NOTES

THE REVOLUTION THAT NEVER CAME AND THE REVOLUTION COMING—*DE LASTEYRIE DU SALLIANT*, *MARKS & SPENCER*, *SEVIC SYSTEMS* AND THE CHANGING CORPORATE LAW IN EUROPE

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INTRODUCTION

PRIOR to 1999, the prevailing theory of incorporation in Europe had long been the real seat doctrine, which requires a company to be incorporated where its central management is located. This system greatly restricts the ability of a corporation to choose the corporate law regime under which it is governed. As a result, continental corporate law developed in a very different direction than that of the United States. The United States, which employs the state of incorporation doctrine, saw the emergence of a dominant jurisdiction with an extremely efficient corporate judiciary and a legal code focused both on conflicts within existing corporations and on the creation, dissolution, and control of corporate entities themselves. By contrast, European corporate law remained decentralized, with no single jurisdiction obtaining a monopoly on corporate charters. Additionally, the continental system developed protections for other stakeholders in the corporation, such as employees and creditors. Although different theories exist as to why a European Delaware failed to emerge, it is unquestionable that the

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inability of corporations to reincorporate easily across jurisdictional lines played a major role.[1]

Between 1999 and 2003, a spate of decisions by the European Court of Justice ("ECJ") revolutionized corporate law in Europe. Relying on Articles 43 and 48 of the Treaty Establishing the European Community,[2] which together guarantee the benefits of freedom of establishment to corporations, the Court began to strike down national laws supporting the real seat doctrine.[3] Three decisions—*Centros*,[4] *Überseering*,[5] and *Inspire Art*[6]—marked the Court's first wave of prohibitions against restrictions on corporate movement between Member States. After each of these rulings, scholars heralded the end of the real seat doctrine and the new choice of jurisdiction rights that corporations would exercise.[7] Even

[1] Hanne Søndergaard Birkmose, A Market for Company Incorporations in the European Union?—Is *Überseering* the Beginning of the End?, 13 Tul. J. Int'l & Comp. L. 55, 59–60 (2005); David Charny, Competition Among Jurisdictions in Formulating Corporate Law Rules: An American Perspective on the "Race to the Bottom" in the European Communities, 32 Harv. Int'l L.J. 423, 427–30 (1991); Jens C. Dammann, Freedom of Choice in European Corporate Law, 29 Yale J. Int'l L. 477, 479–80 (2004).

[2] Consolidated Version of the Treaty Establishing the European Community, Dec. 24, 2002, 2002 O.J. (C 325) 52, 54 [hereinafter EC Treaty]. The first version of the EC Treaty was the Treaty of Rome. Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11. Under the Treaty of Rome, the relevant provisions were Articles 52 and 58. Id. at 37, 40. These articles were recodified and renumbered as Articles 43 and 48, respectively, by the Treaty of Amsterdam Amending the Treaty on European Union, the Treaties Establishing the European Communities and Certain Related Acts, Oct. 2, 1997, 1997 O.J. (C 340) 195, 197, which entered into force on May 1, 1999. The recodified numbering will be used throughout this Note.

[3] The ECJ has jurisdiction under the EC Treaty to decide cases concerning the interpretation of the treaty. EC Treaty, supra note 2, art. 234.

[4] Case C-212/97, Centros Ltd. v. Erhvervs-og Selskabsstyrelsen, 1999 E.C.R. I-1459 [hereinafter *Centros*].

[5] Case C-208/00, Überseering BV v. Nordic Constr. Co. Baumanagement GmbH (NCC), 2002 E.C.R. I-9919 [hereinafter *Überseering*].

[6] Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd., http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62001J0167:EN:HTML (Sept. 30, 2003) [hereinafter *Inspire Art*].

[7] See, e.g., J. William Callison, Federalism, Regulatory Competition, and the Limited Liability Movement: The Coyote Howled and the Herd Stampeded, 26 J. Corp. L. 951, 981 n.188 (2001) ("*Centros* . . . may begin the regulatory competition process for European business organization law."); Werner F. Ebke, *Centros*—Some Realities and Some Mysteries, 48 Am. J. Comp. L. 623, 627 & nn.31–32 (2000) (citing sources);Wulf-Henning Roth, Case Law, 37 Common Mkt. L. Rev. 147, 147 & n.5 (2000) (citing sources).

though this first wave of liberalization significantly limited the direct constraints on corporate mobility, however, the predicted revolution failed to occur.[8] The European Delaware did not materialize.

Beginning in 2004 and culminating on December 13, 2005, a second wave of freedom of establishment eroded the indirect limits on free choice of jurisdiction for companies. Like the three landmark decisions before them, the decisions in *de Lasteyrie du Saillant*,[9] *Marks & Spencer*,[10] and *SEVIC Systems*[11] demonstrated the ECJ's continuing commitment to liberalization. Unlike their predecessors, which targeted legal forms preventing freedom of establishment, the second-wave rulings uprooted the laws that disincentivized the exercise of that freedom. Although the first wave may have enjoyed more attention and generated more controversy, this Note will seek to demonstrate that the second will have a greater impact upon the actual exercise by corporations of the rights guaranteed by the EC Treaty.

Commentators on freedom of establishment for corporations have generally characterized state competition to attract corporate charters as either a climb to the top[12] or a race to the bottom.[13]

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[8] Birkmose, supra note 1, at 60 ("It can be argued that the European Union is very close to establishing a market for incorporations, but it is still not possible to reincorporate an existing company."); Dammann, supra note 1, at 482 ("Despite the ECJ rulings in *Überseering* and *Centros*, a range of practical and legal obstacles to free choice remain in place. At least some of these obstacles are likely to persist.").

[9] Case C-9/02, Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62002J0009:EN:HTML (Mar. 11, 2004) [hereinafter *de Lasteyrie du Saillant*].

[10] Case C-446/03, Marks & Spencer plc v. David Halsey (Her Majesty's Inspector of Taxes), http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62003J0446:EN:HTML (Dec. 13, 2005) [hereinafter *Marks & Spencer*].

[11] Case C-411/03, SEVIC Sys. AG v. Amtsgericht Neuwied, http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=CELEX:62003J0411:EN:HTML (Dec. 13, 2005) [hereinafter *SEVIC Sys.*].

[12] See, e.g., Dammann, supra note 1, at 478; Roberta Romano, Law as a Product: Some Pieces of the Incorporation Puzzle, 1 J.L. Econ. & Org. 225, 225 (1985); Ralph K. Winter, Jr., State Law, Shareholder Protection, and the Theory of the Corporation, 6 J. Legal Stud. 251, 253–55 (1977).

[13] See, e.g., William L. Cary, Federalism and Corporate Law: Reflections Upon Delaware, 83 Yale L.J. 663, 663 (1974); Melvin Aron Eisenberg, The Structure of Corporation Law, 89 Colum. L. Rev. 1461, 1506–07 (1989); Tim Atkins, Can national corporate governance codes sufficiently converge to protect diverse interests within

Based on the conclusion he or she draws, the scholar then advocates rules that either encourage or discourage state competition. This debate is a valuable and nuanced one,[14] shaping the development of state competition and undergirding the subsequent development of the governing law. Methodologically, this Note has a different focus. Rather than discuss whether or not free choice is a positive or negative societal development, this Note will seek to examine why the emergence of a dominant jurisdiction, the logical outcome of free choice, did not occur in the wake of the "landmark" first-wave decisions and why it will become a reality after *de Lasteyrie du Saillant*, *Marks & Spencer*, and *SEVIC Systems*. This Note, then, will attempt to incorporate the three second-wave decisions by the ECJ into the larger corpus of rulings and literature on freedom of establishment and evaluate their impact on that freedom and its exercise throughout the European Community.

To do so, Part I will examine the historical background of company law in Europe and the development of the real seat doctrine. Part II will then analyze the cases constituting the first wave of liberalization and their impact on overt legal obstacles to freedom of establishment. Part III will then describe the indirect restrictions on freedom of establishment remaining in the aftermath of *Centros*, *Überseering*, and *Inspire Art* that prevented the predicted revolution in free choice of law from occurring. Part IV will discuss the response of the ECJ to those indirect restrictions in the second-wave cases, and will use the Court's analysis in those cases as a lens with which to survey the current state of corporate freedom of establishment in Europe. Finally, this Note will offer some concluding remarks on the future of the real seat doctrine and the effects of the ECJ's jurisprudence on the national corporate law of the Member States.

the European Union? 27, 45 (Dec. 2003) (unpublished LL.M. dissertation), available at http://ssrn.com/abstract=573901.

[14] See, e.g., Michal Barzuza, Price Considerations in the Market for Corporate Law, 26 Cardozo L. Rev. 127, 138–39 (2004); Lucian Arye Bebchuk, Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law, 105 Harv. L. Rev. 1435, 1440 (1992); Mark J. Roe, Delaware's Competition, 117 Harv. L. Rev. 588, 591–93 (2003).

