The Cartesio Judgement

A Jurisprudential Analysis

By

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Formalism and rule-skepticism are the Scylla and Charybdis of juristic theory; they are great exaggerations, salutary where they correct each other, and the truth lies between them.

– H. L. A. Hart

Introduction

Cross-border corporate mobility within the European Union (EU) has for a long time been a prominent issue in European company law. One aspect of that prominence has been the case-law of the Court of Justice of the European Communities (ECJ) regarding freedom of establishment for legal persons, which has been a source of much scrutiny and scholarly debate.

In this thesis, ‘The Cartesio Judgement’, I will contribute to that debate by analyzing the European Court’s so-called Cartesio case from December 16th 2008, or, more precisely, the part of the case which deals with cross-border corporate mobility.

First, I am going to give a necessary introduction by accounting for the principle of freedom of establishment within the EU. Then I will put the case in context by discussing the relevant case-law prior to Cartesio. My account of both the principle and the case-law is not simply a repetition of what has been said before, but based on my own insights, and serves as an important prelude to the culmination of my main task of analyzing and assessing the jurisprudence behind the Court’s ruling, from which the thesis takes its subtitle: ‘A Jurisprudential Analysis’. Before I summarize my conclusion, I will discuss the desirability of legislative amendments regarding cross-border corporate mobility and thus deal

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2 The Court of Justice of the European Communities is formerly known as European Court of Justice. My abbreviation is of the latter name, which is still widely used.

with the question whether and in what way a new directive should change the scope of freedom of establishment. Such discussion of *lex ferenda* is particularly proper in relation of *Cartesio* because while the case was pending before the ECJ the European Commission halted its intended directive on cross-border corporate mobility, not least in order to see whether an alleged obscurity would be clarified by the Court and an alleged incongruity harmonized.
1. Freedom of Establishment within the European Union

Rights are a moral concept – the concept that provides a logical transition from the principles guiding an individual’s actions to the principles guiding his relationship with others – the concept that preserves and protects individual morality in a social context – the link between the moral code of a man and the legal code of a society, between ethics and politics. Individual rights are the means of subordinating society to moral law.

– Ayn Rand 4

1.1 The Principle of Free Establishment

The Internal Market of the EU comprises an area without internal frontiers in which four fundamental freedoms are ensured: free movement of goods, persons, services and capital.5 The second of these, free movement of persons, includes a free movement of workers and freedom of establishment.

But what exactly does the term ‘establishment’ mean in European law? The articles concerning establishment in the Treaty on European Union (TEU) are identical to the provisions of the previous Treaty Establishing the European Community (TEC), and they provide no definition of establishment.6 However, its meaning has been formulated in ECJ’s case-law; the following is an extract from the Gebhard case:

The concept of establishment within the meaning of the Treaty is … a very broad one, allowing a Community national to participate, on a stable and continuous basis, in the economic life of a Member State other than his State of origin and to profit therefrom, so contributing to economic and social interpenetration within the Community in the sphere of activities as self-employed persons[.]7

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5 Art. 26(2) TEU (ex. art. 14(2) TEC). The provision was enacted with the Single European Act, which functioned as a vehicle for the completion of the single market.
6 TEU, which entered into force on December 1st 2009, amended TEC (also known as the EC Treaty or the Treaty of Rome). TEC was in force at the time of Cartesio.
A few crucial features can be subtracted from this clause: The pursuit of economic activity of a self-employed person, on a stable and continuous basis, in another Member State than the State of origin. Here, ‘economic activity’ is also meant to cover professional activity, ‘person’ includes both natural and legal persons, and ‘on a stable and continuous basis’ refers both to a stable base in the host country and an indefinite duration of the activity. The cross-border feature is necessary to make European Community law applicable.

The right of establishment is the subject of Arts. 49-55 TEU, which at the time of *Cartesio* were Arts. 43-48 and 294 TEC. The principle of free establishment is codified in the first of these Articles:

> Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

Art. 49 TEU begins by stating the general rule that restrictions on the freedom of establishment shall be prohibited. In the second sub-paragraph, secondary establishment – in the form agencies, branches and subsidiaries – is explicitly included, i.e. undertakings have the right to expand their business in such way in other countries than the state of incorporation.

The second paragraph of Art. 49 casts further light of the scope of freedom of establishment:

> 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 or firms within the meaning of the second paragraph of Article 54 [ex. 48 TEC], under the conditions laid down for its own nationals by the law of

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8 The self-employment feature distinguishes freedom of establishment from free movement of workers, while the lack of temporality feature distinguishes it from service. In *Gebhard* the temporary nature was determined by looking at the factors of duration, regularity, periodicity and continuity.

9 Hereafter: EC law.


11 Art. 49(1) TEU (ex. Art. 43(1) TEC).
the country where such establishment is effected, subject to the provisions of the Chapter relating to capital.\textsuperscript{12}

What concerns us here is the right to ‘set up and manage undertakings’. The term ‘undertaking’ is a broad one, but it is vaguely narrowed down by adding that it applies particularly to ‘companies and firms within the meaning of the second paragraph of Article 54’, which excludes non-profit making entities, but is otherwise very inclusive:

‘Companies or firms’ means 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.\textsuperscript{13}

The first paragraph of Art. 54 TEU states that the principle of free establishment should apply equally to natural and legal persons. It is obvious which natural persons belong to the EU, but it is not clear what legal persons should count as EU undertakings. Thus a rule is laid down in the Article to distinguish between companies and firms within the Community and those who are not regarded as belonging to it:

Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.\textsuperscript{14}

So, on the one hand, a company or firm has to be formed in accordance with the law of one of the Member States. On the other hand, they have to have at least one of the three following links to the Community: a registered office within the EU, central administration within the EU, or principal place of business within its boundaries. These links are called connecting factors. They are a central subject regarding freedom of establishment and they are indeed intertwined with any in-debt analysis of the Cartesio case. But before I give a brief introduction to connecting factors, I will elaborate a little bit further on the context of the principle of free establishment and say a few words about the exceptions from the

\textsuperscript{12} Art. 49(2) TEU (ex. Art. 43(2) TEC).

\textsuperscript{13} Art. 54(2) TEU (ex. Art. 48(2) TEC).

\textsuperscript{14} Art. 54(1) TEU (ex. Art. 48(1) TEC).
principle, which play a role in Cartesio, both in the Opinion of the Advocate General (AG) and, in different context, in the ECJ’s ruling.\footnote{The AGs of the ECJ assist with each case and deliver Opinions on questions, where they offer independent legal solutions. But their Opinions are not binding and they are not participants in ECJ’s deliberations. Eight AGs work for the Court.}

It has to be kept in mind that the provisions regarding the right of establishment are – along with similar rights of workers and suppliers and recipients of services – specific prohibitions of discrimination that fall under the general non-discrimination principle of Art. 18 TEU (ex. Art. 12 TEC) in which prohibition of any discrimination on the ground of nationality is prohibited.\footnote{The non-discrimination principle applies only to EU persons; it does not protect non-EU persons against discrimination.} It has been established in ECJ’s case-law that the fundamental freedoms, including the freedom of establishment, do not only prohibit direct discrimination, where there is discrimination by law, but also indirect discrimination, where there is discrimination by fact. Moreover, it was established in the Gebhard case that the protection of the fundamental freedoms prohibits indistinctly applicable measures that are liable to hinder or render less attractive the freedom of establishment. This kind of protection is considered to be needed because many rules of Member States are non-discriminatory, both legally and factually, but still have negative impact on the capability of non-nationals to exercise their right. This especially concerns indistinctly applicable measures that put a burden on the market access of individuals or companies.

However, there are exceptions from the principle of free establishment. In Art. 51 TEU (ex. Art. 45 TEC) it is stated that the provisions regarding right of establishment shall not apply to activities that are connected with the exercise of official authority, and in Art. 52 TEU (ex. Art. 46 TEC) it is stated that the provisions do not prevent discrimination on grounds of public policy, public security or public health. There are also important exceptions which are only considered when there is neither a direct nor indirect discrimination but indistinctly applicable measures which hinder or render less attractive the freedom of establishment. Such national measures have to fulfill four conditions which were introduced in the Gebhard case and have become a standard test in later cases, known as the ‘Gebhard formula’. First, the measures must be applied
in a non-discriminatory manner; secondly, they must be justified by overriding requirements of the public or general interest; thirdly, they must be suitable for securing the attainment of the objective which they pursue; and at last, they must not go beyond what is necessary in order to attain the objective. It is the second of these conditions, namely when a measure can be justified by reference to overriding requirements in the general interest, which is often the main focal point when the exceptions are considered by the ECJ.

1.2 Introduction to Connecting Factors

The connecting factors mentioned in Art. 54(1) are factors that connect companies and firms to the EU, but national connecting factors also play a huge role in cross-border corporate mobility within the Union.

Countries have two basic conflict-of-law methods of determining the applicable law for companies: a method based on the incorporation theory and a method based on the real seat theory. According to the first method, the applicable law is the law of the state of incorporation, i.e. where the company is formed and registered. When this is the connecting factor it does not matter whether companies transfer their central administration or principal place of business to another Member State; the governing law continues to be the law where they were incorporated and the lex societatis does not change. The situation is different if the home country follows the real seat doctrine because then the applicable law is the law where the company’s real seat is located, which is usually determined by where its central administration is located. When the connecting factor is such, companies cannot transfer their seat to another Member State and remain companies of the original state and continue to be incorporated by its laws and at least partially under its jurisdiction. Thus, company’s residence and nationality are intertwined. Among those countries that follow the incorporation theory are United Kingdom, the Netherlands and Denmark, while the majority of EU Member States – including countries such as Germany, Austria, France and Belgium – follow the real seat theory.

A question can be raised whether Arts. 49 and 54 were intended to change the Member States’ national systems regarding connecting factors, i.e. whether the principle of free establishment was indirectly meant to let European conflict-
of-law rules replace the inharmonious private international law (PIL) trends of the EU countries. This will be discussed later in relation to the *Daily Mail* case.

### 1.3 Overview of the Cartesio Case

Cartesio Oktató és Szolgáltató Bt., the undertaking of the case which bears its name, is a limited partnership, formed according to Hungarian law and registered in the Hungarian commercial registry.17 ‘Bt.’ is an abbreviation of *betéti társaság*, which is a type of limited partnership that is not a legal person *de jure*, but is so *de facto* according to Hungarian legal experts: ‘although the Bt. is not formally a legal person, it has separate legal personality. The Bt. is subject to the same company law legislation as are legal persons and its profits are subject to corporation tax.’18 They therefore conclude that Art. 54 TEU should be interpreted as covering the form of the Bt. enterprise, as the ECJ did indeed confirm in the *Cartesio* ruling.

The owners of Cartesio sought to transfer its central administration from Hungary to Italy and they accordingly applied for a registration of a new seat in the Hungarian commercial registry.19 Their aim was not to move the registered office to Italy, as seemed to be the common perception of Member States before the Opinion of the AG was published, but only to transfer the seat to Italy while remaining being registered in Hungary and governed by Hungarian law. Still, despite the owner’s desire and the fact that the case was resolved on this

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17 The registry located the limited partnership in the small city of Baja in southern Hungary. Cartesio was registered there on May 20th 2004.

18 Veronika Korom & Peter Metzinger (2009) ‘Freedom of Establishment for Companies: The European Court of Justice confirms and refines its *Daily Mail* Decision in the Cartesio Case C-210/06’ (*ECFR*, 1/2009), p. 129f. – In paragraph 22 of the *Cartesio* case on can find the following facts about the Cartesio undertaking: “Cartesio has two partners both of whom are natural persons resident in Hungary and holding Hungarian nationality: a limited partner, whose only commitment is to invest capital, and an unlimited partner, with unlimited liability for the company’s debts. Cartesio is active, inter alia, in the field of human resources, secretarial activities, translation, teaching and training.”

19 A more direct translation of what Cartesio sought to transfer is ‘operational headquarters’ (közponyi ügyvezetés helye), but the meaning is the same. – The seat transfer application was filed in the regional court of Bács-Kiskun on November 11th 2005. The applied location was the city of Gallarate in the region of Lombardo in northern Italy.
ground, there is a good reason for the confusion: ‘statutory seat and the real seat of a company had to coincide under Hungarian law.’

The application was rejected by the Hungarian company court which maintained the commercial registry. The reason which it gave for the refusal was that Hungarian law did not allow a legal person to transfer its seat abroad while continuing to be a legal entity structured by Hungarian law, or, as it is often put, to have Hungarian law as its personal law. Rather, the court maintained that an enterprise that sought to transfer its seat across the Hungarian border would have to be wound up in Hungary and reconstituted according to the law of the country where the new seat would be located. Cartesio appealed the judgement to a higher court, which referred the issue to the ECJ.

Four questions were referred to the European Court, but only the last one is within the scope of our subject. The fourth question was rephrased by the ECJ, but in its original form it was as follows:

a) If a company, constituted in Hungary under Hungarian company law and entered in the Hungarian commercial register, wishes to transfer its seat to another Member State of the European Union, is the regulation of this field within the scope of Community law or, in the absence of the harmonisation of laws, is national law exclusively applicable?

b) May a Hungarian company request transfer of its seat to another Member State of the European Union relying directly on Community law (Articles 43 [TEC] and 48 [TEC])? If the answer is affirmative, may the transfer of the seat be made subject to any kind of condition or authorisation by the Member State of origin or the host Member State?

c) May Articles 43 [TEC] and 48 [TEC] be interpreted as meaning that national rules or national practices which differentiate between commercial companies with respect to the exercise of their rights, according to the Member State in which their seat is situated, are incompatible with Community law?

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20 Korom & Metzinger (2009), p. 135. – Although Cartesio sought to transfer its ‘központi ügyvezetés helye’ (operational headquarters), the Hungarian legal term used for the seat is ‘székhely’, according to which legal entity’s real seat and registered statutory seat are combined.

21 The decision to reject the application was made on January 24th 2006.

22 The request of the Court of Appeal to the ECJ was lodged on May 5th 2006.

23 Now Arts. 49 and 54 TEU.
May Articles 43 [TEC] and 48 [TEC] be interpreted as meaning that, in accordance with those articles, national rules or practices which prevent a Hungarian company from transferring its seat to another Member State of the European Union, are incompatible with Community law?

After the ECJ’s revision of the question it was more concise and to the point:

By its fourth question, the referring court essentially asks whether Articles 43 EC and 48 EC [49 and 54 TEU] are to be interpreted as precluding legislation of a Member State under which a company incorporated under the law of the Member State may not transfer its seat to another Member State whilst retaining its status as a company governed by the law of the Member State of incorporation.

When this question is put in context to the previously discussed connecting factors, one observation is immediately made: the fact that Cartesio’s home state, Hungary, declines to recognize its transfer to a host Member State, while the legal entity would continue to have the law of the home state as personal law, suggests that the home state follows the real seat theory. Because if Hungary would follow the incorporation theory, there would be no problem to transfer Cartesio’s seat across borders to a host state without any change to its governing law. Such possibility is indeed one of the major advantages of the incorporation conflict-of-law method.

However, this observation is not the whole truth regarding Hungary’s connecting factor at the time of the Cartesio case, for the country had a mixed system of conflict-of-law rules concerning legal entities. In fact, the principal PIL rule was that their personal law ought to be the law of the state of incorporation. But this rule was only applicable in inbound situation, i.e. when Hungary was the host country. It was on the other hand not applicable in outbound situation, i.e. when Hungary was the home country. The ground for this major obstruction of the functionality of the incorporation PIL rule was the above-mentioned special clause in Hungary’s company law legislation which stated that a company governed by Hungarian law ought to have its seat where its central administration was located. This of course practically switches the ‘incorporation method’ to the ‘real seat method’ in all outbound situations, such as in the case of Cartesio.

24 AG’s Opinion on Cartesio, para. 4.

25 Cartesio, para. 99.
It was disputed in the case whether the situation had a cross-border feature, but without such condition the European rules would not be applicable. However, both the AG and the ECJ were in no doubt that the cross-border requirement was fulfilled. Such interpretation is hardly surprising: it is clear that an attempt to transfer seat across borders, which is prevented by the home state, is enough to fulfill the cross-border requirement.

The Opinion of AG Poiares Maduro regarding Cartesio was delivered on May 22nd 2008. His conclusion was that Arts. 49 and 54 TEU ‘preclude national rules which make it impossible for a company constituted under national law to transfer its operational headquarters to another Member State’. So he was in favor of Cartesio’s right to establishment under the circumstances of the case. The core reasons for his decision, or his core *ratio decidendi*, was the following:

[I]t is impossible … to argue on the basis of the current state of Community law that Member States enjoy an absolute freedom to determine the ‘life and death’ of companies constituted under their domestic law, irrespective of the consequences for the freedom of establishment. Otherwise, Member States would have *carte blanche* to impose a ‘death sentence’ on a company constituted under its laws just because it had decided to exercise the freedom of establishment.

After rejecting the idea that Member States have ‘absolute freedom’ to determine the fate of their legal entities when they want to exercise their freedom of establishment, the AG went on by distinguishing between unconditional restrictions, that ‘completely deny the possibility’ of cross-border transfer of seat, and restrictions that could be justified ‘on grounds of general public interest, such as the abuse or fraudulent conduct, or the protection of the interests of, for instance, creditors, minority shareholders, employees or the tax authorities’. He maintained that the latter category of restrictions could be in line with the principle of free establishment, but that the former category, which the Hungarian restriction regarding Cartesio belonged to, violated the principle. ‘Especially since the Hungarian government has not put forward any grounds of justification’, he argued, ‘it is difficult to see how such an outright negation of the freedom of establishment could be necessary for reasons of public interest’.26 So the AG did

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26 AG’s Opinion on Cartesio, para. 34.
not think that an exception of free establishment had been justified by the general interest requirement of the Gebhard formula.

