Perspectives in Company Law and Financial Regulation

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Towards the end of the real seat theory in Europe?

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I. Introduction

The mobility of companies has increased significantly over the last decade[1] but, after the *Daily Mail*[2] decision of the European Court of Justice in 1988, the method of company mobility has not been via the transfer of seat.[3] Moreover, recently, Mr McCreevy said 'no to the 14th Company Law directive'[4] on the transfer of registered seat from a Member State to another Member State. In fact, the mobility became a reality in Europe after the revolution realized by the ECJ in the field of the European conflict of corporate laws.[5] Referring to Articles 43 and 48 of the EC Treaty, the ECJ emphasized in its *Centros,*[6] *Überseering,*[7] *Inspire Art*[8] and *Sevic*[9] decisions the freedom of companies to create establishments and to implement cross-border mergers within the EU.

* Chapter completed in April 2008.

[1] *See* R. Dammann, 'Mobilité des Sociétés et Localisation des Actifs', *JCP-Cahiers de Droit de l'Entreprise*, (2006), 41. See also: M. Menjucq, *La Mobilité des Sociétés dans l'Espace Européen* (Paris: LGDJ 1997); M. Menjucq, 'La Mobilité des Entreprises', *Revue des Sociétés* (2001), 210; H. Le Nabasque, L'Incidence des Normes Européennes sur le Droit Français Applicable aux Fusions et au Transfert de Siège Social, *Revue des Sociétés* (2005), 81.

[2] Case C-81/87, *Daily Mail and General Trust*, [1988] ECR 5483.

[3] See E. Wymeersch, 'The Transfer of the Company's Seat in European Company Law', *Common Market Law Review*, 40 (2003), 661.

[4] Speech by Commissioner McCreevy at the European Parliament's Legal Affairs Committee, Brussels, 3 October 2007. See, K. E. Sorensen and M. Neville, 'Corporate Migration in the European Union: an analysis of the proposed 14th EC company law directive', *Columbia Journal of European law*, 6 (2000), 181.

[5] See, W. Ebke, 'The European Conflict of Corporate Laws Revolution: Überseering, Inspire Art and Beyond', *The International Lawyer*, 38 (2004), 813.

[6] Case C-212/97, *Centros Ltd* v. *Erhvervs- og Selskabsstyrelsen*, [1999] ECR I-1459.

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

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

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

These ECJ decisions in favour of the incorporation theory, raise the question about the future of the real seat theory in Europe. Is it the end of this theory?

As is well known, where the incorporation theory 'recognizes all foreign legal entities according to the rule applicable in the State of origin',[10] the real seat theory in private international law considers the location of the central administration (or effective centre of management) of the company which cannot be dissociated from the location of its registered office.[11] In that case, according to the real seat theory, the company should be no longer recognized as a legal person under the law of the state of its central administration. This was exactly the *Überseering* case which applied the German conflict of laws rule.

A less dogmatic interpretation can be found in the interpretation of Article L. 210–3 of the French commercial code, which provides that the location of the registered office determines the *lex societatis*. However, such place of the registered office cannot be invoked against third parties if the effective centre of management of the company is located elsewhere.[12] The classical French doctrine[13] considers that this provision reflects the theory of *siège réel*. Modern doctrine has suggested replacing this principle by the criterion of the statutory office, corresponding to the State of incorporation, unless the registered office is fraudulent.[14] That said, it appears that French law is less dogmatic than the '*Sitztheorie*' in German private international law.[15]

The real seat theory has, however, been viewed as an obstacle to the freedom of establishment in Europe guaranteed by Articles 43 and 48 EC Treaty. In its *Centros*, *Überseering*, *Inspire Art* and *Sevic* decisions the ECJ judged that the prohibition on dissociating the place of

[10] Wymeersch, 'The Transfer of the Company's Seat', (note 3, above), 661.

