

BALTISCH-DEUTSCHES HOCHSCHULKONTOR
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Spring Semester 2010

PRACTICAL CASE-SOLVING IN EUROPEAN LAW

Case 6¹
(facts of the case)

In the EU member state A-land, company law comprises strict requirements for the incorporation of companies with limited liability, in order to protect the financial interest of creditors. In particular, incorporation requires that a corporate capital of 20.000 € is invested and effectively deposited by the shareholders. For this reason, Antons and Berta, two citizens of A-land, incorporate their new company "Sunshine Limited" in the member state B-land, where there are no statutory requirements concerning minimum investments of the shareholders. In fact, the corporate capital of 500 € is never paid up. The "Sunshine Limited" is registered in B-land as company with limited liability. Antons is the executive director. The registered office is at the address of a friend who has emigrated to B-land. The company has no business activity in B-land.

One year later, Antons applies for registration of a branch of "Sunshine Limited" in A-land. However, registration is denied. The Registry Office argues that "Sunshine Limited" has never taken any activity in B-land. It holds that the genuine purpose of the application is not to establish a branch but to install the head office of the company in A-land, and that without complying with A-land's statutory requirements on a minimum corporate capital to be actually deposited. It holds that the registration of a branch would only serve to sidestep the strict requirements of the domestic company law and therefore can be denied in accordance with European Union law. The Registry Office reasons that the denial of registration is necessary in order to protect public and private creditors and to prevent fraudulent bankruptcy.

Thereupon, the "Sunshine Limited" brings the matter before the competent court of jurisdiction. It claims that it has the right to have the branch registered, since it meets the requirements of A-land's company law for the registration of branches of foreign companies. The company points out that it has been established in B-land lawfully and effectively. It argues that for this reason it is entitled to establish branches in all member states of the Union, thus also in the shareholders' country of origin. It holds that the fact that the company has not carried out any business in the member state in which it was established does not make any difference.

The competent court in A-land suspends the proceedings and refers the following question to the European Court of Justice: Is it compatible with the law of the European Union to refuse registration of a branch of a company that has its registered office in another member state and exists in conformity with the legislation of that state, if the company does not itself carry on any business but is desired to set up the branch in order to carry on the entire business in the country in which the branch is established, and if, instead of incorporating a company in the latter state, that procedure must be regarded as having been employed in order to avoid paying up the minimum corporate capital?

What will be the (correct) answer of the European Court of Justice to this question?

Note: Please assume, for the purpose of this examination, that the referred question still demands clarification.

This test is designed for one week of concentrated work. The course paper (minimum: 6 pages) must be submitted in the lecture of March 25 or via e-mail until *April 1st* (e-mail to tshmit1@gwdg.de). After that, no papers will be accepted. Travelling abroad or other professional commitments do not represent an excuse for delay. In case of illness, a medical certificate must establish inability to work for a period of at least two weeks. Course participants may repeat the test only if they have submitted their papers in time.

¹ Case for test 1 (interim examination).

PRACTICAL CASE-SOLVING IN EUROPEAN LAW

Case 6

(discussion of the case)

SUBJECTS: preliminary ruling proceedings; freedom of establishment and pseudo foreign corporations; abuse of fundamental freedoms.

OUTLINE OF THE CASE SOLUTION:

The European Court of Justice will answer to the question of the court in A-land, if the reference for a preliminary ruling under art. 267 FEU Treaty² is admissible (A). It will answer (correctly) in the affirmative if the refusal to register the branch of a company under the described conditions is incompatible with Union law (B).³

A. Admissibility of the reference for a preliminary ruling

I. Jurisdiction of the European Court of Justice: (+)

- see art. 267 sub-sect. 1 and 2 FEU Treaty

II. Right to refer: (+)

- as required in art. 267 sub-sect. 2 FEU Treaty, the reference is made by a *court of a member state*

III. Suitable subject-matter for a reference: (+)

- in the case under consideration: the "interpretation of the Treaties" (art. 267 sub-sect. 1 lit. a FEU Treaty)
- note: the referred question is not about the interpretation or applicability of national law

IV. Relevance of the referred question to the case before the referring court: (+)

- as required in art. 267 sub-sect. 2 FEU Treaty, in the case that is pending at the court in the member state A-land, the decision of the court depends from the answer of the European Court of Justice to the question concerning Union law

V. Question demanding clarification: (+)

- it is uncertain, how Union law (in our case: art. 49 et seq. FEU Treaty⁴, concerning the freedom of establishment) has to be interpreted

VI. Suitable formulation of the referred question: (+)

- abstract question concerning the interpretation of Union law
- in particular no question concerning the interpretation, validity or applicability of national law or the decision in the case pending at the referring court

² Formerly (until the Treaty of Lisbon came into force) art. 234 EC Treaty.