The rationale of the Opinion is simple: (1) the principle of free establishment prohibits restriction of establishment if the restriction cannot be justified by overriding requirements of the general interest; (2) Cartesio is prevented from transferring its seat to another Member State unless it is wound up and reincorporated, thus losing its legal identity; (3) the restriction are not justified by reference to any accepted exception from the principle of free establishment; (4) the restriction is unlawful.

One questionable aspect of this reasoning can be noticed in the second premise. Cartesio wants to transfer its seat to another Member State while retaining its status as a legal entity governed by the law of the Member State of incorporation, but does the principle of free establishment give right to such cross-border mobility? Theoretically it is possible to move a corporate entity across borders and change its personal law accordingly, but without any identity-losing measures of wounding up and reincorporation. Can it be that such corporate mobility is enough to fulfill the requirements of the free establishment principle? There is a void in the AG’s Opinion regarding answering such a crucial question, but the void was filled with the ECJ’s ruling in the case.

The European Court delivered its judgement on December 16th 2008 and it turned around the AG’s Opinion and ruled against the Cartesio undertaking:

[As] Community law now stands, Articles 43 EC and 48 EC [49 TEU and 54 TEU] are to be interpreted as not precluding legislation of a Member State under which a company incorporated under the law of that Member State may not transfer its seat to another Member State whilst retaining its status as a company governed by the law of the Member State of incorporation.\(^\text{27}\)

However this conclusion came with a certain supplement which was not part of the reasoning necessary to make the decision, i.e. an *obiter dictum*, that addressed the subject which was avoided in the AG’s Opinion and indicated how the ECJ would apply the law if certain facts were different:

Nevertheless, the situation where the seat of a company incorporated under the law of one Member State is transferred to

\(^{27}\) *Cartesio*, para. 124.
another Member State with no change as regards the law which governs that company falls to be distinguished from the situation where a company governed by the law of one Member State moves to another Member State with an attendant change as regards the national law applicable, since in the latter situation the company is converted into a form of company which is governed by the law of the Member State to which it has moved.  

So, the situation where a company seeks to move across borders while keeping its personal law, is clearly distinguished from the situation where a company adopts the law of the host state. If the latter is the case, the Court declares in the next paragraph that the home state cannot demand that the company should be wound up and liquidated. That kind of demand would force the company to cease to exist and lose its identity although it would be reincorporated in the host state. Such lack of continued identity would create various disadvantages related to contracts, taxes, etc. – thus effectively making cross-border establishment much less attractive. At the end of the day, a corporate “death and rebirth” is hardly what the principle of free establishment is supposed to mean.

The ECJ sought to make clear in its obiter dictum that even though the principle of free establishment is not applicable in the situation of Cartesio, it should not be interpreted in the way that the principle would lose its status in European law: it still ought to be considered a fundamental rule, in spite of exceptions which are inevitable under the current legal framework.

But what is the ratio decidendi of the ruling? Why is the situation of Cartesio an exception from the principle of free establishment? These questions will be addressed in the next two chapters. The Court states a few reasons for its decision: an interpretation of Arts. 49 and 54 TEU regarding connecting factors, the absence of community regulation in the field, the development of European company law, and an interpretation of relevant prior case-law. The last of these reasons is at the centre of jurisprudential concerns regarding the case and it will need a thorough survey and analysis before the jurisprudence of the Cartesio judgement can be dealt with. Such survey and analysis will be the subject of the next chapter.

28 Cartesio, para. 111.
29 Cartesio, para. 112.
2. Analysis of the Relevant Case Law Prior to *Cartesio*

A firm reputation used to be extremely useful; and wherever society is still dominated by the herd instinct it is still most expedient for every one to pretend that his character and occupation are unchangeable, even if at bottom they are not. “One can depend on him, he remains the same”: in all extremities of society this is the sort of praise that means the most.

Friedrich Nietzsche

2.1 Daily Mail and Criticism

The European Court’s reasoning for its main conclusion in *Cartesio* contained a reference to five previous cases: *Daily Mail*, *Überseering*, *Centros*, *Inspire Art*, *SEVIC Systems* and *CaixaBank France*. The most important of these precedents is the *Daily Mail* case, which has been the subject of much controversy since it was released more than two decades ago. The facts of *Daily Mail* were such that it was immediately brought into the discussion when the *Cartesio* dispute was brought to the European Court – and the question frequently asked was: ‘Is *Daily Mail* still good law?’

*Daily Mail* was a company, incorporated in the United Kingdom, which sought to transfer its seat to the Netherlands for tax reasons. Both countries follow the incorporation theory so there was no problem regarding the applicable law: in principle a British company can freely transfer its seat across borders without losing its legal identity and according to Dutch law such company is recognized as a British company with its seat within Dutch jurisdiction. However, there was a dispute over tax issues: a transfer of company’s central administration away from the UK cannot happen without a permission from British tax authorities. The logic behind such permission is to make sure that all tax obligations are fulfilled before a cross-border transfer takes place. *Daily Mail* neglected its duty to apply for an authorisation and was thus prevented from moving its seat.

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30 Friedrich Nietzsche (1882), *The Gay Science*, Book Four (translated by Walter Kaufmann, New York: Vintage Books, 1974), p. 238 (§296). – This observation regarding how society values the personal characteristics of steady and stable nature, can be expanded in meaning and used for the same characteristics of a judicial system.
The ECJ concluded that the British company did not have the right to exercise its right to free establishment under these conditions. In light of the facts of the case, the Court could have chosen the path of regarding such tax interests as either a legitimate or illegitimate exception from the principle of free establishment. However, the Court chose a different direction and made an argument for its conclusion that had a wider implications for cross-border mobility.

The ECJ began its reasoning by distinguishing between natural and legal persons by stating that the latter ‘are creatures of the law, and in the actual context, creatures of national law, of which there is a variety’ and that they ‘exist only by virtue of the varying national legislation which determine their incorporation and functioning’. Consequently, the Court held that it was up to national authorities whether a company, incorporated by their law, was wound up and liquidated. This assertion indicates that the Court follows the so-called ‘fiction theory’ regarding the nature of legal personality, a view which was originally held and argued for by the eminent 19th-century German jurist Friedrich Carl von Savigny. According to the fiction theory only natural persons, i.e. human beings, can genuinely have rights and obligations, but non-natural persons are not capable of being entitled to them. So any statement that legal persons have rights and obligations is based on mere fiction. Although behind such conceptual framework lies a controversial natural law viewpoint which qualifies natural persons but not legal persons, the core of its meaning has nothing to do with natural law. Rather, it expresses the simple notion that while natural persons should always have certain rights and obligations, it is entirely up to the will of the lawmaker whether it grants such entitlements to legal persons as well. Opposing theories maintain that legal persons should not be distinguished from natural persons in such a crude way – and that morality, of either a realistic or utilitarian kind, demands similar respect for corporate rights as it does for human rights.31

The ECJ went on by interpreting Art. 54(1) TEU (ex. Art. 48 TEC) as giving Member States the right to select a connecting factor. The ground for this interpretation was that by mentioning different factors in the Article, the lawmaker for this interpretation was that by mentioning different factors in the Article, the lawmaker has taken into account the variety of connecting factors of the national laws and

made them a matter of choice for each state. Recall that Art. 54(1) mentions ‘registered office, central administration or principal place of business’ as factors that connect legal persons to the European Community. To interpret it as to have meaning for the possible connecting factors of each Member State is not a literal interpretation, but still not farfetched and rather reasonable interpretation of the legal text. Moreover, the Court maintained that neither any other Articles of the Treaty nor subsequent secondary legislation, dictated what connecting factors the Member States should use.

The Court then pointed to a provision that at the time of the case was Art. 220 of the Treaty establishing the European Economic Community (TEEC), which later became Art. 293 TEC:

Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals the mutual recognition of companies or firms within the meaning of the second para. of Art. 48 [Art. 54 TEU], the retention of legal personality in the event of transfer of their seat from one country to another, and the possibility of mergers between companies or firms governed by the laws of different countries.

The Court’s reference to Art. 54(3)(g) TEEC served the same purpose. A provision with the same meaning was to be found in Art. 44(2)(g) TEC at the time of Cartesio:

The Council and the Commission shall carry out the duties devolving upon them … by coordinating to the necessary extent the safeguards which, for the protection of the interests of members and other, are required by Member States of companies or firms within the meaning of the second paragraph of Article 48 with a view to making such safeguards equivalent throughout the Community.[

Why was it necessary to include in the EC Treaty these provisions about Member States’ negotiations regarding mutual recognition of legal persons and the retention of their identity in case of cross-border transfer of seat or cross-border

32 See Daily Mail, para. 21.
33 Art. 293 TEC.
34 Art. 44(2)(g) TEC. – Art. 54(3)(g) TEEC is as follows: “The Council and the Commission shall exercise the functions entrusted to them … by co-ordinating, to the extent that is necessary and with a view to making them equivalent, the guarantees demanded in Member States from companies within the meaning of Article 58, second paragraph, for the purpose of protecting the interests both of the members of such companies and of third parties[.]”
merger? This question does not have a complicated answer: when the provision was enacted the principle of supremacy of EC law over national law of the Member States had not yet been established by the case-law of the European Court.

However, in *Daily Mail* the Court seemed to disregard this common knowledge and it argued that the lack of harmonizing directives or agreements on grounds of Art. 293 EC had the consequence that the ‘diversity of national laws related to connecting factors of companies and the possibility of transfer of seat [were] not an issue solved by the freedom-of-establishment principle’. This fact is a source of a valid criticism of the Court’s ruling.

We can summarize the *Daily Mail* judgement by saying the following: the Member State’s power over legal persons as products of their law, the diversity of connecting factors and the lack of harmonizing measures, make the fundamental freedom of establishment virtually ineffective in certain circumstances. British authorities were allowed to prevent a company, incorporated under British law, to transfer its seat abroad. As the maker of its legal personality the Member State may lawfully impose the obligation on the company to have the real seat within its territory and the legal situation will remain in that way until the EU lawmaker restricts the Member States’ choice of connecting factors.

It is arguably reasonable to infer from the judgement that the type of situations which the ineffectiveness applies to are *outbound transfers of primary establishment*. Or was the judgement perhaps a bad ground for any general inference regarding what to consider valid interpretation of EC law?

Critics of the *Daily Mail* judgement argued that the case was decided on a wrong basis, that its facts should not have brought about any statements regarding the rights of companies or connecting factors. This seems a valid criticism: a dispute regarding tax-issues was unnecessarily upgraded to a dispute of more depth, namely the nature of legal persons, and to a dispute of wider scope, namely the issue of connecting factors. The tax-issue could have been considered to be a ground for a normal exception from the exercise of freedom of establishment instead of prompting a controversial statement about legal persons, and whereas both countries followed the incorporation theory it was
obviously not connecting factors that created any hindrance of cross-border corporate mobility.

When this kind of judgement is evaluated – i.e. when the logic behind the decision seems twisted – it can be hard to distinguish between its *ratio decidendi* and *obiter dictum*. Some scholars maintained that the declaration that companies were creatures of national law whose existence depended entirely of their home state’s arbitrary legislation, was an *obiter dictum* – which thus had a very limited value as a precedent. However, I find it more convincing to regard the declaration as one of the reasons why the British company lost the case, and thus view it as a part of a peculiar and debatable *ratio decidendi*. In either case, it was hard to predict to what extent the judgement would impact the legal reality, both regarding other cases of outbound transfer of primary establishment and regarding whether it affected also inbound situations or the freedom of secondary establishment. In the reverse order I will discuss how these uncertainties were reduced in the subsequent case-law.

### 2.2 Relevant Post *Daily Mail* Case-Law Regarding Secondary Establishment

The cases of *Centros*, *Inspire Art* and *Cadbury Schweppes* were decisive in determining the legal status regarding secondary establishment.

In *Centros* a Danish couple incorporated their private limited company in the UK, but applied for registration of a branch in Denmark, where they intended to solely conduct their business. To establish the company in the UK and then to have a secondary establishment in Denmark was more convenient because of a lower minimum share capital in the UK. The Danish administrative board that dealt with the branch application decided to refuse the application whereas it claimed that the sole purpose of the couple’s plan was to circumvent Danish law and commit a fraudulent conduct.

The ECJ rejected the logic of the Danish authorities and ruled that the refusal to register the branch violated the principle of free establishment. The Court argued that the fact that the company did not operate in the Member State of its incorporation and registered office, did not in itself prove any unlawful conduct. The judgement was important because it seemed to provide an unambiguous protection for a secondary establishment in a host Member State,
even though the primary establishment was merely in the form of a registration but neither grounded on a real seat of the company nor an actual place of any business operation. Although this is an inbound situation in contrast with the outbound situation in *Daily Mail*, it is reasonable to conclude that a secondary establishment receives a much greater protection than primary establishment. Such privilege for secondary establishment is not strange in light of the wording of Art. 49(1) TEU. The first sub-paragraph of the Article states the right to establishment in another Member State than the state of origin. For natural persons this means e.g. the right of a professional to be self-employed in all the countries where the fundamental freedoms apply, i.e. within the borders of the EU and the EEA. However, for legal persons a distinction can be made whether a company is established from scratch in another Member State, which is always a protected right by the principle of free establishment, or whether you move the company from one Member State to another, which is not a guaranteed right according to *Daily Mail*. But an expansion in the form of secondary establishment cannot be interpreted as falling in the second category because it is straightforwardly protected in the second sub-paragraph of Art. 49(1) TEU: ‘Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.’

The cases of *Inspire Art* and *Cadbury Schweppes* further strengthened the perception that secondary establishment was not “under the spell“ of *Daily Mail* and enjoyed a decisive protection by the principle of free establishment. In *Inspire Art* a Dutch citizen established a company in the UK and opened a branch in the Netherlands. The arrangement was a similar convenience as in *Centros*: a *de facto* circumvention of a Member State’s company law. To inform people that its personal law was not Dutch, the authorities in the Netherlands added a statement that it was formally a foreign company. The ECJ ruled that such statement was contrary to what is now Arts. 49 and 54 TEU, whereas the circumventing arrangement was protected by those articles. Like in *Centros*, the Court argued that arrangement did not in itself prove the existence of an abuse. Rather, an existence of an abuse had to be shown on a case-to-case basis. The
same conclusion was reached for an outbound situation in *Cadbury Schweppes*, regarding subsidiaries of a British company in Ireland.

### 2.3 Relevant Post *Daily Mail* Case-Law Regarding Inbound Situations of Primary Establishment

The *Überseering* case is of a fundamental value for estimating the impact of the *Daily Mail* judgement on the legal status of freedom of establishment.

The ruling in *Überseering* was a groundbreaking judgement regarding inbound situations of primary establishment. The company of the case was incorporated under Dutch law, but had transferred its actual centre of administration to another Member State. The host state was Germany which follows the real seat theory. When the company entered into a legal dispute and sought a litigation, the German court ruled that the undertaking lacked legal capacity. The reason was that according to German law – and in line with the real seat principle – the applicable law was the law where the centre of administration was located, namely German law, but the personal law of the company was Dutch law. This mismatch prompted the German court to reject its legal capacity. The decision meant that to gain legal capacity and be able to bring forth a lawsuit, the company had either to move its real seat back to the Netherlands or to change its personal law by reincorporating in Germany.

By following the reason of *Daily Mail*, the German government argued that the rejection of the legal capacity was not contrary to European law because no ‘multilateral convention pursuant to Art. 293 EC had been adopted on the question of the transfer of a company seat’. However, the ECJ changed its tone regarding Art. 293 EC and distinguished the *Überseering* situation from the *Daily Mail* precedent in a clear and explicit manner. Now the Court argued that the exercise of the freedom of establishment may be facilitated by conventions which Member States enter into pursuant to Art. 293 EC, but it may not be made dependent on the adoption of such conventions.\(^{(35)}\) It then concluded that the decision to deny the legal capacity of the company was ‘tantamount to outright

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\(^{(35)}\) See *Überseering*, para. 55.
negation of freedom of establishment’ – and that the restriction was not justified.36

What has been called the immigration problem in European legal scholarship – i.e. when the host state does not recognize foreign undertakings – had been solved regarding secondary establishment in Centros. The Überseering ruling meant that the immigration problem regarding primary establishment was no longer a problem: a host Member State was considered obliged to recognize undertakings, validly incorporated in other Member States, which moved their real seats to its territory. We can call this the ‘recognition principle’ of cross-border establishment – and it inevitably puts a limit on the use of the real seat as a connecting factor.

The cases of SEVIC Systems and Segers further established the recognition principle. The former concerned a cross-border merger between a Luxembourghish company and a German one, which German authorities had to recognize as valid. The latter concerned a transfer of a British company’s central administration to the Netherlands, where the Dutch authorities could not discriminate against such foreign undertaking with regard to sickness insurance.

2.4 Relevant Post Daily Mail Case-Law Regarding Outbound Situations of Primary Establishment

When the questions regarding secondary establishment and inbound situations of primary establishment have been answered, there is only one major post Daily Mail uncertainty which I have not addressed: the precedential value of Daily Mail regarding what the ECJ took to be the situation of that case, namely an outbound situation of primary establishment. Importantly for the Cartesio judgement, this is exactly the circumstances of that case as well.