I. HISTORICAL BACKGROUND

The march toward emergence of a European Delaware was not always as inexorable as it seems today.[15] One of the necessary elements in the drive to allow corporate charter competition among the European nations is the ability of a corporation to choose the state in which it will incorporate. The state of incorporation doctrine—the idea that a corporation would be governed by the corporate law of the state in which it files the necessary forms to incorporate and that corporations could, with little cost, choose their jurisdiction of incorporation—was not the predominant mode of corporate choice of law in Europe until relatively recently. A string of decisions by the ECJ, beginning in the 1980s and culminating in a pair of rulings handed down on December 13, 2005, slowly eroded barriers to corporate choice of incorporation jurisdiction in Europe. This Part traces this development from the historical national regimes of corporate law through the most recent decisions of the ECJ.

A. The Ancien Régime*: The Real Seat Doctrine*

Prior to the eighteenth century, corporations could only be created by a grant from a sovereign authority for a limited purpose with a limited duration.[16] While England was the first country to move from the concession model to a system of free registration, continental Europe quickly followed.[17] This pattern of English innovation followed by continental imitation would not be seen again for a long time, however. Faced with a wave of reincorporations in the United Kingdom or Switzerland by continental corporations seeking to take advantage of favorable corporate law in those ju-

[15] Jens Dammann, The U.S. Concept of Granting Corporations Free Choice among State Corporate Law Regimes as a Model for the European Community 5–6 (Sept. 23, 2003) (unpublished manuscript), available at http://ssrn.com/abstract=418660.

[16] Carsten Frost, Transfer of Company's Seat—an Unfolding Story in Europe, 36 Victoria U. Wellington L. Rev. 359, 361–62 (2005).

[17] Katharina Pistor et al., The Evolution of Corporate Law: A Cross-Country Comparison, 23 U. Pa. J. Int'l Econ. L. 791, 794 (2002); see also Inne G.F. Cath, Freedom of Establishment of Companies: a New Step Towards Completion of the Internal Market, 6 Y.B. Eur. L. 247, 249 (1986) (citing sources for the development of the state of incorporation doctrine in England in 1730).

risdictions, France established the *siège réel* doctrine in the 1860s.[18] The *théorie du siège réel*, or real seat doctrine, requires that a corporation must be incorporated in the place where its central management decisions are made and implemented, and places the authority to regulate the corporation in the jurisdiction where the real seat is located.[19] *Siège réel* was buttressed by two constraints on corporate mobility. In the entry case, if a corporation moved into a real seat jurisdiction without reincorporating under that jurisdiction's law, the organization would be treated as a partnership, and all of its shareholders would be subject to unlimited liability.[20] For existing corporations seeking to reincorporate (the exit case), the *siège réel* doctrine was even more burdensome because transfers of place of incorporation were treated as liquidations of the corporation, meaning that all capital gains built up in its stock became immediately taxable to the shareholders.[21] By eliminating the ability of a corporation to choose its governing corporate law without substantial relocation costs to the company and inconvenience to the individuals involved, continental Europe also eliminated, or at least greatly curtailed, regulatory competition.[22] This system held for more than a century, even though one of the rights guaranteed by the Treaty of Rome establishing the European Economic

[18] Bernhard Grossfeld, Die Entwicklung der Anerkennungstheorien im internationalen Gesellschaftrecht [The Development of the Theories on the Recognition of Foreign Legal Persons in the Corporate Conflict of Laws], *in* Festschrift Für Harry Westermann 199, 208–09 (Wolfgang Hefermehl et al. eds., 1974), *cited in* Dammann, supra note 15, at 86 n.235; see also Pistor et al., supra note 17, at 794 n.13. The real seat doctrine is known in the German literature as the *Sitztheorie*. See Werner F. Ebke, The "Real Seat" Doctrine in the Conflict of Corporate Laws, 36 Int'l Law. 1015, 1017 (2002).

[19] Dammann, supra note 1, at 479–80, 483–86; Ebke, supra note 18, at 1015–16; Pistor et al., supra note 17, at 794 n.13.

[20] Dammann, supra note 1, at 483.

[21] Martin von Haller Groenbaek, Roberta Romano's *The Genius of American Corporate Law*, 42 Am. J. Comp. L. 655, 668 (1994) (book review).

[22] Dammann, supra note 15, at 10 & n.19; Pistor et al., supra note 17, at 794.

Community in 1957 was the freedom of establishment[23] for both individuals and corporations.[24]

B. Siège *Under Siege: The Scholarly Assault and the* Daily Mail *Decision*

Freedom of establishment constitutes part of the freedom of movement, one of the "four freedoms" guaranteed by the EC Treaty.[25] Article 43 provides that "restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited."[26] This privilege is extended to companies by Article 48, which gives "[c]ompanies 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" the right to be treated "the same way as natural persons who are nationals of Member States."[27] This right can only be limited "on grounds of public policy, public security or public health."[28] Beginning in the 1980s and 1990s, after the *Segers* judgment clarified that companies as well as individuals had a right to sue to enforce their freedom of establishment,[29] scholars began to criticize the real seat doctrine, which

[23] Freedom of establishment is a broad right that allows undertakings to be formed and operated and agencies, branches, or subsidiaries to be set up. Case C-55/94, Reinhard Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, 1995 E.C.R. I-4165 ¶¶ 22–24. A company may be established in more than one country. Id. ¶ 24.

[24] Treaty Establishing the European Economic Community arts. 52, 58, Mar. 25, 1957, 298 U.N.T.S. 11; see supra note 2.

[25] For a discussion of the freedom of movement in the context of the four freedoms, see generally Services and Free Movement in EU Law (Mads Andenas & Wulf-Henning Roth eds., 2002).

[26] EC Treaty, supra note 2, art. 43. The Member States of the European Union are Austria, Belgium, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, the Netherlands, and the United Kingdom. European Union Member States, http://europa.eu/abc/governments/index_en.htm (last visited May 12, 2006).

[27] EC Treaty, supra note 2, art. 48.

[28] Id. art. 46. Scholars have characterized this provision as "very narrowly worded and . . . also narrowly interpreted by the *ECJ*." Ingo Saenger, Recent Developments in European Company and Business Law, 10 Deakin L. Rev. 297, 302 (2005).

[29] Case 79/85, D.H.M. Segers v. Bestuur van de Bedrijfsvereniging voor Bank-en Verzekeringswezen, Groothandel en Vrije Beroepen, 1986 E.C.R. 2375 ¶ 19; see

restricted the ability of companies to establish themselves in another jurisdiction, as being in conflict with the freedom of establishment conferred by Articles 43 and 48.[30]

In its first major decision on the issue, the highest court in the European Community seemed to reject such an analysis.[31] The *Daily Mail* decision in 1988 involved a United Kingdom corporation that sought to transfer its residence to the Netherlands in violation of United Kingdom law to avoid taxes on an asset sale and share repurchase plan.[32] While emphasizing that Articles 43 and 48 prohibit Member States of origin from hindering the establishment in another state of a company incorporated under its legislation,[33] the ECJ nevertheless found that the question of whether a corporation could transfer its registration or central management, and if so how, was governed by national law, and the right to so transfer was not protected by the freedom of establishment.[34] When *Daily Mail* was handed down, many scholars viewed the issue of corporate establishment as settled in the European Community.[35] To the contrary, subsequent case law of the ECJ would chart a slow, but inexorable, course away from this holding.

Roth, supra note 7, at 151–54 (discussing the development of the case law after *Segers*).

[30] See, e.g., Dominik Schnichels, Reichweite der Niederlassungsfreiheit [The Scope of Application of the Freedom of Establishment] 155–99 (1995) (arguing that the real seat doctrine violates the Freedom of Establishment), *cited in* Dammann, supra note 15, at 11 n.23; Cath, supra note 17, at 259–61.

[31] The decisions of the ECJ are binding on Member States because of the delegations of sovereignty that these states made to the European Community institutions. See Robert Badinter, A European constitution: Perspectives of a French delegate to the convention, 1 Int'l J. Const. L. 363, 365–67 (2003).

[32] Case 81/87, The Queen v. H.M. Treasury and Comm'rs of Inland Revenue, ex parte Daily Mail and Gen. Trust PLC, 1988 E.C.R. 5483 ¶¶ 6–7.

[33] Id. ¶ 16.

[34] Id. ¶ 23.

[35] See, e.g., Birkmose, supra note 1, at 73–75 (describing the state of the scholarship at the time).

II. "THREE LANDMARK DECISIONS":[36] *CENTROS*, *ÜBERSEERING*, AND *INSPIRE ART*

Less than two decades after *Daily Mail*, the ECJ would be closely examining any national regulation making corporate legal personality contingent on broad standards and would begin advocating a far-reaching mutual recognition of corporations within the European Community.[37] The first wave of judicial assault on the direct legal barriers to corporate freedom of establishment began with the Court's decision in *Centros*.

A. Centros

In *Centros*, two Danish nationals residing in Denmark sought to incorporate a company under United Kingdom law, which requires no minimum capital contribution, and then establish a branch of the company under the law of Denmark, thus avoiding minimum capitalization requirements of limited liability entities under Danish law.[38] Danish authorities refused to recognize this branch, contending that it was not a branch at all but a primary establishment seeking to circumvent the minimum capital rules.[39]

First, the ECJ found that a straightforward application of Articles 43 and 48 required that a branch of a company formed in a Member State be recognized by all others, regardless of the purpose for which it was formed or where its business is to be conducted, except insofar as the Article 46 public policy exception applied.[40] Second, the ECJ applied the imperative requirements

[36] Tobias H. Tröger, Choice of Jurisdiction in European Corporate Law—Perspectives of European Corporate Governance, 6 Eur. Bus. Org. L. Rev. 3, 5 (2005).

