

# CORPORATE MOBILITY IN EUROPE THROUGH PRIMARY OUTBOUND ESTABLISHMENT: CHALLENGING THE *DAILY MAIL* RULE

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## 1. Introduction

Freedom of establishment<sup>2</sup> of companies<sup>3</sup> within the European Union was and continues to be a matter which creates confusion among scholars and practitioners, despite the remarkable efforts on the part of the Court of Justice of the European Union (hereinafter referred to as “CJEU” or “the Court”) in bringing life to Articles 49 and 54 of the Treaty on the Functioning of the European Union (hereinafter referred to as “TFEU”).<sup>4</sup> Indeed, the *Centros*, *Überseering*, *Inspire Art* and *SEVIC Systems* cases have interpreted freedom of establishment in an extensive manner, demolishing restrictions set up by Member States to curtail it. However, such an admirable development in this area of Union law has been curbed by the Court itself.

This author argues that the Court’s jurisprudence has at times adopted a discriminatory attitude towards companies. In the abovementioned cases, the plaintiff companies’ right to secondary establishment through subsidiaries was restricted, which restrictions the Court very happily dismantled. In other cases, which will be the focus of this paper, it was a company’s right to primary establishment which was subjected to State-imposed obstacles. Unfortunately however, the CJEU remained passive towards the

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<sup>2</sup> Freedom to establish in another Member State is one of the four freedoms on which the internal market rests and includes the freemovement of persons, specifically legal persons.

<sup>3</sup>Art 54 TFEU defines them as ‘companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making [and which are] **formed** in accordance with the law of a Member State and having their registered office, central administration or principal place of business **within the Union**.’ For a detailed explanation, see V Edwards, *EC Company Law* (OUP, 1999)338-341.

<sup>4</sup>C-212/97 *CentrosKtd v Erhvervs-ogSelskabsstyrelsen* [1999] ECR I-01459; C-208/00 *Überseering BV v Nordic Construction Baumanagement GmbH* [2002] ECR I-09919; C-167/01 *Kamer van Koophandel en Fabrikenvoor Amsterdam v Inspire Art* [2003] ECR I-10155;C-411/03 *SEVIC Systems AG* [2005] ECR I-10805.

latter. Its decision is that such restrictions are perfectly valid under Union law and beyond the orbit of the Treaty provisions. This is essentially the motivating rationale in the *Daily Mail* case. In this particular case, the Court developed a rule which holds that since ‘companies are creatures of national law ... [T]hey exist only by virtue of the varying national legislation which determines their incorporation and functioning,’<sup>5</sup> and therefore, Member States are given leave to restrict the primary outward transfer of a company’s seat.

Authors have questioned the insistence of the Court to stand by its dictum. Cains suggests that the Court is in fact bowing down to political pressure by Member States<sup>6</sup> in order to contain regulatory competition.<sup>7</sup> However, in reality, Europe is already engaging in such competition. In recent years, practitioners specialising in company law have seen extensive reforms in substantive company laws in Italy, France, Spain, Hungary and even Germany extensively reforming to attract foreign direct investment and endow domestic actors with the required regulatory flexibility.

Despite these concerns, the present author suggests that the Court must set aside its stubborn insistence to hold on to its *dictum* in *Daily Mail*, a stand which, as will be argued, is not coherent with internal market principles. This rule is, in the eyes of the author, the root of the problem. This short paper thus aims to challenge this rule in the interest of unobstructed corporate mobility within Europe. This shall be illustrated firstly, by discussing the internal market rationale in the context of corporate mobility; secondly, by outlining the various distinctions existing in this area of law which have been upheld by the Court; lastly, the author shall critically analyse the inroads to corporate mobility, specifically primary outbound establishment, as dealt with by the Court and argue against the application of the *Daily Mail* rule to corporate mobility in Europe by crushing its *raison d’être*.

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<sup>5</sup> C-81/87 *The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc* [1988] ECR 05483, para 19.

<sup>6</sup> W. Cains ‘Case Note on *Cartesio* Decision by the European Court of Justice, Case C-210/06, *Cartesio Oktató és Szolgáltató*’ (2010) ERPL 3 569, p 571.

<sup>7</sup> Regulatory Competition is a term used by various scholars and jurists to denote competition among legislators to provide better regulatory frameworks in order to attract companies to their jurisdiction. On this point see E-M. Kieninger ‘The Legal Framework of Regulatory Competition Bases on Company Mobility: EU and US Compared’ (2004) 6 German Law Journal 4. P 741 <<http://www.germanlawjournal.com/article.php?id=591>> accessed 31 December 2010.

## 2. Preliminary Notions

### *Corporate Mobility within the Internal Market*

First of all, one must distinguish legal corporate mobility from physical corporate mobility. In view of the fact that a company can access Member States using a number of legal tools, namely by employing sales representatives, setting up branches and subsidiaries in other Member States,<sup>8</sup> participating in cross-border mergers<sup>9</sup><sup>10</sup> and forming European Companies<sup>11</sup> or European Economic Interest Groupings,<sup>12</sup> some are of the opinion that companies are, to a certain extent and in actual fact moving around and conducting business in other Member States and that therefore, physical corporate mobility is unhindered.

