another member state in order to acquire legal personality under the latter's law and to lose its legal personality under the law of the member state of origin). In *VALE*, the CJEU held that a company has a right of 'arrival' in order to convert into the legal person of the target member state. The right of 'departure' and the right of 'arrival' seem to make up an autonomous EU right of cross-border conversion, the technical implementation of which is left to national laws.

The requirement of equal treatment, applied by the CJEU in *VALE* to the 'arrival' in the host member state, seems to be equally applicable to the company's 'departure' from the member state of origin; what is more, the ruling in *Cartesio* suggests that this is an independent and autonomous right based on EU law.

Albeit in *Cartesio* the Court rejected AG Maduro's proposal to apply the requirement of equal treatment to the cross-border transfer of seat,[73] due to the member state's longstanding right to determine the pre-conditions of legal personality under their own law, this proposition does not cover cases when the seat is transferred in order to lose the initial legal personality and to acquire a new one. Note that in *Cartesio* the company intended to move its seat from Hungary to Italy while retaining its Hungarian legal personality. This can be distinguished from the case when the company wants to move its seat to another country in order to acquire legal personality in the latter, while losing its initial legal personality, and the country of origin precludes this. The CJEU made this clear, and paras 111-113 of the ruling (quoted above) suggest that EU law establishes a right of 'departure' "where a company governed by the law of one Member State moves to another Member State with a concomitant change as regards the national law applicable."[74]

In *VALE*, the CJEU suggested that legal succession can occur only if the law of the country of origin makes this possible, providing that the company is supposed to prove that "the succession was authorised by the law of the Member State of origin" and "a transfer of the assets from the predecessor company to the company in formation can take place only by virtue of the legal system of the Member State of origin."[75] Nonetheless, in para 49, the

73 *See* Opinion of AG Maduro *in* Case C-210/06, *CARTESIO Oktató és Szolgáltató Bt,* para. 25; C-210/06, *Cartesio Oktató és Szolgáltató Bt,* paras 110-111.

74 Para. 111.

75 Para. 77.

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Court suggests that the *existence* of the right of conversion is secured by EU law, and it is only its *implementation* that is left to national law:

> the company concerned enjoys a right granted by the European Union legal order, in this instance, the right to carry out a cross-border conversion, the implementation of which depends, in the absence of European Union rules, on the application of national law.[76]

Taking all this into account, it seems that companies have a *de facto* right to move their seat to another member state in order to convert into a legal person of this country, albeit the technical implementation of this conversion is governed by the national laws of the original and the host member state. The first element of this right (right of 'departure') was established in *Cartesio*, while the second element (right of 'arrival') in *VALE*; though here the CJEU did not say that the right of 'arrival' is an autonomous right, since member states normally enable domestic conversions, the requirement of equal treatment seems to make this right *de facto* available throughout the EU.

18.5 Conclusions

The CJEU's case law on the personal law of companies culminated in *VALE*, where the Court (as regards intra-Union matters) recognized the right to indirectly choose the personal law of the company by making explicit the prevalence of the incorporation theory. Individuals may establish a company in the member state they please and operate it in the member state they please.[77] This plight had been an accomplished fact, though it seems to have been made explicit in *VALE*.

The CJEU's ruling also contributed to the case law with putting down the second brick of an EU right of cross-border conversion. The first brick was put down in *Cartesio*.[78] Accordingly, a company has the right to move its seat (registered or real) to another member state if it is willing to do this at the price of losing the legal personality under the country of origin, while acquiring a legal personality under the law of the host member state. First, although the determination of the pre-conditions of legal personality comes under national law, the transfer of seat with the intention to lose this legal personality (or rather: to change it with another legal personality) falls out of this national legislative competence, and the restriction of this violates the freedom of establishment.[79] Second,

76 Para. 49.

77 On whether and to what extent firms may exploit this forum shopping perspective *see* J. Armour, 'Who Should Make Corporate Law? EU Legislation versus Regulatory Competition', *in:* J. Holder & C. O'Cinneide (Eds), *Current Legal Problems 2005*, Vol. 58, Oxford University Press, 2006, pp. 382-393.

78 Paras 11-113.

79 C-210/06*, Cartesio Oktató és Szolgáltató Bt,* paras 111-113.

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if a member state enables the intra-state move of the seat, it cannot preclude its cross-border move; that is, if a company can move its seat to another *county*, it should also have the right to move it to another *country*. The contrary would be equally discriminatory as Hungarian law's rule quashed in *VALE*, which provided that a company from another county can convert, but companies from another country cannot. It seems to be reasonable that if a member state is obliged to 'receive' foreign companies, it is also obliged to let its companies 'go abroad'. In *VALE*, the CJEU completed this right of cross-border conversion with introducing its second constituent element: the right of 'arriving' in the target member state. Although the second element was derived from the principle of non-discrimination, since member states normally permit domestic conversions, the rejection of the cross-border conversions would qualify as discriminatory. The requirement of equal treatment seems to make this right *de facto* available throughout the EU.

With putting down the second brick of the EU right of cross-border conversion, the CJEU struck an innovative but dangerous path. Company conversions raise complex issues that are to be addressed in complex legislation, prepared in a careful legislative process, and not in the courtroom. The change of the seat and that of the applicable law fundamentally affects, among others, the application of tax law, the creditors' rights, the jurisdiction and applicable law in insolvency proceedings;[80] and the regulation of cross-border conversions have to take these facets carefully into account.[81] However, the EU right of cross-border conversion is a largely unregulated right. National courts will have a special responsibility to address the concerns and avoid the pitfalls of cross-border conversions in a legislative vacuum. It would be welcome if the EU legislator could address the problems of cross-border conversions. This would not be the first case, when the CJEU forces out EU legislation 'passively'.

80 On this *see* Armour 2006, pp. 401-411.

81 On the public interest aspects of these *see* V. Edwards, 'Secondary Establishment of Companies – The Case Law of the Court of Justice', 18 *Yearbook of European Law* 1, 1998, pp. 252-257.