[37] See id. at 6.

[38] *Centros*, supra note 4, ¶¶ 3–6.

[39] Id. ¶¶ 6–7.

[40] Id. ¶¶ 17, 24–25. The Court uses the definition of public interest from Article 46 as expanded by the *van Binsbergen* decision, Case 33/74, van Binsbergen v. Bedrijfsvereniging, 1974 E.C.R. 1299 ¶ 12–14. Essentially, this includes not only legislation in the interest of the entire public, but also requirements "justified by the general good." Id. ¶ 12. This Note, for simplicity, will refer to this doctrine as the public interest standard. The *Centros* judgment refers to Articles 53, 56, and 58 because the decision was made prior to recodification of the EC Treaty.

doctrine to the public interest standard that minimum capital requirements served—the protection of creditors.[41]

The imperative requirements doctrine necessitates that national measures restricting fundamental freedoms, like the freedom of establishment, fulfill four conditions: (i) they must be applied in a non-discriminatory manner; (ii) they must be justified by imperative requirements in the general interest; (iii) they must be suitable for securing the attainment of the objective which they pursue; and (iv) they must be the least restrictive means of attaining that objective.[42] The ECJ found that the Danish minimum capital requirements did not attain the objective of protecting creditors because the entity held itself out as a United Kingdom limited company, and that even if the requirements did minimally protect creditors they were not the least restrictive means of doing so.[43] Thus, an individual in a Member State seeking to avoid the corporate law regime of his nation could simply establish a corporation under United Kingdom law, and then operate in his own country through a branch of that company without restriction, although the Court did hold out the possibility that measures preventing or penalizing fraud could be permissible.[44]

Scholars rushed to point out the ramifications of this decision.[45] Some commentators sought to minimize the impact of *Centros*, either by positing that the decision only affected freedom of secondary establishment,[46] or that, because both Denmark and the United Kingdom were state of incorporation jurisdictions, the deci-

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[41] *Centros*, supra note 4, ¶¶ 31–35. The imperative requirement doctrine was first used by the ECJ in the *Cassis de Dijon* decision. See Case 120/78, Rewe-Zentral AG v. Bundesmonopolverwaltung für Branntwein, 1979 E.C.R. 649 ¶ 8. The ECJ applies this doctrine in the freedom of establishment context. See Case C-250/95, Futura Participations SA & Singer v. Admin. des Contributions, 1997 E.C.R. I-2471 ¶ 31; Case C-55/94, Reinhard Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, 1995 E.C.R. I-4165 ¶¶ 18–25; see also Dammann, supra note 1, at 484 & n.35.

[42] *Centros*, supra note 4, ¶ 34; Dammann, supra note 1, at 484; see also Case C-19/92, Dieter Kraus v. Land Baden-Württemberg, 1993 E.C.R. I-1663 ¶¶ 32–41.

[43] *Centros*, supra note 4, ¶¶ 35–38.

[44] Id. ¶ 38; see also *van Binsbergen*, 1974 E.C.R. 1299 ¶¶ 12–14.

[45] See, e.g., Ebke, supra note 7; Eva Micheler, The impact of the Centros case on Europe's company laws, 21 Company Law. 179 (2000); Catherine Holst, Note, European Company Law After *Centros*: Is the EU on the Road to Delaware?, 8 Colum. J. Eur. L. 323 (2002).

[46] Roth, supra note 7, at 150–53; see also Birkmose, supra note 1, at 79 & n.114 (listing similar articles); Ebke, supra note 18, at 1024–25; Holst, supra note 45, at 331.

sion did not affect states using the real seat doctrine.[47] These possible jurisprudential paths were rejected in the second breakthrough decision[48] of the ECJ with respect to freedom of establishment, *Überseering*.

B. Überseering

Überseering involved a corporation organized under Dutch law whose share ownership was acquired by two German nationals without a liquidation and reincorporation in Germany.[49] When the company sought to bring an action in Germany over defective work done by a contractor, the German trial court ruled that its noncompliance with the real seat doctrine meant that the entity lacked legal capacity as a corporation, and thus standing to sue.[50] Responding to arguments that the EC Treaty only granted the right of secondary establishment of a branch or subsidiary, the ECJ first found that freedom of establishment applied in the primary establishment case, where a company was validly incorporated in one state and is deemed by the law of another to have moved its center of administration to the latter.[51] The Court distinguished its earlier decision in *Daily Mail* on the ground that the corporation in that case had transferred its center of administration in violation of the tax laws of the country in which it had been incorporated, whereas the corporation in *Überseering* had no quarrel with its state of incorporation, but rather with the government of the country to which it had transferred its administration.[52] In other words, freedom of establishment allows restrictions in the exit case, when a company leaves its jurisdiction of incorporation, but not in the entry case, when a company validly incorporated in one Member

[47] Wulf-Henning Roth, From *Centros* to *Ueberseering*: Free Movement of Companies, Private International Law, and Community Law, 52 Int'l & Comp. L.Q. 177, 188 (2003); see also Birkmose, supra note 1, at 78 & n.112 (listing similar articles). For a sophisticated analysis of why scholars failed to foresee the ramifications of *Centros*, see Harald Halbhuber, National Doctrinal Structures and European Company Law, 38 Common Mkt. L. Rev. 1385, 1409–19 (2001).

[48] Roth, supra note 47, at 206–07.

[49] *Überseering*, supra note 5, ¶¶ 2, 7.

[50] Id. ¶¶ 8–9.

[51] Id. ¶ 52.

[52] Id. ¶¶ 62–73.

State takes up residence in another.[53] This distinction is justified because corporations are creatures of national law and, as such, are subject to the law of their formation.[54]

Having found a right of freedom of establishment, the ECJ then evaluated whether characterization of the restriction under the public interest standard[55] survived the imperative requirements doctrine.[56] The German government presented five areas of public policy which justified the refusal to recognize corporate transfers into their jurisdiction: (i) minimum capital standards; (ii) protection of minority shareholders; (iii) codetermination, the system of employee board representation; (iv) tax policy; and (v) the fact that variations in these laws would create a distortion of competition by giving foreign companies advantages that native firms lacked.[57] While holding out the possibility that "overriding requirements . . . such as the protection of the interests of creditors, minority shareholders, employees and even the taxation authorities" may in "certain circumstances" justify restrictions on the freedom of establishment, the ECJ ruled that the denial of legal capacity was not such a circumstance, and that Member States were required to recognize corporations validly incorporated in other Member States.[58]

As a result of its acceptance of the right of freedom of establishment in the entry but not the exit case, *Überseering* was regarded as a "halfway approach towards the acceptance of the incorporation system."[59] Although Member States were not required by the ruling to maintain the legal status of one of their own corporations if it should change its seat, they did have a duty of recognition toward a company that had transferred its central administra-

[53] Roth, supra note 47, at 206; Patrick S. Ryan, Case Note, 11 Colum. J. Eur. L. 187, 190–91, 194–95 (Winter 2004/2005); see also Saenger, supra note 28, at 309.
[54] *Überseering*, supra note 5, ¶ 70.
[55] See supra note 40.
[56] *Überseering*, supra note 5, ¶¶ 92–93.
[57] Id. ¶¶ 87–90.
[58] Id. ¶¶ 92–93.
[59] Luca Cerioni, Case Note, The "Überseering" Ruling: The Eve of a "Revolution" for the Possibilities of Companies' Migration Throughout the European Community?, 10 Colum. J. Eur. L. 117, 129 (2003). Some viewed *Überseering* as going more than halfway toward acceptance of the state of incorporation doctrine. See Ryan, supra note 53, at 195 ("[*Überseering*] indicates the end of Sitztheorie . . . ."). See generally Birkmose, supra note 1.

tion in conformity with the law of the state of incorporation.[60] Member States employing the real seat doctrine quickly moved to limit this duty by enacting laws imposing restrictions on pseudo-foreign corporations—companies that are incorporated in another Member State but have their central administration in the real seat state.[61] One such regulation, the Dutch Law on Formally Foreign Companies,[62] would be tested in the ECJ's next major freedom of establishment decision, *Inspire Art*.

C. Inspire Art

In July 2000, a Dutch national incorporated a company, Inspire Art Ltd., under United Kingdom law to engage in business as an art dealer in the Netherlands.[63] The company did not register as a formally foreign company, as was required by Dutch law for such entities, and Dutch authorities requested that the relevant court amend the registration.[64] The company claimed that the registration requirement and another Dutch legal provision calling for the satisfaction of minimum capital requirements were violations of its freedom of establishment under Articles 43 and 48 of the EC Treaty.[65] The Netherlands, along with several other continental Member States, responded that the requirements imposed by Dutch law were the same regulations imposed on native companies, and that avoidance of these requirements would give foreign corporations an unfair advantage.[66] The ECJ found this argument unpersuasive, ruling that any restriction by a Member State on the operation of a corporation which conducts business in that country,

[60] See Birkmose, supra note 1, at 93 (describing the legal landscape in the aftermath of *Überseering*).