³ Note: In cases of references for preliminary rulings, the second parts of the introductory sentences will be varying according to the referred questions. Therefore, there is no standard phrasing as for the actions for failure to fulfil obligations or for the actions for annulment.

⁴ Formerly art. 43 et seq. EC Treaty.

B. The answer of the European Court of Justice to the referred question

The European Court of Justice will answer to the question in the *affirmative*, if the *refusal to register* the branch of a company *under the conditions described* in the decision of reference, i.e. the foundation of a company in another member state and the following setting-up of a branch in the home state in order to avoid paying up the minimum corporate capital, *is incompatible with Union law*. In such cases, the refusal to register might be incompatible with the freedom of establishment in the European Union (art. 49 et seq. FEU Treaty); thus, the European Court of Justice might have to answer in the negative. This, however, requires that the sphere of protection [scope/area of protection] of the freedom of establishment is concerned (I.), that the refusal to register represents an encroachment on [interference with / intrusion in] this freedom (II.) and that this encroachment is not justified by the limits of the freedom of establishment and therefore illegal (III.).⁵

NOTE: In the preliminary ruling proceedings, the European Court of Justice *only* discusses *the abstract question of law* but not the individual case of the "Sunshine Limited" from the proceedings before the referring court of member state A-land! For this reason, the *following parts of the case solution should not comprise any special comments on the case of the "Sunshine Limited"*!⁶

I. Sphere of protection ["Schutzbereich"]⁷

1) Personal sphere of protection: (+)

- companies (legal persons) are generally protected under art. 54 sub-sect. 1 FEU Treaty⁸
- there are no doubts concerning the "*profit-making*" character (cf. art. 54 sub-sect. 2 FEU Treaty): the company as a whole aims to make profit, commercial activities in the country of establishment are not required.
- as required in art. 49 sub-sect. 1 phrase 2 FEU Treaty, the company is established in the territory of a (any) EU member state

2) Material sphere of protection

a) Situation of cross-border mobility (→ relevance of Union law)

- problem: cross-border mobility in case of pseudo foreign corporations?

- the problem: In such cases, the company has been established as a "foreign" corporation for the only purpose to create an artificial context of cross-border mobility, in order to achieve the protection by the freedom of establishment and thus to circumvent the national provisions on minimum corporate capital
- EUROPEAN COURT OF JUSTICE, case C-212/97, *Centros*⁹: It is irrelevant if a company is only established in a member state in order to settle down in another member state, in which it is planning to perform its business activities exclusively or mainly.
- ANOTHER REASONABLE OPINION: there is no cross-border mobility in such cases because the company does not perform or plan any transnational economic activities
- OWN DECISION: For didactic reasons, this case solution follows the approach of the ECJ. (→ YOU, however, must DEBATE AND REASON!)

b) Gainful occupation as self-employed person (see art. 49 sub-sect. 2 FEU Treaty): (+)

- in the cases described in the referred question, a gainful occupation is actually intended (in the country of the branch)

c) Establishment (see art. 49 sub-sect. 1 FEU Treaty): (+)

d) Generally protected activity: (+)

- taking-up and exercise of the gainful occupation, setting-up an enterprise in the form of a branch (cf. art. 49 sub-sect. 2 FEU Treaty)

⁵ In the English language, the legal terminology in the field of the dogmatics of the economic fundamental freedoms is not yet settled. See *Diagram 2* from the course "EC Internal Market Law", autumn semester 2009 (http://home.lanet.lv/~tschmit1/Downloads/Schmitz_EC-IntML_diagram2.pdf).

⁶ However, the European Court of Justice has not always met these requirements in a successful manner in the similar case *Centros* (ECJ, case C-212/97; see the case-specific observations in no. 18, 35 ff.).

⁷ See for the examination of a possible violation of the freedom of establishment *Diagram 5* from the course "EC Internal Market Law", autumn semester 2009 (http://home.lanet.lv/~tschmit1/Downloads/Schmitz_EC-IntML_diagram5.pdf).

⁸ Formerly art. 48 sub-sect. 1 EC Treaty.

⁹ ECJ, case C-212/97, *Centros*, no. 17 f.; cf. also ECJ, case 79/85, *Segers*, no. 16.

