Utvecklas en Delawareeffekt inom den Europeiska Gemenskapen?

Filosofie magisteruppsats inom Europeisk bolagsrätt

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Is a Delaware effect developing within the European Community?

Master's thesis within European Company law

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Abstract

The inner market of the European Community is developing and as a part of this company law and the freedom of establishment are doing the same. Some of this development is carried out through case law from the European Court of Justice as well as through Community harmonisations. As this has happened some worried voices has been raised arguing that a development similar to that in the USA, known as the Delaware effect, might occur. There has been some development indicating such development; companies have made use of the freedom of establishment to seek a more favorable legislation and Member States have changed and adapted their legislations. An example is the lowering of the minimum paid-up capital for limited liability companies that has occurred.

In this paper the Delaware effect is investigated in order to clarify what it is and how it has developed. This knowledge is vital to be able to see if a Delaware effect might be developing within the European Community. There has been a large discussion on the Delaware effect in the USA and it is evident from that discussion that there are scholars arguing in several directions and that it is inconclusive whether or not the Delaware effect is detrimental to shareholders, companies and others.

In this paper it is argued that, as it is questionable what the Delaware effect entails in the USA it is even more questionable to talk about a Delaware effect within the European Community. The Member States are to some extent restricted, due to Community harmonisations, as to what they can do in order to compete for incorporations. Companies are also hampered in their attempts to make use of the freedom of establishment, especially companies already incorporated in a MS. It is also argued that there is a lack of incentives and possibilities for both Member States and companies to facilitate a competition for company law.

Adding these components together, the preconditions within the European Community are not suitable for a Delaware effect or a European Community Delaware to emerge. The continued development of the freedom of establishment along with the companies increased understanding of its benefits might create incentives to seek more favorable legislations, but it is highly unlikely that a Member State will emerge to be as successful as Delaware.
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1 Introduction

1.1 Background
In the beginning of the 1900s the development of modern corporation statutes started in the USA and soon Delaware emerged as the state most prone to modernise its company law. Because of this Delaware over time became the most successful state when it comes to attract listed companies to incorporate there. This development is sometimes referred to as the Delaware effect. Several issues concerning the Delaware effect has been discussed over the course of time, such as if the Delaware effect is detrimental or not and if there really is competition between the states. The discussion really started in the 1970s and has continued to this very day. Regardless of one’s own position regarding the issue of the Delaware effect, one fact remains; Delaware has been very successful in attracting companies.

The development of the company law within the European Community (EC) and the freedom of establishment are of a somewhat later date. As the development of EC company law and the freedom of establishment in the EC have progressed through harmonisations and case law, it has been said that there is a risk that it could result in a EC Delaware effect.

1.2 Purpose
The purpose of this paper is to investigate if the development of company law and the freedom of establishment within the EC is creating preconditions enabling the development of a EC Delaware effect. In order for us to look in to this matter we needed some fundamental knowledge of what the Delaware effect is; therefore we carry out our research in two steps.

- Firstly we try to create a basic understanding of what the Delaware effect is and how it has developed.
- Secondly we aim at examining the development of freedom of establishment and company law within the EC in order to identify if this development might lead to a development similar to that in the USA.

1.3 Method
In order to create a basic understanding of the Delaware effect we have studied articles concerning the matter. The articles have provided us with a good and diverse view on the Delaware effect without having to fully investigate the entire field of American company law.

When studying the development within the EC we examined relevant articles in the consolidated version of the Treaty Establishing the European Community\(^1\) (ECT) together with case law from the European Court of Justice (ECJ) concerning the freedom of establishment. We have also examined some Community harmonisations concerning company law such as some company law directives. We have also read articles concerning the development of company law within the EC.

\(^1\) C 325/33, Consolidated version of the treaty establishing the European Community, 24.12.2002.
To give a brief overview of if Swedish companies utilises the freedom of establishment we have contacted two consultants, which work with guidance concerning establishments abroad, and the Swedish Company Registration Office (Bolagsverket).

1.4 Delimitation

We make no in depth investigation of company law in the USA, but instead we aim to provide with an overview of the concept of the Delaware effect, what it is and its development.

In the regard to the interviews, we have chosen not to contact persons who sell complete solutions of foreign companies since we are uncertain if they will provide with an objective view of the problems connected with the arrangement.

Tax issues are only briefly mentioned in the paper when necessary for the understanding of the development of EC company law and of the Delaware effect.

1.5 Outline

- We start off with an overview of the development of the Delaware effect in the USA by showing some of the arguments presented by the initiators of the discussion of the Delaware effect as well as some recent empirical studies.
- Secondly, we examine the community provisions concerning the freedom of establishment.
- Thirdly, an overview of European Community harmonisations concerning company law is made.
- Fourthly, a brief examination of the Swedish development in regard to the freedom of establishment is done by contact with legal advisors working with company law and the Swedish Business Registration office.

