The cross-border merger directive and the non-EU initiatives regarding the 14th Directive on the cross-border transfer of registered office

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[Outline]

I – ***Why we still have not found the community directive on the cross-border transfer of seat that for decades we have been looking for?***

- Article 48 of the European Community Treaty provides that "companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the community shall … be treated in the same way as natural persons who are nationals of Member States."

- Companies' migration in the EU through a direct cross-border transfer of their registered office and/or of their real seat (centre of management and control) still remains a very complex operation. Frequently it will even prove to be impossible to occur. This situation is in sharp contrasts with the mobility that European natural persons have in the EU.

- At the present stage of Community law, in the absence of community coordination or harmonization measures on that regard, the success of a transfer of the registered office and/or the transfer of the real seat of a company from one Member State to another depends on the existing private international law (PIL) rules of the Member States.

- Such national PIL rules determine the law governing company law relationships (the *lex societatis)* and decide whether, and on which terms, a company may transfer its registered office and/or its real head office abroad.

- The divergence among Member States regarding the connecting factors employed to determine the *lex societatis* of a company is an important obstacle to the migration of companies in the EU and a major reason for the inexistence, so far, of a community law legal instrument governing the cross-border transfer of companies' seat in the EU.

- Opting for the incorporation or the real seat theory is much more than a mere PIL technicality: Private Law versus Public Law conception of Company law. Shareholders interests versus stakeholders interests.

- Incorporation States:

Member States adopting the incorporation theory easily accept the transfer of the real head office of its companies to another Member State. They are, however, restrictive, regarding the transfer of registered office. A company will continue to be subject to the Member State of incorporation irrespective of the place where its centre of administration is located. The transfer of the registered office of the corporation is, however, generally inadmissible (see UK Companies Act of 1985, Section 2(1)(b), (7), 14, 287).

- Real Seat States:

Member States adopting the real seat connecting factor are traditionally hostile to the cross-border transfer of the registered office and of the head office of a company alike. Both the real seat theory and the incorporation theory consider that a company must be formed according to the law of the place where it is incorporated. The seat theory, however, requires that the real seat of the corporation be situated in the State of incorporation. If a strict version of the real seat theory is adopted, then, when a company moves its real seat to another State it ceases to be subject to the law of the State where it was incorporated and had its real seat and, as a logical consequence, has to be wound up there.

- The Portuguese corporations' PIL regime (Companies Act of 1986, article 3). It allows for both inbound and outbound cross-border transfers of a companies' seat with a change on the *lex societatis*. Even a cross-border transfer of the registered office alone of a company is admitted, provided that certain requirements are fulfilled, namely that when a company has its real seat in a State different from the one where its registered office is situated it may not invoke the law of its registered office against third parties who had reasons to believe that the external relations of the company were governed by the law of the place where its real head office was situated.

- The Community legislator seems to be unable to solve these PIL controversies in a clear-cut manner and enact a legal instrument directly addressing the problem of the cross-border transfers of seat.

- Member States seem to be, by and large, against any substantial changes on their traditional PIL rules in a sense that facilitates their businesses to move to other jurisdictions. The real seat theory has indeed been regarded by some commentators as an instrument adopted by States to avoid their businesses from moving to competing jurisdictions.

- The case law of the Court on freedom of establishment and cross-border mobility of companies falls short of being coherent. Such incoherence is particularly evident, not only if we compare the Courts' ruling in *Daily Mail* with the series of rulings initiated with *Centros* but also, and more interestingly, if we confront the Court's notion of the right of establishment in its recent judgment in *Cadbury Schweppes* (Judgement of the 12^{th} September 2006 in case C-196/04) with the notion that it had adopted in *Centros*.

II – The case law of the Court of Justice

- Daily Mail – The pre-Europeanization stage of PIL.

Every discussion about the case law of the Court on the issue of the cross-border transfer of the registered office or real head office of companies in the EU begins with Daily Mail.

This was a tax law case involving the UK Treasury's right to refuse to allow a company to transfer its tax residence without paying accumulated tax which was decided as a conflict of laws case even though no conflict of laws problem and no loss of legal personality were involved.

The Court's ruling: an issue such as the demand by a company incorporated according to the laws of a Member State to transfer its registered office or real head office to another Member State falls outside the scope of the Treaty provisions on freedom of establishment.