- e) No sector excluded according to art. 51 FEU Treaty: (+)
- f) problem: no protection due to an abuse of the freedom of establishment?
- the problem: The setting-up of a domestic branch after the establishment of the company in another state exclusively serves the purpose to circumvent the national provisions on minimum corporate capital. The freedom of establishment is exploited for objectives that were not in view when the member states guaranteed this freedom.
 - EUROPEAN COURT OF JUSTICE, case C-212/97, *Centros*¹⁰: Nevertheless, the setting-up of a branch is protected. The fact that a national of a member State who wishes to set up a company chooses to form it in the member state whose rules of company law seem to him the least restrictive and to set up branches in other member states cannot, in itself, constitute an abuse of the right of establishment. This question is different from the question whether or not a member state may adopt measures in order to prevent attempts by certain of its nationals to evade domestic legislation by having recourse to the possibilities offered by the Treaty.
 - ANOTHER REASONABLE OPINION: The freedom of establishment does not protect activities, which are exploiting it for unwanted purposes. If there are no transnational economic activities and none of the objectives of the FEU Treaty are supported, the sphere of protection of the freedom of establishment is not concerned.
 - OWN DECISION: For didactic reasons, this case solution follows the approach of the ECJ. (→ YOU, however, must DEBATE AND REASON!) - By the way, from a general dogmatic perspective, it is problematic to counteract the abuse of a freedom by excluding the concerned activity from the freedom's sphere of protection: This would eliminate the protection of the citizen by the *need of the holders of public power to justify restrictions*. When a freedom is abused, the fact of the abuse should be taken into consideration when applying the *limits* of the freedom.

II. Encroachment ["Beeinträchtigung"]: (+)

- problem: open discrimination or non-discriminative restriction?
 - the problem: A member state pointedly refuses the registration (and thereby the setting-up) of a branch of a *foreign* company that is legally recognized in its country of establishment because it has not performed business activities. Domestic companies are not confronted with such requirements. This might represent an open discrimination.
 - However, the real motive for the refusal lies in the circumstance that the foreign company does not have a paid up corporate capital. The fact that it has not taken up activities presents a further but not the essential reason. Hence, the foreign company is *ultimately treated equally* with the domestic companies, whose establishment presupposed the payment of a minimum capital. For this reason, the refusal of the registration is to be classified as a restriction that ultimately concerns both, domestic and foreign companies, in the same way. In its *Centros decision*, the ECJ has considered the refusal of the registration of a branch of a company in a similar case as a restriction;¹¹ the same applies to legal scholars in case studies referring to this judgement.¹²
 - Both classifications are acceptable. (→ YOU must DEBATE AND REASON!)

III. Illegality of the encroachment (no justification by the fundamental freedom's limits) ["Schränken"]

- 1) Justification by the explicit limit in art. 52(1) FEU Treaty¹³: (-)
- art. 52(1) FEU Treaty does only justify "special treatment for foreign nationals" and therefore only applies to open discriminations
 - Furthermore, it is doubtful whether the preconditions of the limitation clause art. 52(1) FEU Treaty are fulfilled: - problem: the objectives of protecting creditors and preventing fraudulent bankruptcy as grounds of public policy ["ordre public"]?
 - note the restrictive interpretation of the concept of "public policy" ["ordre public"] in the jurisprudence of the ECJ - serious threats affecting the fundamental interests of society?
 - DEBATE AND REASON! OWN DECISION: (-) (→ see also the ECJ's *Centros decision*)¹⁴

¹⁰ ECJ, case C-212/97, *Centros*, no. 27, 17 f.

¹¹ Cf. ECJ, case C-212/97, *Centros*, no. 22, 34. However, the position of the ECJ is not unambiguous and not explained or motivated.

¹² See, for example, *Lorz*, Fallrepetitorium Europarecht, 2006, case 8, p. 114; *Epping/Lenz*, Fallrepetitorium Europarecht, 2005, case 18, p. 148.

¹³ Formerly art. 46(1) FEU Treaty.

¹⁴ Cf. ECJ, case C-212/97, *Centros*, no. 32 ff. Apparently, the ECJ does not consider these grounds as serious grounds.