What is at stake here is whether a legal person’s home Member State is allowed to demand the dissolution of the legal person if it intends to transfer its real seat to another Member State. This has been called the ‘exit problem’ by European lawyers, or, more specifically, the exit problem of primary establishment; the putative exit problem for secondary establishment has been dissolved, as I have discussed.

36 Überseering, para. 81 and 93.
There is no ECJ case between *Daily Mail* and *Cartesio* where the facts relate to an outbound situation of primary establishment, so a guideline in the form of a precedent on how to interpret *Daily Mail* was not available at the time of *Cartesio*. However, a strong indication of how to understand *Daily Mail* was offered in the following *obiter dictum* of the *Überseering* judgment:

Asked by the High Court of Justice whether the Treaty provisions on freedom of establishment conferred on a company the right to transfer its centre of management to another Member State, the Court observed, at paragraph 19 of *Daily Mail and General Trust*, that a company, which is a creature of national law, exists only by virtue of the national legislation which determines its incorporation and functioning.\(^{37}\)

At paragraph 20 of that judgment, the Court pointed out that the legislation of the Member States varies widely in regard both to the factor providing a connection to the national territory required for the incorporation of a company and to the question whether a company incorporated under the legislation of a Member State may subsequently modify that connecting factor.\(^{38}\)

The Court concluded, at paragraph 23 of the judgment, that the Treaty regarded those differences as problems which were not resolved by the Treaty rules concerning freedom of establishment but would have to be dealt with by legislation or conventions, which the Court found had not yet been done.\(^{39}\)

In these three paragraphs the European Court revisited the *Daily Mail* case and literally confirmed the reasoning and the conclusion of that case. This restatement in *Überseering* in combination with the *ratio decidendi* of the case, revealed that the Court’s intention was to distinguish between inbound situations of primary establishment and outbound situation of primary establishment. The former being protected by the right of free establishment, but the latter being unprotected by the fundamental principle, as the law stood at the time of the case – and as it still stands.

Although these paragraphs of *Überseering* have to be considered a mere *obiter dictum* of the case, they have more value for subsequent case-law than *obiter dicta* normally have. The reason for the extra value is of course that *Überseering’s obiter dictum* is a confirmation of a controversial reasoning of a

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\(^{37}\) *Überseering*, para. 67.

\(^{38}\) Ibid., Para. 68.

\(^{39}\) Ibid., Para. 69.
former case, which is an integral part of the conclusion of that case and must therefore count as belonging to its *ratio decidendi*.

So, after Überseering there was a clear indication where the ECJ stood on free establishment regarding legal persons’ outbound transfer of primary establishment.
3. The Jurisprudence of the Cartesio Judgement

Nothing we do can be defended definitively. But only by reference to something else that is established. / I.e. no reason can be given why you should act (or should have acted) like this, except that by doing so you bring about such and such a situation, which again you have to accept as an aim.

– Ludwig Wittgenstein

3.1 Confirmation of the Case-Law and the Alternatives

The Cartesio Judgement is in line with the precedent that was given in Daily Mail and restated in an obiter dictum in Überseering. By following the precedent the judgement further confirms the understanding that legal persons cannot rely on the freedom to transfer its primary establishment, while keeping its personal law and identity, if it is contrary to the law of its home Member State, by which laws the legal person is incorporated.

The analysis of the judgement in terms of the previous case-law, surveyed and explained in the last chapter, counts in favor of the reasonableness of ECJ’s main conclusion in the Cartesio case. So, from the angle of precedential treatment, the ruling was indeed logical and justified.

However, submission to precedents has not been absolute in any legal system, not even in the most drastic precedent-dominated common-law arrangement. Although a straightforward overturn of an earlier precedent is not frequent, there is usually a way to distinguish earlier precedents. The act of distinguishing precedents is of course most often a normal and simple jurisprudence, but it can also take the form of a sly tactic to turn back on precedents which are considered wrong or impractical. Furthermore, it is commonly accepted that precedents loose value over time, especially if the legal development has somehow changed the circumstances of the precedent, even though a new legislation has not overruled it.

When the Cartesio case was brought before the European Court, approximately 20 years had passed since the Daily Mail judgement was released.

and roughly six years since its confirmation in the Überseering ruling. Although the latter case gave a clear indication of the Court’s view at the time, it could arguably have been overlooked or dismissed as a mere obiter dictum. The two decades since the only actual precedent is a time span that gave the Court a considerable flexibility in relation to how to treat that precedent, especially in light of the robust development of European law, driven by both judicial and legislative initiative, which has transformed the legal landscape of the European Union in the given period of time.

The ECJ had at least two reasons to reflect critically on the legal situation and reach the same conclusion as the AG did, namely to strengthen the protection of the principle of free establishment by ruling in favor of the Hungarian undertaking which sought to move its seat to Italy. One reason is the aim of the principle. It is a crucial part of one of the four fundamental freedoms of the Internal Market, which have the goal of making a single market possible by securing a free movement of goods, persons, services and capital. There is no doubt that the lawmaker intended these freedoms to be a far-reaching and effective principles. If their scope would be limited and their effectiveness would be lacking, the single market would be at serious risk, and thus the whole project for European integration. The fact of the matter is that the four fundamental freedoms are at the core of the idea behind the European Union – and the ever increasing integration of the Member States demands an ever increasing respect for the fundamental freedoms, including the protection of legal persons’ freedom of establishment.

Another reason concerns the questions whether it is illogical to discriminate between inbound and outbound situations. Many critics of the Cartesio judgement have maintained that such discrimination is unjustified. Their argument is a reflection of the AG’s position, which he expressed in paragraph 28 in his Opinion. He began by pointing out the following:

Several efforts were made – including by the Court itself – to distinguish Daily Mail and General Trust on the facts from Centros, Überseering, and Inspire Art, by focusing on aspects such as primary as opposed to secondary establishment, and inbound versus outbound establishment.41

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41 AG’s Cartesio opinion, para. 28.
This is a correct observation, as is evident from my earlier discussion of the case-law between *Daily Mail* and *Cartesio*. But the AG considered this endeavor of the Court to be dubious jurisprudence. He continued by stating that ‘these efforts were never entirely convincing’ and that he particularly found the inbound-outbound distinction unconvincing:

[T]he distinction between situations in which a Member State prevents or dissuades companies that are constituted under its *own* company law from seeking establishment abroad, and situations in which the *host* Member State restricts the freedom of establishment, never fitted the Court’s general analytical framework for Articles 43 and 48 EC.  

So, he claims that the distinction is contrary to ‘the Courts general analytical framework’ for the Articles where the principle is stated. But what does that mean? Here a further elaboration is needed – and the same applies to many of the jurists who have criticized the distinction. The AG’s next step did not cast much more light on his argument; he referred to the Opinion of his colleague in the *SEVIC Systems* ruling, Advocate General Tizzano, and quoted the following from him:

It is evident from [the] case-law that Article 43 EC does not merely prohibit a Member State from impeding or restricting the establishment of foreign operators in its territory, it also precludes it from hindering the establishment of national operators in another Member State. In other words, restriction “on entering” or “on leaving” national territory are prohibited.

It is hard to see how that is evident from the case-law. Rather, the opposite seems to be the truth. The *Überseering* judgment’s demonstration of an inbound-outbound distinction is as clear as possible.

It is nothing inherently illogical about distinguishing between inbound and outbound situations. It is completely coherent to hold the position that the Member State whose law provides an entity with legal personality or its equivalent, should have some more authority over that entity than the Member State that is in the role of becoming a host of the entity.

Still, keeping in mind what I said earlier about the importance of the effectiveness of the fundamental freedoms, there must be one or more out-

42 Ibid.

43 Ibid.
balancing reasons for keeping the outbound situations of primary establishment outside the protection of the principle of free establishment. For, at the end of the day, no one can deny that such an exception from the principle is a major blow to the right of establishment – and, moreover, an unfortunate impediment to the advancement of the European single market and the whole integration agenda.

I claim there are three distinct but concurrent reasons for the inbound-outbound distinction and the consequent restraint on freedom of establishment. The first is a proper conformance to precedents, the second relates to connecting factors, and the third has to do with the legislative development.

### 3.2 Respecting Precedents

Before I directly discuss the treatment of precedents in the Cartesio judgement, I will give my analyses a useful prologue by making some general jurisprudential observations.

The idea of European integration is unpopular among a large part of the public in many European countries. In the democratic system of Europe, politicians do of course have to rely on the support of the electorate, and from the beginning of the EU even pro-integration politicians have been reluctant to pursue a progressive means to secure the success of the European project. Instead the judicial apparatus became the driving force of progress, the motor of integration. It is not least in this context that case-law has played a fundamental role in the development of the EU legal order, for instance. by forming key principles as the supremacy of European law over national law, the direct effect of European law, and the Member States’ liability for damages caused to EU citizens because of a breach of European law by the States. This weight that is put on the judicial branch within the EU system resembles the underlying philosophy of common law jurisdictions where precedents have more leverage and are more prominent in shaping the law than in civil law jurisdictions. The legal scholars K. Zweigert and H. Kötz explain the civil law approach nicely in their *An Introduction to Comparative Law* by pointing to the political origin of the system:

> In France … after the Revolution had destroyed the ‘noblesse de robe’ of the ancien régime, the judges of the restored Empire, like the judges of Prussia and Austria, saw themselves as ‘servants
of the state’, anonymous members of a Ministry of Justice which appointed, promoted, remunerated, decorated, and pensioned them off, operating a code conceived as comprehensive and conclusive, and following an extreme doctrine of the separation of powers which sought to restrict to the minimum the judges’ scope for creativity and which claimed that the disputes of real life could be resolved by mere acts of subsumption.\footnote{K. Zweigert & H. Kötz (1977), \textit{An Introduction to Comparative Law} (revised 3rd edn., translated by Tony Weir, Oxford: Clarendon Press, 1998), p. 258.}

One can easily see that the circumstances of the ECJ has from the very beginning been quite different from this description. The political reality of the European Community has entailed a legal structure which has given the ECJ much greater and more creative role than the judiciary has in the quoted text above.

On the other hand, the more independence and weight that the judiciary and the case-law has in the common law system, influences its forms of procedure, which is eloquently explained by the brilliant scholar Roscoe Pound:

\begin{quote}
Behind the characteristic doctrines and ideas and technique of the common-law lawyer there is a significant frame of mind. It is a frame of mind which habitually looks at things in the concrete, not in the abstract; which puts its faith in experience rather than abstractions. It is a frame of mind which prefers to go forward cautiously on the basis of experience from this case or that case to the next case, as justice in each case seems to require, instead of seeking to refer everything back to supposed universals. It is a frame of mind which is not ambitious to deduce the decision for the case in hand from a proposition formulated universally.\footnote{Ibid., p. 259.}
\end{quote}

This faith in experience rather than abstractions brings forth another interrelated feature of a common law system: the binding force of precedents, or \textit{stare decisis} in latin, i.e. the view that lower courts are bound by rulings handed down by higher courts and that higher courts are bound by their own precedents. Outside of common law countries it is arguably more appropriate to speak of a precedent having a certain degree of persuasive force rather than being binding.

But, as I have touched upon, the binding element of precedents is never absolute and there is an upper limit of how rigorously they can be followed. Any legal system has to have a minimum flexibility for its judiciary to avoid following unsatisfactory previous decisions and to secure a proper development of the law.
Such deviation from precedents, either by simply overturning them, which is never a frequent approach, or by using a more subtle tactic of ingeniously distinguishing earlier precedents from the case at hand.\footnote{As the Hungarian lawyer Rita Szudoczky points out, the ECJ has never expressly overruled its precedents, but has been diligent and resourceful in the act of distinguishing cases. (Rita Szudoczky (2009), ‘How Does the European Court of Justice Treat Precedents in Its Case Law? Cartesio and Damseaux from a Different Perspective: Part I’ (Intertax, 37 (6)), p. 349).} To distinguish a precedent can be done by defining the ratio decidendi of an earlier case in a way that the part of the judgement which could have had a precedential value for the case at hand, is categorized as a mere obiter dictum, not requiring consideration. It can also be done by differentiating between the facts of the two cases and deem them to lack necessary analogy. Another factor is that the binding force of a judgement decreases usually slowly by time, making the gravity of recent precedents stronger than the gravity of older ones. In addition, if a ruling is thought to be mistaken not in judgement but on the legal facts, e.g. based on an invalid directive, the case is not considered to have any binding force.

However, any legal system has also to have a minimum respect for precedents. Without a considerable compliance to earlier decisions the legal system would be in a dysfunctional mode, caused by a grave unpredictability and a sense of unfairness – because analogous situations would not be treated in the same way. As Zweigert and Kötz put it, the norm of following precedents ‘provides at least some degree of certainty upon which individuals can rely in the conduct of their affairs as well as a basis for orderly development of legal rules’.\footnote{Zweigert & Kötz (1977), pp. 261-262.}

Such induction from reason is also evident in deduction from actual practice, as for instance the scholars René David and Henry P. De Vries observed in the case of the prototype civil law country of France:

Despite the absence of a formal doctrine of stare decisis, there is a strong tendency on the part of the French courts, like those of other countries, to follow precedents, especially those of the higher courts. … The Cour de Cassation can, of course, always overrule its own prior decisions. But it is equally certain that it will not do so without weighty reasons.\footnote{René David & Henry P. De Vries (1958), The French Legal System (New York: Oceana Publications for Parker School of Foreign and Comparative Law, Columbia University). p. 113f; cf. Zweigert & Kötz (1977), p. 262.}
These facts illustrate the natural balance there has to be regarding precedents, between flexibility, on the one hand, and rigorousness, on the other hand. The existence of such natural balance is a remembrance neither to overestimate the difference between the civil- and common law systems nor to have a one-sided view of precedents as a source of law. So, a future-orientated “progressive jurisprudence”, which serves either some particular fairness or some foundational structural aim, is unbalanced and harmful if it does not strike a balance with a past-orientated “conservative jurisprudence”, which serves justice by securing equal treatment of equal cases and which maintains the stability of the system.⁴⁹ So, although the jurisprudence of the ECJ with regard to the binding force of precedents probably resembles civil law systems more than common law systems, there is always the need to upheld the certainty and the integrity of the system. The manifestation of this need is a reluctance to depart from previous case-law, except when there are compelling reasons to do so.

Such reluctance is evident in the Cartesio Judgement. After making clear what the real issue of the case’s fourth question was, which I accounted for in the first chapter, the ECJ turned to its previous case-law. The Court based its reasoning primarily on precedents, in particular the Daily Mail and Überseering, but to a lesser extent on Centros, Inspire Art, SEVIC Systems and CaixaBank France. The Court confirmed the most overt interpretation of Daily Mail and dealt with the subsequent case-law in the same direct and rational way I accounted for in the second chapter, or as it is put in relation to Überseering in paragraph 107 of Cartesio:

[T]hat a Member State is able, in the case of a company incorporated under its law, to make the company’s right to retain its legal personality under the law of that Member State subject to restrictions on the transfer to a foreign country of the company’s actual centre of administration.⁵⁰

The thrust of the Court’s reasoning was a repetition of the argument behind the Daily Mail ruling. In paragraph 104 one finds the premise that ‘companies are creature of national law and exist only by virtue of the national legislation which

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⁴⁹ By ‘foundational structural aim’ I mean a political vision which is backed by de jure acceptance of the sovereign, e.g. by statements in treaties, as is the case of the European integration idea.

⁵⁰ Cartesio, para. 107.
determines its [sic] incorporation and functioning’. In paragraphs 105 and 108 one finds the premises regarding the absence of uniform EC law in this respect, the variety of connecting factors, and the Member States freedom to choose between them. These premises are followed by an elaborated conclusion in paragraph 110 regarding the potency of Member States in cases of outbound situations of primary establishment:

[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 reorganize 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.51

This paragraph summarizes the legal understanding of the ECJ regarding the issue of the \textit{Cartesio} case, a legal understanding which is a result of an interpretation of \textit{Daily Mail} and \textit{Überseering}. It is possible to simplify the Court’s position by rephrasing the argument in the way that the first premise would be that the “raw material” of legal persons is the relevant company law of their Member State of incorporation. The second premise would be that the Member State of incorporation is the owner of the raw material, i.e. it owns its national law, and it can only be exported under the conditions that the Member State allows. The third premise would be that neither the principle of free establishment nor any current Community legislation are sufficient to either abolish or restrict the Member States’ ownership of the raw material which legal persons are incorporated by. And finally, the conclusion is inevitable: a legal person does not have a right to export its raw material without some form of approval from the raw material’s owner, the Member State of incorporation.

When the reasoning is put in this form, it becomes evident that the argument is indeed the same as the Court made in \textit{Daily Mail} and was confirmed in \textit{Überseering}.

\footnote{\textit{Cartesio}, para. 110.}
The ECJ mentioned other cases than *Daily Mail* and *Überseering* only in order to distinguish them by facts from the current case and thus to demonstrate that they did not have precedential value for *Cartesio*. The *SEVIC Systems* ruling was not considered to ‘relate to the same problem’ and therefore that it did not ‘qualify the scope’ of *Daily Mail* and *Überseering*.52 The reason that it did not relate to the same problem, according to the Court, was that it was a cross-border merger which had the same implications as an inbound situation and should therefore by categorized along with the cases of *Centros*, *Überseering* and *Inspire Art*.53 This is the same kind of inbound-outbound distinction as I made when I analyzed the case-law in chapter two.

