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INTERNATIONAL AND EUROPEAN COMMERCIAL AND COMPANY LAW

Inspire Art – Freedom of establishment for companies in Europe between “abuse” and national regulatory concerns

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A. The ECJ decision

Recent developments in Europe have had an almost unprecedented effect on international company law – particularly in states hostile toward companies with foreign corporate structures that operate within their territories.¹ Here, the European Court of Justice and Community lawmakers are in a remarkable race. For its part, the Council has already established a new corporate entity in the form of the European public limited-liability company;² plans are underway to enact directives on cross-border mergers and transfers of corporate addresses.³ But it was the ECJ that contributed to this dynamic at an early stage through its landmark decisions in *Segers*,⁴ *Daily Mail*,⁵ *Centros*,⁶ and *Überseering*.⁷

For this reason alone, the ECJ takes obvious pains in its most recent decision, *Inspire Art*,⁸ to adhere to its previous

rulings as good law. This appraisal is especially true for its judgements in *Segers* and *Centros*, which also concerned the treatment of so called formally foreign companies that conduct no business in their country of establishment but instead operate exclusively through branch offices in other Member States. In *Inspire Art* (para. 103) the ECJ does not upset the solution arrived at in *Daily Mail*, which the Court manages to distinguish on the facts.⁹ However, the judgment makes a novel statement with respect to those restrictions on the freedom of establishment, which fall within the scope of the Eleventh Council Directive concerning disclosure requirements in respect of branch offices.¹⁰ As far as its provisions are exclusive, Member State rules that depart from this directive constitute violations of secondary Community law (paras 55 to 72). It is worthy to note the rationale the Court provides in ruggedly rejecting as incompatible with the freedom of establishment rules falling outside the scope of the Eleventh Directive that require a certain minimum share capital and impose joint and several liability where these national safeguards have been ignored. Since *Inspire Art* appears as a company governed by English law and not as a Netherlands company, the argument goes, its potential creditors are put on sufficient notice that it is not covered by Netherlands legislation (para. 135). Militating against this “disclosure model”¹¹ is the fact

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¹ Implicated here are, above all, those countries that on the basis of the corporate seat principle automatically defer to the law governing companies in the Member State in which the company is actually domiciled. See *Staudinger/Großfeld*, Internationales Gesellschaftsrecht, current: 1998, para. 26 et seq.

² Council Regulation (EC) No. 2157/2001 of 8 October 2001 (OJ 2001 L 294 at 1); Council Directive 2001/86/EC of 8 October 2001 (OJ 2001 L 294 at 22).

³ Proposal of 18 November 2003 for a Directive on cross-border mergers of companies (10th Directive), [COM (2003) 703 final]; Preliminary draft of directive on transfers of corporate addresses (14th Directive), reprinted (in German) at: 1997 ZIP 1721 et seq.

⁴ ECJ 10 July 1986 – C-79/85 – *Segers* [1986] ECR 2375. This decision went long unnoticed in the German legal literature.

⁵ ECJ 27 September 1988 – C-81/87 – *Daily Mail* [1988] ECR 5483.

⁶ ECJ 9 March 1999 – C-212/97 – *Centros* [1999] ECR I-1459.

⁷ ECJ 5 November 2002 – C-208/00 – *Überseering* [2002] ECR I-9919.

⁸ ECJ 30 September 2003 – C-167/01 – *Inspire Art*, nyr; reprinted in this

issue at: 8

⁹ For a detailed discussion of this issue, see *infra* at 6.

¹⁰ Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State (OJ 1989 L 395 at 36) (“Eleventh Council Directive”). See *Inspire Art* (*supra* note 8), paras 12-21.

¹¹ About substance, implications and limitations, see, e.g., *Rebbert*, Der Versicherungsabschluss als Informationsproblem, Baden-Baden (D), 2003, at 55 et seq., 73 et seq., 249 et seq.; *Rehm*, Aufklärungspflichten im Vertragsrecht, Munich (D), 2003, at 156 et seq.

that non-contractual creditors are not always savvy to the respective legal form of the company owing them a debt. Even when it comes to contracts, creditors will only seldom scrutinize the commercial set-up of a foreign undertaking or will write off the provision of such information as uneconomical.¹²

B. Corporate “abuse” of freedom of establishment

The issue of qualifying national safeguards as measures against “abuse” takes on particular gravitas in light of the rather strict tests against which justifications are generally measured. In *Inspire Art*, the ECJ explicitly stresses that Member States may prevent certain of their nationals from attempting “improperly to circumvent their national legislation” (para. 136). This statement raises complex dogmatic questions in light of “the fact that the company was formed in a particular Member State for the sole purpose of enjoying the benefit of more favourable legislation does not constitute abuse even if that company conducts its activities entirely or mainly in that second State” (para. 96). This statement is hardly surprising – as it can also be found in *Segers* or *Centros*. However, it does seem to contradict with conclusions that the ECJ has reached with respect to abuses of fundamental freedoms on a general level. The remainder of this article will consider the extent to which this perceived contradiction truly exists.