Yet, there are other issues such as disparity in culture, custom and language as well as the diverse legal traditions and taxation regimes among Member States, which cause friction in a European company law scenario.<sup>13</sup> Hence, it is submitted that the EU should always aim to improve existing avenues for freedom of establishment or devise new ones to maintain an accessible internal market. Particularly, restrictions against the outward transfer of a company's seat must be addressed.

It is worthwhile to point out at this stage that freedom of establishment should always be seen as a specific tool in achieving

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<sup>8</sup> Secondary establishment as guaranteed by art 49 and 54 TFEU and CJEU jurisprudence; C-127/97 Centros, op.cit., C-208/00 Uberseering, op.cit., C-167/01 Inspire Art, op.cit.

<sup>9</sup>C-411/03 *SEVIC Systems AG* (n 4).

<sup>10</sup>Council Directive 2005/19/EC of 17 February 2005 amending Directive 90/434/EEC 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States OJ L58/19.

<sup>11</sup>Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE).

<sup>12</sup>Council Regulation (EEC) No 2137/85 of 25 July 1985 on the European Economic Interest Grouping (EEIG).

<sup>13</sup> As pointed out by W.W.Bratton, J.A.McCahery, E.P.M.Vermeulen(eds) 'How does Corporate Mobility affect Lawmaking?: A Comparative Analysis' (2007) Amsterdam Center for Law & Economics Working Paper No. 2008-01, p 4 <<http://ssrn.com/abstract=1086667>> accessed 31 December 2010. These factors present obstacles to corporate mobility not only on a European, but also on a global scale.

corporate mobility and not as synonymous with the generic term ‘corporate mobility’.

Freedom of establishment within the Union must be studied within the context of the internal market. The creation of an internal market without frontiers between Member States has been instrumental in giving life to economic integration in Europe. In the words of Craig & De Burca, the internal market’s ‘[b]asic economic aim is the optimal allocation of resources for the [Union] as a whole which is facilitated by allowing the factors of production (i.e. goods, persons, capital and services), the elements that are used to make a product, to move to the area where they are most valued.’<sup>14</sup> The right to establishment of legal persons must be accessible as much as possible for the efficient allocation of resources. Unrestricted but nonetheless regulated, the freedom to establish in another Member State is necessary to achieve an ever economically integrated Europe and a true internal market.

The restrictions to primary outbound establishment should not be discussed only against an EU Law compatibility test, but it should also be questioned whether they are in harmony with the internal market rationale.

*Treaty provisions: Articles 49 and 54 TFEU*

The TFEU provides for freedom of establishment in Articles 49 and 54. The ongoing debate on company movement in Europe is inconclusive. According to Edwards,<sup>15</sup> 49 and 54 TFEU have three limbs, being – (i) the prohibition of restrictions on freedom of establishment of companies<sup>16</sup> in the territory of another Member State; (ii) the prohibition (in a similar fashion to the prohibition of restrictions on the freedom of establishment of companies) of restrictions on the setting up of agencies, branches or subsidiaries by companies in the territory of any Member State and the principle that (iii) freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies under the conditions laid down for its own nationals by the law of the country where such establishment is affected. It is precisely the first limb which is of particular relevance to this paper, because it recognises the question of primary establishment within the Treaty provisions.

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<sup>14</sup>P. Craig & G. De Burca, *EU Law: Text, Cases & Materials* (OUP, 2008), 605.

<sup>15</sup>V. Edwards (n 3) 337.

<sup>16</sup> As defined in 54 TFEU.

Since the TFEU fails to provide a definition for ‘establishment’, one must turn to the CJEU’s jurisprudence for one. AG Darmon<sup>17</sup> has defined establishment as meaning ‘integration into a national economy’,<sup>18</sup> While in *SEVIC Systems AG*,<sup>19</sup> the CJEU made AG Tizzano’s definition its own and held that,

right of establishment covers all measures which permit or even merely facilitate access to another Member State and<sup>20</sup>the pursuit of an economic activity in that Member State by allowing the persons concerned to participate in the economic life of the country effectively and under the same conditions as national operators.<sup>21</sup>

This definition deserves a thorough comment. Admirably, the CJEU has broadened the reach of the treaty articles not only to ‘all measures which permit access to another Member State,’ but also to measures which ‘even merely facilitate it.’ In fact, in this case, the restriction imposed by German law, in that only mergers between German companies or firms could be recorded in the company register of mergers, was found to be in violation of Articles 49 and 54 TFEU. Secondly, this definition reiterates the objective purpose of freedom of establishment as held by the CJEU in earlier judgments, as being the ‘actual pursuit of an economic activity through a fixed establishment in that Member State for an indefinite period.’<sup>22</sup> Thirdly, it reflects the general Union principle of non-discrimination. This has been most evident where the Court abolished restrictions

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<sup>17</sup>Case C-81/87 *The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc* [1988] ECR 05483, Opinion of Mr Advocate General Darmon.

<sup>18</sup>Ibid para 3.

<sup>19</sup>*Sevic Systems AG* (n 4).

<sup>20</sup> The original wording of the Advocate General’s opinion held and/or [emphasis is the author’s]. However, the CJEU removed the alternative character of the statement and opted for the cumulative, thus requiring both elements of the definition.