It was a reassuring judgment for PIL lawyers who feared that primary Community law could interfere with the traditional real seat connecting factor and its corollaries.

- The era of Europeanization of PIL in the EU

1999 – The entry into force of the Treaty of Amsterdam and the beginning of a Tetralogy (*Centros*, *Überseering*, *Inspire Art* and *SEVIC*).

The Court's "pragmatic" approach based on mutual recognition: a forward-looking, non-dogmatic, consequentialist and party-centred approach.

The Court focuses on the effects that national regulations or practices, irrespective of their conceptual nature, might have on freedom of movement of companies. It does not exclude in an a priori conceptual way, any particular segments of the law of the Member States from the scope of the right of establishment.

- The current crises of PIL in the EU – The end of the traditional State-centred PIL regimes.

The present time represents an opportunity for change and for a dogmatic reconstruction of companies' PIL rules adapting them, through innovative solutions, to the needs of the internal market.

III – What has the Community legislator done so far to facilitate cross-border mobility of companies in the EU? And what has the Commission decided, at least for the time being, not to do?

III.1 - The *Societas Europeae* (SE) – Council Regulation (EC) Nº 2157/2001

Article 3: an SE remains largely governed by the law of the Member State where its registered office is situated.

Article 8(1): an SE is allowed to transfer its 'registered office' to another Member State without the company having to loose its personality.

Article 7, however, requires that "both registered office and head office be located in the same Member State". This very article even provides that a Member State may choose to require both elements – registered office and head office – to be located at the same address.

The impossibility for an SE to transfer its registered office alone to another Member State: the real seat theory has been rescued.

The problems posed by the Regulation at the level of the determination of the law applicable to the company. Art. 8(10), Article 8(14) and Article 9(1)(c) (ii).

III.2 - The cross-border merger 2005/56/CE Directive

- The SEVIC judgement and the enactment of the Directive.

- The possibility conferred by the Directive to limited liability companies to transfer their registered office by means of a cross-border merger.

- Twenty years after Daily Mail, apart from studies, public consultations and a draft proposal of a 14th Directive made by the Commission, there is still no legal instrument directly addressing the issue of the transfer of the registered office of non SE companies from one Member State to another, even though such transfer remains impossible according to the law of most Member States.

- Mr. MacCreevy's speech of the 3rd October 2007 and the Commission's staff working document of the 12th December 2007 [SEC (2007) 1707].

IV – Analysis of the possibilities offered to companies by the 10th CLD to transfer their registered offices through a cross-border merger

- Will the cross-border merger directive make possible in the EU, a similar result to the one that is achieved in the US where the reincorporation of a company in another Member State is made possible by a merger into a subsidiary shell company incorporated in the State of the new domicile?

- Assessment of the impact that still existing divergences among Member States regarding the determination of the *lex societatis* may have on a transfer of registered office with a change on the applicable law by way of a cross-border merger.

- Article 4(1) of the cross border Directive: each company "taking part" in the cross-border merger must comply with the provisions and formalities of the national law to which it is subject. The Directive is neutral regarding the connecting factors adopted by the Member States to determine the *lex societatis* of the companies participating on the cross border merger.

The question of knowing if through a cross border merger it will be possible for a company to transfer its registered office alone to another Member State, or if, on the contrary, that company will also have to move its head office together, will ultimately depend on the connecting factors adopted by the PIL systems of the Member States involved. Several hypotheses have to be considered:

1st - The participating companies and the resulting company are from incorporation Member States.

2nd - The resulting company intends to have its registered office in a real seat Member State and retain its head office elsewhere. Apparently, article 4(1) b) of the Directive, does not disallow a real seat State to decline the application of its law and, therefore, to frustrate the merger, by insisting on the application of its real seat connecting factor.

Some commentators consider that persistence on the application of the real seat connecting factor by the Member State of the resulting company, with the consequence that the company is therefore not allowed to have its real seat abroad, is incompatible with the community freedom of establishment.