I. “Abuse”: One term, two meanings

To bring ourselves closer to this goal, we need to make a substantive distinction – one that the ECJ has regrettably neglected to make in its own case law. The distinction concerns all fundamental freedoms as well as both natural and legal persons. The ECJ understands “abuse” in at least two different ways, each of which must be understood apart from the other.¹³ Only in this way can the respective conclusions of *Segers*, *Centros* or *Inspire Art* be properly understood and classified.

1. “U-turn” constructions

a) Case law

The first category of abuse involves “artificially” creating situations with cross-border elements. This frequently recurring notion found its first articulation in *Van Binsbergen*: “[A] Member State cannot be denied the right to take measures to prevent the exercise by a person providing services whose activity is entirely or principally directed towards its territory of the freedom guaranteed by article [49] for the purpose of

avoiding the professional rules of conduct which would be applicable to him if he were established within that state”.¹⁴ Here we see that the determining factor when it comes to the exercise of fundamental freedoms is whether the requisite cross-border dimensions were apparently created for the sole purpose of enjoying the respective freedom.

In *Knoors*, a Netherlands national who qualified to work as a plumber in Belgium relied on the right of establishment as authorisation for him to carry on the same trade in the Netherlands.¹⁵ The ECJ stressed that a Member State may have a legitimate interest “in preventing certain of its nationals, by means of facilities created under the Treaty, from attempting wrongly to evade the application of their national legislation as regards training for a trade”. Although the Court denied that there had been abuse in this case, the distinguishing feature once again consisted of a “U-turn” construction. Not only was the plaintiff a Netherlands national, but one who also wanted to carry on his business exclusively in the Netherlands. The detour to Belgium only made sense for him in that – assuming the protection of the fundamental freedoms – he could make himself subject to the less stringent Belgian professional standards.

This central idea also found emblematic expression in *Leclerc*.¹⁶ In that case, books were first exported from France and then immediately reimported. The only explanation for this curious business practice, with its high transaction costs, was to test French legislation fixing book prices against the benchmark of European fundamental freedoms. The ECJ disallowed it on precisely this ground, reasoning that the sole purpose of the reimportation was to circumvent the national legislation.

b) Assessment

Characterising these sorts of “U-turn” constructions as “abuses” is understandable and doctrinally consistent. They involve improperly taking advantage of legal principles,¹⁷ which, like the circumvention of the law, is to be tested with regard to the range of Articles 43, 48 EC in terms of interpretation. Treaty freedoms must be understood with their object and purpose in mind: They are meant to ensure the mobility of work and capital across national borders by strictly demanding justification for any restriction on this free movement.

Yet another important inference that can be drawn from this basic thought is that we need not take account of subjec-

¹² *Eidenmüller*, *Mobilität und Restrukturierung von Unternehmen im Binnenmarkt*, 2004 JZ 24, at 27 with further references.

¹³ In fact, the aspects described *infra* represent only a portion of those which are seen as “abuse” constellations at the national and Community levels. For a classification of cases involving “abuse”, see *Schön*, *Der „Rechtsmissbrauch“ im Europäischen Gesellschaftsrecht*, FS *Wiedemann*, Munich (D), 2002, at 1271; *Fleischer*, *Der Rechtsmissbrauch zwischen Gemeineuropäischem Privatrecht und Gemeinschaftsprivatrecht*, JZ 2003, at 865 (each with additional references).

¹⁴ ECJ 3 December 1974 – C-33/74 – *Van Binsbergen* [1974] ECR 1299, para. 13.

¹⁵ ECJ 7 February 1979 – C-115/78 – *Knoors* [1979] ECR 399, para. 24.

¹⁶ ECJ 10 January 1985 – C-229/83 – *Leclerc* [1985] ECR 1, para. 27; see also ECJ 14 December 2000 – C-110/99 – *Emsland-Stärke* [2000] ECR I-1857. In that case, an undertaking exported consignments which were then transported back to Germany unaltered and by the same means of transport.

¹⁷ The determinative issue is whether there is an improper exploitation of the fundamental freedoms, which take precedence over national law. Others deem this to be a case of evading norms; see, e.g., *Fleischer (supra* note 13), at 869).

tive elements.¹⁸ The only necessary question is an objective one – whether the single benefit of the “U-turn” construction lays in the very possibility of gaining the protection of treaty freedoms.¹⁹

2. Fraud and misrepresentation

The aforementioned constellations must be distinguished from those which involve deceitful practices of individual citizens. In these cases, the fundamental freedoms are not just germane in light of an artificially created situation with cross-border elements, but encounter a genuine need for mobility. The well-known decision in *Paletta II* provides an instructive example in this regard.²⁰ That case concerned a medical certification of incapacity for work that was alleged to have been fraudulently procured in another country. In contrast with the rulings discussed previously, the Court did not inquire as to whether Mr Paletta was abroad solely to exploit the weaker Italian standards relating to such medical certifications, which he would not have obtained under German law (“U-turn” construction). Instead, mention was made of the extent to which the certification was obtained only through deceitful conduct that would be regarded unfavourably under both German and Italian law.