[61] Id. at 94.

[62] The Dutch Wet op de Formeel Buitenlandse Vennootschappen [Law on Formally Foreign Companies] of 17 December 1997 imposed various obligations on formally foreign companies, requiring them to register with Dutch authorities (art. 2), to indicate that the company is a formally foreign company on all documents and notices (art. 3), to meet the Dutch minimum capital requirements at all times (art. 4(1)), and to comply with Dutch annual reporting requirements (art. 5). Noncompliance with any of these provisions would result in joint and several liability for the directors of the company (art. 4(4)). See *Inspire Art*, supra note 6, ¶¶ 2, 22–33.

[63] *Inspire Art*, supra note 6, ¶ 34.

[64] Id. ¶¶ 35–36.

[65] Id. ¶ 37.

[66] Id. ¶¶ 81–82.

but is incorporated in another Member State, violates the freedom of establishment. This is true even if the corporation carries on activities exclusively within the Member State in which it is not incorporated, except "where abuse is established on a case-by-case basis."[67] Clearly, under the Court's reasoning, establishment in another Member State solely to avoid the corporate law of the center-of-administration country does not constitute such abuse.[68]

The continental parties then resorted to the public interest standard as justification for the restrictions,[69] contending that the Dutch foreign-company requirements countered fraud, protected creditors, and ensured that business dealings were fair and tax collections effective.[70] Inspire Art argued instead for a contract model rather than a regulatory model, observing that if the "assurances given [creditors] by the law of [the United Kingdom] do not satisfy them, they can either insist on additional security or refuse to conclude contracts" with the company.[71] Applying the imperative requirements doctrine,[72] the ECJ found that inherent in the freedom of establishment was the ability of a Member State national to set up a company in the regime "which seem[s] to him the least restrictive and then set up branches in other Member States."[73] The Court ruled that none of the justifications offered by the Netherlands to support its application of minimum capital standards fell within the public interest standard.[74]

Inspire Art is a successor to *Centros* in several crucial respects. It reiterated the central idea of *Centros* that corporations can be formed and establish branches in any Member State, even if the sole purpose of doing so is to avoid the company law of the real seat country.[75] *Inspire Art* went further by eliminating the possibility that Member States would be able to require corporations to

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[67] Id. ¶ 105.

[68] Id. ¶¶ 95–97, 120.

[69] Case 33/74 Johannes Henricus Maria van Binsbergen v. Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid, 1974 E.C.R. 1299 ¶¶ 12–14.

[70] *Inspire Art*, supra note 6, ¶¶ 108–10.

[71] Id. ¶ 125.

[72] Restrictions must be non-discriminatory, justified by imperative requirements in the public interest, suitable for attaining the objective which they pursue, and be the least restrictive means necessary. See id. ¶ 133.

[73] Id. ¶ 138.

[74] Id. ¶¶ 131, 140–41.

[75] See *Centros*, supra note 4, ¶¶ 17–18.

abide by their own corporate law regimes through what formally appear to be regulations on foreign corporations. The final case of the landmark decision trilogy of the ECJ was, however, entirely unremarkable in one respect. The Court in *Inspire Art* did not divert at all from its nearly unrestricted endorsement of the state of incorporation doctrine.

III. BARRIERS REMAINING IN THE WAKE OF THE FIRST WAVE OF LIBERALIZATION

The decisions in *Centros*, *Überseering*, and *Inspire Art* dramatically altered the legal landscape of company establishment in Europe. Secondary establishment—the freedom of a corporation to set up a branch, agency, or subsidiary—had received robust protection from the ECJ. Branches were not subject to the real seat doctrine, and restrictions beyond those preventing fraud or abuse of the freedom of establishment had been invalidated.

Primary establishment, a corporation's right to transfer its state of incorporation, had seen some jurisprudential development as well. While small firms would most likely continue to incorporate in their home state anyway, as such entities in the United States currently do,[76] the initial evidence suggested that the impact of *Überseering* was nevertheless significant. For example, the number of new English limited liability companies established in the two weeks following *Überseering* increased from around 5500 to 7000.[77]

Progress had clearly been made on the company formation level. Corporations that were formed prior to the three decisions, however, could not take advantage of this newfound freedom. The *Daily Mail* view that "companies are . . . creatures of national law" that "exist only by virtue of the varying national legislation which determines their incorporation and functioning"[78] continued to prevent freedom of establishment in the exit case throughout the ECJ's otherwise promiscuous liberalization of corporate freedom

[76] See Dammann, supra note 15, at 52–53 & n.143.
[77] Ryan, supra note 53, at 199 n.39 (citations omitted).
[78] Case 81/87, The Queen v. H.M. Treasury and Comm'rs of Inland Revenue, ex parte Daily Mail and Gen. Trust PLC, 1988 E.C.R. 5483 ¶ 19.

of establishment.[79] Given that pre-existing entities comprise the vast majority of the companies within the European Community,[80] the jurisprudential developments of the first-wave cases had little impact on the larger question of free corporate choice of jurisdiction. The real seat doctrine had been bloodied, but in the wake of the ECJ's landmark decisions it continued to contain pre-existing companies within national borders. After the *Centros/Überseering/Inspire Art* trilogy, there were two major obstacles to free choice of incorporation jurisdiction for large, previously established entities, and one remaining hurdle for secondary establishment to be fully effective.

The first primary establishment problem was procedural. In the United States, transfer of the jurisdiction of incorporation is accomplished by the creation of a corporation under the law of the desired jurisdiction and the merger of the existing corporation into that entity.[81] This process, however, requires a cross-border merger statute at the federal or state level. Germany and Austria do not allow their domestic corporations to merge with foreign corporations.[82] Several other countries, including the United Kingdom, Ireland, France, and Italy, seem to allow cross-border mergers, but in these and other Member States the legal situation is "frequently fraught with uncertainty."[83]

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[79] See Saenger, supra note 28, at 310 ("In contrast to the aspects of taking up residence, the legitimacy of restrictions on the *departure* of companies remains absolutely unclear in light of the *Daily Mail* decision.") (emphasis in original).

[80] For instance, thirty-one of the fifty largest firms incorporated in Sweden in 2000 were founded before 1914, and no company founded after 1970 is on the list. Peter Högfeldt, The History and Politics of Corporate Ownership in Sweden 44 (European Corporate Governance Inst., Finance Working Paper No. 30/2003, 2004), available at http://ssrn.com/abstract=449460. However, scholars have argued that firms incorporating in jurisdictions with better access to external capital will acquire those firms in countries with poor corporate law systems, leading to the presence of more and bigger companies in the "good" regimes than initial incorporations alone would predict. See Joseph A. McCahery & Erik P.M. Vermeulen, The Evolution of Closely Held Business Forms in Europe, 26 J. Corp. L. 855, 862 (2001).

[81] Dammann, supra note 1, at 489; Tröger, supra note 36, at 15. For examples of enabling state law, see, e.g., Del. Code Ann. tit. 8, §§ 251, 252 (2001); N.Y. Bus. Corp. Law §§ 901–03 (McKinney 2003); Model Bus. Corp. Act §§ 11.02, 11.04 (2002).

[82] Dammann, supra note 1, at 489–90 & nn.70–71.

[83] Id. at 490; see also Ann Neir et al., International Legal Developments in Review: 2004, 39 Int'l Law. 569, 580 (2005) ("In the absence of an appropriate EU-wide legal framework, [cross-border] mergers are currently either impossible or extremely complex."); Mathias M. Siems, The European Directive on Cross-Border Mergers: An

Tax law also presented a problem for companies seeking to change their jurisdiction of incorporation. While Member States are prohibited from taxing hidden assets in the event of a transnational merger,[84] most continental jurisdictions would, upon a company's reincorporation in another Member State, treat the company as liquidated and tax the latent asset appreciation.[85] For most corporations, this meant that unless merger without liquidation existed, the costs of changing their state of incorporation would outweigh the benefits of a more efficient corporate law.

Freedom of secondary establishment likewise suffered from tax disincentives. Companies had the right after *Centros* and *Inspire Art* to set up branches or subsidiaries. Any restrictions on this right were subject to the imperative requirements doctrine, which the ECJ construed strictly against the state applying the restrictions.[86] Fearing that secondary establishment would be used as a tool for tax evasion, Member States enacted corporate tax provisions that prevented a parent company from deducting losses incurred by a subsidiary established in another Member State. The parent company could deduct such losses for a subsidiary in the same country as the parent.[87] These provisions prevented cross-border offset of profits, making secondary establishment significantly less attractive and thereby reducing corporate incentives to operate multinational enterprises within the European Community.

IV. THE SECOND WAVE OF FREEDOM OF ESTABLISHMENT

The first wave of liberalization ensured secondary and primary establishment in the entry case but left previously incorporated entities caged in their real seat jurisdiction and the taxation arrangements of Member States sacrosanct. The second wave would break

International Model?, 11 Colum. J. Eur. L. 167, 167 (Winter 2004/2005) ("[T]he existing law on cross-border mergers in the Member States of the European Union . . . can make cross-border mergers difficult or even impossible.").