[11] H.J. Sonnenberger, *Münchener Kommentar zum Bürgerlichen Gesetzbuch, Internationales Privatrecht* (München: Beck, 2005), 163, 181 et seq.

[12] Art. 1837 para. 2 of the French civil code provides for a similar provision.

[13] *See* H. Batiffol, and P. Lagarde, *Droit international privé* (Paris: LGDJ, 1981) No. 196, Y. Loussouarn, P. Bourel and P. de Vareilles-Sommières, *Droit international privé, Précis Dalloz*, (Paris: Dalloz, 2007), No. 707.

[14] See Menjucq, *Droit international et européen des sociétés, Précis Domat*, (Paris: Montchrestien, 2001), No. 71 et seq.; also J. Béguin and M. Menjucq (ed.), *Droit du commerce international*, (Paris: LexisNexis Litec, 2005), No. 470; P. Mayer and V. Heuzé, *Droit international privé*, 9th edn, (Paris: Economica, 2006), No. 1037.

[15] In the *Überseering*-case, German lower courts held that a company incorporated in the Netherlands with an effective seat located in Germany does not exist as a legal person under German law. This jurisprudence was reversed by the BGH after the *Überseering* decision of the ECJ.

incorporation from the administration or business activities of a company was contrary to the EC Treaty. This jurisprudence constitutes 'the victory of the Anglo-Saxon incorporation theory pursuant to which the founders of a corporation freely choose the place of incorporation of a company and hence the law applicable to its organization (*lex societatis*)'.[16] Once incorporated, the company can develop its business activities without any geographical restriction within the European Community. Consequently, the company is also free to choose the place of its headquarters and its central administration. The generalization of the incorporation theory will favour the mobility of companies in Europe. Following the jurisprudence of the ECJ, an increasing number of companies have been incorporated in the United Kingdom, despite exercising their activities exclusively in Germany.

II. What are the direct consequences of *Centros, Überseering, Inspire Art* decisions?

The *Centros*, *Überseering*, *Inspire Art* and *Sevic* decisions have provoked a 'legal earthquake' in Germany. After years of discussions, German doctrine and jurisprudence has drawn the following conclusion: the real seat theory is, *de facto*, contrary to the EC Treaty and needs to be abrogated and replaced by the incorporation concept. Therefore, in early 2006, the German government prepared a proposal for a Council Regulation (CE) regarding conflict of law issues with respect to companies adopting, *inter alia*, the theory of incorporation.[17] The purpose of this proposal is to harmonize the private international law regarding companies in Europe. Even if this proposition is not adopted in the form of an EC Regulation, in any event, the German legislator plans to amend its private international law accordingly.

In France, the modern doctrine mostly agrees with the ECJ decisions but insists on the need to take into consideration the fraud or abuse as it is evoked in the *Centros* and the *Inspire Art* cases.[18] With this

[16] See R. Dammann, 'Mobility of Companies and Localization of Assets – Arguments in Favour of a Dynamic and Teleological Interpretation of EC Regulation no 1346/2000 on Insolvency Proceedings', in G. Affaki, *Cross-border Insolvency and Conflict of Jurisdictions, a US-EU Experience*, (Brussels: Bruylant, 2007), 105.

[17] See the proposal of the German Council for Private International Law under the presidency of Prof. H. J. Sonnenberger, *Revue Critique de Droit International Privé* (2006), 712.

[18] See M. Menjucq, 'La notion de siège social : un unité introuvable en droit international et en droit communautaire', *Mélanges en l'honneur de J. Béguin* (Paris: Litec, 2005), 499.

consideration of fraud or abuse, articles L. 210–3 of the commercial Code and 1837 of the civil Code could be read in conformity with articles 43 and 48 EC Treaty: indeed, if a third person could invoke the real seat only in case of fraud or abuse, the interpretation of articles L. 210–3 of the commercial Code and 1837 of the civil Code would comply with the ECJ jurisprudence.