It is not difficult to characterise this group of cases. Rather than focus on the range of Articles 43, 48 EC,²¹ these cases target the level of justification.²² Denying recognition to a medical certificate obtained in another Member State imposes a restriction on fundamental freedoms and must therefore be justified. One such justification would rely on the fact that the certificate was obtained through fraud. Quite often such fraudulent conduct will affect objects of regulation, which provide an admissible ground of justification (e.g. under Article 46 EC). However, the extent to which the principle of the country of origin is to be applied remains an open question. Depending on the degree of harmonisation and control, the state concerned can be expected to dispense with a new control in the sense of the fundamental freedoms.

In contrast with the “U-turn” cases, subjective elements must be taken into account in cases of fraud and misrepresentation. If the grounds for the justification concern fraudulent conduct, it follows that there must be a finding of fraud. This by necessity includes subjective elements. The same holds true

for misrepresentations.

3. Provisional Result

For the ECJ, “abuse” encompasses two constellations that are, at their core, dogmatically distinct. The conclusions of *Paletta II* make clear the fact that this unfortunate mixing is not merely a product of terminology. On the question of whether national courts are bound by the guidelines of a specific regulation in cases of abuse, the *Paletta II* judgment, rather than citing decisions concerning fraudulent conduct, relies on those involving the “U-turn” pattern described above – in other words, instances in which there has been an abusive enactment of fundamental freedoms (para. 24). In *Paletta II*, this constellation was not even relevant, which is why the Court states in the next paragraph that the national courts may as a matter of principle take account of “objective evidence of abuse or fraudulent conduct”. This concerns – now substantively correct – the constellation of fraud and misrepresentation.

There is another, doctrinally incompatible notion that often crops up in the ECJ’s “abuse” line of cases. Where there is harmonisation within a particular area – or at least where such harmonisation is possible,²³ the ECJ is more apt to see abuse. In *Knoors*, the Court rejected an abuse with reference to conditions that were covered by a directive. The Court took a similar approach in *Bouchoucha*.²⁴ Precisely because there was no mutual recognition of diplomas for osteopathy, the ECJ recognized a justifiable interest of Member States in preventing certain individuals from circumventing national rules regarding vocational training.

Here, we must make a clear distinction. Where a “U-turn” constellation is at issue, it is questionable whether the degree of harmonisation is at all relevant. If fundamental freedoms are not pertinent to those cases that lack genuine cross-border dimensions, further scrutiny is superfluous. Only the factual brisance of the legal question is affected. The circumstances are different in cases of fraud and misrepresentation. At the level of justification, it is worth considering whether one can presume an interest worth protecting in a restriction given an existing or potential harmonisation. When a (minimal) harmonisation of this sort is accomplished, there are often good reasons under the principle of the country of origin to rely on the rules and controls of the country of origin. Likewise, there can be grounds for a Member State to resort to other methods to fight abuse. In this regard, a Member State may have the option of applying national provisions uniformly to all foreign companies.

The consequences of such a lack of differentiation should not be underestimated. Aside from the fact that it raises questions that are dogmatically imprecise (do we place cases of “abuse” at the level of protection or justification?) and that it results in unnecessary scrutiny (attention to subjective ele-

¹⁸ But see *Emsland-Stärke* (*supra* note 16), paras 52 et seq. In that case, the ECJ stated that “a finding that there is an abuse presupposes an intention on the part of the Community exporter to benefit from an advantage as a result of the application of the Community rules by artificially creating the conditions for obtaining it.”

¹⁹ It shall not be argued that such a purely objective formulation often contradicts the ordinary linguistic usage, which is virtually riddled with finalities. The subjective linguistic usage is unproblematic as long as the subjective element is not raised to an element of the charge.

²⁰ ECJ 2 May 1996 – C/206/94 – *Paletta II* [1996] ECR I-2357, para. 25, *passim*.

²¹ On cases in which the disapproval by the country of origin of such conduct can be decisive at the level of protection, see *infra* at 6 et seq.

²² Sometimes the ECJ seems to follow this differentiation (“U-turn” construction: scope of Articles 43, 48 EC; fraud and misrepresentation: justification). When taking up the issue of the improper exploitation of fundamental freedoms, it argues in elements of fraud *Leclerc* (*supra* note 16), and toward the level of justification in *Paletta II*.

²³ This leaves open how far the Court should really go in taking into account the mere *possibility* of Council action.

²⁴ ECJ 3 October 1990 – C-61/89 – *Bouchoucha* [1990] ECR I-3551, paras 14, 25.

ments and/or the extent of harmonisation in “U-turn” cases), the lack of differentiation also hinders an adequate appreciation of the Court’s judgments in *Segers*, *Centros* and *Inspire Art*.