So, it can justifiably be maintained that the ECJ’s ruling is an example of a sophisticated treatment of case-law and a seemly compliance with precedents. But was there not good enough reason to depart from the rule of *Daily Mail*? Is it not unfair to make the inbound-outbound distinction? When a company transfers its primary establishment across borders, is it not unsatisfactory to accept the company’s right to be recognized by its host state, but at the same time reject the company’s right to be allowed to leave by its home state? According to my reading of the *Cartesio* case, the Court’s answer of these questions is hidden in two subjects which are addressed in the judgement: ‘connecting factors’, on the one hand, and ‘legislative development’, on the other hand.

### 3.3 Caution Regarding Connecting Factors

In reading the ECJ’s reasoning for its conclusion in *Cartesio* it is not hard to see that concerns regarding connecting factors play a major role. In *Daily Mail* the Court had pointed out the empirical fact the Member States did not use the same connecting factor. It then interpreted Art. 58 TEEC (later Art. 48 TEC, now Art. 54 TEU) as presuming the legitimacy of this variety of connecting factors and that the Member State had the authority to choose between them. Such interpretation seems justifiable, as I have mentioned, and the issue was handled in the same way in *Cartesio*. The variety of connecting factors is discussed in paragraph 105.

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52 *Cartesio*, para. 121.

53 Ibid., para. 122. – As I have pointed out earlier, the double-edged characteristic of *Überseering* is due to the fact that although the case concerned an inbound situation, the outbound situation of *Daily Mail* was also addressed in an *obiter dictum*.
and the interpretation of the Treaty’s provision is confirmed and restated in paragraphs 106 and 108. The confirmation of this aspect of Daily Mail is one link in the logical chain that makes up the Court’s reasoning in Cartesio – and the matter is discussed right before the conclusion is reached regarding the potency of Member States:

[I]n accordance with Article 48 EC [54 TEU], in the absence of a uniform Community law definition of the companies which may enjoy the right of establishment on the basis of a single connecting factor determining the national law applicable to a company, the question whether Article 43 EC [49 TEU] applies to a company which seeks to rely on the fundamental freedom enshrined in that article – like the question whether a natural person is a national of a Member State, hence entitled to enjoy that freedom – is a preliminary matter which, as Community law now stands, can only be resolved by the applicable national law.54

If we put this in context to the above-mentioned metaphoric version of the argument, the connecting factor decides in what way the raw material, which companies are made of, is exported. It is thus at the core of the Cartesio judgement: if the legal framework of freedom of establishment is considered to require the Member States to have one particular connecting factor, for instance that only the ‘incorporation method’ would be compatible with the fundamental freedom, the Member States’ authority over the exportation of its raw material would be abolished – and legal persons would acquire the ownership of their raw material, which would enable them to transfer their primary establishment freely across borders while being made of the same raw material as before. If we continue with the metaphor we can say that one Member State’s authority to prevent the import of the relevant raw material from another Member State had already been seriously restricted by the recognition principle established for primary establishment in Überseering, SEVIC Systems and Segers, and for secondary establishment in Centros and Inspire Art.

I have pointed out that the cross-border mobility of primary establishment is not as well protected in the Treaty as such mobility of secondary establishment – and the ECJ has indeed ruled that the latter is more decisively protected than the former. This is especially true if the only alleged outbound secondary

54 Ibid., para. 109.
establishment judgement, *Cadbury Schweppes*, is considered to be an important precedent for that kind of situations. Such indulgence to the principle of free establishment has of course limited the authority of the Member States. The ECJ’s position regarding inbound situations of primary establishment, i.e. to impose duty on a host Member State to recognize foreign EU legal persons which transfer their real seat to its jurisdiction, has further limited the Member States’ authority. Furthermore, it has restricted a great deal the Member States’ freedom to choose a connecting factor. If a Member State is forced to recognize legal persons as belonging to its jurisdiction, without those legal person belonging to its jurisdiction according to the Member State’s connecting factor, then its chosen connecting factor is basically ineffective in all inbound situations.

If the same would apply to outbound situations of primary establishment the Member States’ command over connecting factors would not just be further restricted, it would virtually be eliminated. The question that the ECJ must have asked itself is whether the Court would not be too audacious if it would by its judgement take the power to decide the connecting factors from the Member States and, at the same time, harmonize the European Union legal order regarding connecting factors. The Court interpreted the EC Treaty as presuming the variety of connecting factors, but in order to estimate whether it would be a more satisfactory judgement to depart from its precedents by interpreting the fundamental freedom in a broad enough way to harmonize the connecting factors, the most natural jurisprudential step would be to analyze whether the will of the lawmaker had palpably changed since the signing of the Treaty – and that will be our next subject.

### 3.4 The Legislative Development

The European Court touches on the legislative development as a final justification for the course of action it eventually took in the *Cartesio* judgement. In paragraph 114 the Court pointed out the following regarding the legislative activity after the groundbreaking rulings in the *Daily Mail* and *Überseering* cases:

>[D]evelopments in the field of company law envisaged in Articles 44(2)(g) EC and 293 EC, respectively, as pursued by means of legislation and agreements, have not as yet addressed the differences, referred to in those judgements, between the
legislation of the various Member States and, accordingly, have not yet eradicated those differences.\textsuperscript{55}

This comment should of course be considered in context with the argument which the Court first made in \textit{Daily Mail} regarding that in the present state of EC law the right of legal persons in outbound situations of primary establishment was unprotected. I accounted for Arts. 44(2)(g) EC and 293 EC in relation to \textit{Daily Mail} and made a critical comment on their interpretation. But the comment should also be considered in a more general way: as the Court’s assessment of the legal development and whether the lawmaker has shown a willingness to depart from the precedents of \textit{Daily Mail} and \textit{Überseering}. After concluding that such will was not directly demonstrated, the Court went on by assessing whether it was indicated indirectly by the lawmaker. That assessment was made in context with the Commission’s view that legislative actions had sufficiently addressed the issue and removed the hindrance of freedom of establishment which was evident in \textit{Daily Mail}’s conclusion:

The Commission maintains, however, that the absence of Community legislation in this field – noted by the Court in paragraph 23 of \textit{Daily Mail and General Trust} – was remedied by the Community rules, governing the transfer of the company seat to another Member State, laid down in regulations such as Regulation No 2137/85 on the EEIG and Regulation No 2157/2001 on the SE or, moreover, Council Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for a European cooperative society (SCE) (OJ 2003 L 207, p. 1), as well as by the Hungarian legislation adopted subsequent to those regulations.\textsuperscript{56}

Here, the ECJ mentioned three European Regulations which the Commission held that should be applied \textit{mutatis mutandis} to the situation of the \textit{Cartesio} case, leading to a ruling in favor of the Hungarian undertaking. First, the Court mentioned Regulation on the European Economic Interest Grouping, which was enacted roughly three years before \textit{Cartesio}. Secondly, the Regulation from 2001 on a statute for a European company, i.e. a European Union public limited-liability company form, known under its Latin label, \textit{Societas Europaea} (SE). And thirdly, the Council Regulation on a co-operative type of company, which was passed

\textsuperscript{55} Ibid., para. 114.

\textsuperscript{56} Ibid., para. 115.
into law in 2003 but did not become applicable until 2006. – The Court’s assessment of these regulations was contrary to the Commission’s evaluation, as is revealed in paragraph 117:

[[I]t should be noted that although those regulations, adopted on the basis of Article 308 EC, in fact lay down a set of rules under which it is possible for the new legal entities which they establish to transfer their registered office (siège statutaire) and, accordingly, also their real seat (siège réel) – both of which must, in effect, be situated in the same Member State – to another Member State without it being compulsory to wind up the original legal person or to create a new legal person, such a transfer nevertheless necessarily entails a change as regards the national law applicable to the entity making such transfer.\(^{57}\)

So, the ECJ concluded that the idea which was manifested in the Regulations, was not the idea of legal persons’ free transfer of primary establishment without a change of their personal law, but the idea that legal persons in such situation should preserve their \textit{identity} while they would have to adopt a new personal law in accordance with the laws of the host state.

This verdict marks the final turning point of the \textit{Cartesio} Judgement. After the Court had rejected the view that the lawmaker had directly or indirectly expressed its will to overturn the restrictions of free establishment that results from \textit{Daily Mail}, its final crossroads was passed and the destination determined.

The next paragraph featured a more precise reasoning in the form of a reference to particular provisions of the statute for \textit{Societas Europaea}, namely Articles 7 to 9(1)(c)(ii) of the Regulation No. 2157/2001. The first of these provisions is as follows:

The registered office of an SE shall be located within the Community, in the same Member State as its head office. A Member State may in addition impose on SEs registered in its territory the obligation of locating their head office and their registered office in the same place.\(^{58}\)

So, the provision requires SE companies to have their registered office and its head office within the same Member State – and thus literally makes the ‘real seat method’ the connecting factor for this type of companies. On the other hand, a connecting factor based on the incorporation theory is literally outlawed for SE

\(^{57}\) Ibid., para. 117.

\(^{58}\) Regulation No. 2157/2001, Art. 7.
companies, the most prominent pan-European type of business organization. This prompted the Oxford Corporate Law Professor Paul Davies to point out the following in his *Introduction to Company Law*:

> In the Community legislature the real seat doctrine has received a fairer wind. On the one hand, the SE may move its registered office freely from one Member State to another (subject to certain shareholder and creditor safeguards), but its registered office must be in the same Member State as its head office. If this ceases to be the case, the state of registration must take steps to require the SE either to move its head office back to the state of registration or to move its registered office to the State where its head office now is; failing either of these things, the state of registration must have the SE wound up.

This is not of a minor importance, because if the ECJ had ruled against the Hungarian authorities and in favor of the Hungarian undertaking, the Court would automatically be ruling against the real seat theory and in favor of the incorporation theory. In other words, the Court would have been making the real seat doctrine impossible for Member States with regard to their national legal persons, while the European lawgiver makes the ‘real seat method’ the sole connecting factor for its predominant company form. One could argue that such outcome would have been based on a highly questionable jurisprudence, in fact that it would have required judicial audacity beyond accepted limits.

However, the lawmaker’s will is not as clear-cut as the text of Art. 7 of the Regulation suggests. In that regard, professor Davies made the following observation regarding the provision:

> It has all the hallmarks of a temporary arrangement, arrived at for the purpose of getting a version of the SE Statute through the Community’s legislative process. Thus, Recital 27 of the Preamble makes it clear that the rule for the SE is not intended to require Member States which follow the incorporation theory to adopt the real seat theory for domestic companies nor is it to be regarded as pre-empting any decision which may be made on the matter in future Community company legislation. In addition, Art. 69 requires the Commission to initiate a review of the Regulation within five years of its coming into force and one of the subjects specified for review is “allowing the location of an

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SE’s head office and registered office in different Member States\textsuperscript{61}

This reveals the lawmaker’s indecisiveness on the matter. It also reveals that it was definitely not the lawmaker’s intention to affect the Member States’ possibility to follow the incorporation theory. But such statements strongly indicate the willingness to preserve the Member States’ choice of connecting factors, so a judgement of the ECJ that would virtually make the ‘real seat method’ ineffective seems to be against the comment in Recital 27. Moreover, the lawmaker’s indecisiveness does hardly count in favor of overturning the Daily Mail ruling; rather the Court would have needed to find a decisive will of the lawmaker to depart from the precedent in order to have the jurisprudential resources to do so.

The Hungarian jurists Veronika Korom and Peter Metzinger have argued that the Court’s position on this issue is based on a misconception of the actual facts of the Cartesio case:

\[T\]he Court exposed that the rules referred to by the Commission concerned the transfer of the seat followed by the modification of the national law applicable to the entity making such transfer. Cartesio however merely wished to transfer its székhely (transfer of real seat incidentally leading to simultaneous transfer of statutory seat) from Hungary to Italy without any change in the applicable national law.\textsuperscript{62}

This criticism, however, is to be rejected. The transfer of the székhely, where the entity’s real seat and its registered statutory seat are combined, is in fact comparable with a simple transfer of the real seat. It is not the registered office that matters, but the intention to transfer the real seat while preserving the personal law. If the Court would have ruled in favor of Cartesio bt., the Hungarian authorities would have been obliged to allow the transfer, whether or not the

\textsuperscript{61} Davies (2008), p. 145. – “In the context of an integrated market, the Commission proposed, in 1970, the Statute for the European Company, officially named the Societas Europaea (SE). The idea behind the SE was to create a supranational business organization to enable enterprises to restructure their businesses at Community level. The original proposal was very ambitious. The Commission suggested that the statute cover all aspects of modern company law to avoid the application of divergent national laws, but the proposal was substantially amended and weakened in that respect before it was eventually adopted in 2001. As a result, the SE Regulation on the Statute of the SE and the SE Directive supplementing the statute with regard to the involvement of employees entered into force on 8 October 2004.” (Adriaan Dorresteijn, Tiago Monteiro, Christoph Teichmann, and Erik Werlauff (2009), European Corporate Law (2nd edn., Alphen aan den Rijn: Kluwer Law International), pp. 103-104).

undertaking would be registered in Hungary or not. If the Hungarian authorities would after such judgement want to have entities with Hungarian personal law registered in Hungary, they just would have to change their company statute to make that possible.

Art. 81 of the SE Regulation is a source of another important observation of the ECJ, namely that although company’s personal law is not preserved in case of cross-border transfers of primary establishment, the lawmaker wants the company’s personal identity to be preserved: ‘The registered office of an SE may be transferred to another Member State in accordance with paragraphs 2 to 13. Such a transfer shall not result in the winding up of the SE or in the creation of a new legal person.”63 In the second edition of European Corporate Law by Dorresteijn, Monteiro, Teichmann and Werlauff, the SE company form is said to open up ‘new possibilities for the restructuring and internationalization of European businesses’ and the not-winding-up quality in case of cross-border transfers is said to offer ‘flexibility’, which is generally denied to legal persons ‘operating under national law’.64 This kind of flexibility, i.e. law-changing but identity preserving transfer, is something that the ECJ clearly takes as a prototype, provided by the lawmaker, of how the legal order should be in this field. It serves as a compromise between the principle of free establishment and Member States’ freedom to choose connecting factors – and the Court was eager to introduce this compromise in an obiter dictum in Cartesio. That will be the subject of my next sub-chapter, but an appropriate final remark in this one is that the legislative development and the contemporary will of the lawmaker seem to have played an important role in the Court’s decision. The judgement was more than in line with the development, it was tailored to it.65

The ECJ’s final remarks in Cartesio regarding the legislative development are to be found in paragraphs 119 and 120 of the judgement:

As it is, in the case before the referring court, Cartesio merely wishes to transfer its real seat from Hungary to Italy, while

63 SE Regulation, Art. 8(1).

64 Dorresteijn, Monteiro, Teichmann and Werlauff (2009), p. 104.

65 In the fifth chapter, ‘The Need for Legislative Change’, a few more examples of the legislative development are mentioned, which are all in line with the conclusion of this sub-chapter.
remaining a company governed by Hungarian law, hence without any change as to the national law applicable.\textsuperscript{66}

Accordingly, the application \textit{mutatis mutandis} of the Community legislation to which the Commission refers – even if it were to govern the cross-border transfer of the seat of a company governed by the law of a Member State – cannot in any even lead to the predicted result in circumstances such as those of the case before the referring court.\textsuperscript{67}

### 3.5 The Obiter Dictum

The first part of how the \textit{Cartesio} judgement was tailored to the legislative development was its main conclusion to rule in favor of the Hungarian authorities and thus reject that Cartesio bt. had the right to transfer its seat to Italy while continuing being incorporated under Hungarian law. The second part of how the judgement was tailored to the will of the lawmaker, as it was manifested in the Regulations, was the Court’s \textit{obiter dictum} in the case, which I accounted for in chapter one. I explained the approval of a personal law changing but an identity preserving transfer as the Court’s effort to indicate the continuing effectiveness of the principle of free establishment, in spite of a ruling which reduced its effectiveness. But a speculation of the motive behind the \textit{obiter dictum} does not explain why it took the form it did. This sub-chapter will cast light on that by providing substantial reasons for the Court’s ruling.

The ECJ elaborated on its position regarding legal persons’ identity-preservation in case of their cross-border transfer of real seat, by stating that the Member States’ power to define the connecting factor did not at all mean ‘that national legislation on the incorporation and winding-up of companies enjoys any form of immunity from the rules of the EC Treaty on freedom of establishment’.\textsuperscript{68} Moreover, the Court particularly stated that the before-mentioned power of the Member State could not be used to require ‘the winding up or liquidation of the company’ in order to prevent ‘that company from converting itself into a company governed by the law of the other Member State, to the extent that it is permitted

\begin{itemize}
\item \textsuperscript{66} \textit{Cartesio}, para. 119.
\item \textsuperscript{67} Ibid., para. 120.
\item \textsuperscript{68} Ibid., para. 112.
\end{itemize}
under that law to do so'.

This last thing mentioned is of a particular interest, because it suggests that the ECJ is only suggesting an obligation on behalf of the home country, but not the host country. In other words: the host states do not have to permit an identity-preserving conversion of a legal person into an entity incorporated under their law, but home states, on the other hand, must recognize the legal person’s right to convert in that way. Why the Court makes such distinction between the home state and the host state is not clear. A reflection on the situation might help to understand the difference. The obligation put on the home state is in the form of recognizing a right of an entity established under its law to transform itself to be a product of a different legislation, but an obligation of the host state would not be in the form of any kind of recognition. Rather, it would be an obligation to change its legal framework in order to make the conversion possible. The Court might consider the latter kind of obligation to be too intrusive to the sovereignty of the Member States.