- 2) Justification by the inherent limits of the freedom of establishment ["immanente Schranken"]
- a) Applicability of the inherent limits: (+)
- since the refusal of the registration ultimately represents a (non-discriminative) restriction (see above, B.II.); note: if you have classified it above as an open discrimination, you must not apply these limits!
- b) Fulfilment of the preconditions of the inherent limits: pursuit of imperative reasons of public interest: (-)
- terminology of the ECJ: "justified by pressing reasons of public interest" (case C-19/92, Kraus); "imperative requirements in the general interest" (case C-212/97, Centros)
 - the objectives of protecting creditors and preventing fraudulent bankruptcy in business life might not represent grounds of public policy but are at any rate among the imperative reasons of public interest, which, according to the jurisprudence of the ECJ,¹⁵ can justify restrictions of the freedom of establishment
- c) Compliance with the limits of limits ["Schranken-Schranken"]
- problem: proportionality?
 - It is already doubtful if the refusal to register a company without minimum capital that has not taken up business activities is suitable, since the branch would be registered (and thereby established) and the creditors would not be protected if the company performed any business activities, even minor activities, in the country of establishment.
 - Anyway, these means are not necessary, since there are *less restrictive means* of protection of creditors available. For the protection of private customers and business partners, *obligations of information* might be enough, at least if combined with a strict *duty to control that the information has been actually noticed*. For example, the company and its registered branch may be obliged by national law to get a special signature of all contractual partners that they have been informed about the minimum corporate capital that actually has been or has not been paid up. Obligations of that kind are common in the area of consumer protection. For the protection of *public creditors* (in particular tax authorities), these means are not sufficient. However, national law could *grant the right* to these creditors to *obtain the necessary securities* (bailments and guarantees of the shareholders, sureties etc.).¹⁶ National law could also submit the shareholders of foreign companies with a lower paid-up corporate capital than generally required in the host member state to *personal liability* for the amount of capital that corresponds to the required minimum capital. It could require a personal declaration of liability as a condition for the registration of the branch, making sure that the creditors are protected, that registration is still possible and that the personal liability of shareholders is confined to these exceptional cases. That kind of solution might not represent the dream of the experts in company law but would be less intrusive on the freedom of establishment than making it impossible to set up a branch in the member state.
 - NOTE: This is a main problem of the case. In this part of the case solution, a lawyer has to DEBATE AND REASON thoroughly and to SHOW IMAGINATION. The conclusion is not compelling. Not the outcome but the QUALITY OF YOUR REASONING is decisive!

So the encroachment on the freedom of establishment is unproportional and therefore not justified by the fundamental freedom's limits.

Under the specified conditions, the refusal to register a branch of a foreign company violates the freedom of establishment and hence is incompatible with Union law.

Conclusion: The European Court of Justice will answer the question of the court in A-land. It will answer it in the negative.

NOTE / FURTHER READING:

This case follows the *Centros* decision from 1999 (ECJ, case C-212/97, Centros). See for a similar case *Lorz*, Fallrepetitorium Europarecht, 2006, p. 109 ff. with a variation that also refers to ECJ, case C-167/01, Inspire Art, and case C-208/00, Überseering.

More informations on this course at www.lanet.lv/~tschmit1. For any questions, suggestions and criticism please contact me via e-mail at tschmit1@gwdg.de.

(Datei: Case6 (Cases-EULaw))

¹⁵ Cf. ECJ, case Rs. C-19/92, Kraus.

¹⁶ Cf. ECJ, case C-212/97, Centros, no. 37.

A. Admissibility of the reference for a preliminary ruling

I. Jurisdiction of the European Court of Justice

II. Right to refer

III. Suitable subject-matter for a reference

- question concerning the "interpretation of the Treaties" (art. 267 sub-sect. 1 lit. a FEU Treaty)

IV. Relevance of the referred question to the case before the referring court

V. Question demanding clarification

VI. Suitable formulation of the referred question

B. The answer of the European Court of Justice to the referred question

- possible incompatibility with the freedom of establishment (art. 49 ff. FEU Treaty)

I. Sphere of protection

1) Personal sphere of protection

- no doubts concerning the "profit-making" character

2) Material sphere of protection

a) Situation of cross-border mobility

- problem: cross-border mobility in case of pseudo foreign corporations?
(→ ECJ, case C-212/97, *Centros*)

b) Gainful occupation as self-employed person (see art. 49 sub-sect. 2 FEU Treaty)

c) Establishment

d) Generally protected activity

e) No sector excluded according to art. 51 FEU Treaty

f) Problem: no protection due to abuse of the freedom of establishment?

- ECJ, *Centros*: intention to circumvent national law cannot, in itself, constitute an abuse of the freedom

II. Encroachment

- problem: open discrimination or non-discriminative restriction?

III. Illegality of the encroachment (no justification by the fund. freedom's limits)

1) Justification by the explicit limit in art. 52(1) FEU Treaty

- this limit does not apply
- problem: grounds of public policy ["ordre public"]?

2) Justification by the inherent limits of the freedom of establishment

a) Applicability of the inherent limits

b) Fulfilment of the preconditions of the inherent limits: pursuit of imperative reasons of public interest

c) Compliance with the limits of limits

- problem: proportionality (→ suitability, necessity)?
- in particular: discussion of less restrictive means of protection of creditors