<sup>21</sup>*Sevic Systems AG*, (n 4); Decision of the CJEU, para18; Opinion of the Advocate General, para30. To support his view, AG Tizzano refers to a string of CJEU jurisprudence which, in his view, has interpreted the Treaty articles in a broad manner, namely *Commission v Italy*, *Commission v Greece*, *Konle*, *Baars* and *Überseering*. Yet, J.Bomhoff in ‘Grand Chamber: Sevic Systems (C-411/03)’, (Comparative Law Blog, 15 December 2005) <<http://comparativelawblog.blogspot.com/2005/12/ecj-grand-chamber-sevic-systems-c.html>> accessed 31 December 2010, criticises the Advocate General’s sources and claims that ‘in none of these[referring to the cases] did I find a similar categorical and broad statement.’

<sup>22</sup>C-221/89 *The Queen v Secretary of State for Transport, ex parte Factortame Ltd and others* [1991] ECR I-03905, para 20; C-246/89 *Commission v United Kingdom* [1991] ECR I-04585, para 21; C-196/04 *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I-7995, paras 54 and 66.

against the inbound establishment, whether of a company's seat or a subsidiary, of a company in a Member State. As in *Inspire Art*, Dutch law imposed on pseudo-foreign companies<sup>23</sup> compliance with legal requirements over and above those required from domestic actors. This was held to be both contrary to Union law and also discriminatory.

In the light of the Court's interpretation of 'establishment', it is submitted that present restrictions imposed against the outward transfer of a company's primary seat is against Union law. As will be explained further below, primary outbound establishment, contrary to what has been held in *Daily Mail*<sup>24</sup> and *Cartesio*,<sup>25</sup> falls within the ambit of the Treaty, and is not solely a matter of national law. Therefore, the Court is justified in exploring this issue, and should not be excluded from doing so.

### **3. Fine and Subtle: Distinctions made in the realm of European Company Law**

The various distinctions made in the field of European company law must also be kept in mind in exploring this topic.

#### *International company law v National company law*

Corporate mobility is a matter of both substantive company law and private international law, yet the present analysis focuses on primary establishment as from a substantive company law perspective.<sup>26</sup> This distinction is fundamental in understanding the impact of the incorporation theory against the real seat theory<sup>27</sup> on freedom of establishment. These theories have influenced both spheres of the law. From a private international law perspective, the place of incorporation and the location of the administrative seat, respectively, determine the connecting factor to a Member State, or

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<sup>23</sup> Briefly, a pseudo-foreign company is a company with its registered office in a Member State, through which it conducts minimal or no business at all. Usually, pseudo-foreign companies incorporate within a particular jurisdiction owing to its flexible company law and tax regimes.

<sup>24</sup> *Daily Mail and General Trust plc* (n 5).

<sup>25</sup> C-210/06 *Cartesio Oktató és Szolgáltató* [2008] ECR I-00000.

<sup>26</sup> W. H. Roth 'From Centros to Ueberseering: Free Movement of Companies, Private International Law, and Community Law' ICLQ vol 52, January 2003, 184.

<sup>27</sup> Also known as *sitztheorie* in German.

the choice of *lex societatis*. Once the connecting factor is determined, that State's substantive company law comes into play to regulate the internal affairs of the company. In turn, as shall be seen below, the manner in which substantive company law deals with companies is influenced by these theories.

*Incorporation theory v Real Seat theory*

The incorporation theory determines the connecting factor according to the place of the company's incorporation that is the company's registered office.<sup>28</sup> It may be argued that this is quite a subjective approach, owing to the fact that party autonomy (the original subscribers are free to choose where to register their company) is the rule. England, Ireland, Italy, the Netherlands, Denmark, Switzerland,<sup>29</sup> and Malta follow the incorporation theory.<sup>30</sup> The real seat theory, on the other hand, determines the connecting factor objectively, that is on the company's administrative seat,<sup>31</sup> which is defined as 'the place where the basic decisions of the board are effectively transformed into daily managerial and administrative decisions.'<sup>32</sup> Contrary to the incorporation theory, the real seat theory excludes party autonomy. Austria, France, Belgium, Spain, Portugal, Greece and Luxembourg<sup>33</sup> follow the real seat theory. Korom and Metzinger succinctly point out that the incorporation theory remains a 'formalistic seat concept,' being concerned with the place of the registered office, while the real seat theory is a 'substantive seat concept,' focusing on the place of the actual main business activity.<sup>34</sup>

<sup>28</sup>Edwards (n 3) at 336 explains that the French term *siege statutaire* is at times erroneously translated as registered office.

<sup>29</sup> F.M.Mucciarelli 'Company 'Emigration' and EC Freedom of Establishment: *Daily Mail* Revisited' (2008) 9 EBOR 267, 284.

<sup>30</sup> Germany seems to have followed suit from a substantive company law perspective with the recent MoMiG reform, pushed in late 2008 and entitled 'Law for the Modernization of the GmbH and to Stop its Misuse.' See J. Fingerhuth & J. Rumpf 'MoMiG und die grenzüberschreitende Sitzverlegung – Die Sitztheorie ein (lebendes) Fossil?' (2008) 28 IPRax: praxis des Internationalen Privat- und Verfahrensrechts 2 90.