Still, the home state’s obligation to recognize the legal person’s right to an identity-preserving conversion is not absolute, as the next paragraph of the judgement reveals:

Such a barrier to the actual conversion of such a company, without prior winding-up or liquidation, into a company governed by the law of the Member State to which it wishes to relocate constitutes a restriction on the freedom of establishment of the company concerned which, unless it serves overriding requirements in the public interest, is prohibited under Article 43 EC (see to that effect, inter alia, CaixaBank France, paragraph 11 and 17).

So, the Gebhard test is made applicable regarding the conversions in question; they could be prevented by the home state if such a measure served overriding requirements in the public interest. In the parenthetical remark at the end of the paragraph the Court referred to the CaixaBank France case, where Art. 49 TEU was said to require ‘the elimination of restrictions on the freedom of establishment’ and that all ‘measures which prohibit, impede or render less

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69 Ibid.

70 Ibid., para. 113.
attractive the exercise of that freedom must be regarded as such restrictions’. A little later in the CaixaBank France ruling, an exception is spelled out: ‘a measure ... may be justified where it serves overriding requirements relating to the public interest, is suitable for securing the attainment of the objective it pursues and does not go beyond what is necessary in order to attain it.’

This a classic formulation of the Gebhard test, which needs no further discussion here. But one could wonder whether the ECJ is not going astray by elaborating in this way on its obiter dictum, i.e. by addressing in such details an issue which is strictly speaking not relevant to the facts in Cartesio. The answer is most likely to be found in what I touched on in chapter one: the court wanted to make up for its anti-free-establishment conclusion and to decrease the unfortunate uncertainty which was likely to result from the ruling. The Court was eager to point out that it is the ‘personal law’ which is the primary issue. Moreover, a wound up and a liquidation of a legal person can be a very harsh and disadvantageous action and the Court must have considered necessary to make clear that the home Member State has no authority to demand such a measure when an undertaking seeks to transfers its real seat to another Member State by simultaneously converting its personal law into the law of the host Member State, unless legitimate exceptions allow the hindering of that kind of conversion.

But does the obiter dictum sufficiently decrease the legal uncertainty and does it sufficiently pave the way for the type of transfers which it deems lawful? Arguably not – and the reason is the above-mentioned qualification that the conversion can take place ‘to the extent that it is permitted under [the host Member State] law to do so’. The decision not to put any obligation on the host state makes the obiter dictum quite ineffective, because under the current national laws of EU countries such conversion seems generally impossible, as Korom and Metzinger have pointed out:

A quick survey reveals that currently the national company laws generally lack any regulating permitting international

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72 Ibid., para. 17.
transformations. This is for example the case under German and Austrian law, while under French law the position is unclear.\textsuperscript{73} It would be curious if a case were brought before the ECJ where the reason for a prevention of a seat transfer would be the fact that a conversion is not permitted by the law of the host state. In such a case, the Court would in no way be bound by the qualification of its \textit{obiter dictum} in \textit{Cartesio}, although it would be jurisprudentially prudent to at least address it, and either confirm it in the new case’s \textit{ratio decidendi} or depart from it on grounds of solid reasons. My prediction is that the Court would look for every acceptable way to deviate from the qualification by obliging the host state to provide the necessary legal framework for identity-preserving conversions. An alternative conclusion would arguably be too restrictive for the fundamental freedom of establishment.\textsuperscript{74}


\textsuperscript{74} I will account for a couple of problematic aspects of \textit{Cartesio’s obiter dictum} in the fifth chapter.
4. Overall Jurisprudential Assessment

There are ... two minimum conditions necessary and sufficient for the existence of a legal system. On the one hand those rules of behavior which are valid according to the system's ultimate criteria of validity must be generally obeyed, and on the other hand, its rules of recognition specifying the criteria of legal validity and its rules of change and adjudication must be effectively accepted as common public standards of official behavior by its officials.

– H.L.A. Hart

4.1 Overview of Criticism and Endorsement

The *Cartesio* Judgement sparked a great controversy and it has been harshly criticized by many scholars. One of the critics is the jurist Jan Bohrenkämper who wrote an article in the journal *European Law Reporter*, where he expressed views that are quite typical for the criticism of the *Cartesio* case:

What should cross-border company law be like? The *leitmotiv* should be the idea of one single market or legal area where a legal person should act such despite the fact that its existence depends on the law of a particular Member State. However, the *Cartesio* case did not contribute to achieving this aim. As the alleged difference the Court draws between exit and entry situations seems artificial and questionable, *Daily Mail* has been decided wrongly; but triply insisting on its validity in *Cartesio* makes it even worse. On this long and winding road towards freedom of establishment within the Internal Market, *Cartesio* regrettably represents a mere stop-over.

Here, Bohrenkämper begins with the teleological statement that the principle aim of European corporate mobility rules should be the single market idea, and he claims that the ruling in *Cartesio* is contrary to that aim. Next he criticizes *Daily Mail* as a precedent and the distinction of exit and entry situation or what I have called outbound and inbound situations. Then he swings right back to teleology by stating, in a poetic way, that the judgement puts the acquirement of freedom of establishment on hold temporarily, or, to use his metaphor, that the judgement


'regrettably represents a mere stop-over'. It is hard not to put this kind of criticism in the category of an overly progressive jurisprudence on behalf of a critic.

Among other critical jurists are Korom and Metzinger, who e.g. point out a dissimilarity between Cartesio and Daily Mail, which made the former case a more radical ruling against free establishment than the latter:

The Court's position in Cartesio is “tougher” and more conservative than that in Daily Mail. In fact, the English law examined in Daily Mail was much less restrictive of the seat transfer than the Hungarian law in Cartesio. English law did not exclude the seat transfer per se, it merely made it subject to certain (acceptable) conditions. Hungarian law however prohibited the seat transfer altogether. Albeit this difference between the national laws in question was an important point in the argumentation of both Cartesio and AG Maduro, the Court did not address the issue in its judgement.

This is true. However, as the ECJ dealt with the Daily Mail case, the result for the legal order was de facto the same as of the Cartesio judgement. Moreover, one must keep in mind that the legal understanding which the Court considered itself to be confirming in Cartesio was the same as was expressed in Überseering, and the ECJ frequently referred to that case along with Daily Mail in its Cartesio ruling. But there is no doubt that a significant theme in the critical review of many jurists – including Bohrenkämper, Korom, Metzinger, Carsten Gerner-Beurle, Michael Schilling, Petra Novotná, Oliver Valk and Beata Węgrzynowska – has indeed been a discontent with the Daily Mail judgement, the inbound-outbound distinction that it was based on, and the confirmation of that judgement along with that distinction in the Cartesio case. I have accounted for these controversial issues in this thesis.

Against this bulk of criticism there are dissident voices who agree with the Cartesio Judgement. The most eloquent of the supporters of the ruling is Tom O'Shea, lecturer at University of London, Queen Mary, who endorsed both the Daily Mail and its confirmation in Cartesio – and explained the conclusion in a clear and convincing way:

The Court’s ruling in Cartesio follows the reasoning it adopted in Daily Mail but extends the scope of freedom of establishment

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78 The names and publications of their papers can be found in my list of cited works (pp. 86-90).
considerably from an origin member state perspective. [...] The Court confirmed its Daily Mail decision and determined that the Hungarian rules were not incompatible with the freedom of establishment because to enjoy that freedom the company had to have the necessary connecting factor with the territory of its member state of incorporation. This was a matter governed by the domestic rules of that member state in the absence of any harmonized Community rules. Thus, the member state of incorporation has the right to determine when the company came into existence as a national company and the right to determine whether the company maintained that link with the territory of the member state of incorporation. 79

Both the views against and for the Cartesio judgement can be easily comprehended by those who have read the first three chapters of this thesis. Although the critics are more in number than the supporters, the former tend to possess less objectivity and clarity in their attacks than the latter in their defenses; in other words, the critics’ attacks tend to be more biased and murkier. They tend to overlook two things in particular. First, that there are genuine technical problems which apply to legal persons but not to natural persons, or, as it is put in a popular book on EU law by Paul Graig and Gráinne de Búrca:

Although [Article 54 TEU] requires companies to be treated in the same way as nationals for the purposes of the Treaty provisions on freedom of establishment, this is not strictly possible, given the differences between natural and legal persons. 80

The second thing the critics tend to avoid is that the Cartesio judgement showed many signs of proper legal methodology and a prudent way of solving the dispute, while their own approach is at times less keen on sophistication; a comprehensive perspective is sacrificed for a purpose-driven outlook. A stable and successful legal system requires that a progressive, future-orientated and teleological way of deciding cases, is tempered by a past-orientated respect for precedents. As I have demonstrated, the way which the ECJ decided the Cartesio case – how it distinguished the case-law, how it interpreted the law in accordance with both the intention of the lawmaker and the legal development, how it showed consistency in many aspects, and etc. – was more or less


according to commonly accepted standards of jurisprudence. At the end of the day, some legal changes or “corrections” have to be imposed by legislation rather than being reached by an effort of the judiciary. One young critic, Rita Szudoczky, frankly admits this at the end of her paper:

The lack of legal means to freely transfer within the EC the place where a company’s core management and business activities are carried on is one of the most severe obstacles to the freedom of establishment in the internal market nowadays. The ECJ’s unwillingness to remove this obstacle must have been motivated by more than its recognized reluctance to expressly overrule an existing precedent. It is likely that the ECJ did not change the status quo because of policy considerations. It must have been taking the view that a step that would practically harmonize the conflict of laws connecting factors for companies in the EC should be taken by the Community legislator rather than the judicial body. Ideally this should indeed be a task for positive legislation.\(^{81}\)

This is a good analyses of the judgement and a vice remark at the end. But unfortunately she continued by adding the following: ‘However, if we take into account how far the ECJ went with negative integration in other fields, such as direct tax law, this attitude is less explicable.’\(^{82}\) The ECJ’s jurisprudence in the field of direct tax law is not the subject of this thesis, but the remark reflects an harmful approach to legal issues, namely that one ill-founded judgement justifies another. A better approach would be to let a sound jurisprudence be consistent, but let unsound jurisprudence be as rare as possible. What is at stake is the accountability of the judiciary and the rule of law.

### 4.2 Rule of Law

Any question on the appropriateness of certain jurisprudential approach, at least within the boundaries of the Western Civilization, ultimately touches on the corner-stone concept of ‘rule of law’. The exact meaning of rule of law is multiform and fluid, but some definitions are surely better than others.

The rule of law is an underlying feature of the European Convention for the Protection of Human Rights and Fundamental Freedoms from 1950, which has all the EU Member States among its signatories. The jurist Marius Emberland


\(^{82}\) Ibid.
claims in his recent book, *The Human Rights of Companies: Exploring the Structure of ECHR Protection*, that the rule of law is helpful in explaining ‘why corporate persons enjoy ECHR protection’, which the European Court of Human Rights (ECHR) has been expanding in its case-law. But how does the ECHR define the rule of law? Emberland gives a good account of its rational and sapient position:

Based on its case law it can be inferred that the Convention’s notion of the rule of law equals a ‘formal’ rather than a ‘substantial’ conception of the principle. The formal conception is occupied with providing a system in which governmental action is subjected to law in order to prevent arbitrary exercise of power and to secure equality and foreseeability in law.

This formal meaning of the rule of law is, as Emberland points out, in line with the conception of the distinguished legal philosopher Joseph Raz – except of the issue of equality:

The Rule of Law is just one of the virtues which a legal system may possess and by which it is to be judged. It is not to be confused with democracy, justice, equality (before the law or otherwise), human rights of any kind or respect for persons or for the dignity of man.

But if a rule of law is a purely formal concept according to the ECHR, how can it have anything to do with why corporate persons enjoy ECHR protection, as Emberland argues. The answer lies in how certain formal rules unavoidably influence substantial law, as is easy to read between the lines when e.g. the United Nation’s definition is considered:

A principle of governance in which all persons, institutions and entities, public and private, including the State itself, are accountable to laws that are publicly promulgated, equally enforced and independently adjudicated, and which are consistent with international human rights norms and standards. It requires, as well, measures to ensure adherence to the principles of supremacy of law, equality before the law, accountability to the law, fairness in the application of the law, separation of powers, participation in decision-making, legal

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84 Ibid., p. 45.

certainty, avoidance of arbitrariness and procedural and legal transparency.\textsuperscript{86}

Here, private entities are mentioned as accountable to laws and thus bearing responsibilities. The other side of that coin is to have certain rights – and that is what must lie behind Emberland’s claim.

But what relevance has this discussion to the \textit{Cartesio} judgement and its meaning? The relevance is twofold. First, it raises a question regarding whether the post-\textit{Cartesio} legal situation has been changed after the Charter of Fundamental Rights of the European Union (CFREU) had full effect by the entry into force of the Lisbon Treaty on December 1st 2009, i.e. if the charter will cause the ECJ to give legal persons more rights. It is possible that it will change some aspects of company rights, as Emberland maintains, but there is no reason to think that it will affect corporate mobility issues in any way. Art. 16 CFREU says that the ‘freedom to conduct a business in accordance with Union law and national laws and practices is recognized’, but such an acknowledgement has hardly any meaning for \textit{how} business is conducted. There is neither anything in the case-law of ECHR that would affect the legal situations regarding free establishment.

The second and more important relevance has to do with the jurisprudence of the \textit{Cartesio} judgement, i.e. whether the ECJ honored the rule of law and whether it would have done so in a better or worse way if it had reached an alternative conclusion. What I am primarily concerned with in this regard are the intertwined aspects of foreseeability, legal certainty, avoidance of arbitrariness, and legal transparency. These are exactly the aspects that the British judge Lord Thomas Bingham emphasizes in his recent book \textit{The Rule of Law}.\textsuperscript{87} Bingham’s principle of the rule of law is that the law ‘must be accessible and so far as possible intelligible, clear and predictable’.\textsuperscript{88} One of the reasons he mentioned to support his proposition is business-related and, according to him, ‘extremely compelling’: ‘the successful conduct of trade, investment and business generally


\textsuperscript{87} The book was published shortly before Lord Bingham’s death in 2010.

is promoted by a body of accessible legal rules governing commercial rights and obligations. When this wisdom is kept in mind, the analysis changes of what kind of judicial rulings are in the long run beneficiary for the success of the European Union and the advancement of its business environment. The benefits of progressive judgements to serve the political aim of a single market can eventually turn into casualties, because a too loose methodology in deciding cases can be counter-productive.

However, the rule of law does of course not prevent all discretion. The necessity to decide cases, even if the law runs out or if sources of law are inadequate, compels judges to develop the law in certain direction. They do it in a way where they are not just declaring what the law is, but rather in a way which makes it linguistically proper to say that they ‘make’ the law. What matters is that the judiciary is wary of not crossing the indefinite line between itself and the legislative branch – and as a result breaking the eighth of Lon Fuller’s famous ‘eight routes of failure for any legal system’, namely to create divergence between adjudication and legislation. The legal philosopher Mark C. Murphy uses a good metaphor in describing the judicial activity:

[T]o apply the rules to a case is to take those rules as one’s guide in reaching the decision in the case. Applying rules is like using a map: to use a map is to take it as a guide to determining locations, or to finding one’s way on a real or imagined trip; to apply rules is to take them as a guide to determining the result of a real or hypothetical case.

To find the most appropriate destination on such a map is not easy and there can be profound disagreement between navigators. The more indecisive the rules are, the more arbitrary the destination will become. Surely, there are other schools of thought with different perspective, e.g. the American Realists, who are rule-skeptics in a way that the University of Chicago professor Brian Leiter has explained well:

[They] located the indeterminacy of law not in general features of language itself, but in the existence of equally legitimate, but

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89 Ibid., p. 38.


conflicting, *canons of interpretation* that courts could employ to extract different rules from the same statutory text or the same precedent.\(^{92}\)

Instead of rules, according to the Realists, judges consider the facts in each case and apply fairness to reach conclusion. But even from that perspective, a well functioning legal system has to have some predictable patterns in its method to decide cases in order to avoid uncertainty about the law. To establish predictable patterns the judiciary has to honor methodological duties and keep its teleological aspiration in check.\(^ {93}\) The rationale behind such jurisprudence is of course not only based on a systematical concerns, but also on a notion of justice. The Berkeley professor Daniel A. Farber discusses this in *The Jurisprudential Foundations of Corporate and Commercial Law*, and makes for instance the following reference to Ronald Dworkin’s views:

> Even if the application of existing legal rules to the case is not clear-cut, Ronald Dworkin has argued, the parties are entitled to a decision based on the best possible interpretation of existing legal rules, precedents, and principles, not on “social engineering” for the future.\(^ {94}\)

In this respect it has to be noted that an alternative conclusion in *Cartesio* would not necessarily have been a judicial social engineering. It could have been rooted in a direct and clean-cut interpretation of a principle, manifested in Treaty provisions. But such an interpretation would have deviated from previous case-law, without a ground in the legal development, and with radical consequences for conflict-of-law rules of Member States.


\(^{93}\) Lon Fuller discusses the morality of duty and the morality of aspiration in his *The Morality of Law*. One can argue that past-orientated jurisprudence resembles the morality of duty, while future-orientated jurisprudence resembles the morality of aspiration. “The morality of aspiration is most plainly exemplified in Greek philosophy. It is the morality of the Good Life, of excellence, of the fullest realization of human powers. [...] Where the morality of aspiration starts at the top of human achievement, the morality of duty starts at the bottom. It lays down the basic rules without which an ordered society is impossible, or without which an ordered society directed toward certain specific goals must fail of its mark. It is the morality of the Old Testament and the Ten Commandments.” (Fuller (1964), p. 5).