But the problem is the definition of fraud or abuse in the field of conflict of corporate laws. Merely circumventing the application of Member State companies law is not fraudulent or abusing as the ECJ stressed in the *Centros* decision, except perhaps if the purpose of the founders is to realize a fraud or an abuse of third-party interests. But the ECJ had not given any concrete elements to determine what are fraud and abuse against third-party interests.

Finally, in the field of Community freedom of establishment, if there is a place for the real seat theory, it is only for a much reduced real seat theory, limited only to the consideration of the real seat when there is a fraud or an abuse against third-party interests.

However, this is obviously paradoxical, as the real seat theory is applied in the status of all Community legal persons European Economic Interest Grouping,[19] European Cooperative Society[20] and especially the European Company.

III. The real seat theory and the European Company: a paradox?

A paradox can be drawn with the European Company (*Societas Europea – SE*) that is governed by Council Regulation (EC) no. 2157/01 of 8 October 2001. Pursuant to Article 7 of this Regulation, the registered office must always be situated at the place of its central administration.[21] This provision, which reflects the real seat theory, has been imposed by Germany in the first draft Regulation in the seventies, when German company laws were the model for Community corporate Regulations.[22]

[19] Council Regulation 2137/85/EEC on the European Economic Interest Grouping (EEIG), Article 12.

[20] Council Regulation 1435/2003/EC on the Statute for a European Cooperative Society (SCE), Article 5.

[21] See also art. L. 229–1 paragraph 3 C. com.

[22] The first draft Regulation on European Company also contained provisions on groups of companies inspired by German law. About the opportunity of such rules, see, E. Wymeersch, 'Do We Need a Law on Groups of Companies?', in K. J. Hopt and E. Wymeersch, *Capital Markets and Company Law*, (Oxford University Press, 2003).

Consequently, according to Article 8, the transfer of the registered office of an *SE* to another Member State is only possible, provided that a transfer of its central administration occurs simultaneously in order to comply with the provisions of Article 7.

In view of the foregoing, Council Regulation (CE) no. 2157/01 of October 8, 2001 regarding the *SE* appears to be somewhat anachronistic.[23] That said, Article 69 provides for a reassessment of the effective business seat rule by the Commission within five years after the entry into force of the Regulation. Hence, it would appear rather likely that the Regulation will be revised in the future by adopting the incorporation theory in order to increase the attraction of the *SE*. Likewise, the Report on the *Societas Europeae*, written in 2007 by Mrs Lenoir,[24] former French Minister of European affairs, suggests to modify the status of the SE to introduce the incorporation doctrine.

Hence, it is not sure that the real seat doctrine has a future in the European Company. But in the field of insolvency, the presumption in favour of the registered office is losing ground. Is it the revenge of the real seat theory?

IV. The Insolvency Regulation: the revenge of the real seat theory?

Council Regulation (EC) no. 1346/2000 of May 29, 2000 on insolvency proceedings was conceived in the sixties.[25] At the time the location of the registered office was stable and corresponded to the place where the headquarters and the main activities of the company were located. Consequently, save in exceptional circumstances, the centre of main interests of a company was always located at the place of its registered office.

But, nowadays, as we said before, after the *Centros*, *Überseering*, *Inspire Art* and *Sevic* decisions of the European Court of Justice, the mobility of companies has increased significantly. In particular, the discussion has focused on the famous term 'centre of main interests' – COMI – which

[23] See M. Menjucq, 'Rattachement de la société européenne et jurisprudence communautaire sur la liberté d'établissement : incompatibilité ou paradoxe?', *Recueil Dalloz* (2003), 2874.

[24] See N. Lenoir, Rapport au Garde des Sceaux sur la *Societas Europeae (SE).* Pour une citoyenneté européenne de l'entreprise, *La documentation Française* (2007).