II. Legal issues involving companies: “Use, not abuse”

If we compare the case law discussed up to this point with decisions dealing with freedom of establishment for *undertakings*, the latter decisions seems clearly at odds with the ECJ’s general take on “abuse”. The previous cases deemed the freedom of establishment irrelevant insofar as the cross-border element was purely “artificial” and there was no genuine need for mobility. However, the judgments in *Segers*, *Centros* and *Inspire Art* concerned companies that were only nominally “foreign” – in other words, companies whose only presence in their state of incorporation was at best a post box.

1. Choice of a foreign corporate form as a “U-turn” construction?

a) Formal consideration as principle

In fact, such misgivings are unfounded. The ECJ’s statement in *Inspire Art* (para. 96) that “the fact that the company was formed in a particular Member State for the sole purpose of enjoying the benefit of more favourable legislation does not constitute abuse even if that company conducts its activities entirely or mainly in that second State” is in keeping with how the distinction was made in the “U-turn” patterns discussed earlier.

First, it makes clear that legal persons enjoy the protection of the fundamental freedoms *in and of themselves* – not just the natural persons that found or run them. The freedom of establishment mandates only that companies or firms be “formed in accordance with the law of a Member State and [have] their registered office, central administration or principal place of business within the Community.”²⁵

Once we have pointed to the autonomous character of legal persons, the answer becomes obvious. An abuse in the sense of a “U-turn” construction would exist in cases where, for instance, a company having its central administration in the Netherlands moves to England and then immediately returns to the Netherlands with the sole purpose of subjecting certain Netherlands rules – like those allowing for worker participation in management – to the scrutiny of the freedom of establishment.

However, this is somewhat different from the case where a company is formed in England and then for the first and only time crosses over the border, either by actually transferring its corporate seat or by setting up a branch office in another Member State. This pattern is distinct from the types of abuse that the ECJ has considered. Indeed, it is the Treaty’s goal to enable the cross-border movement also of legal persons.²⁶ To

put it another way: Before one accuses a company of abuse, it must first be recognised as such. The accusation cannot consist merely of the fact that the person crossed a border. On the contrary, here we have an instance of a *use*, rather than an *abuse*, of the freedom of establishment. Consequently, we must also agree with the ECJ’s conclusions that a measure denying legal capacity to a company properly incorporated in another Member State solely because it transacts business in another Member State is tantamount to a negation of the freedom of establishment.²⁷

Another interesting question is how to deal with those natural persons who are ultimately behind the company’s formation and transfer. Conceivably, we could deny these individuals the chance to rely on the foreign company law, although we could not do the same for the foreign company itself or for those directors who did not participate in the company’s formation.²⁸ Such a differentiation raises concerns, however. In a practical sense, there is the complicated question of how to make these distinctions. The ECJ makes it clear in *Inspire Art* that it does not want such a result. At the same time, one can call into question whether a classical “U-turn” pattern really exists with regard to natural persons.

b) Remaining questions of substantive consideration

The preceding analysis provokes questions concerning the extent to which a strict separation of how natural and legal persons are regarded is not entirely a formality. The Court’s judgments in the *Veronica* and *TV10* cases could serve as good examples for a stronger substantive consideration. In *Veronica*, a Netherlands company was prohibited from helping set up and running a commercial radio station in Luxembourg only broadcasting to the Netherlands.²⁹ The declared goal of this action was the maintain pluralism in the radio industry. The ECJ held that broadcasters may be prevented from exercising the freedoms guaranteed by the EC Treaty in such a way as to evade the obligations deriving from national legislation concerning the pluralistic and non-commercial content of programmes. In *TV10*, a company was formed in Luxembourg with the sole purpose of circumventing provisions of Netherlands law.³⁰ The ECJ ruled that it was permissible to equate the Luxembourg company with a Netherlands company in order to prevent abuse.

Both cases involve a legal person initially incorporated under Luxembourg law whose business is directed across the border, into the Netherlands. These cases are thus not “U-turn” constructions in a formal sense. Yet in substantive terms, they should be treated no differently from the case in which a natural person sends the programmes (or corre-

²⁷ *Überseering* (*supra* note 7), para. 93.

²⁸ Substantively, this concerns the question of an inverse piercing of the corporate veil, i.e. where the director’s misconduct is attributed to the company, see *Damman*, *The Future of Codetermination after Centros: Will German Corporate Law move closer to the U.S. Model?*, 2003 *FdmJCF* 607, 642.

²⁹ ECJ 3 February 1993 – C-148/91 – *Veronica* [1993] ECR I-487, para. 13.

³⁰ ECJ 5 October 1994 – C-23/93 – *TV10* [1994] ECR I-4795, paras 21, 26.

²⁵ See *Segers* (*supra* note 4), para. 16, and *Centros* (*supra* note 6), para. 27.