This survey of themes regarding the rule of law is fruitful for a jurisprudential analysis of the *Cartesio* judgement and a necessary prologue to the conclusion of my overall assessment of it, which will be my next subject.

### 4.3 Conclusion Regarding the Jurisprudence

The *Cartesio* case received a lot of attention, for a reason that is well formulated in the following observation of Rita Szudoczky: it concerns ‘previously addressed issues in a rather direct manner so that the ECJ can hardly avoid to make a clear pronouncement on whether the previous cases still represent good law or should be considered overruled’. The results are clear: the previous case-law is upheld instead of overruled. Szudoczky maintains that this conclusion ‘did not bring about relevant change in the ECJ’s approach to precedents’ and added that ‘it did not become the first judgement in which the ECJ expressly overrules previous case law’. She is right regarding the second point, but I disagree with her first point: I don’t think that an alternative conclusion would have represented a relevant change in the Court’s approach. Rather, the Court’s decision was important to reinforce a certain approach, namely a respect for a jurisprudence where a strict legal methodology is respected and where compelling reasons are needed to depart from previous case-law.

In putting the ECJ’s pre-*Cartesio* jurisprudence in context with the rule of law, one can argue that the reason Szudoczky mentions for the attention *Cartesio* received, is a sign that there has been too much methodological unpredictability – and that it was in fact the lack of such predictability that caused both scholars and the legislative branch to be unsure about the legal status of outbound situations of primary establishment. The Court lacked enough consistency in order for spectators to be able to forecast the most likely outcome. Arguably, the uncertainty of the legislator had among other things the consequences that legislation was halted and a decision was made to wait for further case-law instead of acting by enforcing new laws.

My account of the *Cartesio* judgement is not stripped of criticism, but an overall review demonstrates the soundness of the ruling – it is an example of a

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95 Szudoczky (2009), p. 349.

96 Ibid.
sophisticated and proper way of deciding a case. Previous case-law is carefully examined and distinguished in the ruling, the interpretation of the legal text is based on how the text has been interpreted before, the developing legal framework is considered in relation to the dynamic will of the lawmaker, the consequences of a different outcome are looked into, a rather rational qualification is made in an *obiter dictum*, the boundaries between the judiciary and the legislator are respected – all these characteristics contribute to the jurisprudence of predictability and ultimately to a stronger rule of law.

The peculiar or questionable things with the *Cartesio* judgement, such as some details of the *obiter dictum*, can be explained in terms of another topic which Lord Bingham discussed in relation to the rule of law:

The European Court, created in the continental European image, gives a single judgement, with no dissents. It is a fact of judicial life (as of human life more generally) that different minds react differently to the same problem, and this is the more likely to be so where a number of judges have been brought up in countries with different legal systems, cultures and traditions. The text of the single judgement will seek to accommodate the views of as many judges as possible, but the process of accommodation can lead to an undesirable blurring of lines and obfuscation of issues.97

The policy of no dissidents requires a greater compromise and the lowest common denominator of legal opinions can water-down or confuse the meaning. However, the defects of the *Cartesio* judgement are of minor importance in comparison to its overall soundness.

An opinion of the quality of a *legal judgement* is one matter, but an opinion of the quality of the *law* is another and different matter. Next I will discuss the post-*Cartesio* legal situation and address the need for a change in legislation.

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97 Bingham (2010), p. 47.
5. The Need for Legislative Change

I hate all bungling like sin, but most of all bungling in state-affairs, which produces nothing but mischief for thousands and millions.

– Johann Wolfgang von Goethe

5.1 The current situation

The problem which arose in the Cartesio case could not arise in Hungary today, because on September 1st 2007, more than a year before the Cartesio judgement was released, the Hungarian law was changed in a way that a legal person’s registered office and its real seat need not to coincide any more. Hungary has thus removed the discrepancy between its company law rules and international private law rules – and made the incorporation theory applicable in both inbound and outbound situations. The Hungarian jurists Korom and Metzinger explain the Member State’s motive by saying that the ‘amendment was enacted as part of a comprehensive reform aimed at simplifying and modernizing Hungarian company law and enhancing the attractiveness of the Hungarian business environment’. Furthermore, some other Member States, such as Germany and Spain, have followed suit and made amendments in order to have a more competitive legal framework for companies.

But the problem, in many Member States and on the European level, remains: freedom of establishment is still seriously hindered in outbound situations of primary establishment. I use the tendentious word ‘problem’, because it is indeed a problem from two crucial perspectives; from the perspective of legal persons and from the perspective of the single market, which is so intertwined with the idea behind the European Union that the two can hardly be separated.

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The European Commission – the executive branch of the EU which has for instance the role of upholding the Union’s treaties and proposing legislation – expressed its worries about the legal situation in the proceedings of Cartesio. It claimed that companies were complaining about the persistent inconvenience of many sorts in relation to cross-border transfer of seat. The inconveniences had to do with the length of the process, its costliness and cumbersomeness, but not with it being impossible. For, as a matter of fact, there are three ways of lawfully accomplish cross-border transfers of seat; a one way which companies are expected to use if they can, and two ways which in this respect can to a large extent be categorized as legal ‘trickery sideways’.

The first mentioned route is simply to convert the company into a European Union entity – of which the most relevant option is the previously mentioned Societas Europaea. The advantages of such company form are in particular, as the law professors Joechem Reichert and Noëlle Lenoir point out, the ‘facilitation of cross-border mergers and easy transfer of the registered office on the one hand and the European image attached to an SE on the other hand’. But a national company’s transformation to SE has to meet certain requirements, most importantly there has to be a European dimension. It can either be in the form of more than one company, with at least two of them governed by different Member States – which decide to form a new EU entity; or it it can be in the form of a parent company and its subsidiary or branch, where the subsidiary has ‘for at least two years’ be ‘governed by the law of another Member State’ or the branch been ‘situated in another Member State’ for the same period of time.

The applicable law for SE companies is partly determined by the SE Regulation and partly determined by ‘the Member State in which the SE has its registered office’. Thus, as I have accounted for before, the personal law partly

101 Other business organizations under EU law are the ‘European Economic Interest Grouping’ (EEIG) the ‘European Cooperative Society’ and the ‘European Private Company’.

102 Marie-Louise Lennarts (2008), ‘Company Mobility Within the EU, Fifty Years On: From a Non-issue to a Hot Topic’, (Utrecht Law Review, 4 (1)), p. 3.

103 Dorresteijn, Monteiro, Teichmann and Werlauff (2009), p. 107. – One of the main differences between a subsidiary and a branch is that the former is governed by the laws of the country where it is located, but the latter is governed by the laws of the country where the company, which it is a branch of, is located.

104 Ibid., p. 105.
changes in case of a cross-border transfer of the seat. This arrangement increases the convenience of cross-border mobility from the situation in real seat doctrine countries, but from the point of view of companies formed in incorporation doctrine countries, it decreases the convenience. Surely, it is particularly unattractive for entrepreneurs from incorporation doctrine countries to choose the SE form for their companies – where the registered office and the real seat are not allowed to be in different Member States – rather than their own national public company form. Not surprisingly, a large proportion of SE are incorporated in real seat countries, such as Germany, but overall the number of registered SE companies has been relatively low and the SE project has not been a great success. In addition to the connecting factor disadvantages, the minimum capital requirement is much higher for SE’s than the Member States’ national variant.

Here above, I put the conversion to SE company form in a different category than the legal trickery sideways, but the distinction is not clear-cut. The sideways do not have to represent any direct or indirect circumvention and the SE conversion can be used as a crooked trickery way to reach a certain goal, as Bohrenkämper explains:

Hence, a company may indeed transfer its registered office by means of an SE. This is, in brief, how such a transfer may be realized: First, a Member State public limited company converts or transforms itself into an SE. ... Subsequently, the – then – SE transfers its registered office to another Member State. Finally, the SE converts back into a public limited company governed by the law of the Member State in which its registered office is situated. However, no decision on conversion may be taken before, in short, two years have elapsed since its registration.\textsuperscript{105}

So, a reverse conversion can take place after the newly formed SE company has moved to another Member State. But the two general circumvention sideways to achieve the aim of a cross-border transfer of seat are the following: on the one hand a cross-border merger, either a horizontal merger or a vertical reverse merger; and on the other hand a vertical reverse move of central administration.

The \textit{SEVIC Systems} case was groundbreaking for the sanction of cross-border mergers and it was immediately followed by the 10th Company Law

\textsuperscript{105} Bohrenkämper (2009), p. 89.
Directive, which enacted a protection for such mergers. How the rules of the Directive can be used if a company wants to move its seat across borders is spelled out in *European Corporate Law* by Dorresteijn, Monteiro, Teichmann and Werlauff: a ‘cross-border merger may also be realized by acquisition or by formation of a new company, and the consequences of the cross-border merger are the same as that of a domestic merger’.\(^{106}\) So one can buy or found a company in the Member State of entry and then make a merger between that and the original company. The company which is acquired or formed in the Member State of entry can either be a company unrelated to the original company in the exit Member State or it can be its subsidiary. In the former case the appropriate term would be ‘a horizontal merger’, but a ‘reverse vertical merger’ in the latter.\(^{107}\) This merger option has significantly advanced company’s freedom of emigration and it has become a widely used method. However, it can be rather burdensome and inconvenient, including complexities related to the fact that the tactic involves more than one company and the need to reincorporate. The same applies here as with SE cross-border seat transfer that the personal law changes, i.e. it becomes the law of the legal person incorporated in the host country. The identity-preserving but personal-law changing transfer suggested in the *obiter dictum* of Cartesio is therefore not only in line with the SE company form but also with the arrangement of the 10th Directive.

The other trickery sideway is the possibility for a company to set up a subsidiary or a branch in another Member State and then move its central administration to it, as was in fact done in *Centros* and *Inspire Art*. Still, this is of course only an option if the Member State of incorporation follows the incorporation theory and allows the real seat to diverge from the registered office, which was not the case in Hungary at the time of the Cartesio bt. dispute.

But the discrimination between Member States following the incorporation doctrine and Member States following the real seat doctrine, does not only pertain to the crooked sideways of cross-border seat transfers. It is embodied in

\(^{106}\) Dorresteijn, Monteiro, Teichmann and Werlauff (2009), p. 80.

\(^{107}\) The merger is called ‘vertical’ because it takes place between a parent company and its subsidiary. The merger is ‘reverse’ because the parent company is discontinued, but the subsidiary is continued.
the alleged solution which was introduced in *Cartesio’s obiter dictum*, the solution of identity-preservation combined with altered personal law, as the jurist Oliver Valk cleverly points out – and which needs to be quoted in some length:

> [The Cartesio] judgement has a potential discriminatory effect on companies incorporated in an MS that adheres to the incorporation doctrine. After *Cartesio* a company that seeks to transfer its central place of administration from a real seat MS can now rely on the freedom of establishment because the applicable law will no longer be that of the home MS. If, however, a company seeks to transfer its central place of administration from an incorporation doctrine MS the national law which is applicable will not change from the perspective of the home MS and subsequently the freedom of establishment cannot be relied upon against the home MS. However, as has been indicated above, the application of the incorporation doctrine by no means entails that the MS will allow companies to freely transfer their central place of administration to another MS. When it restricts such a transfer, this will not be qualified as a restriction of the freedom of establishment. Therefore the judgement has a potential discriminatory effect in that companies seeking to transfer their central place of administration from an incorporation doctrine MS cannot rely on the freedom of establishment while those incorporated in a real seat doctrine MS can rely thereon.¹⁰⁸

So, if the arrangement suggested in *Cartesio’s obiter dictum* becomes the established procedure, legal persons from incorporation doctrine Member States will be discriminated against. Such scenario will hardly become the permanent arrangement. Furthermore, the current SE conversion scheme and the sideways regarding mergers and other tricks are hardly an acceptable system for cross-border mobility in the long run. As Bohrenkämper rightly observes, it is ‘remarkable that these rather cumbersome maneuvers are possible under current EC law whereas the overt seat transfer is not’.¹⁰⁹

The ECJ did not consider itself to be in a position to virtually outlaw the real seat theory as a conflict-of-law method of Member States’ company law, but should more appropriate institutions address the issue of the *Cartesio* case and find a permanent solution? In other words, should the European Commission initiate a directive to put before the European legislator – principally composed of the European Parliament and the Council of the European Union – in which the

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¹⁰⁹ Bohrenkämper (2009), p. 89.
problem of Cartesio is solved? In order to have a well functioning system of corporate mobility within the single market of the European Union, some harmonizing measures regarding connecting factors seem necessary. To remove the hindrance to cross-border seat transfer, which a legal person’s home state is allowed to impose, would be facilitative, cost-saving, time-saving, and better safeguard the effectiveness and non-discrimination of the fundamental principle of free establishment. A directive with such aim would arguably be very important for the functioning of the single market and the success of the European Union – and such directive has for a long time been known as the 14th Company Law Directive.

5.2 The 14th Company Law Directive

In the Daily Mail case of 1988 the ECJ basically ruled that a transfer of the British company’s seat could not be based on the principle of free establishment as laid down in Art. 49 TEU – and that such right would have to rely on future legislation. Ever since, the cross-border transfer of a corporate seat and registered office has been a problematic issue in European law. A pressure on the European Commission to initiate a directive to solve the problem slowly started to build. The endeavor came from various interest groups, along with some scholars and statesmen, who wanted an effective directive to meet two important demands of a common market. The first demand is the possibility for companies to adapt their location and organizational structure to a changed market situation. The second demand is to be able to carry out such adaptation without being wound up and liquidated.

In 1993 the Commission published a study on the topic which started the drafting process of the 14th Company Law Directive on the transfer of the seat from one Member State to another, eventually leading to its proposal four years later. According to the proposed Directive, companies would be enabled to transfer their registered office across Member States’ borders. They would be reregistered in the Member State of entry and would acquire a legal identity there, while simultaneously being removed from the register in the Member State

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110 KPMG European Business Centre (1993), ‘Study on transfer of the head office of a company from one member state to another’ (Brussels: Office for Official Publications of the European Communities).
of exit and loosing its legal identity there. The legal persons would not be bothered by the legal and tax inconveniences of being wound up and liquidated. Their assets and liabilities would remain belonging to the same transformed legal personality, although they would need to adapt their structure to be able to meet formal and substantive conditions required by the host Member State. So, they would simply cease to be legal persons under the law of the home Member State and become legal persons under the law of the host Member State without any “death and rebirth”.

This arrangement sounds of course familiar; it is based on the same identity-preserving law-changing scheme as the SE company form and Cartesio’s *obiter dictum*. Still, it should be noted that the proposal enables the ‘registered office’ to be moved to the Member State of entry with a subsequent change in the company’s personal law. The possibility of a transfer of the registered office is line with the SE company form, although it is based on the real seat doctrine and does not allow the separation of registered office and real seat. But it is not in line with the *obiter dictum* which depicts a conversion only in case of a real seat transfer but leaves out a transfer of registered office. However, the ECJ might consider to modify its *obiter dictum* in this regard when it addresses the issue again in another case; both because of the peculiarity and irrationality of leaving the registered office in the Member State of exit if the system of law-changing transfers has been chosen, and because of the discrimination against legal persons formed in incorporation doctrine Member States.

Such discrimination was not part of the scheme of the proposed Directive, but the Directive, on the other hand, would have reduced the liberty of such legal persons in a drastic way: companies formed in incorporation doctrine countries would have been required to change their personal law instead of being able to preserve it, as in the current legal order, after transferring their real seat – a right which applies no matter whether the Member State of entry follows the incorporation doctrine or the real seat doctrine, as was eventually confirmed in *Überseering*. This is the reason why the proposed Directive was not only criticized by those who saw increased corporate mobility as a threat to either social protection or national sovereignty, but was also opposed by some adherents of economic liberalism.
The work on the draft was abandoned. The abandonment can largely be blamed on widespread political disagreement, but there were also some apparent faults in the mechanism of the proposed system which contributed to the project’s standstill. For instance the following faults mentioned in a consultative document of a group of high level company law experts, published in 2002:

[A] company which is formed in state A with its de facto head office in state B will be subject to A’s law, yet a company formed in state A but moving its head office to B will be subject to B’s; and a real seat doctrine company may (it seems) move its registered office to another state and change its law, leaving its de facto head office in its state of origin (thus escaping local mandatory rules) or may transfer its de facto head office while leaving its registered office where it is, requiring a change of law but no change of registered office.\textsuperscript{111}

The report is referred to as the High Level Group Report and its authors were recruited by the European Commission the year earlier in order to investigate the need to modernize the regulatory framework for company law in Europe. One chapter of it was devoted to corporate restructuring and mobility, which continued to be a subject of discussion and public consultations although the draft had been abandoned. The real seat doctrine and arrangements that required law-changing transfer were harshly criticized in the report, while a suggestion was made to harmonize the national laws ‘on the basis of incorporation and thus reducing the need for migrating companies to adopt new laws’.\textsuperscript{112} The standpoint reflected an economic liberal position of a kind which is favorable to regulatory competition. Such position may have many advantages, as I will later discuss, but it was not a good ground for a political harmony in Europe.

In May 2003 the European Council and the Parliament received a Communication from the Commission, an action plan which responded to the High Level Group Report. One of the two declared key objectives of the Communication was ‘to foster the efficiency and competitiveness of business’.