[84] Council Directive 90/434/EEC, art. 4, 1990 O.J. (L 225) 3.

[85] Tröger, supra note 36, at 16–18 (surveying such law and challenging this system's compatibility with freedom of establishment); Dammann, supra note 15, at 8–9, 22–23; see also supra notes 8–11 and accompanying text.

[86] See supra notes 28–31 and 56–62 and accompanying text.

[87] See, e.g., Income and Corporation Taxes Act, 1988, pt. I, §§ 8(1), 11(1); pt. VI, § 208; pt. X, §§ 402–03 (U.K.).

firms out of their prisons[88] and begin to find indirect restrictive provisions in violation of the right of establishment.

A. Crossing the Borders

Although commentators had argued for some time that the tax laws that made leaving a Member State prohibitively expensive were violations of freedom of establishment,[89] the ECJ ruling on the issue did not come until relatively recently. The decision addressing this question followed the previous path of the ECJ in coming down solidly in favor of freedom of establishment.

1. Freedom of Establishment and Departure Taxes: de Lasteyrie du Saillant

On March 11, 2004, the ECJ handed down its decision in *de Lasteyrie du Saillant*. Hughes de Lasteyrie du Saillant, a French national, left his home country to settle in Belgium for the purpose of carrying on his profession there.[90] The French authorities were not pleased with his decision. French tax regulations required that, if an individual owned certain types of securities within five years of leaving the country, he or she would be taxed on the difference between the price at which they were purchased and the market value on the date of departure, unless the individual posted a guarantee and held the securities for five years after leaving France.[91] Apparently a capable investor, de Lasteyrie du Saillant's securities had appreciated significantly.[92] Several governments, allied on the French side, contended that this tax provision had only an insignificant effect on the freedom of establishment, and did not deter individuals from moving from one Member State to another.[93] The Court rejected that argument, relying on the simple fact that a taxpayer wishing to transfer his tax residence outside French territory is subjected to disadvantageous treatment compared to one who maintains his French residence.[94] Even if of limited scope or minor

[88] Ebke, supra note 18, at 1036.
[89] See, e.g., id. at 1037.
[90] *de Lasteyrie du Saillant*, supra note 9, ¶¶ 12, 20.
[91] Id. ¶¶ 3–11.
[92] Id. ¶ 12.
[93] Id. ¶¶ 21, 23.
[94] Id. ¶ 46.

importance, the Court wrote, a restriction on freedom of establishment is prohibited.[95]

Perhaps anticipating this outcome, France chose to concentrate on providing sufficient justification for the restriction under the imperative requirements doctrine, pointing out that the measure was intended to prevent tax evasion and, in the absence of effective treaties, other methods of recovery of the tax would be problematic.[96] Finding that the tax provisions were of general application to everyone who left the country, however, the ECJ ruled that the French tax law violated the fourth prong of the imperative requirements doctrine, which requires that restrictions on freedom of establishment be the least restrictive means necessary to attain their objective.[97] Thus, the Court ruled that freedom of establishment precluded Member States from establishing "a mechanism for taxing latent increases in value . . . where a taxpayer transfers his tax residence outside that State."[98] Additionally, the ECJ concluded that diminution of tax receipts can never be an overriding general interest sufficient to justify a restriction on a fundamental freedom, such as the freedom of establishment.[99]

The implications of *de Lasteyrie du Saillant* in the corporate context were being discussed before the ECJ published the decision in the official reports.[100] The Court's reasoning in *de Lasteyrie du Saillant*, if applied to corporate freedom of establishment, would undercut the foundation of the real seat doctrine. Member States employing the real seat doctrine rely on the fear that firms will be treated as liquidated and taxed on their asset appreciation upon reincorporation to prevent companies from relocating.[101] As *Überseering* had already eliminated the entry barrier by forcing Member States to recognize companies from across the European Commu-

[95] Id. ¶ 43.

[96] Id. ¶¶ 24–27. The imperative requirements doctrine is applied to freedom of establishment for individuals. Case C-250/95, Futura Participations SA & Singer v. Admin. des Contributions, 1997 E.C.R. I-2471 ¶ 26.

[97] *de Lasteyrie du Saillant*, supra note 9, ¶¶ 49–52.

[98] Id. ¶ 58.

[99] Id. ¶ 60.

[100] See Tröger, supra note 36, at 17.

[101] See supra notes 21–24 and accompanying text.

nity,[102] this development would leave little protection for real seat states from jurisdictions with a more efficient corporate law.

De Lasteyrie du Saillant is an interesting decision for another reason. The ECJ wrote:

> Even if, like the other provisions concerning freedom of establishment, Article 52 of the Treaty is, according to its terms, aimed particularly at ensuring that foreign nationals are treated in the host Member State in the same way as nationals of that State, it also prohibits the Member State of origin from hindering the establishment in another Member State of one of its own nationals.[103]

Fifteen years earlier in another ECJ decision, another taxpayer of a Member State attempted to cross European Community borders and incurred the wrath of the home country's tax authorities. That case was, of course, *Daily Mail*.[104] In *Daily Mail*, the Court ruled that language like the passage above did not apply to restrictions by tax authorities on movement across European borders.[105] The reasoning of *de Lasteyrie du Saillant*—that taxation occurring upon border crossing, thus treating migratory persons differently than those who remain, violates freedom of establishment—seems to call this conclusion into doubt. The two decisions could be distinguished on the ground that, as the Court wrote in *Daily Mail*, "unlike natural persons, companies are creatures of the law and, in the present state of Community law, creatures of national law." Under this reasoning, these entities would be completely at the mercy of their jurisdiction of incorporation.[106] The development of corporate freedom of establishment since 1988, however, makes this outcome far from certain should the ECJ take such a case.[107]

[102] See supra notes 49–54 and accompanying text.

[103] *de Lasteyrie du Saillant*, supra note 9, ¶ 42 (citations omitted).

[104] See supra notes 25–35 and accompanying text.

[105] Case 81/87, The Queen v. H.M. Treasury and Comm'rs of Inland Revenue, ex parte Daily Mail & Gen. Trust PLC, 1988 E.C.R. 5483 ¶¶ 16–18.

[106] Id. ¶ 19; see Tröger, supra note 36, at 17–18 (distinguishing the cases on those grounds, but nevertheless maintaining that *de Lasteyrie du Saillant* "may mark a cataclysm in European tax law").

[107] See Neir et al., supra note 83, at 571 (suggesting that *de Lasteyrie du Saillant* may have considerable impact on the tax consequences of corporate entity relocation); Siems, supra note 83, at 180 (arguing that, after *de Lasteyrie du Saillant*, "discrimina-

Further, this complication would only apply as long as the real seat doctrine made liquidation the consequence of reincorporation. If companies were allowed to merge, keeping their corporate form in the process, there would be little to distinguish the corporate case from that of Hughes de Lasteyrie du Saillant.[108]

2. Making Mergers Possible: SEVIC Systems

Although the European Community had promulgated a directive concerning internal mergers in 1978,[109] legislation at the Community level enabling combinations across borders remained elusive. At the beginning of 2005, the possibility of efficient cross-border mergers within the European Community looked years, perhaps decades, away. By the end of that year, they were a reality. This drastic development was largely the result of the December 13, 2005, decision by the ECJ in *SEVIC Systems*.

Cross-border mergers were first introduced to Europe in a systematic way by the Statute for a European Company, which, after thirty years of negotiation and development, became effective October 8, 2004.[110] This Statute enables an existing company whose registered and principal offices are located within the European Community to be restructured as a Societas Europea ("SE"). It also enables two or more public limited liability companies formed under the laws of at least two different Member States and having both registered and principal offices within the Community to merge their companies into an SE, or to create an SE as a parent

tion imposed by tax law would also be unlawful for corporations that indirectly transfer their statutory seat by transferring their assets").

[108] As discussed below, the development of the ECJ's jurisprudence made existing directives of the European Council applicable to prevent taxation in this context. See Council Directive 90/434/EEC, art. 4, ¶ 1, supra note 84, at 3. *De Lasteyrie du Saillant* is still significant in its characterization of non-taxation of border crossing as a fundamental freedom, entailing protections against restriction not otherwise applicable to a mere directive.

[109] Council Directive 78/855/EEC, 1978 O.J. (L 295) 36.

[110] Council Regulation 2157/2001, 2001 O.J. (L 294) 1 (EC). The Societas Europea was actually introduced by this regulation, which set up the corporate form and many of the default rules, and a directive which concerned laws to be enacted regarding employee participation. Council Directive 2001/86/EC, 2001 O.J. (L 294) 22.

company holding more than half of the shares of each company.[111] The SE is regarded as a public limited liability company governed by the law of the Member State in which it has its registered office.[112] In addition to allowing two corporations to merge into the SE, the Statute also contains a process by which the registered office of the SE can be transferred to another Member State without liquidation or the creation of a new legal person.[113] However, though the SE was a positive step in the direction of facilitating cross-border mergers, two major problems rendered its effectiveness minimal. First, the formation procedure for an SE between companies from two or more Member States is complex, lengthy, and cumbersome.[114] Second, the Statute establishing the SE mandates the use of many elements that companies seeking to reincorporate try to avoid.[115]

In the face of these problems, and considering that SE formation was almost unworkable for small- and medium-sized enterprises, the European Council and Parliament enacted the Cross-Border Merger Directive a year later on October 26, 2005.[116] Meant to reduce the legal and administrative difficulties for limited liability

[111] Neir et al., supra note 83, at 579. Additionally, an SE could be created as a joint venture between corporate bodies in different Member States or as a wholly-owned subsidiary of an SE. See id. at 579–80.