<sup>31</sup> Alternatively referred to as 'central management and control' or 'real seat' in English, or '*siège social*' or '*siège réel*' in French.

<sup>32</sup>C.Kersting 'Corporate Choice of Law – A Comparison of the United States and European systems and a proposal for a European Directive' (2002) 28 BROOKLYN J. INT. L. 1, 37. W-H.Roth, (n 26), at 181 cites BGH 21 March 1986, BGHZ 97, 269, at 272 for this definition of seat as per German Federal Court.

<sup>33</sup>V. Korom and P.Metzinger 'Freedom of Establishment for Companies: the European Court of Justice confirms and refines its *Daily Mail* decision in the *Cartesio* Case C-210/06' (2009) 1 ECFR 125, 140.

<sup>34</sup>Korom and Metzinger (n 33) 138.

Again, one must not see these theories strictly against a private international law background. The relevance to the present analysis relates to the interplay of these theories in the domestic context. It is beyond the remit of this paper to conduct a comparative analysis of how will Member States' national company laws react to a case of primary establishment, that is the transfer of a company's primary seat;<sup>35</sup> hence, a fictional example will be deployed.

Company X is lawfully incorporated in a Member State which follows the incorporation theory. The Member State's substantive company law requires the company to have a registered office within its jurisdiction to maintain legal status. Company X decides to transfer its administrative seat to a Member State which follows the real seat theory. Irrespective of which theory is followed for issues of private international law, one must investigate how the respective national company laws relate to such a transfer. Will the law of the State of departure allow such a transfer of the administrative seat while the company continues to be regulated by the national company law of that State? Additionally, will the law of the State of destination recognise such a company? There may be instances, in fact, where the law of the State of destination requires the concurrence of both the registered office and the real seat of the company within its jurisdiction for recognition. Undoubtedly, it is an intricate exercise to establish these issues,<sup>36</sup> and the CJEU has had to face these problems in practice.

#### *Primary Establishment v Secondary Establishment*

European company law distinguishes primary from secondary establishment. While the former relates to the transfer of a company's primary seat, being either its registered office, its administrative seat or both, from one Member State to another, the latter excludes any transfer of the primary seat. Instead, it refers to the setting up of agencies, branches or subsidiaries in the territory of any Member State. Strictly speaking, the Treaty provisions<sup>37</sup> cover both primary and secondary establishment, as has been pointed out above. Whereas the first part of Article 49-1 is drafted in a broad manner and could well cover both, the second part, on the other hand, specifically prohibits the placing of restrictions on secondary establishment. The CJEU has not been afraid to strike down national

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<sup>35</sup>That is either its registered office or its administrative seat.

<sup>36</sup> See F.M.Mucciarrelli, (n 29), 282-292 for an extensive analysis.

<sup>37</sup>Referring to Articles 49 and 54 TFEU.

legislation restraining secondary establishment;<sup>38</sup> four landmark judgements were particularly instrumental to this effect. It is beyond the purpose of this paper to enter into the intricate details regarding *Centros*,<sup>39</sup> *Überseering*,<sup>40</sup> *Inspire Art*<sup>41</sup> and *SEVIC Systems AG*;<sup>42</sup> what must be kept in mind is that the CJEU has challenged the real seat theory,<sup>43</sup> or as an author cleverly put it, has buried the real seat theory alive,<sup>44</sup> while opening its doors for regulatory competition in view of what some authors have coined, a ‘race to the bottom’ or ‘the Delaware effect’.

### *Outbound Establishment v Inbound Establishment*

Briefly, inbound establishment refers to the entry of companies into a Member State, while outbound establishment refers to the exiting of companies from a Member State. The CJEU’s approach to these forms of establishment was and continues to be ambiguous. In the *Centros* and *Inspire Art* cases, the CJEU rejected restrictions against the inbound establishment of subsidiaries formed in the United Kingdom, and the same seems to apply to secondary outbound establishment.

However, in the *Cartesio* decision, as shall be seen below, the inbound establishment of a company’s primary seat (a company which has undergone the process of cross-border conversion or

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<sup>38</sup>C-270/83 *Commission v France* [1986] ECR 00273; C-221/89 *The Queen v The Secretary of State for Transport, ex p Factortame* [1991] ECR I-03905; C-146/89 *Commission v United Kingdom* [1991] ECR I-03533; C-330/91 *The Queen v Inland Revenue Commissioners, ex p Commerzbank AG* [1993] ECR I-04017; C-1/93 *Halliburton Services v Staatssecretaris van Financien* [1994] ECR I-01137; C-101/94 *Commission v Italy* [1996] ECR I-02691; C-250/95 *Futura Participations SA and Singer v Administration des Contributions* [1997] ECR I-02471; C-264/96 *ICI v Colmer* [1998] ECR I-04695; C-446/03 *Marks & Spencer plc v David Halsey (Her Majesty’s Inspector of Taxes)* [2005] ECR I-10837; C-196/04 *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I-7995.

<sup>39</sup>*Centros*, (n 4).

