EU Internal Market Law

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FREE MOVEMENT OF COMPANIES WITHIN THE EU

The right of establishment of companies

I. RIGHT OF ESTABLISHMENT OF COMPANIES

Preliminary remarks

Why a separate lecture on companies?

- Art. 49 TFEU confers the right of establishment on companies too
- Art. 54(1) TFEU **equates**, for the purposes of the right of establishment, **companies and firms** with **natural persons** («Companies or firms… shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States»)

BUT

- Corporate entities are **artificial**: «unlike natural persons, companies are creatures of the law and … **creatures of national law**. They exist **only by virtue of the varying national legislation** which determines their incorporation and functioning» (ECJ, judgment of 27.9.1988, case 81/87, *Daily Mail*, para. 19)

ISSUE 1 – THE SCOPE OF THE RIGHT OF ESTABLISHMENT OF COMPANIES

The notion of «company or firm» relevant to Arts. 49 and 54 TFEU

«Companies or firms» under Art. 54(2) TFEU 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.

- INCLUDED all entities pursuing profit
- EXCLUDED entities not aiming at exercising economic activities

Spatial scope of application

Only «intra-Union» movements are concerned

Two conditions have to be **cumulatively met**:

i. a link with the territory of the EU
ii. a cross-border factor

i. The link with the territory of the EU

Art. 54 requires a **twofold link**

a) Connection with the territory of a member State: **formation in accordance with the law of a Member State**

b) Connection with the territory of the EU: **registered office, central administration or principal place of business within the Union**

ATTENTION: a) and b) must NOT NECESSARILY be with the same MS!

Why three alternative links to the territory of the EU?

«The **legislation of the Member States varies widely in regard to … the factor providing a connection to the national territory required for the incorporation of a company** …

The Treaty has taken account of that variety in national legislation. In defining, in Article 58, the companies which enjoy the right of establishment, the Treaty places **on the same footing**, as connecting factors, the registered office, central administration and principal place of business of a company» (ECJ, *Daily Mail*, paras. 20-21)

In particular, under the case-law of the ECJ:

"The location of their registered office, central administration or principal place of business serves as the **connecting factor with the legal system** of a particular State in the same way **as does nationality in the case of natural persons**" (see*, inter alia*, *Tax credit*, para. 18; *Segers,* para 13; *Commerzbank*, para. 13; *ICI* para. 20; *Centros*, para. 20; *Überseering*, para. 57)

ii. The cross-border factor

- **Wholly internal situations** are **EXCLUDED** from the scope of the freedom of establishment

What does amount to a cross-border factor for the purposes of the right of establishment?

Case C-212/97, *Centros*

Danish government's argument: The **situation** is **purely internal to Denmark**: Mr and Mrs Bryde have formed a company in the United Kingdom which **does not carry on any actual business** there **with the sole purpose** of carrying on business in Denmark through a branch and thus of **avoiding application of Danish legislation** on the formation of private limited companies. of establishment

Open issue: Is the **real pursuing of an economic activity** in the State under whose law the company has been formed needed? In other words, is **an effective and continuous link with the economic life of the that country needed** in order to benefit from the freedom of establishment?

According to the **Advocate General La Pergola**:

«The Danish authorities insist that the principal establishment must really pursue the activities stated to be the object of the company. However, that line of reasoning leads them to see in Article 58 of the Treaty an **additional condition** to which the right to set up a secondary establishment is subject. However, in my view, **the formal requirements set out in Article 58, for the purpose of identifying companies that have that right, are definitive**. **The legal form of the company is decisive**. This is the point: there is **no need to inquire into the nature and content of the activities the company is pursuing or intends to pursue**»
(Opinion of Mr Advocate General La Pergola delivered on 16 July 1998, para. 18)

The Court's ruling: a situation in which a company formed in accordance with the law of a Member State in which it has its registered office desires to set up a branch in another Member State falls within the scope of EU law since **«it is immaterial that the company was formed in the first Member State only for the purpose of establishing itself in the second, where its main, or indeed entire, business is to be conducted**»

According to the **Court of Justice** a distinction has to be made between:

- the question of the **application of those Arts. 49 and 54 of the Treaty**

and

- 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**

(*Centros* case, para. 18: *Inspire Art* case, para. 98)

➢ Situations connected with third States are excluded from the scope of Arts. 49 and 54 TFEU

E.g. Fidium Finanz: the situation of a company incorporated under Swiss law and having its office and central administration in Switzerland granting credit on a commercial basis to persons resident in Germany falls **outside the scope of the provisions on the free circulation of services**