[112] Council Regulation 2157/2001, art. 3, supra note 110, at 4.

[113] Id. art. 8, at 4. For a discussion of this aspect of the SE, see Neir et al., supra note 83, at 579–80.

[114] See Neir et al., supra note 83, at 580 ("The complexity and length of the formation process may, however, severely complicate the use of the Company Statute for [cross-border mergers], particularly for listed public companies."); see also Luca Enriques, Silence is Golden: The European Company Statute As a Catalyst for Company Law Arbitrage 3–4 (European Corporate Governance Inst., Law Working Paper No. 07/2003, 2003), available at http://ssrn.com/abstract=384801 (describing the SE as a cumbersome but useful instrument for facilitating cross-border mergers, and thus regulatory arbitrage within the Community).

[115] These elements include minimum capital requirements, Council Regulation 2157/2001, art. 4, supra note 110, at 4; host state capital maintenance requirements, id. art. 5, at 4; and the real seat-like provision that the registered office of the SE must be located in the same Member State as its head office, id. art. 7, at 4. Additionally, companies must comply with employee participation requirements established by the Council Directive 2001/86/EC, supra note 110.

[116] Directive 2005/56/EC, 2005 O.J. (L 310) 1. For a more detailed discussion of the reasons for the development of the Cross-Border Merger Directive after the SE Statute, see Siems, supra note 83, at 181–83.

company mergers across Member State borders,[117] the basic provision of the Cross-Border Merger Directive requires that nations apply their law governing internal mergers to the cross-border context.[118] At the time of the Directive's enactment, Germany, Austria, and several other Member States did not permit cross-border mergers involving their companies at all.[119] The significance of this provision, then, was that countries could no longer make cross-border mergers impossible through national law.[120] The Cross-Border Merger Directive borrowed its treatment of employee participation, minority shareholder protection, and host Member State review from the SE Statute and the previous internal merger directive enacted in 1978, while allowing the national law of the surviving corporation more influence than either of those statutes.[121] To give the Member States time to adapt their national laws to the new system, the Cross-Border Merger Directive was not scheduled to go into effect until December 15, 2007.[122]

While the Member States were negotiating the Cross-Border Merger Directive, however, the ECJ was considering a case that would render that directive superfluous.[123] German scholars had suggested as early as 1994 that freedom of establishment for corporations meant that cross-border mergers had to be permitted within the European Community.[124] Nevertheless, it was not until late 2003 that the Court heard a case on the issue.

In 2002, SEVIC Systems AG, a German corporation, and Security Vision Concept SA, a Luxembourg company, concluded a merger agreement providing for the dissolution of Security Vision without liquidation and the transfer of its assets to SEVIC, notwithstanding the fact that German law only provided for mergers

[117] Directive 2005/56/EC, preamble, ¶ 1, supra note 116, at 1.
[118] Id. art. 4, at 4.
[119] Siems, supra note 83, at 170.
[120] Id. at 174.
[121] Id. at 174–75.
[122] Directive 2005/56/EC, art. 19, supra note 116, at 9.
[123] But not worthless. See Siems, supra note 83, at 170 (noting that, unlike a court ruling, a directive can establish detailed enabling rules that go beyond the basic question of whether cross-border mergers are permissible under EC law).
[124] See id. It is interesting that, like the prophet Daniel in the hall of King Belshazzer, those who read the writing on the wall were in the midst of the regime most offensive to freedom of establishment—Germany—which did not allow cross-border mergers under national law in any situation. Id.

between national companies.[125] In light of this, the relevant German court rejected the application for registration of the merger.[126] In response to the allegation by SEVIC Systems that the refusal to register the merger constituted a violation of the freedom of establishment, Germany contended that, because the Luxembourg company would be liquidated as a consequence of the merger and the German company remained in Germany, freedom of establishment was not implicated.[127] Advocate General Tizzano, in his opinion to the Court, made two arguments refuting this position.[128] First, Tizzano wrote, the consequence of the merger, liquidation, cannot be the justification for a law which precludes the merger from occurring.[129] Second, cross-border mergers are an essential feature of the freedom of establishment:

> [T]he right of establishment does not concern only the right to move to another Member State in order to purse an activity there, but also all the aspects which are linked in any way . . . with the pursuit of that activity and thus the exercise in full of the freedom laid down by the Treaty.
>
> It appears to me evident that this is so also in the case of the national legislation in question. It relates to aspects which are not complementary but actually essential to the activity of an economic operator since it precludes the conclusion of specific legal transactions (mergers) and in particular operations relating to acquisition/disposal or formation of new companies.[130]

The ECJ followed this logic, finding that freedom of establishment was applicable and violated by the differential treatment of national and non-national mergers.[131] The Court rejected Germany's argument that freedom of establishment concerning cross-border

[125] *SEVIC Sys.*, supra note 11, ¶¶ 6–7.
[126] Id. ¶ 7.
[127] Id. ¶ 16; see also Opinion of Advocate General Tizzano, Case C-411/03, SEVIC Sys. AG v. Amtsgericht Neuwied, http://eur-lex.europa.eu/LexUriServ/ LexUriServ.do?uri=CELEX:62003C0411:EN:HTML (July 7, 2005) ¶¶ 21–23.
[128] Advocates General make impartial and independent reasoned submissions to the Court in cases which require their involvement. See EC Treaty, supra note 2, art. 222.
[129] *Opinion of Advocate General Tizzano*, supra note 127, ¶¶ 25–26.
[130] Id. ¶¶ 32–33.
[131] *SEVIC Sys.*, supra note 11, ¶¶ 18–19.

mergers could only be guaranteed through harmonizing directives such as the Cross-Border Merger Directive.[132]

Germany then attempted to justify the restriction on the ground that German corporate law protects employees, creditors and minority shareholders, and allowing cross-border mergers would circumvent these protections.[133]

The ECJ agreed that protection of creditors, minority shareholders, and employees may, "in certain circumstances and under certain conditions, justify a measure restricting the freedom of establishment."[134] As it had repeatedly in the first wave of liberalization, however, the Court held that the German refusal to recognize cross-border mergers violated the dictate of the imperative requirements doctrine, which requires national measures that limit a fundamental freedom to take the least restrictive means necessary to attain its objectives.[135]

Three aspects of *SEVIC Systems* are significant. First, and most obviously, the nations of the European Community can no longer forestall enactment of the Cross-Border Merger Directive until the end of 2007.[136] Whether or not Member States have enacted the relevant provisions in their national law, corporations have the right under *SEVIC Systems* and the freedom of establishment under the EC Treaty to engage in cross-border mergers. Presumably, such mergers will be governed by national provisions relating to internal mergers. The Court, however, gave no guidance in *SEVIC Systems* as to what the governing law would be. Thus, Member States will probably proceed to enact the Cross-Border Merger Directive as quickly as possible, given that its protections for continental priorities such as capital maintenance requirements and employee participation may not otherwise apply.

Second, and more importantly, the Court in *SEVIC Systems* held that corporate engagement in cross-border mergers constitutes the exercise of a fundamental freedom, the freedom of establishment.[137] Had such mergers been governed by harmonization

[132] Id. ¶¶ 24–25.
[133] Id. ¶ 24.
[134] Id. ¶ 28.
[135] Id. ¶¶ 29–30.
[136] Directive 2005/56/EC, art. 19, supra note 116, at 9.
[137] *SEVIC Sys.*, supra note 11, ¶¶ 18–19, where the Court wrote:

through the Cross-Border Merger Directive alone, Member States need only have complied with the minimum standards of that Directive, leaving them otherwise free to enact more stringent provisions to protect national interests or pursue other policy objectives. If harmonization provides a floor upon which Member States can build, however, a finding of fundamental freedom creates a ceiling beyond which they may not go. After *SEVIC Systems*, national regulations that exceed the minimum standards of the Cross-Border Merger Directive are subject to scrutiny as restrictions on a fundamental freedom. As such, they must meet the standards of the imperative requirements doctrine, including nondiscrimination between foreign and domestic entities and the least restrictive means test.[138] As a result, Member State restrictions on cross-border mergers will be very difficult to uphold when they exceed the Cross-Border Merger Directive mandates.

A third point, made succinctly by the Advocate General, is worth noting. Citing *de Lasteyrie du Saillant*, Advocate General Tizzano argued that freedom of establishment precludes a Member State from hindering the rights guaranteed to its nationals, meaning that restrictions on entering or leaving national territory are prohibited.[139] The ECJ appeared to adopt this conclusion, writing that a general refusal to register cross-border mergers constituted too broad a restraint on freedom of establishment.[140] The Court's reasoning gives equal protection to the entry and exit situations in the cross-border merger context. Although such a conclusion constitutes dicta because the Court was only considering an incoming merger, the logic of extending the Court's reasoning in *SEVIC Systems* to the case of a corporation seeking to be acquired is difficult

[T]he right of establishment covers all measures which permit or even merely facilitate access to another Member State and the pursuit of an economic activity in that State . . . .