\textsuperscript{112} Ibid., p. 34.
with special attention to cross-border issues.\footnote{Commission of the European Communities (Communication, 2003), ‘Communication from the Commission to the Council and the European Parliament: Modernizing Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward’ (Brussels: Office for Official Publications of the European Communities), p. 9.} The other key objective can be regarded as a closely related one because it addresses issues which trouble skeptics of increased corporate mobility: to strengthen the rights of shareholders and the protection for employees, creditors and other parties with which companies deal.\footnote{Ibid., p. 8}

The Communication stated five reasons for new initiatives in these fields at the EU level, which serve as an excellent account of the subject’s relevance. The first reason was to make the most of the Internal Market: ‘the growing trend of European companies to operate cross-border in the Internal Market calls for common European company law mechanisms, inter alia, to facilitate freedom of establishment and cross-border restructuring.’\footnote{Ibid., p. 7.} The second reason was to create a more ‘coherent, dynamic and responsive European legislative framework’ in order to integrate EU capital markets. The third reason was to ‘maximize the benefits of modern technologies’; an advanced technological environment is a matter which has been undermining strict forms of the real seat doctrine:

the rapid development of new information and communication technology (video conferencing, electronic mail and above all the Internet) is affecting the way company information is stored and disseminated, as well as the way corporate life is conducted (e.g. virtual general meetings, video-link board meetings, exercise of cross-border voting rights).\footnote{Ibid.}

The fourth reason mentioned in the Communication was the then forthcoming fifth enlargement of the Union. The ten new EU Member States in 2004 and the additional two in 2007 have significantly increased the diversity of the national regulatory frameworks, which, according to the Commission, increases ‘the importance of a principle-based approach’, which is ‘able to maintain a high level of legal certainty in intra-Community operations’. To modify the company law was also crucial in order to ‘ease the rapid and full transition’ of the new Eastern
European Member States to ‘fully competitive modern market economies’.\textsuperscript{117} The fifth and final reason was to increase transparency and improve the availability of corporate information in order to address the challenges raised by the recent financial scandals; a reason which is solely linked to the objective of securing the rights and protection of shareholders, employees, creditors, and other parties.\textsuperscript{118}

In the Communication’s chapter on corporate restructuring and mobility, the Commission acknowledged the need for the 14th Company Law Directive on the transfer of the seat from one Member State to another:

In the absence of legislation governing the cross-border transfer of seat, such an operation is currently impossible or at least contingent on complicated legal arrangements. This is because Member States laws do not provide the necessary means and, when a transfer is possible by virtue of simultaneously applying national laws, there are frequent conflicts between those laws because of the different connecting criteria applied in the Member States. A legislative effort is needed in this field in order to implement the freedom of establishment in the manner intended by the Treaty.\textsuperscript{119}

However, the 14th Directive was considered less urgent than a new proposal for the 10th Company Law Directive on cross-border mergers, as is evident in the following expression:

The Commission intends to present in the short term a new proposal for a Tenth Company Law Directive on cross-border-mergers as well as a proposal for a Fourteenth Company Law Directive on the transfer of the seat from one Member State to another. Both proposals are faced with the task of solving difficulties relating to board structure and employee participation.\textsuperscript{120}

It was not only the upcoming 10th Directive which reduced the immediate importance of the 14th Directive, because the European Company Statute, by which the SE company form was enacted, seems to have eased the demand for a directive on cross-border mobility. The Commission welcomed the approval of

\textsuperscript{117} Ibid.

\textsuperscript{118} Ibid.

\textsuperscript{119} Ibid., p. 20f.

\textsuperscript{120} Ibid., p. 20.
the Statute and stated that it opened up ‘promising prospects for the solution of comparable issues in the 10th and 14th Directives’.  

In 2004 an Internet consultation was launched by the Commission in which business associations and lawyers were encouraged to comment on the outline of the planned proposal for the 14th Directive. Two earlier public consultations, conducted in 1997 and 2002, had indicated the need to improve the EU’s legislative framework on cross-border transfer of registered office or seat. The Internal Market Commissioner Frits Bolkestein expressed his standpoint in the following way:

We need to make it as easy as possible for companies to transfer their registered office while making sure that third parties, including creditors, are protected. This consultation exercise will give us the chance to listen to the views of those affected before coming up with a detailed proposal.  

The outline proposal was on a transfer of registered office under similar conditions as before, although there was a notable additional clause on the protection of employees:

According to the outline proposal on which the Commission is now consulting, employee participation in companies transferring their registered office would be governed by the national law of the host Member State. However, where such participation is already provided for by law or by agreement in a more extensive form in the home country it would have to be maintained, unless new arrangements could be negotiated and agreed between the company and its employees. Each home Member State would be free to adopt its own measures governing these negotiations.  

The consultation was carried out and the results were published in a summary report in 2005. One of the questions asked was whether, in ‘light of the existing instruments’, there is ‘still a need for a directive on the transfer of registered office’. Of all of the participating stakeholders, 42.6% chose to address the

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121 Ibid.


question and of them a decisive majority of 79.6% gave a positive answer.\textsuperscript{125} A number of participants maintained that it ought to be ‘a high priority to come forward with a long-awaited proposal’, while some claimed it to be ‘less urgent in the light of the recent developments’, which have made cross-border transfers easier. The recent developments in question were the Statute on a European Company and the enactment of the 10th Company Law Directive on cross-border mergers. However, those who considered the 14th Directive to be necessary argued that the SE company form and the 10th Directive provided only indirect measures for a cross-border transfers and that the possibility of a ‘straightforward transfer’ was necessary.

A few of the comments made by the stakeholders highlight some important considerations in relation to the issue, such as the need for legal certainty and a formal procedure:

Several respondents also emphasized that there is still uncertainty on the legal and tax consequences of transfer under present law and jurisprudence of the European Court of Justice on the freedom of establishment. Therefore, enhanced certainty is needed. The need for a directive to ensure a proper protection of the interests of creditors, shareholders and employees in relation to the transfer as well as a formal procedure for the transfer was also underlined.\textsuperscript{126}

Among other commonly expressed views was that it was necessary to ensure transparency and adequate supervision ‘through proper cooperation and information exchange between the home and host Member States’.

The report’s account of the argumentation of those who oppose legislative action is representative for the position of the critics of the 14th Directive since the beginning of its drafting process:

[They stated] that the existing measures and the case law are sufficient for the time being and that no new initiatives should be undertaken before the practical implications of those measures have been properly assessed. Some suggested focusing on the facilitation and adaptation of existing measures. A few respondents questioned the practical value of a potential


\textsuperscript{126} Ibid. p. 17.
directive due to obstacles such as taxation or employee participation issues.\textsuperscript{127}

So, reliance of ECJ’s case-law, modification of existing measures, and problems regarding taxation and employee participation, are things which have been prominent in the argumentation of the Directive’s critics. The first two of these views express differences regarding means rather than ends, methods which were later undermined by the \textit{Cartesio} ruling. The last view, however, is at the core of the underlying political debate which hinders the necessary consensus. In order to explain the nature of the debate it is useful to simplify it by highlighting the two contrasting poles. On the one hand, there are business-orientated people who want to liberalize the system and make it more business friendly and efficient, but on the other hand, there are people whose primary concerns are either certain kind of social protection or preservation of national sovereignty in the field. One paragraph in the report crystallizes this debate:

Several stakeholders took position on employee participation, calling for a satisfactory standard of employee participation. A number of industry representatives opposed the inclusion of the employee participation regime in a directive, in particular the one agreed for SE Statute or the 10th Company Law Directive on cross-border mergers as this would very much reduce the attractiveness of a cross-border transfer of registered office.\textsuperscript{128} But the main conclusion of the report was that an overwhelming majority of respondents regarded legislative change to be necessary. Consequently, the drafting process received the status of a ‘priority initiative’ by the Commission, a status which required an ‘Impact Assessment’ to take place. A comprehensive Impact Assessment was released in December 2007, where all sides of the issue were discussed.\textsuperscript{129} The Commission stated in the assessment that the ‘twin objectives of any initiative on this matter’ should be as follows:

\textit{[T]o improve the efficiency and competitive position of European companies by providing them with the possibility of transferring their registered office more easily and, hence, choose a legal environment that best suits their business needs, while at the}

\textsuperscript{127}Ibid.

\textsuperscript{128}Ibid., p. 18.

same time guaranteeing the effective protection of the interests of the main stakeholders in respect of the transfer.\textsuperscript{130}

The twin objectives reflect an attempt to bridge the gap between the two contrasting poles, although those who fundamentally reject further European integration on nationalistic grounds are naturally left out in the outreach for a consensus.

The seriousness of the issue is clearly recognized in the Impact Assessment and the situation is accurately described:

As the law stands in most Member States, moving a registered office would typically imply the winding-up of the company in Member State A and its re-incorporation in Member State B. Given the high costs involved, the time involved and the related administrative burden, with sometimes more than 35 procedural steps to overcome, this hardly ever occurs and European companies are, in practice, deprived of the possibility of moving their place of registration within the EU.\textsuperscript{131}

The Commission compared five different options to respond to the situation: no action, action by the Member States, action on a European level in the form of a non-binding and flexible instrument such as a recommendation, action in a form of an EU directive, or action in a form of an EU regulation. The ‘no action’ option was essentially a reliance on the cross-border merger Directive, which was going to enter into force in December 2007, in addition to the possible positive impact of European company forms. The Commission considered such ‘no action’ strategy to be the best way to attain the objectives along with the directive option.

And, to the surprise of many stakeholders and to the disappointment of those who argued for a directive, the Commission eventually reached the conclusion in the Impact Assessment that, for the time being, ‘no action’ would be the most suitable response:

However, when the proportionality test is applied, it is not clear that adopting a directive would represent the least onerous way of achieving the objectives set. Since the practical effect of the existing legislation on cross-border mobility (i.e. the cross-border merger directive) is not yet known and that the issue of the transfer of the registered office might be clarified by the Court of Justice in the near future, the assessment concludes that it might be more appropriate to wait until the impacts of those

\textsuperscript{130} Ibid. p. 5.

\textsuperscript{131} Ibid.
developments can be fully assessed and the need and scope for any EU action better defined.\footnote{Ibid., p. 6.}

The reference to the ECJ has to do with the Cartesio case, so the Commission argued that a favorable conclusion in Cartesio, in addition to the 10th Directive, would likely solve the problem and further legislative activity would not be needed at this point. The view was spelled out in the following way in a speech by Charlie McCreevy, the Commissioner for the Internal Market, in June 2007:

\[\text{T}he\ \text{Court\ of\ Justice\ will\ soon\ take\ a\ decision\ in\ a\ case\ that\ could\ provide\ us\ with\ new\ insights\ on\ the\ current\ legal\ situation\ in\ Europe.\ As\ you\ know,\ the\ Court\ has\ already\ in\ the\ past\ delivered\ fundamental\ judgements\ in\ the\ area\ of\ company\ mobility.\ I\ am\ therefore\ convinced\ that\ we\ should\ wait\ for\ the\ outcome\ of\ this\ case\ which\ is\ likely\ to\ bring\ more\ clarity\ into\ this\ complicated\ matter.\ We\ expect\ the\ judgement\ to\ be\ delivered\ in\ the\ autumn\ of\ this\ year.}\footnote{Charles McCreevy (June, 2007), Speech/07/441, 28/06/07 (Company Law and Corporate Governance Today, Fifth European Corporate Governance and Company Law Conference, Berlin).}

The outcome of Cartesio did clarify the matter, although not in the way that Commissioner McCreevy obviously hoped. However, although the “hot potato” was again in the hands of the Commission after the ruling, the outcome did not automatically insist any action upon it, because McCreevy had made another speech in October 2007 where he announced his decision to abandon the 14th Directive process. The decision was very disappointing for those who had been advocating for the enactment of the Directive – and the timing of the speech surprised many of them: it was made less than six weeks before the Impact Assessment was released and more than a year before the ruling in Cartesio. The conclusion, however, was only moderately surprising; the seeds of the abandonment were already sowed in his earlier speech in June:

\[\text{O}ur\ \text{preparatory\ work\ has\ led\ me\ to\ the\ conclusion\ that\ we\ should\ not\ rush\ forward\ with\ legislation.\ If\ we\ are\ to\ propose\ legislation,\ we\ must\ be\ sure\ there\ is\ a\ reasonable\ chance\ of\ a\ result\ with\ added\ value\ for\ business.\ The\ economic\ case\ is\ not\ as\ obvious\ or\ clear-cut\ as\ it\ may\ seem\ and\ Member\ States\ currently\ follow\ different\ approaches\ to\ which\ they\ are\ strongly\ attached.}\footnote{Ibid.} \]
In the following months a lot of discussion and private consultations took place in relation to the work on the Impact Assessment. The results of these advances were obviously not in favor of legislative action. In his speech in October, Commissioner McCreevy had hardened his tone regarding the ‘economic case’ for the 14th Directive. He stated that ‘the results of the economic analysis of the possible added value of a directive were inconclusive’, and he basically argued that the current framework could not only be sufficient to normalize cross-border mobility, but that it should be given a chance to proof its effectiveness:

Companies already have legal means to effectuate cross-border transfer. Several companies have already transferred their registered office, using the possibilities offered by the European Company Statute. Soon the Cross-Border Mergers Directive, which will enter into force in December, will give all limited liability companies, including SMEs, the option to transfer registered office. They could do so by setting up a subsidiary in the Member State to which they want to move and then merging the existing company into this subsidiary. To my mind it is only if this framework is found wanting, that further legislative action in the shape of a 14th Company Law Directive would be justified. Therefore, I have decided not to proceed with the 14th Company Law Directive.\(^\text{135}\)

This verdict was contrary to the position of the European Parliament, which had in March 2006 called on the Commission to submit a proposal for the 14th Directive.\(^\text{136}\) The Parliament stated that such legal amendment would be ‘crucial for freedom of establishment’, because the transfer dealt with in the intended directive was ‘either impossible or hindered by the requirements imposed at national level’.\(^\text{137}\) After the abandonment announcement the Parliament issued a statement where it regretted the decision and declared its intention to continue to pressure the Commission on the issue, i.e. pressure it to coordinate the Member States’ laws in order to facilitate cross-border transfers of registered offices within

\(^{135}\) Charles McCreevy (October, 2007), Speech/07/592, 03/10/07 (The European Parliament’s Legal Affairs Committee, Brussels). – SME is an abbreviation for ‘small and medium-sized enterprises’.

\(^{136}\) European Parliament resolution on restructuring and employment (March, 2006), 2005/2188(INI) (Strasbourg, 15/03/06), p. 13.

\(^{137}\) European Parliament resolution on recent developments and prospects in relation to company law (July, 2006), 2006/2051(INI) (Strasbourg, 04/07/06), pp. 32-33.
the EU. Such recommendations are also made in a recent Report of the Reflection Group On the Future of EU Company Law, released on April 5th this year:

EU harmonisation is called for to provide a right for national companies to transfer their registered office from one Member State to another, effectively changing the applicable company law regime from that of the former to that of the latter. Such a change would entail a cross-border conversion from a company form recognized by the former into a company form recognized by the latter.

However, the authors of the report did not think that the issue of national connecting factors needed to be addressed in harmonization act: ‘The Reflection Group believes that a right to transfer the registered office of national companies would not require major harmonisation of national law in respect of international private law and conflict of laws provisions.’ However, what immediately follows is a little cryptic: ‘Some members furthermore believe that it is time to envisage an EU regulation to clarify the conflict of law issues.’ Clarify in what way? The context suggests it is a clarification in favor of the Member States’ right to choose their connecting factor.

Before I discuss the economic case for or against a new directive to solve the problems of legal persons’ freedom of establishment, I will address one central aspect of the issue, namely a phenomenon called the ‘Delaware effect’.

5.3 European Delaware Effect

As is evident from my earlier account, the transfer of company’s ‘registered office’ is the focal point of the idea behind the 14th Company Law Directive, but not the ‘real seat’. Still, the issue regarding the seat always looms behind, as can be seen in the Impact Assessment, for instance in an interesting account of the

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138 European Parliament resolution with recommendations to the Commission on the cross-border transfer of the registered office of a company (March, 2009), 2008/2196(INI) (Strasbourg, 10/03/09), p. 1. – See also the European Parliament resolution on the European Private Company and the 14th Company Law Directive (October, 2008), 2008/2196(INI) (Strasbourg, 17/10/08).