²⁶ *Inspire Art* (*supra* note 8), para. 137, and *Centros* (*supra* note 6), para. 26.

sponding media) to Luxembourg in order to broadcast them back to the Netherlands. It is acceptable not to apply the fundamental freedoms, given their object and purpose of protecting genuine needs for mobility. An overly restrictive notion of abuse could cause Member States to defend their interests with appeals to general grounds of justification in the context of fundamental freedoms. This would mean that the national provisions at issue would no longer be limited to companies which are “foreign” only in a formal sense, but also to truly foreign companies.³¹ This kind of development would run counter to interests conducive to European integration.

The essential difficulty of these considerations lies in the distinction with *Segers*, *Centros* and *Inspire Art*. If the Dutch businessman attempts to dodge national rules on minimum capital by going to England, only to return as a “Ltd.,” we could be inclined to see this as abuse, given a substantive understanding attuned to the object and purpose of the treaty freedoms.

The fact that fundamental freedoms are not generally extended to legal persons, but only in Article 48 EC, offers only limited help in making the desired distinction. Even if one does only consider the freedom to provide services as relevant to the *Veronica* and *TV10* cases, this freedom is equally extended to legal persons by way of Article 55 EC. In the same way, it cannot be argued that the Netherlands rules are geared toward companies (and not just the natural persons behind them). If the ECJ does not want to overturn its previous rulings, it has no choice but to limit its strictly formal reasoning to a “core” of company law that does not involve rules governing the media or the exercise of certain trades, professions or businesses. In this way, a distinction could be made between those rules that apply equally to natural and legal persons and those that govern matters that specifically relate to companies. Although this distinction would have no binding logic,³² it would be justiciable to some extent. Furthermore, it could also refer to certain areas of law that are commonly accepted with regard to the personal statute in private international law.³³ It would also be wise to adapt the criteria developed here with those to be developed for a potential separation of mere “modalities of establishment”.³⁴ The degree to which the national rules in question significantly inhibit market access by foreign companies should be considered.

Anyway the ECJ seems to aim for such a differentiation. In *Centros* (see para. 27) the court explicitly narrows its cardinal declaration of the term “use, not abuse” to “rules of company law”. Just before it emphasises that the national regulations which the people affected want to elude from are the ones about “formation of companies and not [...] the carrying on

of certain trades, professions or businesses”.³⁵

c) Cases of Transformation

Cases in which it is the company itself (and not a natural person) taking the way to another Member State and back are no less complicated. We have already shown that such scenarios can constitute an abuse.³⁶ Say there is a Netherlands “B.V.” (for which the incorporation theory applies) that wants to avoid certain national rules designed to protect minority shareholders. The company thus transforms itself into an English “Ltd.” while continuing to conduct all of its business in the Netherlands. This step could be accomplished by means of a merger with an already existing “Ltd.” once the Tenth Directive takes effect.³⁷ Here, we must ask the extent to which the mere fact of a change in corporate form from a company established under Netherlands law to one established under English law would trump objections of abuse. This is particularly doubtful as the merger directive has the objective to allow a change of governing law without winding up the old company and incorporating a new one.

Another example would be the case where a director prohibited by some domestic law from continuing to run his or her existing firm (e.g. § 6(2) of the German act on limited liability companies [*Gesetz betreffend die Gesellschaften mit beschränkter Haftung*, “GmbHG”]) transforms it into a foreign company governed by less stringent rules. The ability of this foreign company to turn to a broader group of directors and export this privilege to Germany could be seen as a usurpation of fundamental freedoms and therefore an abuse.

2. Fraud and misrepresentation

It is much easier to assess cases of fraud and misrepresentation. The ECJ has made it clear that the Member States can take appropriate measures to prevent or prosecute fraud. This applies to companies as well as to their directors.³⁸ The proposition that restrictions on freedom of establishment may be justified even beyond the wording of Article 46 EC accords with clearly established case law and is explicitly stressed in *Überseering* (para. 92). Even in *Segers* (para. 17), the ECJ held that combating fraud can be justified under Article 46 EC and thereby allow a difference in treatment, even if it did not make the necessary distinction with the “U-turn” cases.³⁹

These principles are illustrated by way of two examples. First, piercing the corporate veil is permissible in cases where

³¹ Insofar as one does not see discrimination as incapable of justification. See *Segers* (*supra* note 4), para. 17.

³² Ultimately, companies are no more than the sum of the courses of action permitted to them by law, regardless of what that law might be. See *infra* at 6.

³³ Internal and external, from the company’s formation to its winding up; see, e.g., *Kindley*, in: Münchner Kommentar zum Bürgerlichen Gesetzbuch, vol. 11, 3rd ed., Munich (D) 1999, para. 412 et seq. However, here it would depend on a European standard.

³⁴ For further discussion on this matter, see *infra* at 7.

³⁵ Critical, see *Dammann* (*supra* note 28), at 636 et seq., who refers to problems of making such distinctions by considering as an example the special corporate co-determination developed for the coal and steel industry.

³⁶ See *supra* at 4.

³⁷ See *supra* note 3.