Cross-border merger operations, like other company transformation operations, respond to the needs for cooperation and consolidation between companies established in different Member States. They constitute particular methods of exercise of the freedom of establishment, important for the proper functioning of the internal market, and are therefore amongst those economic activities in respect of which Member States are required to comply with the freedom of establishment . . . ."

[138] See supra notes 40–44 and accompanying text.

[139] *Opinion of Advocate General Tizzano*, supra note 127, ¶ 45.

[140] *SEVIC Sys.*, supra note 11, ¶ 30.

to refute. *SEVIC Systems*, therefore, has almost certainly provided the elusive exit freedom that real seat states have sought to prevent.[141] Combining the exit case guarantees of *de Lasteyrie du Saillant* and *SEVIC Systems* with the entry case protections of *Überseering* completes the freedom of primary establishment for corporations.

B. Taxation of Multi-National Companies: Marks & Spencer

On the same day that the ruling in *SEVIC Systems*, an important development in primary establishment, was handed down, the ECJ also decided a case concerning the exercise of the right of secondary establishment, *Marks & Spencer*.

Marks & Spencer, a United Kingdom company specializing in retail groceries, homeware, and financial services, operated subsidiaries in Germany, Belgium and France. These subsidiaries were ultimately unsuccessful, and recorded losses through the mid- to late 1990s.[142] By 2001, Marks & Spencer had divested itself of these subsidiaries, and the company sought group tax relief under United Kingdom tax law for the losses incurred by the subsidiaries.[143] Under existing United Kingdom law, however, group tax relief was only available for losses recorded by a subsidiary residing in the United Kingdom.[144] Marks & Spencer argued that this provision violated freedom of establishment.

Taxation, under European Community law, is a reserved competence, meaning that the power to tax does not fall within the purview of the Community institutions.[145] Thus, differences in the tax treatment of corporations resulting from legislative disparities between two Member States do not constitute prohibited discrimination.[146] Reserved competences are not unlimited, however, and

[141] The Court may also have done more. See infra note 182 and accompanying discussion.

[142] *Marks & Spencer*, supra note 10, ¶¶ 18–20.

[143] Id. ¶¶ 21–22.

[144] Income and Corporation Taxes Act, 1988, pt. I, §§ 8(1), 11(1); pt. VI, § 208; pt. X, §§ 402–03 (U.K.).

[145] Case C-279/93, Finanzamt Köln-Altstadt v. Schumacker, 1995 E.C.R. I-225 ¶ 21.

[146] See Opinion of Advocate General Maduro, Case C-446/03, Marks & Spencer plc v. David Halsey (Her Majesty's Inspector of Taxes), http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62003C0446:EN:HTML (Apr. 7, 2005) ¶ 23.

must be exercised consistently with European Community law.[147] The result is that the ECJ will scrutinize national tax laws for equal treatment of national and foreign entities, but these laws need not meet the other mandates of the imperative requirements doctrine.[148] In *Marks & Spencer*, the Court first found that freedom of establishment was implicated insofar as exclusion of tax advantages deterred a parent company from setting up subsidiaries in other Member States.[149] Second, the Court saw a clear violation of freedom of secondary establishment in the different treatment of national and foreign subsidiaries under United Kingdom tax law.[150] The United Kingdom then argued that this violation was justified given existing international tax law, which applies the principle of territoriality to prevent the Member State of the parent company from exercising tax jurisdiction over non-resident subsidiaries.[151] Taking into account the risk of tax avoidance, the Court held that the restrictions under United Kingdom law preventing the consolidation of foreign subsidiary losses furthered legitimate objectives compatible with the EC Treaty.[152] The threat of tax avoidance, therefore, constituted an overriding reason in the public interest which effectively attains its objectives.[153] The Court, however, held that such means were not the least restrictive available to attain the objective of preventing tax avoidance.[154] If a company were able to demonstrate to a Member State that the foreign subsidiary had exhausted the possibilities of using the losses in its home country against previous or future income, Articles 43 and 48 of the EC Treaty would preclude restrictions on the parent company's ability to offset its own income against these foreign subsidiary losses.[155] At the same time, the ECJ's judgment left open the possibility that

[147] Case C-279/93, Finanzamt Köln-Altstadt v. Schumacker, 1995 E.C.R. I-225 ¶ 21.
[148] Case C-311/97, Royal Bank of Scotland plc v. Elliniko Dimosio (Greek State), 1999 E.C.R. I-2651 ¶¶ 19–21.
[149] *Marks & Spencer*, supra note 10, ¶ 33.
[150] Id. ¶ 34.
[151] Id. ¶¶ 36–37.
[152] Id. ¶¶ 50–51.
[153] Id.
[154] Id. ¶¶ 53–55.
[155] Id. ¶¶ 55–56.

Member States could enact laws to prevent wholly artificial arrangements seeking to circumvent tax laws.[156]

Marks & Spencer marked an evolution in the jurisprudence of the ECJ. Prior to the decision, the primary authority on freedom of secondary establishment and international taxation was *Futura Participations*.[157] *Futura Participations* upheld a system that considered only profits and losses arising from activities within a nation for purposes of tax assessment.[158] "Such a system," the Court wrote, "which is in conformity with the fiscal principle of territoriality, cannot be regarded as entailing any discrimination, overt or covert, prohibited by the Treaty."[159] *Marks & Spencer*, while not overturning *Futura Participations*, does move toward a more strict examination of national tax law. At the least, *Marks & Spencer* means that territoriality is insufficient in itself to justify a restriction by a Member State's tax law on freedom of establishment.[160]

The *Marks & Spencer* decision also signals a broader conception of freedom of secondary establishment by the ECJ. *Centros* and *Inspire Art*, the cases from the first wave of freedom of establishment that set standards for freedom of secondary establishment, both concerned prohibitions or restrictions on the formation of a subsidiary.[161] The Court in *Marks & Spencer* delved a level deeper. Not content to invalidate initial restrictions, the ECJ extended its jurisprudence to cover restrictions on advantages which could deter an entity from setting up subsidiaries in other Member States.[162] In other words, not only are restrictions on freedom of establishment prohibited, but even laws discouraging its exercise are banned. The scope of this new standard is far broader than its predecessor. It effectively brings to secondary establishment what the *Dassonville* formula produced in the freedom of trade context, the proscription of "rules enacted by Member States which are capable of hinder-

[156] Id. ¶ 57.
[157] Case C-250/95, Futura Participations SA & Singer v. Admin. des Contributions, 1997 E.C.R. I-2471.
[158] Id. ¶¶ 21–22.
[159] Id. ¶ 22.
[160] *Marks & Spencer*, supra note 10, ¶¶ 38–40, 54–55.
[161] See supra notes 38–48, 63–75 and accompanying text.
[162] *Marks & Spencer*, supra note 10, ¶ 33.

ing, directly or indirectly, actually or potentially, intra-Community trade . . . ."[163]

C. The Current State of Corporate Freedom of Establishment

The rulings comprising the second wave, *de Lasteyrie du Saillant*, *SEVIC Systems*, and *Marks & Spencer*, have dramatically increased the protections of the freedom of establishment against restriction. Such restrictions are still possible, but the scrutiny that they must survive is daunting. In the wake of the second wave of liberalization, the Court's analysis of a corporate freedom of establishment case would proceed as follows.

Initially, the ECJ must determine the scope issue—whether the restriction implicates the freedom of establishment at all.[164] The scope of protection under Articles 43 and 48 "covers all measures which permit or even merely facilitate access to another Member State and the pursuit of an economic activity in that State . . . ."[165] This applies to the situation of countries seeking to restrict the entrance of companies into their country as well as hindrances placed by the Member State of origin on the establishment elsewhere of one of its companies.[166] A restriction that could implicate the freedom of establishment includes not only one that prevents its exercise, but also regulations, including tax laws, likely to discourage a national of a Member State from enjoying its rights.[167]

Once the freedom of establishment applies, the Court then examines the issue of whether the national law violates this fundamental freedom. Discrimination in favor of a Member State's own citizens against nationals of another Member State clearly violates this freedom.[168] The second wave of liberalization has broadened this discrimination standard. Now, any difference in treatment between domestic and international actions, like that between inter-

[163] Case 8/74, Procureur du Roi v. Dassonville, 1974 E.C.R. 837 ¶ 5. For a discussion of the different standards applying to the fundamental freedoms, see Saenger, supra note 28, at 300–02.

[164] See Saenger, supra note 28, at 299.

[165] *SEVIC Sys.*, supra note 11, ¶ 18.

[166] *Marks & Spencer*, supra note 10, ¶ 31; *de Lasteyrie du Saillant*, supra note 9, ¶ 42.

[167] *Marks & Spencer*, supra note 10, ¶¶ 31–34; *de Lasteyrie du Saillant*, supra note 9, ¶¶ 42–46.