This point is highly questionable. When the Member State of the resulting company frustrates a cross border merger based on the fact that the resulting company does not have its real seat in that State, this may be regarded as a restriction on the right of establishment (*SEVIC*). Such restriction may, however, be justified where it serves overriding reasons relating to the public interest. In this regard, one should not exclude that the Court of Justice may acknowledge as an overriding reason in the general interest, the need to ensure that a Member State has an effective possibility of exercising control over companies which are subject to its law and to ensure the coherence of its PIL system. It is also possible that such restriction does not go beyond what is necessary to attain the objectives it pursues. As long as the company's head office is located outside the territory of that State where the company merely intends to have its registered office, such control and supervision may prove to be unworkable. It may be possible to argue, therefore, that a Member State's refusal to apply its law, as *lex societatis*, to a resulting company whose real seat is situated elsewhere, is not contrary to community law.

3rd - Resulting company with registered office in an incorporation State. In this situation the participating company will succeed in transferring its registered office to the incorporation Member State with a change of the *lex societatis*. This will be possible even if the participating company is from a real seat State and the resulting company intends to keep its real head office in that real seat State (*Überseering* - foreign company validly incorporated in an incorporation State, with its centre of administration in a real seat State).

Results of the analysis:

- A limited liability company wishing to transfer its registered office from one Member State to another with a change of its *lex societatis* by way of a cross-border merger will be confronted with significant uncertainties and difficulties. The feasibility of a transfer of registered office alone will ultimately depend on the law of the Member State of the resulting company.

- The Cross-border merger directive does not provide existing companies in the EU with a possibility of transferring their registered office alone to another Member State similar to the possibility of re-incorporation through merger that companies in the US have.

V – Does it still make sense to adopt a community legal instrument directly addressing the issue of the cross-border transfer of registered office?

There are several different roads "leading to Rome"… but if one road proves to be shorter than the others we would better opt for that one.

A cross-border transfer of the registered office of a company through a cross border merger is an indirect form of transferring a companies' registered office. Compared to a direct transfer it necessarily requires an extra step for the company intending to transfer its registered office (setting up of a new company in the host Member State).

A cross border merger is a "particular method of exercise of the freedom of establishment, important for the proper functioning of the internal market" (SEVIC, paragraph 19). The direct transfer of a company's seat from one Member State to another is also a modality of exercise of the right of establishment created by Community law and it cannot in itself warrant the suspicion of abuse (Judgement of the 7th June 2007, *Commission v Hellenic Republic*, case C-178/05, paragraph 32).

A direct transfer of seat to another Member State is one of the simplest ways at the disposal of a company to move its economic activity into another Member State without having to face the additional cost of setting up a shell company to merge into in the Member State of destination.

Article 43 EC includes the freedom for economic operators beneficiaries of the right of establishment "to choose the most appropriate legal form for the pursuit of activities in another Member State" (Judgment of the 21 September 1999, *Saint-Gobain*, case C-307/97, paragraph 42). Moreover, the reasons for which a company chooses to establish itself in a particular Member State "are, save in case of fraud, irrelevant with regard to application of the rules on freedom of establishment" (*Centros*, paragraph 18 and *Inspire Art*, paragraph 95).

The existing possibility for limited liability companies to emigrate from one Member State to another through a cross-border merger does not render superfluous the adoption of community legal instrument specifically addressing the issue of the direct transfer of the registered office of companies from one Member State to another.

VI – The two possible legislative approaches identified by the Commission regarding the creation of an EU legislative measure on the transfer of companies registered offices

VI.1 - The limited approach

Member States applying the real seat principle would be allowed to require a company moving its registered office to their territory to transfer its real seat/head office as well.

- Comparison with the draft proposal of the 14th Directive on the transfer of registered office, as it stood in 2004, and with the now existing possibility of transfer of registered office by way a cross border-merger.

VI.2 - The extensive approach

The host Member State, irrespective of whether it applies the real seat or the incorporation doctrine would not be allowed to require that the company moving its registered office to its territory transfers also its real seat. As a result, companies would have the possibility of relocating solely their registered office to any Member State with a change on the applicable law.

This approach would provide companies in the EU with the freedom to relocate their registered office alone in the Member State providing the company law regime that best suits their needs.

According to this extensive approach a company may apparently be allowed to transfer its registered office alone even if it does not even have any sort of economic activity in the Member State where the registered office is located.

Anchoring this extensive approach on the need to contribute to achieving freedom of establishment for companies is difficult to accept in the light of the recent case law of the Court in the *Cadbury Scweppes* case concerning the application of British rules on corporate taxation of profits, in a case where subsidiaries of a British company were established in States with a lower level of taxation.