Material scope of application

- So called «Primary establishment»:
  - right to set up and manage undertakings
    - Taking part in the incorporation of a company in another MS
    - Transfer of company seat from a MS to another MS
    - Cross-border mergers
- So called «Secondary establishment»:
  - right to set up agencies, branches or subsidiaries in the territory of any member State

Primary establishment

Case 81/87, *Daily Mail*

Given:

- the **peculiar nature of companies** (creatures of national laws) and
- the **wide variety in the legislation of the MBs**

the Court of Justice held that

… in the present state of Community law Arts. 52 and 58 of the EEC Treaty, properly construed, confer **no right on a company** incorporated under the legislation of a Member State and having its registered office there **to transfer its central management and control to another Member State** while retaining their *status* under the legislation of the first Member State (para. 25)

➔ Has anything changed since the *Daily Mail* judgment in 1988?

Secondary establishment

The landmark decision: **Case C-212/97, *Centros Ltd*, Judgment of the Court of 9 March 1999** …

i. shed light on the conditions to be fulfilled by companies in order to enjoy the freedom of establishment
ii. gives a **broad** interpretation of the **scope** of arts. 49 and 54 TFEU
iii. defines the concept of **abuse of right** with regard to the companies' freedom of establishment
iv. introduces in relation to companies's freedom of establishment the **general criteria for assessing whether restrictions on fundamental freedom are compatible** with the Treaty provisions already set in *Kraus* and *Gebahrd* (issue 3)

The «*Centros* doctrine»: i. **Freedom of incorporation**

➔**How broad** is the **scope** of the right of establishment of companies?

«is a company **lawfully exercising** the right to set up a **secondary establishment** when it intends to carry on its own business **exclusively** in the country in which the branch is registered and when it is clear that the original decision to incorporate the company in a Member State other than the State in which it is intended to do business was motivated **solely by a desire to avoid** the stricter legal requirements in respect of minimum company capital imposed by the law of the Member State in which the secondary establishment was to be set up?»

- «… the provisions of the Treaty on freedom of establishment are **intended specifically to enable companies** 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 **to pursue activities in other Member States through an agency, branch or subsidiary**.
- «That being so, 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. **The right to form a company in accordance with the law of a Member State and to set up branches in other Member States is inherent in the exercise, in a single market, of the freedom of establishment guaranteed by the Treaty**» (paras. 26-27)

And, as to the **purpose** of the right of establishment:

«… The **right of establishment** is essential to the achievement of the objectives set in the Treaty, the **purpose** of which is to guarantee to all Community citizens alike the freedom to engage in business activities through the instruments provided by national law, thus **giving them the *chance* to enter the market, irrespective of the motives** that may actually have prompted the person concerned. In other words, **it is the *opportunity* to exercise business activities that is protected, and with it the contractual freedom to make use of the instruments provided for that purpose in the legal systems of the Member States**. In the present case, the right of establishment was exercised by setting up the company in accordance with the requirements of the law of the host country. **So long as that right is exercised in accordance with the Treaty**, the motives, calculations and particular personal interests underlying the choice do not come into consideration and are consequently not open to judgment…» (Opinion of Advocate

ii. **Abuse** of the right of establishment

«… **the fact that a company** does **not** conduct **any business** in the Member State in which it has its registered office and **pursues its activities only in the Member State where its branch is established is not sufficient to prove the existence of abuse or fraudulent conduct** which would entitle the latter Member State to deny that company the benefit of the provisions of Community law relating to the right of establishment» (*Centros* para. 29; then also in *Inspire Art*, para. 139)

«It is true that the Court has consistently upheld in its case-law the principle that **`rights conferred under Community law may not be relied on for fraudulent or abusive ends'** which is **among the general principles of Community law**. It is however by no means easy to define the precise scope of that principle. According to the recent judgment in *Kefalas*, a person **abuses the right** conferred on him if he **exercises it unreasonably** to **derive**, **to the detriment of others**, **an improper advantage**, **manifestly contrary to the objective pursued** by the legislator in conferring that particular right on the individual» (*Centros*, Advocate General La Pergola, para. 20)

In other words, **ABUSE** occurs where four conditions are met:

1) unreasonable use of the right of establishment
2) to derive an improper advantage
3) to the detriment of others
4) manifest contrariety of the advantage derived by using the right of establishment to the objectives pursued by the legislator

➔ Abuse = Diversion of a right from its natural purposes

Nonetheless, according to the ECJ, **member States** are still

«entitled to take **measures designed to prevent certain of its nationals from attempting**, under cover of the rights created by the Treaty, **improperly to circumvent their national legislation or to prevent individuals from improperly or fraudulently taking advantage of provisions of Community law**» (para. 24).

iii. Competition among legal orders

«the fact that a national of a Member State may take advantage of the flexibility of United Kingdom company law ... must be viewed in that context that is, in the context of the Community system. In short, **in the absence of harmonisation, competition among rules must be allowed free play in corporate matters**. In the present case, as in Segers, the above-mentioned freedoms are part of the material content of the right in question and it cannot be held that Mr and Mrs Bryde took `an improper advantage, manifestly contrary to the objective' pursued by Articles 52 et seq. of the Treaty in abusively avoiding the application of binding rules of the State where the secondary establishment was to be set up» (Opinion of AG La Pergola, para. 20)

Regulatory competition = the rule in absence of harmonisation ← how may free movement be achieved? Two models: i) positive or ii) **negative integration**?