[25] It is based on the text of a draft treaty of 1995 which was the fruit of a difficult compromise, but which never entered into force because the United Kingdom refused to ratify it. *See* for the historical genesis of the Regulation, C. Saint-Alary-Houin, *Droit des entreprises en difficulté* (Paris: Monchrestien, 2001), n°1147 et seq.

determines the court with jurisdiction to open the main insolvency proceedings and, hence, in accordance with Article 4(1) of the Regulation, the law applicable to such proceedings.

Moreover, most of the cross-border insolvencies falling within the scope of the Regulation involve groups of companies, a phenomenon that needs to be addressed. Unfortunately, the Regulation does not deal with this topic. In order to efficiently address the insolvency of groups of companies, a vast majority of European jurisdictions have adopted a rather wide interpretation of Article 3(1) of the Regulation, judging that the COMI of each entity of the group can be located at the registered office of the controlling (parent) company if such parent company is directly involved in the management of its subsidiaries.[26] This case law has been severely criticized by some authors.[27] It is accused of triggering forum and law shopping, legal uncertainty for third parties and conflicts of jurisdictions. Others have favoured a more teleological approach of Regulation 1346/2001 which enables the application of the Regulation to groups of companies.[28]

After the *Eurofood* decision of the ECJ dated 2 May 2006[29] and despite the restrictions of ECJ, the application of the Regulation on groups of companies has become an established fact, as it appears from the *Eurotunnel* decision of the Court of Paris[30] dated 2 August 2006.

[26] For a synthesis of this jurisprudence *see* R. Dammann, 'L'évolution du droit européen des procédures d'insolvabilité et ses conséquences sur le projet de loi de sauvegarde', *Lamy Droit des Affaires* (2005), 18 and M. Raimon, 'Centre des intérêts principaux et coordination des procédures dans la jurisprudence européenne sur le règlement relatif aux procédures d'insolvabilité', *Journal de Droit International* (2005), 739.

[27] See e.g. M. Menjucq, *JCP – Cahiers de Droit de l'Entreprise* (2006), 10089.

[28] *See R. Dammann, 'Mobility of Companies and Localization of Assets', (note 16, above), 105.*

[29] Case C-341/04, *Eurofood*, [2006] ECR I-3813. See *Recueil Dalloz* (2006), 1286 note A. Lienhard; *Recueil Dalloz* (2006), 1752 note R. Dammann; *JCP-Cahiers de Droit de l'Entreprise (*2006), 10089 note M. Menjucq; *Bull. Joly* (2006), 923 note D. Fasquelle; *Revue des Sociétés* (2006), 360 note Rémery; *JCP-Cahiers de Droit de l'Entreprise* (2006) n° 2071 note J.-L. Vallens; *Lamy droits des affaires* (2006), 29 note Y. Chaput.

[30] *See Recueil Dalloz* (2006), 2329 note R. Dammann and G. Podeur, 'L'affaire *Eurotunnel*, première application du règlement CE n° 1346–2000 à la procédure de sauvegarde'. The judgment was confirmed by the Commercial Court of Paris on January 15, 2007, *Recueil Dalloz* (2007), 313; *Bull. Joly* (2007), 459 note Jault-Seseke and D. Robine. The appeal was rejected by the Court of appeal of Paris in a judgment dated November 29, 2007, *Recueil Dalloz* (2007), 12 note A. Lienhard; M. Menjucq, 'Réflexions critiques sur les arrêts de la Cour d'appel de Paris dans l'affaire *Eurotunnel*', *Revue des procedures collectives* (2008), 9.