- *Cadbury Schweppes* v *Centros* – Is the reasoning of the Court based on principle or it varies depending on the subject matter?

In Cadbury the Court indicates that it is necessary to examine the behaviour of the taxpayer who incorporates a company in another Member

State in the light of the aim of the right of establishment in order to assess if the behaviour at stake is a mere exercise of the right of free movement or an abusive practice. The Court considered that the freedom of establishment requires a genuine intent to participate in a stable and continuous basis in the economic life of a Member State other than his State of origin (*Cadbury Scweppes*, paragraph 53). As a consequence a company cannot invoke the right of establishment in another member State, for the purpose of benefiting from a more advantageous legislation, unless this establishment corresponds to a genuine set-up of the undertaking in the host State, involving the actual exercise of genuine economic activity there (*Cabury Schweppes*, paragraph 66). The Court adds further that such a finding "must be based on objective factors which are ascertainable by third parties with regard, in particular, to the extent to which the CFC physically exists in terms of premises, staff and equipment". That cannot be the case if the company is merely a "letterbox" or "front" subsidiary (*Cadbury Schweppes*, paragraphs 67-68). Even though the criteria established by the Court are not free from difficulties in application it is clear that the Court is aiming at excluding from the scope of application of free movement rules, operations which have as their sole purpose the avoidance of less advantageous legislation of the State of origin.

With this ruling the Court moves away from *Centros* and *Inspire Art*. What the two Danish residents, the Brydes, did in *Centros* was precisely to set up a private limited company in the United Kingdom – which has never exercised any genuine economic activity there – with the sole purpose of avoiding the less favourable mandatory rules of Danish company law on minimum share capital.

- The political and economic foundations of the extensive approach.

The Community legislator may legitimately wish to adopt an extensive legislative approach allowing companies in the EU to transfer their registered offices from one Member State to another, with a change of the applicable law.

An option for such an extensive approach will, however, have to be founded on political and economic grounds as an instrument for the promotion of regulatory competition among member States' company laws. Such an option will be defensible, therefore, to the extent that it confers on all existing companies in the EU the possibility of choosing the applicable corporate legal framework that best suits their needs and enhances their value.

In the light of *Cadbury Schweppes* it is doubtful that it can be based on freedom of establishment as long as the mere act of transferring the registered of a company to another Member State does not correspond to any exercise of effective economic activity in that State.

The pending Cartesio case C-210/06 – "I know not what tomorrow will bring" (F. Pessoa).

The Commission apparently considers that the outcome of the Court's Judgement in Cartesio may affect the scope and content of a possible EU legislative measure" on the transfer of the registered office of a company from one Member State to another (Commission's Staff working document, p. 38). If a principle of freedom of transfer of the registered office alone of a company is established by the Court on the basis of the Treaty, this will surely press on the Community legislator to give preference to an extensive legislative approach.

Cartesio is a Hungarian private limited company, whose application for registration in Hungary of the transfer of its seat (*székhely*) to Italy was rejected by the Hungarian courts. According to the referring jurisdiction (the Court of Appeal Szeged) it results from Articles 1(1) and 11 of the Hungarian Law of 1997 on the commercial register that if a company constituted under Hungarian law wishes to transfer its seat abroad, it must first be wound up in Hungary and must reconstitute itself under foreign law. Article 12, paragraph 1, a) of that Law provides that the information relating to the seat of each company shall be entered in the commercial register. According to Article 16, paragraph 1 of that Law, the seat is the place in which the "centre of administration of the company is situated".

On these grounds Hungarian authorities refused to accept Cartesio's intended transfer of its seat to Italy while maintaining Hungarian legal personality. By the question referred to the Court of Justice, the Court of Appeal Szeged asks in substance whether articles 43 and 48 EC preclude a Member State from imposing an outright ban on a company incorporated under its legislation, to transfer its seat to another Member State without having to be wound up in Hungary first, and to have that transfer of seat registered in the Hungarian register of companies.

- Should the Court, in Cartesio, establish a principle of freedom of transfer of registered office of a company alone?

- Cartesio is, to a large extent, a "Daily Mail revisited" twenty years after. But perhaps it is not only Daily Mail that needs to be revisited…

- Has a "third way" diverging from both *Daily Mail* and *Centros* been open by the recent case law of the Court concerning freedom of establishment and direct taxation?