140 Ibid.
possibilities of those who intend to form a company, operating somewhere within the EU:

Newly formed companies may incorporate in a Member State which they think has the most advantageous corporate regime and subsequently transfer their real seat to a different Member State. As an empirical study conducted by M. Becht, C. Mayer and H. F. Wagner shows, following the judgements of the Court of Justice allowing the transfer of the company's real seat to another Member State, many companies registered in one Member State transfer their head office to another Member State.\textsuperscript{141}

Here, the Commission was pointing out that the post-Überseering corporate mobility system offers the option for entrepreneurs to choose a favorable incorporation doctrine jurisdiction to register and incorporate their companies, and thus enabling them to move their companies' seat freely. The study by Becht, Mayer and Wagner, which the Commission then referred to, reveals that this possibility has increasingly been utilized, especially by choosing the UK as the Member State of incorporation:

In particular, there were numerous new companies registered in the UK (considered as one of the cheapest and efficient regime for company formation) which had all their operations in other EU countries. Table A1 reports new incorporations of private limited companies in the UK from other European states. In 2005 there were 19,686 companies registered in the UK, having their head offices in other Member States (i.e. 5 times more than in 2001, before the relevant judgements of the Court of Justice were delivered. In particular, in 2005 there were 12,019 companies registered in the UK and operating in Germany (as compared to 516 in 2001). Similarly, there were 2,127 companies registered in the UK and operating in the NL in 2005 (as compared to 91 in 2001). In 2005 alone 2401 German companies and 621 Dutch companies incorporated in the UK. This amounts to respectively 3% of all private limited liability companies incorporated during that year in DE and 1% in NL.\textsuperscript{142}

What is described here can appropriately be labelled as a small-scale 'Delaware effect', which is a term used for a scenario where states or countries compete to attract registrations and incorporations of companies by providing a desirable regulatory environment. It is named after the State of Delaware, one of the 50


\textsuperscript{142} Impact Assessment (2007), p. 11.
states of Unites States of America. Every state of the United States has its own company law in the same way as the Member States of the European Union. But contrary to the EU, every state of the U.S. follows the incorporation theory, just as the country itself. This system creates competition between states, in which Delaware turned out to be the far most popular state to register and incorporate companies in – it has for instance got more than half of all publicly traded companies in the country. The state’s benefit from succeeding in the regulatory competition is primarily twofold: it gains by getting the incorporation fees and the popularity is also advantageous for the professions in the state which assist the corporations, such as lawyers and accountants. The reason for Delaware’s popularity is adequately accounted for in the Impact Assessment:

Reportedly, the main reasons for the attractiveness of Delaware for corporations were its reputation for the most comprehensive corporate case law as well as its judicial and legal expertise in administering corporate law. Major identified motives for existing businesses to reincorporate in Delaware are: a prospective public offering and the intended implementation of a merger and acquisition program. According to the studies companies involved in such complex transactions, which may involve substantial transaction costs, look for the certain and predictable corporate legal rules (for which Delaware has reputation) to assist in structuring these transactions and reduce firms’ operating costs. As studies show, reincorporation in Delaware increases the company’s stock-market value.143

So, what attracts corporations is the overall quality of the jurisdiction: its legislation, case-law, courts, legal certainty, administration, and so on.

But of course it is quality from the vantage point of the corporations themselves, so lax obligations and low-cost rules can be advantages in this sense, although they may not be so from some other perspectives. This kind of regulatory competition can be regarded as the other side of what is called ‘forum shopping’, the practice of choosing the most favorable legal venue – jurisdiction with certain laws, habits, courts and procedure. While forum shopping is a term used to describe the activity of the players on the market, regulatory competition relates to the activity of the jurisdictions’ regulators who compete for the players. The system creates an environment where the regulators have incentive to provide the most efficient legal framework in order to attract “customers”, or to

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use my earlier metaphor: to provide the most desirable raw material for construction. However, the kind of competitive advantages in question are not seen as advantages for those who are skeptical of freedom of contract regarding the interest of employees, creditors, and others who have a contractual relationship with legal persons. The social policy of protectionism is likely to go downhill in the regulatory competition which the Delaware effect creates. From the point of view of social protectionism, such competition is blamed for deregulation and it is nicknamed “race to the bottom”.

The proponents of a competitive system tend to answer such criticism in the same manner as the jurists Kilian Baelz and Teresa Baldwin do in the following passage:

> [L]ooking at the corporate law of Delaware more closely, one finds that it is not only the alleged laxity that attracts investors from all over the U.S. Instead, the free market of company forms seems to favor “reasonable” high standards of investor protection and corporate governance, hereby avoiding unnecessary hurdles and formalities. A public company targeting institutional investors, for instance, simply cannot afford being incorporated under a legal order that falls short of the basic requirements of investor protection. When incorporating an investment company, it would not be wise to choose a legal order with undeveloped corporate governance rules or little transparency. What is correct, however, is that investors are attracted by a jurisdiction that has a developed and flexible problem solving capacity. … Competition among corporate regimes in Europe will, therefore, lead to a certain concentration of corporations in “favorable” jurisdictions while it is unlikely that his will be accompanied by a general erosion of standards in corporate law (“race for laxity”).

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As Baelz and Teresa correctly point out, the competition is useful to cut off all superfluous ‘hurdles and formalities’ and it encourages a ‘flexible problem solving capacity’. Furthermore, the business attraction is likely to contribute to prosperous economy – and thus reducing the social concerns. When the competition is seen in such positive light it is sometimes called “a race to the top” and the American example has been viewed in that way, as is pointed out in the Commission’s Impact Assessment:

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The Delaware case is acknowledged to be a case of positive regulatory competition (“race to the top”) for the US legal system. The Delaware migration has encouraged other US states to modify their national legislation towards guaranteeing a more efficient legal environment for US companies.\textsuperscript{145}

This paragraph of the document indicates the position of the Commission regarding regulatory competition and what immediately follows supports that impression:

According to Romano ‘one of the advantages of a competitive corporate law regime is that it is less likely to make regulatory mistakes than a centralized one, and any mistakes by a particular state are more easily corrected’.\textsuperscript{146}

Here, the authors of the Impact Assessment referred to the Yale Law Professor Roberta Romano and her point regarding the major advantage of a decentralized systems: they allow for more experiments which must lead to more knowledge about what kind of arrangement is fruitful and what kind of arrangement is not. The best solution often becomes a widespread solution so there is a certain natural limitation to the variety of the competing systems; the competition leads constantly to an optimal harmonization. Professor Romano explains the impact of the Delaware effect in the United States in the following way: ‘Delaware is the quickest state among the U.S. states to introduce more efficient new legislation. However, in the long term other U.S. states appear to follow Delaware.’\textsuperscript{147}

But although the signs of regulatory selection in the EU are a pointer to a Delaware effect, the amount of incorporations which results from the selection between competing jurisdictions have not been significant. In other words, the European Delaware effect is on a small scale – the increasing number of incorporations in the UK is not yet high enough to make the country an equivalent to the State of Delaware, as Bohrenkämper has pointed out:

Albeit recent studies show that European firms have widely used the possibility opened up by the ECJ’s case law to freely choose the country of incorporation while placing the company’s


\textsuperscript{146} Ibid.

\textsuperscript{147} Ibid.
administrative seat in another country, it must be held, however, that a “European Delaware” has not materialized.\textsuperscript{148} Why has fully-fledged Delaware effect not evolved in Europe? The answer of this question might lie in the differences between the U.S. and EU systems. Firstly, there is a major linguistic and cultural variety in Europe which is not to be found in America, at least not on the same scale. But this fact is probably not the reason behind the different situations on the two sides of the Atlantic. Research has shown that the main deciding factor in regulatory selection seems to be the time and costs of incorporation, particularly the amount of the required minimum capital.\textsuperscript{149} When this is taken into account, the UK would be the best candidate to be a “European Delaware”, as it has proven to be. Still, this prospect has not materialized although the UK has both the lingua franca of English as a national language and a highly cosmopolitan capital city – which suggests that linguistic and cultural barriers are not a significant obstacle to a regulatory selection. This a priori observation is supported by empirical data: the above-mentioned study by Becht, Mayer and Wagner showed that linguistic or cultural barriers were not a significant obstacle of a regulatory selection.

The second difference might be more promising in providing an answer to the question. The corporate law of the American states are much more harmonized than the corporate law of the European Member States. In this regard the Impact Assessment especially mentioned ‘the quality of measures on investor, creditor protection and the accounting standards’, which are not harmonized on the EU level.\textsuperscript{150} A certain degree of harmonization of such basic setup and standards might reduce complexities and clear the ground for a full-scale Delaware effect in Europe.

But more can be done to encourage regulatory selection and competition. The main preconditions of a Delaware effect are twofold: party autonomy and free mobility, or in other words a jurisdiction’s permission to choose its regulatory environment and a free mobility between a number of jurisdictions. Regarding the latter precondition, there is one kind of free mobility which is fundamental, namely

\textsuperscript{148} Bohrenkämper (2009), pp. 89-90.

\textsuperscript{149} Impact Assessment, p. 15.

\textsuperscript{150} Ibid.
that a company registered and incorporated in one Member State is not discriminated against in other Member States and always recognized in them. This should not be a problem after the Überseering ruling, but the lack of definite procedure and the overall lack of certainty regarding the arrangement, may discourage the way of thinking which produces the mechanism of Delaware effect.

But another important feature of corporate mobility is a major aspect of the former precondition. Although party autonomy is in place for the establishment of new companies, it is lacking for existing companies because of the main subject of this thesis: the restraint on companies’ right to transfer their real seat or registered office to other Member States.

5.4 A Rational Way Forward

The reason why I decided to discuss the Delaware effect before I address the Commission’s argument that the 14th Directive lacks an ‘economic case’, is that I believe that the latter relies fundamentally on the former.

Officially, the Commission argues that legal means are available for companies to bring about cross-border transfer, essentially through the European Company Regulation and the 10th Directive on cross-border mergers. However, as I have accounted for above, the system is not rational and efficient enough. The 14th Directive would most definitely reduce inequalities between legal persons of different Member States and make cross-border transfers of registered office or real seat more streamlined and viable. The Commission could hardly have overlook these facts.

Still, this does not rule out that there was an economic case for abandoning the 14th Directive. As I have pointed out, the authors of the Impact Assessment seem to have a positive “race to the top” persuasion regarding the Delaware effect. But the law-changing scheme of the intended directive, based on a real seat doctrine framework, would fundamentally go against the idea of an American system of regulatory competition. It would not be an efficient-secured harmonization through liberalization, as the Delaware effect would bring about, but a consensus-based harmonization through centralized planning.
According to this theory, the ‘no action’ decision is a defensive strategy of those who favor a European Delaware effect, necessary because an attacking strategy of a legislative action to improve the preconditions of a Delaware effect, is impossible for political reasons. There are too many leading European politicians and Eurocrats who consider regulatory competition to be a “race to the bottom”, providing insufficient protection of the interests of employees, creditors, shareholders and other stakeholders.

The stagnation of the process to solve the problems of corporate mobility can be explained by a grand disagreement about which route to go; whether to go in the direction of a more competitive system or in the direction of a more centralized system. The views of those that want more social protection or national sovereignty than the 14th Directive stipulates, make the situation more complicated and contribute to the disagreement and the consequent stagnation.

Viewed in this light, the ‘no action’ policy of the Commission may indeed be the most sensible political position. However, apart from the political reality, it is not the most rational way forward. A different version of the 14th Directive, which would pave the way for a full-scale regulatory competition, is the ideal solution. The view that European corporate law should evolve through regulatory competition gets a decisive support from John Armour, an Oxford professor of law and finance, which wrote a convincing paper on the subject, published by the Institute for Law and Finance at the Johann-Wolfgang-Goethe-Universität Frankfurt am Main in 2005. Professor Armour analyzes the European situations and argues that “the “market” for the regulatory provisions can act, in the fashion celebrated by [Friedrich von] Hayek, to stimulate innovation and to aggregate the information available to firms about regulatory effectiveness”:

Similarly, if diversity of systems means that there is no global ‘best’ regulatory choice, but rather simply locally-optimal solutions, then a ‘market’ for regulatory provisions may result in greater specialization, if states perceive the best way to attract incorporations as being to capitalize on complementarities. Again, innovation and mutual learning may be expected.\(^{151}\)

Professor Armour maintains that regulatory competition would under the right framework ‘promote the beneficial development of national company law where a federal legislator is faced with regulatory agnosticism’. This last point about the agnosticism of authorities is important, because one of the major arguments against regulatory competition is that the lawmaker should impose the right kind of rules and standards, instead of letting them evolve by some blind mechanism. Such criticism is based on the questionable presumption that the lawmaker is able to acquire enough knowledge to know how things should be. The blind mechanism, however, gathers knowledge by multiple tests, analogously to the scientific method. The Austrian-British philosopher Karl Popper was for instance relentless in pointing out such analogy between political knowledge and scientific knowledge. The empirical ‘trial by error’ method does not only bring us scientific knowledge about our physical environment but it can also bring us facts about the optimal business environment. ‘Harmonized legislation runs two risks’, according to professor Armour, ‘which are avoided by a process of benign regulatory competition’:

First, such legislation tends to encourage Member States to converge their laws on a central model, which may be inappropriate where one ‘size’ does not ‘fit’ all. Decentralized solutions can permit Member States to continue patterns of diversity, whilst regulatory arbitrage allows individual firms for which the national model is inappropriate to opt out. Secondly, harmonization presupposes that the European legislator is able to specify the ‘best’ regulatory solution to any given problem. In an area such as company law, where the configuration of the optimal rules is hotly debated, regulatory competition can promote innovation and mutual learning between national legislators.\(^{152}\)

The clauses of a 14th Directive, which would take this into account, need to include a certain degree of harmonization of setup and standards, a definite and reliable procedure for cross-border transfers, and an harmonization of connecting factors by making the incorporation doctrine the sole method of deciding the connecting factor. An effort has to be made to convince both policy makers and the electorate to accept such repair of the system.

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\(^{152}\) Ibid., pp. 51-52.
This kind of legislative change would be a proper respond to the *Cartesio* judgement and permanently solve the systematic problems which the case is rooted in. Freedom of establishment for both natural and legal persons is one of the fundamental freedoms of the European Union – a right that should be cherished and protected. Corporate mobility is indistinguishable from a well functioning common market and without it a cornerstone of the Union is missing – and the vision of the European integration is seriously broken.
Conclusion

It takes a lot of intellect and confidence to accept that what makes sense doesn’t really make sense.

– Nassim Nicholas Taleb\textsuperscript{153}

In this thesis, ‘The Cartesio Judgement: A Jurisprudential Analysis’, I have thoroughly analyzed the central subject of the European Court’s ruling in the \textit{Cartesio} case, namely the scope of legal persons’ right to transfer their seat across borders within the European Union.

In the first two chapters I framed my project by exploring the foundational material of my analysis. The principle of free establishment and the issue of connecting factors were explained in the first chapter, before an overview was given of the \textit{Cartesio} case. The relevant case-law prior to \textit{Cartesio} was discussed in the second chapter. I began with an account of the \textit{Daily Mail} and then proceeded by studying subsequent cases, categorized by whether they concern secondary or primary establishment, and by whether they concern inbound or outbound situations. I maintained that the judgements in \textit{Daily Mail} and \textit{Überseering} clearly indicated that Member States could lawfully prevent outbound transfer of primary establishment. The reasons were their authority over the products of their own laws, including legal persons, and their right to decide their own private international law rules, including their connecting factor.

In the next two chapters I discussed the jurisprudence of the \textit{Cartesio} ruling, assessed negative and positive views on the judgement, and put the case in context with the rule of law and a proper legal methodology. The analysis brought me to the conclusion that \textit{Cartesio’s ratio decidendi} and \textit{obiter dictum} were, despite some faults, the result of a sound and sophisticated jurisprudence. The European Court had three compelling reasons for making an inbound-outbound distinction which excepted outbound situations of primary establishment from being protected by the right to cross-border establishment. These compelling reasons were proper conformance to precedents, which a

\textsuperscript{153} Nassim Nicholas Taleb (2010), \textit{The Bed of Procrustes} (London: Penguin Books), p. 84.
deviation from had no sufficient grounds; the lack of justifiability of eliminating Member States’ command over connecting factors; and the legislative development – the lawmaker had been employing the real seat doctrine in its legislation and had not not showed any clear will to overturn the results of the Daily Mail ruling, which were confirmed in the Überseering case. The Court honored its precedents and was cautious not to overstep the boundaries between the judiciary and the legislator, while at the same time being respectful to the aims of the European common market and thoughtful of the consequences of its ruling. The reasoning and conclusion of the Court was a victory for a just and predictable jurisprudence, which is, in the long term, beneficial for the business environment and the society as a whole.

In the fifth and final chapter, I analyzed the legal situation created by the ruling in Cartesio before dealing with the question if and how the legislator should respond to the judgement. I discussed the proposed 14th Company Law Directive and the motive behind abandoning it. I explained the Delaware effect and compared regulatory competition with centrally planned harmonization. My conclusion was that the current situation is not satisfactory, but that it is still better than adopting the clauses of the intended 14th Directive. A desirable legislative action, however, would be to improve the preconditions of a Delaware effect by certain substantial, procedural and structural amendments. The most radical change needed is to outlaw the real seat as a connecting factor and establish a method based on the incorporation doctrine as a connecting factor for all of the EU Member States.

At the time I began the research for this thesis, I held the opinion that the Cartesio judgement was faulty and ill-founded. I also believed that the 14th Directive should be enacted and that the Commission’s decision to abandon it was a mistake. However, as the work proceeded, I became more and more doubtful about my original views. At a certain point, I got convinced that I had been wrong regarding both the ruling and the legislation. As a result I switched my position. In a way has my analysis of the Cartesio judgement reminded me of the wisdom of the 17th century French philosopher who lends the Hungarian undertaking its name, René Descartes. He argued for the importance of engaging in an independent investigation of things instead of learning about them
second-handedly from other people. I devoted my self to an open-minded first-hand research – and ultimately I came to a different conclusion than a vast majority of commentators.

Let us honor Seneca the Younger by letting him have the last words: *Vita sine litteris mors est*.\(^\text{154}\) *Vale*.\(^\text{155}\)

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Reykjavik, Iceland, October 10, 2011

Asgeir Johannesson

\(^{154}\) ‘Life without learning is death’.

\(^{155}\) ‘Farewell’. – Seneca’s way of ending his letters.
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