<sup>40</sup>*Überseering*, (n 4).

<sup>41</sup>*Inspire Art*, (n 4).

<sup>42</sup>*SEVIC Systems AG*, (n 4).

<sup>43</sup> On this point refer to K.Baelz&T.Baldwin ‘The End of the Real Seat Theory (Sitztheorie): the European Court of Justice Decision in Ueberseering of 5 November 2002 and its Impact on Germany and European Company Law’ (2002) German Law Journal <<http://www.germanlawjournal.com/print.php?id=214>> accessed 31 December 2010.

<sup>44</sup> J-J Kuipers ‘Cartesio and Grunkin-Paul: Mutual Recognition as a Vested Rights Theory Based on Party Autonomy in Private Law’ (2009) 2 EJLS 2 66, 71.

international transformation) may be refused by the Member State of destination. This contrasts with the *Überseering* decision, where the Court accepted that no restrictions could be imposed on the inbound establishment of a company's primary seat (notably, the applicant in this case did not undergo any conversion or transformation). On the same note of primary establishment, the Court has upheld restrictions on the primary outbound establishment of a company (which wished to retain its legal personality under the Member State of departure) as in *Daily Mail* and *Cartesio*. Although the Court's approach may appear perplexing at first, upon closer inspection, these seemingly arbitrary distinctions are not so at all. These different rules for inbound and outbound transfers are rooted in the *Daily Mail* rule, as shall be illustrated. However, to what extent this reasoning is correct is yet to be seen.

On a concluding note and for clarity's sake, it must be pointed out that the author feels that there is nothing wrong *per se* with the existence of the distinctions made above; rather, it is the discrimination made on the basis of such distinctions which will be questioned below.

#### **4. Inroads to Primary Establishment**

This author deliberately dealt with the distinctions separately so as to clarify the main distinctions in this field of Union law. With the above distinctions clear in mind, the decisive role these played in the CJEU's deliberations against primary establishment, and whether their use was correct or otherwise, will now be analysed. Interestingly, three direct roads to primary establishment have been put forth by the CJEU.<sup>45</sup>

##### *(a) The Daily Mail/Cartesio route*

As the name suggests, this is the route opted by *Daily Mail & General Trust plc* and *Cartesio Oktató és Szolgáltató*, in their respective cases. It refers to a scenario wherein a company lawfully incorporated in the Member State of departure wishes to transfer its seat to another Member State while continuing to be regulated by the law of the first Member State. Unfortunately, the CJEU has held, both in *Daily Mail*<sup>46</sup> and *Cartesio*, that the Treaty provisions do not cover this route on the basis of the *Daily Mail* rule.

*Daily Mail & General Trust plc*, an investment holding company, with a registered office in the United Kingdom and a branch in the

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<sup>45</sup> This author has decided to omit cross-border merger for the purposes of the present paper.

<sup>46</sup> *Daily Mail and General Trust plc* (n 5).

Netherlands, wished to shift its central management and control, or its administrative seat, there, while still being regulated by UK law. UK company law does not require the administrative seat to be situated within the United Kingdom for a company to maintain its existence; therefore it was possible to transfer the seat ‘without losing legal personality or ceasing to be a company incorporated in the United Kingdom.’<sup>47</sup>In truth, Daily Mail & General Trust plc, by transferring its central management and control to the Netherlands, wished to shift its tax residence there. Hence, after the Treasury’s objection, the issue before the CJEU was whether a particular provision in the Income and Corporation Taxes Act of 1970 violated the Treaty provisions on freedom of establishment by requiring the permission of the Treasury for the shift in residence.

AG Darmon in his opinion concluded that under Union law ‘a Member State may not require a company wishing to establish itself in another Member State, by transferring its central management there, to obtain prior authorization for such transfer.’ However, he held that a Member State may require a company to settle its tax dues.<sup>48</sup> Despite the AG’s conclusion, the CJEU disagreed, holding instead that a company lawfully incorporated in the Member State of origin, with its registered office there, may not transfer its administrative seat or central management and control to another Member State, while retaining its status as a company incorporated under the law of the Member State of origin. The motivating rationale was based on the rule that,

unlike natural persons, companies are creatures of the law and, in the present state of Community law, creatures of national law. They exist only by virtue of the varying national legislation which determines their incorporation and functioning.<sup>49</sup>

This view was subsequently confirmed in *Überseering*<sup>50</sup> and *Cartesio*.<sup>51</sup> In view of this conclusion and of the fact that conventions<sup>52</sup> or harmonisation efforts are absent on this point, the

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<sup>47</sup>Ibid para 3.

<sup>48</sup>Ibid Opinion of Advocate General Darmon para 15.

<sup>49</sup>*Daily Mail and General Trust plc* (n 5) para 19.

<sup>50</sup>*Überseering* (n 4) para 81.

<sup>51</sup>*Cartesio* (n 25) para 104.

<sup>52</sup> Although the CJEU in *Überseering* reiterated the need for future legislation, in para 60 it departed from *Daily Mail* in holding that ‘no argument that might justify limiting the full effect of those articles can be

Court argued that issues relating to the required connecting factor and to the question whether, and if so, how the registered office or real seat of a company may be transferred from one State to another, are not resolved by the Treaty provisions.<sup>53</sup> As shall be illustrated, *Überseering*<sup>54</sup> and *Cartesio*<sup>55</sup> have followed suit. Therefore, the Court held that this remains a matter regulated by national law.