The «***Centros* doctrine**» means:

i. Freedom of incorporation
ii. Abuse of the right of establishment: (negative) notion and MSs' prerogatives
iii. Competition among legal orders (➔in the absence of harmonisation)
iv. General criteria fors assessing the compatibility of restrictions

(*See* also: Court of Justice, Judgment 30 September 2003, case C-167/01, *Inspire Art Ltd*)

What's the very purpose of the fundamental freedoms?

i. conferring to market participants an absolute right to economic/trade freedom

or

ii. liberalising inter-state trade?

ISSUE 2 - RESTRICTIONS

Arts. 49 and 54 TFEU: Content

I. Negative content: general prohibition on restrictions imposed both on the host and the home State

I. National treatment with regard to
   a) **Access to the market** of the host State
   b) **Excercise** of the right of establishment of companies

Restrictions to the right of establishment of companies

TFEU provisions on the right of establishment:

- are **directed mainly to ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State**
- but they **also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation** which comes within the definition contained in Art. 54. Otherwise, the rights guaranteed Art. 49 «would be rendered meaningless if the Member State of origin could prohibit undertakings from leaving in order to establish themselves in another Member State» (*Daily Mail* case, para. 20)

… *therefore* obstacles to the right of establishment may arise from both

- **discriminatory measure** and
- **non-discriminatory measures hindering the excercise of the right of establishment**

For instance:

- by hampering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation (which comes within the definition contained in Art. 54 TFEU) (*Daily Mail,* para. 20)
- as well as preventing any exercise of the right freely to set up a secondary establishment which Arts. 49 and 54 TFEU are specifically intended to guarantee (Centros, para. 30)

In particular:

«… the **refusal** of a Member State to register a branch of a company formed in accordance with the law of another Member State in which it has its registered office on the grounds that the branch is intended to enable the company to carry on all its economic activity in the host State, with the result that the secondary establishment escapes national rules on the provision for and the paying-up of a minimum capital

is **incompatible** with Articles 52 and 58 of the Treaty,

in so far as it prevents any exercise of the right freely to set up a secondary establishment which Articles 52 and 58 are specifically intended to guarantee» (Centros, para. 30)

ISSUE 3 - DEROGATIONS FROM AND JUSTIFICATIONS TO RESTRICTIONS ON THE RIGHT OF ESTABLISHMENT OF COMPANIES

Derogations from and justification to obstacles to the right of establishment

A. **Derogations** expressly provided for by Arts. 51 and 52 TFUE (exhaustive list)
   - **Activities connected**, even occasionally, **with the exercise of official authority** (Art. 51) **public policy**, **public security** or **public health** (art. 52)

B. **Justifications** (open-ended list)
   - according to the settled case-law of the ECJ restrictions may also be justified by «**imperative reasons in the public interest**»

Justifications in relation to non-discriminatory measures

National measures «**liable to hinder or make less attractive the exercise of fundamental freedoms** guaranteed by the Treaty» must fulfill **four conditions**:

i. they must **be applied in a non-discriminatory manner**;

ii. they must be **justified by imperative requirements in the general interest**;

iii. they must **be suitable for securing the attainment of the objective which they pursue**;

iv. and they must **not go beyond what is necessary** in order to attain it.

(*Centros*, para. 34; *Inspire Art*, paras. 132-133)

Possibile imperative reasons in the public interest

Examples of imperative reasons specifically raised in cases relating to the right of establishment of companies:

- Protection of creditors in general (*Centros; Inspire Art*)
- Protection of non-contractual public creditors - i.e. social security, tax authorities… - (*Centros)*
- Fair trading / fairness of commercial transactions (*Inspire Art;* case C-411/03, *SEVIC Systems*; case C-378/10, *VALE)*
- Protection of the rights of dependent companies, minority shareholders and employees (*Überseering*; *SEVIC systems*; *VALE*)
- Protection of the interests of the tax authorities /effectiveness of the tax system / fiscal supervision (*Überseering*; *SEVIC systems*; *VALE*)