³⁸ *Inspire Art* (*supra* note 8), para. 38; see also *Segers* (*supra* note 4), para. 17.

³⁹ This leaves open the degree to which the unequal treatment is necessary and permissible. If one takes the approach that the state of incorporation can from the outset limit the course of action potentially protected by the freedom of establishment (*infra* at 6 et seq.), fraud will be the best candidate for such a limitation.

the directors of a company limited by shares exploit their company to perpetrate fraud. This is true regardless of whether the company is a “Ltd.” or a “GmbH”. A local Hamburg court took up a case in which all corporate assets were allocated to one (German) company while an (English) “Ltd.” assumed all liabilities (the “Cinderella model”).⁴⁰ The underlying legal issue was a general one directed at all companies, whether foreign or domestic. One could also inquire as to the extent to which sanctioning such behaviour involves something more than mere modalities of establishment.⁴¹ As a result, a Member State may ignore the limitation on liability of a foreign company in such special circumstances, to the extent this is necessary to protect the interests of creditors (see *Überseering*, para. 92).

However, the principle of the country of origin may apply here as it also can do in cases of fraud and misrepresentation by natural persons. Depending on the degree of harmonisation and control, it can be reasonable for the state concerned to rely on the enforcement in the other Member State alone.

3. Choice of the favourable law

What needs to be distinguished from the cases described above – and this is the ECJ’s core holding not just in *Inspire Art* – are those cases in which natural persons choose at the outset a foreign corporate form because it provides them with certain advantages. For instance, if the annual accounts required of small businesses under English law are much simpler than those required under German law – this fact must simply be accepted.⁴² Extending the German notion would necessitate a showing that the strict requirements for restrictions on freedom of establishment are met, which would be difficult in the concrete case.

A controversial case is that in which a German national whose criminal record prevents him from founding a limited-liability company (GmbH) in Germany (§ 6(2) of the GmbHG) opts to set up a foreign company instead. Here, the concept of the foreign company law may include fewer restrictions. It is entirely conceivable that the ECJ will order Germany to accept this decision in terms of the principle of country of origin.⁴³ The situation would be different were it to involve a regulatory vacuum (such as when the foreign law comes up against certain dangers by insolvency law not being applicable in Germany) or were the company is registered in another Member State only due to the fact that the local authorities never learn of the criminal record for want of cross-

border exchanges of such information.⁴⁴

However, were German lawmakers or judges to decide to extend the principles of corporate co-determination to foreign companies,⁴⁵ this could not be classified as “combating abuse”. First, English lawmakers made a conscious decision not to impose such a worker-participation with respect to “its” corporate forms. And with regard to “substantive considerations” the question of co-determination forms part of the core of any company charter. This integral characteristic of the company makes it also impossible to categorise such an extension of legal principles as a mere “modality of establishment”.⁴⁶

C. Additional approaches to limiting the freedom of establishment of companies

I. Companies as creatures of the law

One oft noted peculiarity of legal persons is that they are ultimately constructs that owe their existence to legal instruments of the state of incorporation. This suggests that a company’s range of possible action is circumscribed by the law under which it is formed. It is therefore consistent that the ECJ holds in *Daily Mail* (para. 19) that the state of incorporation can limit the potential alienation of its own corporate forms.

Consequently, the courses of action that a Member State denies to its “own” companies cannot be tested for their compatibility with fundamental freedoms.⁴⁷ If a foreign law for moral reasons prevents companies from being involved with prostitution, a similarly worded German prohibition could not violate their freedom of establishment. Closely connected to this is the question of whether the foreign state’s claim to governing the use of “its” companies could possibly be territorially limited, which is to be established through interpretation. A good example for this are German rules in effect until February 1999 under which bribes to foreign officials were not only exempt from punishment, but also allowable as tax deductions. Having said that, one must also consider whether EU law itself contains binding valuations that are therefore of general applicability. This would also have the potential to limit or open the playing field for companies.

In view of these conclusions, we are confronted with the question of whether they can be applied to natural persons. Ultimately, it is the law that creates, protects or limits opportunities for action. Legal capacity may be given and, in extreme cases, also taken away.⁴⁸ There are arguments against

⁴⁰ AG Hamburg (D) 14 May 2003, [2003] NJW 2835.

⁴¹ See *infra* at 7. If already the law under which a company is formed disapproves such behaviour patterns, the „*Daily Mail-Argumentation*” is relevant, see *infra* at 6 et seq.

⁴² For discussion of the legal landscape in England, see *Ebert/Levedag*, Die zugezogene “private company limited by shares (Ltd.)” nach dem Recht von England und Wales als Rechtsformalternative für in- und ausländische Investoren in Deutschland, [2003] GmbHR 1337, 1339 et seq.

⁴³ On the other hand, it is difficult to identify a substantive difference between this instance of a start-up and the settled case of the “U-turn” movement of an already existing company.

⁴⁴ It could be argued in turn that the state of incorporation substantively does not want this person to form an overseas company by this person; see *infra* at 6.