*Cartesio*, a company incorporated and having its registered office and administrative seat in Hungary, decided to transfer its administrative seat to Italy, while remaining regulated by Hungarian law. *Cartesio*'s application before the Court to amend the commercial register was rejected on the ground that it was not possible under Hungarian law to shift the administrative seat and remain regulated by Hungarian law. The CJEU reiterated the *Daily Mail* rule<sup>56</sup> and concluded that,

[t]hus a Member State has the power to define both the connecting factor required of a company if it is to be regarded as incorporated under the law of that Member State and, as such, capable of enjoying the right of establishment, and that required if the company is to be able subsequently to maintain that status. That power includes the possibility for that Member State not to permit a company governed by its law to retain that status if the company intends to reorganise itself in another Member State by moving its seat to the territory of the latter, thereby breaking the connecting factor required under the national law of the Member State of incorporation.<sup>57</sup>

Hence, the Court found that the Treaty provisions do not prohibit Member States from restricting the transfer of the administrative seat of a company, incorporated under their law, while retaining its status as a company governed by that law.

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derived from the fact that no convention on the mutual recognition of companies has as yet been adopted on the basis of Article 293 EC.' This case has been strengthened further after this provision was abrogated by the Treaty of Lisbon.

<sup>53</sup>*Daily Mail and General Trust plc* (n 5) para 23.

<sup>54</sup>*Überseering* (n 4) paras 69-70.

<sup>55</sup>*Cartesio* (n 4) para 108.

<sup>56</sup>*Ibid* paras 106-110.

<sup>57</sup>*Ibid* para 110.

As regards the above-quoted paragraph 110, Szydło<sup>58</sup> and Korom and Metzinger<sup>59</sup> interpreted ‘status’ as referring to the capacity of enjoying the right of establishment. These authors feared that the power of Member States had been extended to cover the question of whether or not a company or firm is entitled to enjoy this right. It is submitted that such an interpretation is purely speculative. Indeed, the CJEU expressed itself in an unsurprisingly vague manner, but it has not extended the *Daily Mail* rule. If such an interpretation is correct, then the CJEU deliberately expressed itself in a manner contrary to Article 54-1 TFEU. Even if this were to be the case, the CJEU’s view would not be sustainable. In fact, this provision is clear in that it necessitates only two requirements for a company or firm to qualify for protection by the Treaty provisions: (i) it must be formed in accordance with the law of a Member State, and (ii) it must have its registered office, central administration or principal place of business within the Union. The TFEU does not require that a company continues to exist in accordance with the law of a Member State, but merely requires that it is formed as such. It is therefore submitted that the CJEU, by the use of the term ‘status’, simply referred to a company governed and regulated by the law of the Member State of incorporation.<sup>60</sup>

That being said, it is submitted that the *Daily Mail* rule curbs the exercise of freedom of establishment under TFEU. This author has two submissions to make for the demise of this rule.

Firstly, the assumption made in *Daily Mail*, that the right to primary outbound establishment is outside the scope of the Treaty provisions, is irreconcilable with the body of CJEU jurisprudence since *Centros* and erroneous. In fact, AG Maduro disagreed with this rationale in his opinion in *Cartesio*. The Advocate General held that ‘the Court consistently rejected the argument that rules of national company law should fall outside the scope of the Treaty provisions on the right of establishment.’<sup>61</sup> It may therefore be concluded that the

<sup>58</sup>See M.Szydło ‘Annotation of Case C-210/06, *CARTESIO Oktatóés Szolgáltató*’ (2009) 46 CML Rev 703, 714-716 and M.Szydło ‘The Right of Companies to Cross-Border Conversion under the TFEU Rules on Freedom of Establishment’ (2010) 3 ECFR 414, 429-431.

<sup>59</sup>*Korom and Metzinger* (n 33) 151.

<sup>60</sup>See, W.Cains ‘Case Note on *Cartesio* Decision by the European Court of Justice, Case C-210/06, *Cartesio Oktatóés Szolgáltató*’ (2010) ERPL 3 569, 571 and P.Novotná ‘Connecting Criteria After *Cartesio*’ in eds. R.Dávid, J.Neckář, D.Sehnálek *COFOLA 2009: the Conference Proceedings* (1<sup>st</sup> edn, MUNI Press 2009) 677, at 692 held that a ‘[l]iteral reading of article 48 suggests that only valid incorporation is required, not the further existence of a company. Coming into existence is therefore a question of national law only, while the national rules governing the exercise of the existence should be subject to ECJ scrutiny.’

<sup>61</sup>*Cartesio* (n 25) Opinion of Advocate General Maduro, para 27.

*Daily Mail* rule simply does not correspond with the development in the CJEU's jurisprudence and has a negative impact on freedom of establishment.