The risk of forum and law shopping is real since judges have a large discretion when interpreting the notion of COMI. Consequently, questions arise as to whether an interested party taking the view that COMI is situated in a Member State other than that in which the main insolvency proceedings were opened could effectively challenge the jurisdiction assumed by the court which opened proceedings. In the *Eurofood* decision, the ECJ emphasized the principle of mutual trust among the jurisdictions of the Member States. Consequently it held that any review of jurisdiction must be done by the court of the opening State in accordance with the remedies prescribed by national law of that Member State.[31]

Recent decisions illustrate however some practical problems. In the *Hans Brochier* case, on 4 August 2007, the London High Court of Justice opened administration proceedings. The appointment of the joint liquidators occurred in the framework of the so-called out-of court-appointment proceedings at the request of the management of *Brochier*. In such proceedings, the court does not verify the underlying facts establishing jurisdiction. Consequently, in the *Brochier* case the court relied on the representations made by the management stating that the COMI of *Hans Brochier* Ltd. was located at its registered office in the UK. A fortnight later, German employees filed a bankruptcy petition for *Brochier* with the insolvency court of Nürnberg. In its order of 15 August 2007, the German bankruptcy court held that the COMI of *Brochier* was clearly located in Germany and that the UK main proceedings had been fraudulently opened. Thus the Tribunal of Nürnberg refused to recognize the opening of the UK main proceedings on the grounds that they were contrary to public order in accordance with Article 26 of the Regulation.[32] The principal of mutual trust is difficult to apply if a foreign court is not obliged as a matter of national insolvency law to verify the underlying facts establishing the COMI. In the *Brochier* case, the conflict of jurisdiction was rather quickly resolved. At the request of the UK joint liquidators of *Hans Brochier*, on 15 August 2007, the High Court retracted its judgment opening main proceedings in favour of *Brochier*.[33]

Finally, the question arises under what circumstances the simple presumption of the competence of the jurisdiction of the Member State where the registered office of the debtor is located, could be rebutted. Is there a place for the real seat doctrine in the Insolvency Regulation?

[31] See recitals 43 *et seq.* of the *Eurofood* decision (note 29, above).
[32] *Zeitschrift fürWirtschaftsrecht* (2007), 81.
[33] *Neue Zeitschrift für das Recht der Insolvenz und Sanierung* (NZI) 3/2007 p. 137.

The answer can be found in the *Eurofood* decision of the ECJ:[34]

> It follows that, in determining the centre of the main interests of a debtor company, the simple presumption laid down by the Community legislature in favour of the registered office of that company can be rebutted only if factors which are both objective and ascertainable by third parties enable it to be established that an actual situation exists which is different from that which locating it at that registered office is deemed to reflect.
>
> That could be so in particular in the case of a 'letterbox' company not carrying out any business in the territory of the Member State in which its registered office is situated.
>
> By contrast, where a company carries on its business in the territory of the Member State where its registered office is situated, the mere fact that its economic choices are or can be controlled by a parent company in another Member State is not enough to rebut the presumption laid down by the Regulation.

There is no doubt: the COMI is not the real seat of the debtor because it does not refer to the effective centre of management but to the place where the company carries on its business. In fact, the ECJ refers to an economic criterion. Consequently, there is no 'revenge' for the real seat doctrine in the field of Insolvency Regulation.

V. Conclusion

In sum, it seems that there is no future for the real seat theory in the European area even if 'it will remain applicable in the relation to third States'.[35] Actually, this theory was conceived in a different economic and legal environment which is now over. But the possible end of the real seat theory in a few years does not mean that the real seat criterion has absolutely no future. Indeed, if, referring to the *Centros* and *Inspire Art* ECJ decisions, there is a place for fraud or abuse, especially towards third persons, the real seat criterion could be the evidence of such fraud or abuse. However, it is a very small place[36] for a criterion and a theory which were dominant in most of the Member States laws: it is probably the symbol of the new leadership of Anglo-Saxon rules.

[34] Recitals 34, 35 and 36 of the *Eurofood* decision (note 29, above).
[35] See Wymeersch, 'The Transfer of the Company's Seat', (note 3, above), 695.
[36] In the same way, see Wymeersch, 'The Transfer of the Company's Seat', (note 3, above), 661.