⁴⁵ This instance is to be distinguished from the problematic case in which an already existing legal person goes abroad and then returns to the original country; see *supra* at 4 et seq.

⁴⁶ See *infra* at 7.

⁴⁷ To this extent there is a certain equivalent to the incorporation principle in international company law, where there is deference to the company law of the state of incorporation with respect to the specific area of the law applicable to persons.

⁴⁸ The clearest and most tragic examples are to be found in totalitarian

such a parallel, including the fact that when natural persons cross a border, they can readily adapt to the laws of the new state in that they have no internal structures that must be altered. More importantly, natural persons have – at least according to a conviction deeply rooted in Europe, innate and inalienable rights. The state must respect these rights and create a legal order in which they may be realised. Despite Article 19(3) of Germany's Basic Law or Article 48 EC, the same cannot be said for legal persons.

II. "Keck differentiation" within the context of freedom of establishment?

In spite of what has been said up to this point, the freedom of establishment enjoys an extremely broad scope of protection. This also holds true for legal persons. If a company transfers its corporate seat to Germany, it will come across a large number of restrictions that it might not have had in its country of incorporation. These might include restrictions on the times and days of the week that shops may be open, which may differ from those of their own country. It therefore stands to reason that we should make the distinction introduced by the ECJ with respect to the free movement of goods. The purpose of the treaty freedoms is not to require an adequate justification of any and all national restrictions. Therefore mere "establishment modalities" should be separated from the scope of Article 43 EC.⁴⁹

D. Summary and conclusions

I. Doctrine of fundamental freedoms

The aspects and distinctions that have been discussed above can be better evaluated and comprehended by putting them through a concrete series of tests. There is the initial question of the extent to which an action for which a company claims freedom of establishment as a protection belongs to the courses of action permitted by the law under which the company was incorporated. Next, we must test the scope of protection of the freedom of establishment. This presumes a certain impairment of access for companies. Mere modalities of establishment must be distinguished from substantial obstacles to market access. Moreover, freedom of establishment is also not pertinent where there is abuse in terms of a "U-turn" variety. Only then, in a third step, do we arrive at the test of whether the impairment can be justified. In instances of fraud

and misrepresentation, an interest recognised by Article 46 EC or in the Court's case law will frequently be relevant. This need not be fraud as such, it may also concern the goods and interests endangered by such fraud.

In this context of necessity, the degree of harmonisation and the principle of the country of origin can play an important role. It is often reasonable to rely on the rules and controls of the state of incorporation. However, here one must pay attention to the fact that more invasive controls by the state of domicile are tolerated with respect to the freedom of establishment than is the case with respect to the freedom to provide services. In instances where a company has a continuing presence in another Member State, adaptation seems more acceptable than it does where a company's presence is merely transitory.⁵⁰ In all of these steps there is a clear "division of labour": The state of incorporation determines the ambit within which its company may operate. The test of the scope of Articles 43, 48 EC and possible justifications takes place at the level of European law, which takes account of national needs to protect imperative interests of the general public. National law determines those legal consequences that must be measured against the standard of the freedom of establishment.

A few doctrinal grey areas can also be clarified. The abuse constellations in the form of a "U-turn" represent applications of the "internal theory", whereas fraud and misrepresentation form part of "external" thresholds.⁵¹ For the decisiveness of subjective elements in the case of abuse, the same principles apply as have been developed for natural persons. Subjective elements are decisive only in cases of fraud and misrepresentation.⁵²

II. Competition between systems of private law?

This contemplation of "abuse" permits us to make important conclusions as well to the extent to which the EC Treaty is based on the notion of competition between systems of private law, or at least of company law.⁵³ The "abuse" line of cases relatively clearly shows with respect to the rights of natural persons that European fundamental freedoms are not concerned with a general competition of private laws. For example, the "U-turn" case law prevents individuals from choosing the rules of one legal system without truly having to move when they want to avoid a provision of national law which they may find unfavourable. The autonomy to make such choices is clearly rejected.

The same holds true for the line of cases that deal with fraud and misrepresentation, as well as for the special requirements of justification. This becomes clear in the significance of the

systems in which minority groups, by being denied legal capacity, are stripped of legal rights and protections. See, e.g., *Rüthers*, Recht als Waffe des Unrechts – Juristische Instrumente im Dienst des NS-Rassenwahns, [1988] NJW 2825, 2833.

⁴⁹ See ECJ 24 November 1993 – C-267/91 & C-268/91 – *Keck and Mithouard* [1993] ECR I-6097; about the differentiation, see *Eidenmüller* (*supra* note 12) at 26 et seq.; *Habersack*, Europäisches Gesellschaftsrecht, 2nd ed., Munich (D), 2003, para. 28; *Schanze/Jüttner*, Anerkennung und Kontrolle ausländischer Gesellschaften – Rechtslage und Perspektiven nach der Überseering-Entscheidung des EuGH, [2003] AG 661, 666 et seq.; *Spindler/Berner*, Inspire Art – Der europäische Wettbewerb um das Gesellschaftsrecht ist endgültig eröffnet, [2003] RIW 949, 955. It is appropriate to note that ultimately the decisive aspect is the degree to which market access is significantly impaired.