The consequence of this rationale as adopted in *Daily Mail* and subsequently, in *Überseering* and *Cartesio*, is that since companies are creatures of national law, the Member State of incorporation has gained a privileged status over the incorporation, functioning and existence of companies. It is quite absurd that the Member State of incorporation enjoys this privilege over the functioning and existence of a company, irrespective of the consequences this privileged status may have over freedom of establishment. This author submits that consequently, the need arises for the *Daily Mail* rule to be corrected for the sake of freedom of establishment. Although Member States are free to establish legal rules in respect of the incorporation of companies, once a company has been duly incorporated, it is 'free to exercise freedom of establishment throughout the European Union just as individuals do.'<sup>62</sup> However, in its present state, the rule is diametrically opposed to the purpose and underlying logic of the CJEU's jurisprudence with respect to free movement of legal persons,<sup>63</sup> as developed in *Centros*, *Inspire Art* and *SEVIC Systems AG*.

Secondly, the *Daily Mail* rule and the consequent discrimination to the detriment of the exercise of freedom of establishment on the basis of certain distinctions run contrary to freedom of establishment under Articles 49 and 54 TFEU. It is suggested that the CJEU knowingly relied on primary against secondary establishment and outbound against inbound establishment distinctions to sustain the assumption that a company seeking to exercise outbound primary establishment is not protected by the present TFEU provisions,<sup>64</sup> hence going against the purpose of and rules for the free movement of persons.

The (ab)use of such distinctions was strongly criticised by AG Maduro in his opinion in *Cartesio*,<sup>65</sup> as 'never [being] entirely convincing.'<sup>66</sup> The Advocate General argued that the cross-border transfer of the

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<sup>62</sup>Ibid.

<sup>63</sup>M.Szydło 'The Right of Companies to Cross-Border Conversion under the TFEU Rules on Freedom of Establishment' (2010) 3 ECFR 414, 430.

<sup>64</sup> The Court hoped they will be by future conventions and legislation yet to be promulgated.

<sup>65</sup>*Cartesio* (n 25) Opinion of Advocate General Maduro.

<sup>66</sup>Ibid para 28.

administrative seat does fall within the objective scope of Articles 49 and 54 TFEU;<sup>67</sup> in that there is the ‘actual pursuit of an economic activity through a fixed establishment in another Member State for an indefinite period.’<sup>68</sup> Thus, burdensome rules on such transfers amount to discrimination against the cross-border movement of companies within the Union and amount to a clear violation of the Treaty provisions.<sup>69</sup> Similarly, Mucciarelli points out that the words ‘should be treated the same way as a natural person’<sup>70</sup> must be interpreted as ‘implicitly interfer[ing] with national substantive rules, and hence ... [prohibiting] restriction[s] on outbound primary establishment.’<sup>71</sup> The fact is that apart from a strictly literal interpretation of the TFEU provisions,<sup>72</sup> there is no sensible rationale for discriminating against primary outbound establishment from secondary or primary inbound establishment—hence, this author posits there is no sensible rationale to uphold the *Daily Mail* rule.

(b) *Cross-Border Conversion*<sup>73</sup>

Despite closing its doors to the *Daily Mail/Cartesio* route, the CJEU in *Cartesio* has provided a new route for the exercise of primary establishment, that is, cross-border conversion.<sup>74</sup> *Obiter dictum*, the Court distinguished cross-border transfer of the seat while maintaining the legal status of incorporation from cross-border transfer of the seat with an attendant change in the applicable national law.<sup>75</sup> The latter refers to cross-border conversion and

<sup>67</sup>Ibid para 25. M. Szydło ‘The Right of Companies to Cross-Border Conversion under the TFEU Rules on Freedom of Establishment’ (2010) 3 ECFR 414, at 430 produces an argument reminiscent of AG Maduro’s opinion; ‘[t]hus, when a company [...] undertakes an activity included in the objective scope of protection of the freedom of establishment [such as the *Daily Mail/Cartesio* Route], then it should be free from all and any obstacles created in that respect by the Member State of its primary incorporation.’

<sup>68</sup>C-221/89 *The Queen v Secretary of State for Transport, ex parte Factortame Ltd and others* [1991] ECR I-03905, para 20; C-246/89 *Commission v United Kingdom* [1991] ECR I-04585, para 21; C-196/04 *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I-7995, paras 54 and 66.

<sup>69</sup>*Szydło* (n 58).

<sup>70</sup>Art. 54-1 TFEU.

<sup>71</sup>*Mucciarelli* (n 29) 298.

<sup>72</sup>*Roth* (n 26) 188-190.

<sup>73</sup> International Transformation is preferred by *Koromand Metzinger* (n 33).

<sup>74</sup>See M. Szydło ‘The Right of Companies to Cross-Border Conversion under the TFEU Rules on Freedom of Establishment’ (2010) 3 ECFR 414.

<sup>75</sup>*Cartesio* (n 25) para 111.

involves not only reincorporation in the Member State of destination, but also a change in the governing law without winding up or liquidation. The former, on the other hand, refers to the *Daily Mail/Cartesioroute* and, as explained above, does not require reincorporation in the Member State of destination, nor does it involve any change in the governing law.