[168] See Saenger, supra note 28, at 302.

nal and cross-border mergers in *SEVIC Systems*, will also fulfill this requirement.[169] This means that virtually every law constraining any aspect of the location of a corporation is suspect, even restrictions of limited scope or minor importance.[170]

National laws violating freedom of establishment can be justified on two grounds. The first is Article 46 of the EC Treaty, which allows violations of freedom of establishment on grounds of public policy, public security, or public health.[171] Second, a law could be justified because it protects overriding objectives relating to the general interest.[172] This category involves goals like protection of the interests of creditors, minority shareholders, and employees,[173] ensuring the fairness of commercial transactions,[174] and preventing wholly artificial arrangements meant to circumvent national tax regimes.[175] Considerations incapable of justifying a restriction include a general reduction in tax revenue[176] and the incorporation in one Member State to avoid the company law of another, even if the corporation only conducts business in the latter.[177]

If a justification for a restriction on a fundamental freedom exists, it must meet the four conditions of the imperative requirements doctrine to be valid.[178] The restriction must be (i) applied in a nondiscriminatory manner; (ii) justified by imperative requirements in the public interest; (iii) suitable for securing the attainment of the objective which they pursue; and (iv) must not go beyond what is necessary to obtain that objective.[179] The second-wave cases substantially enlarged the scope of this doctrine for freedom of establishment. *Marks & Spencer* demonstrated that if the ECJ can imagine, or a party can propose, a less restrictive means to ac-

[169] *SEVIC Sys.*, supra note 11, ¶¶ 20–23; *Marks & Spencer*, supra note 10, ¶¶ 32–33; *de Lasteyrie du Saillant*, supra note 9, ¶¶ 46–48.
[170] *de Lasteyrie du Saillant*, supra note 9, ¶ 43.
[171] EC Treaty, supra note 2, art. 46. But see Saenger, supra note 28, at 302 ("Art. 46 EC is very narrowly worded and is on the other hand also narrowly interpreted by the *ECJ*.").
[172] See, e.g., *Überseering*, supra note 5, ¶ 92.
[173] *SEVIC Sys.*, supra note 11, ¶ 28.
[174] Id.
[175] *Marks & Spencer*, supra note 10, ¶ 57.
[176] Id. ¶ 44.
[177] *Inspire Art*, supra note 6, ¶¶ 138–39.
[178] See, e.g., id. ¶ 133.
[179] See id.; see also notes 40–43 and accompanying text.

complish an objective, the Court will not only prohibit the more restrictive regulation but will also establish the less restrictive method as law.[180] *De Lasteyrie du Saillant* showed that to apply the nondiscrimination standard, the Court will not only look for differential treatment of nationals and foreigners, but also for differential treatment of nationals remaining within the country and nationals departing.[181] This nondiscrimination test necessarily means that any regulations affecting the act of crossing an intra-Community border are invalid.

These expansions of the imperative requirements doctrine were significant, but the greatest evolution of the imperative requirements doctrine emerged from *SEVIC Systems*. The ECJ wrote:

> To refuse generally, in a Member State, to register in the commercial register a merger between a company established in that State and one established in another Member State has the result of preventing the realisation of cross-border mergers even if the interests mentioned . . . are not threatened.[182]

At the least, this passage strengthens the least restrictive means test significantly. Taken to its logical conclusion, it adds another prong to the imperative requirements doctrine. The Court's reasoning means that national regulations must not only be the least restrictive method but also cannot prevent the exercise of freedom of establishment when articulated interests are not threatened. Like the other developments of the second wave, this policy symbolizes the Court's jealous defense of corporate freedom of establishment against national infringement.

CONCLUSIONS

If the decisions in the first wave of freedom of establishment made choice of governing law possible for corporations, then those of the second made it worthwhile. Through the willingness of the ECJ to look beyond direct restrictions on the freedom of establishment to the motivations for its exercise, particularly in the area

[180] *Marks & Spencer*, supra note 10, ¶¶ 54–56.
[181] *de Lasteyrie du Saillant*, supra note 9, ¶ 42.
[182] *SEVIC Sys.*, supra note 11, ¶ 30.

of taxation, corporate choice of jurisdiction will become a reality in Europe.

A. The Future of the Real Seat Doctrine

What, then, will become of the real seat doctrine? The Court's interpretation of Articles 43 and 48 of the EC Treaty threatens to make the place of central administration wholly irrelevant for corporate law purposes. Member States with market power may move toward a system of pseudo-foreign corporation statutes regulating the conduct of business in their territory, perhaps following the model of U.S. states such as New York and California.[183] Given that the EC Treaty provides guarantees where the internal affairs doctrine in the United States only prohibits restrictions, however, even pseudo-foreign corporation statutes may run afoul of the freedom of establishment.[184]

The defeat of the real seat doctrine in the corporate law context does not, however, entail its disappearance. Use of a company's real seat as a basis for taxation was upheld by the ECJ in *Daily Mail*,[185] and the Court has repeatedly taken pains to distinguish and reaffirm that holding.[186] In fact, the use of the real seat doctrine in this area may be gaining momentum. In the United States, a bastion of the state of incorporation doctrine, the influential Staff of the Joint Committee on Taxation recently introduced a proposal based on Dutch law to determine a company's residence by "the location of the company's primary place of management and control" for tax purposes.[187] What ground the real seat doctrine loses in the corporate context may be recovered as taxation authorities discover the benefits of its inflexibility for their purposes.

[183] See Dammann, supra note 1, at 519 & n.213.

[184] In fact, a Dutch pseudo-foreign corporation statute was invalidated by the Court in *Inspire Art*. See *Inspire Art*, supra note 6, ¶ 143.

[185] *Daily Mail*, supra note 32, ¶ 18.

[186] See, e.g., *Inspire Art*, supra note 6, ¶¶ 102–103.

[187] Staff of Joint Comm. on Tax'n, 109th Cong., 1st Sess., Options to Improve Tax Compliance and Reform Tax Expenditures 178–81 (Comm. Print. 2005).

B. Outcomes in a Market for Corporate Charters

While the process will take longer than many assume as a result of particularities of pension investment and large share ownership by financial institutions in Europe,[188] corporate choice of law is inevitable after the second wave of liberalization. Yet some scholars contend that regulatory competition among Member States still will not occur, as a result of the severe limitation on franchise taxes within the European Community.[189] Franchise taxes comprise fifteen to twenty percent of Delaware's budget, a considerable incentive for that state to provide a desirable corporate code.[190] This approach, however, neglects the other half of the equation. Corporations in Europe have gained the ability to choose their company law jurisdiction whether or not Member States compete for their charters.

Without delving too deeply into the climb-to-the-top/race-to-the-bottom debate, let us assume that two outcomes generally result from regulatory competition.[191] On the positive side, unnecessary and inefficient procedures and restrictions are eliminated, allowing parties to obtain their desired result with a lower cost.[192] This effect, however, is coupled with elimination of some rules and regulations that, while inefficient in a narrow economic sense, are necessary to protect rights that the community considers more important than the cost of compliance.[193] If this is the case, European

[188] Roberta Romano, The Genius of American Corporate Law 131–36 (1993).

[189] See, e.g., Karsten Engsig Sørensen & Mette Neville, Corporate Migration in the European Union, 6 Colum. J. Eur. L. 181, 207–08 (2000). Franchise taxes are governed by Council Directive 69/335/EEC, 1969 O.J. (L 249) 25. Cf. Birkmose, supra note 1, at 107–08 ("The existence of a large number of companies will have downstream effects for groups like lawyers and accountants in the state of incorporation. Therefore, the Member States will have some indirect income that can be an incentive for competition.").

[190] Tröger, supra note 36, at 44 n.174.

[191] See Holst, supra note 45, at 335–36 (discussing in depth the top/bottom outcomes of regulatory competition).

[192] See Daniel R. Fischel, The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law, 76 Nw. U. L. Rev. 913, 921 (1982) ("This competition in corporate charters ensures that, as in any other competitive market, only the efficient will survive.").

[193] See Joel Seligman, The Case for Federal Minimum Corporate Law Standards, 49 Md. L. Rev. 947, 971–74 (1990) (weighing the costs of federal regulation against the value of protection of rights for several corporate governance rules).

Community legislators may want to encourage regulatory competition by allowing jurisdictions to levy franchise taxes. A Member State with the revenue incentives to seek corporate charters would be far more likely than a nation without such incentives to undertake projects that produce the positive outcomes discussed above. For example, a nation could develop a specialized, efficient corporate court system modeled on the Court of Chancery in Delaware. Without revenue inducements to encourage positive developments, the situation could devolve into one where corporations simply select the most lax of the current regimes rather than gravitating to an increasingly efficient one. The probable result of this scenario is the realization of the race to the bottom—all the drawbacks of regulatory competition without any of the benefits.

These conclusions are merely suggestive, but hopefully they illuminate possible directions for further scholarship in this area. After *de Lasteyrie du Saillant*, *Marks & Spencer*, and *SEVIC Systems*, company law in the Community is a wide-open field ready for the growth of original ideas and the development of novel doctrines. Due to the Court's persistence, a new perspective on corporate choice is fast becoming a reality in Europe.