⁵⁰ *Randelzhofer/Forsthoff*, in: *Grabitz/Hilf*, Kommentar zur Europäischen Union, vor Art. 39-55 EGV, 2003, para. 181 et seq.

⁵¹ For more on this distinction, see *supra* note 13. However, this is not the case where restrictions of the law of the state of incorporation or the "Keck differentiation" apply. This makes clear that the conceptual pair of "internal/external" theory is a technical legal distinction.

⁵² In this sense, see also *Inspire Art* (*supra* note 8), para. 95; *Centros* (*supra* note 6), para. 18.

⁵³ For additional references, see, e.g., *Eidenmüller*, Wettbewerb der Gesellschaftsrechte in Europa, [2002] ZIP 2233; *Kieninger*, Wettbewerb der Privatrechtsordnungen im Europäischen Binnenmarkt, Tübingen (D), 2002, at 105 et seq.

respective degree of harmonisation. If the true concern is a competition of legal systems, a lack of harmonisation would be no argument for denying the protection of the fundamental freedoms.⁵⁴ That this restrictive stance is compatible with the interests of these freedoms has already been demonstrated.⁵⁵

The interesting question here is the clearly different situation that exists for companies. They can export a considerable portion of their legal frameworks into other Member States. This remarkable situation is not a concept that was intentionally put into the EC Treaty; it is a completely unintended by-product of legislative interest in allowing companies – i.e. legal persons – the benefit of freedom of establishment by way of Article 48 EC. For only the recognition of legal persons as such leads to the denial of a “U-turn” pattern in *Segers*, *Centros* or *Inspire Art*.

National lawmakers can do little but accept these facts and conceive of at least minimal corrections. However, the economic ramifications must be independently assessed. Even when national regimes for company law

⁵⁴ One conceivable interpretation would be that such competition would (only) be permissible when there is a minimum of the necessary, common framework conditions for such competition. The Court has not made any comments in this direction, however.

⁵⁵ See *supra* at 2.

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Articles 43 EC, 46 EC and 48 EC – Company formed in one Member State and carrying on its activities in another Member State – Application of the company law of the Member State of establishment intended to protect the interests of others

It is contrary to Article 2 of the Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State for national legislation such as the *Wet op de Formeel Buitenlandse Vennootschappen* (Law on Formally Foreign Companies) of 17 December 1997 to impose on the branch of a company formed in accordance with the laws of another Member State disclosure obligations not provided for by that directive.

It is contrary to Articles 43 EC and 48 EC for national legislation such as the *Wet op de Formeel Buitenlandse Vennootschappen* to impose on the exercise of freedom of secondary establishment in that State by a company formed in accordance with the law of another Member State certain conditions provided for in domestic company law in respect of company formation relating to minimum

get under pressure and lose “market shares”, this still can be advantageous. For possibly the new prospect of investing in a Member State without having to adapt e.g. to the local rules on worker co-determination may be in some cases the decisive point in making a decision where the company shall be based.

III. Europeanization of international company law

It is apparent that the international company law of the Member States is much more strongly determined by provisions at the Community level, as some still believe.⁵⁶ The wide scope of the freedom of establishment, the strict requirements for justification, and the multitude of criteria that must be respected do not give much leeway. Ultimately, the ECJ’s entire jurisprudence on fundamental freedoms deals with the question of when the legal provisions of one Member State may be applied to persons, services or goods of another.

⁵⁶ A symptom of this is the attempt to evade the application of the law of incorporation in such a way that the company law principles with respect to tort, insolvency, or public law assume a different quality. The ECJ will take up this issue only to a limited extent.

capital and directors' liability. The reasons for which the company was formed in that other State, and the fact that it carries on its activities exclusively or almost exclusively in the Member State of establishment, do not deprive it of the right to invoke the freedom of establishment guaranteed by the Treaty, save where the existence of an abuse is established on a case-by-case basis.

Facts: Inspire Art was formed on 28 July 2000 in the legal form of a private company limited by shares under the law of England and Wales and it has its registered office at Folkestone (United Kingdom). Its sole director, whose domicile is in the Hague (Netherlands), is authorised to act alone and independently in the name of the company. The company, which carries on activity under the business name Inspire Art Ltd in the sphere of dealing in objets d'art, began trading on 17 August 2000 and has a branch in Amsterdam.

Inspire Art is registered in the commercial register of the Chamber of Commerce without any indication of the fact that it is a formally foreign company within the meaning of Article 1 of the WFBV.

Taking the view that that indication was mandatory on the ground that Inspire Art traded exclusively in the Netherlands, the Chamber of Commerce applied to the Kantongerecht Amsterdam on 30 October 2000 for an order that there should be added to that company's registration in the commercial register the state-