The CJEU, wary of the confusion this new route would stir,<sup>76</sup> elaborated as much as possible in its *obiter dictum*. It held that Articles 49 and 54 TFEU preclude the Member State of incorporation/departure from requiring the windingup or liquidation of a company which wishes to transfer its seat through cross-border conversion.<sup>77</sup> This means that a number of Member States, including Poland, the Netherlands and Germany, will have to amend their legislation which has this effect to reflect the Court's *dictum*.<sup>78</sup> However, this right of establishment remains subject to whether the conversion is permitted by the law of the Member State of reincorporation/destination.<sup>79</sup> Unfortunately, at present many Member States consider cross-border conversion of a foreign company as legally impossible, including France, the Netherlands, United Kingdom, and Poland.<sup>80</sup>

Naturally, the latter view is but an application of the *Daily Mail* rule. The arguments presented in the section dealing with the *Daily Mail/Cartesioroute* against this rule are valid here as well, if that cross-border conversion falls within the objective scope of freedom of establishment.<sup>81</sup> In this respect, Szydlo produces another interesting argument. The author points out that all national company laws in Europe allow the transformation or conversion of domestic companies' legal form; for example, under the Maltese Companies Act, a partnership *en nom collectif* may transform itself into a limited liability company. In view of this, the author relies on the principle of non-discrimination to argue that this transformation/conversion process should be equally accessible to apply to foreign companies.<sup>82</sup>

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<sup>76</sup>See Case [C-378/10] Reference for a preliminary ruling from the Magyar Köztársaság Legfelsőbb Bírósága (Hungary) lodged on 28 July 2010 - VALE Építési Kft (pending before the CJEU).

<sup>77</sup>*Cartesio* (n 25) para 112.

<sup>78</sup>Szydlo (n 58) 419.

<sup>79</sup>*Cartesio* (n 25) para 112.

<sup>80</sup>Szydlo (n 58) 421.

<sup>81</sup>*Ibid* 422-426.

<sup>82</sup>*Ibid* 437.

Despite the persuasive character of these arguments, it is still to be seen whether the CJEU will depart from its own *dictum* in *Cartesio*. Indeed, at the time of writing, there are pending before the CJEU four questions referred by the Supreme Court of Hungary on cross-border conversion in the case of *VALE ÉpítésiKft.*<sup>83</sup> The issue revolves around the cross-border conversion of an Italian company, or *società a responsabilità limitata*, into a Hungarian company, referred to as *askorlátolt felelősségű társaság*. VALE, having first cancelled its name from the Italian Register, went on to record it in the Hungarian Register, only to be blocked by the Company Court because it goes against Hungarian law.<sup>84</sup> The first and second questions referred to the Court specifically inquire about *Cartesio's obiter dictum* and ask whether the Member State of destination must 'pay due regard' to Articles 49 and 54 TFEU, and if so whether that Member State is precluded from prohibiting the primary and inbound establishment of a company which has undergone cross-border conversion. It is submitted that the CJEU has the perfect opportunity to abandon its reasoning in *Cartesio* and distance itself from the *Daily Mail* rule. Although, it is premature to comment on this case, the probability of the Court to take such a stance is quite paltry.

(c) *Winding Up and Subsequent Incorporation*

Certainly, winding up and subsequent incorporation is a painful route to take which shareholders avoid, if possible. In reality, the exercise of freedom of establishment via this route is not vested in the company, but in its shareholders, as nationals. Once a company is wound up, its legal personality ceases; the shareholders, in their own capacity, incorporate a new legal entity in the State of destination. By way of comparison, while the governing law changes, there is no re-incorporation, but incorporation.

**5. Conclusion**

This author firmly stands by the view that once a company is born or incorporated, it has an independent existence and is consequently entitled to the right to establish, irrespective of what the laws of individual Member States may provide. The CJEU must set aside its positivistic conception of the legal personality [since] the

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<sup>83</sup> Case [C-378/10] Reference for a preliminary ruling from the Magyar Köztársaság Legfelsőbb Bírósága (Hungary) lodged on 28 July 2010 - VALE ÉpítésiKft.

<sup>84</sup> *Korom and Metzinger* (n 33) 157.

consequences are squarely in contrast with[...]freedom of establishment.’<sup>85</sup>This can only be achieved by departing from *Daily Mail*’s dictum, and instead to opt for a broader interpretation of 49 and 54 TFEU. Should the CJEU, in *VALE*, deviate away from the rule established in *Daily Mail*, the EU will enter into a new era of European company law, by making company movement within Europe’s internal market more efficient and effective and existent paths to primary outbound establishment, namely, the *Daily Mail/Cartesio* route, and cross-border conversion, properly accessible.

That being said, the future direction of corporate mobility in Europe is very much open to speculation. While awaiting for the CJEU’s deliberation in the *VALE* case or maybe for the fourteenth company law directive, it is clear that *Cartesio* has further opened the floodgates to regulatory competition by allowing cross-border conversion. Irrespective of whether a ‘race to the bottom’ is desirable or not, one cannot ignore the changes in the company laws of Member States since *Centros*, indicating that a race to the bottom has already started. However, irrespective of the path taken by Member States and the consequent direction of European company law, the *Daily Mail* rule, as shown, remains inadequate to resolve these issues.

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<sup>85</sup>*Mucciarelli* (n 29), 297.