1.6 Other

We would like to give our thanks to Tord Fredriksson, Christer Andersson and Susanne Thungren for gracefully answering our questions.
2 The Delaware effect

2.1 Introduction

In order to investigate the eventuality of a EC Delaware effect a brief overview of the history and discussion concerning the fundamentals of the original Delaware effect is needed, this is provided with in the following.

2.2 Early development of the Delaware effect

2.2.1 History

It is evident from the name, “the Delaware effect”, that its origin is the state of Delaware, the second smallest state in the USA.²

The corporation statutes present in the USA during the late 1800s were quite restrictive in regard to “the size and powers of the business units”.³ However, as the states realised that these rules would be “circumvented by foreign companies”⁴ the states started to remove some of these restrictions.⁵

Although the name of this development might suggest that it was the state of Delaware that initiated the development this was not the case. Instead it was the state of New Jersey that started it as the first modern liberal corporation statutes in the USA were created there in 1896. Delaware soon copied the New Jersey corporation statutes, possibly to gain revenue due to the increase of incorporated companies; however New Jersey later amended its statutes in order to “tighten its law”⁶. This tightening of the law was never done by Delaware and as a result of this Delaware over the time gained its position as the leading state when it comes to attract companies to incorporate themselves there. Delaware has kept this lead since then.⁷

The alterations that occurred of the corporation statutes of Delaware in the early beginning lessened the rights of the shareholders in relation to the power of the management. This development also meant an increase in the simplicity as well as it enhanced the flexibility of company law.⁸

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In 1946 Nevada “attempted to become a western Delaware”\textsuperscript{9} but did not achieve “comparable success”\textsuperscript{10} to that of Delaware in their attempt. Several other states changed their corporation statutes to follow the path initially travelled by Delaware.\textsuperscript{11}

The lead Delaware has enjoyed has taken it to its unique position where it surpasses all other states when it comes to attracting public companies. Today over “800,000 business entities have their legal home in Delaware including more than 50% of all U.S. publicly-traded companies and 60% of the Fortune 500”\textsuperscript{12}.

The development of the Model Business Corporation act\textsuperscript{13} is one example that emphasises the Delaware effect. The Model Business Corporation act, created in 1943 to serve as a model business corporation act for states to adopt, initially offered a quite different approach than that of Delaware as it sought to protect investors rather than lessening their protection. However, the Model Business Corporation act has over time become increasingly similar to Delaware’s company law and some of its parts were in 1970s actually identical to that of Delaware’s company law.\textsuperscript{14} Although there are several major differences between the Model Business act and Delaware’s company law today both of them are still to a great extent similar as “several provisions in the Model Act represent near codifications of Delaware common law”.\textsuperscript{15,16} Today there is a widespread use of the Model Business Corporation act amongst the states in the USA in order to mitigate the costs for producing complex company law.\textsuperscript{17}

In recent empirical studies attempts have been made to measure the Delaware effect although coming to entirely different conclusions.\textsuperscript{18} Daines finds in his study, covering the 1981 – 1996 that companies in Delaware are generally worth 5% more than non Delaware companies\textsuperscript{19} whilst Subramanian’s study, covering the years 1991 – 1996, shows that the in-

\textsuperscript{9} Cary, Federal and Corporate Law: Reflections upon Delaware, p. 665.
\textsuperscript{10} Cary, Federal and Corporate Law: Reflections upon Delaware, p. 665.
\textsuperscript{11} Cary, Federal and Corporate Law: Reflections upon Delaware, p. 666.
\textsuperscript{12} State of Delaware - Department of State: Division of Corporations. http://corp.delaware.gov/default.shtml
\textsuperscript{14} Cary, Federal and Corporate Law: Reflections upon Delaware, p. 665.
\textsuperscript{16} Dooley & Goldman, Some comparisons between the Model Business Corporation act and the Delaware General Corporation Law, p. 739.
\textsuperscript{18} Daines, Robert, Does Delaware law improve firm value?, Journal of Financial Economics, Volume 62, 525, January 2001,
\textsuperscript{19} Daines, Does Delaware law improve firm value?, p. 533.
crease of value is disappearing over time, and that in some cases that the increase in value is nonexistent.20

As previously mentioned Delaware’s company law has been rather lax compared to that of other states; there may have however been a turn for an increased friendliness towards shareholders by the state of Delaware during the 1990s as Delaware did not pass a constituency statute which several other states have done.21 Typically constituency statutes make it possible for the management of a company, when trying to determine what is best for the company, to consider other interests than that of the shareholders.22

2.3 American Discussion on the Delaware effect

2.3.1 Introduction

As the development of Delaware’s company law has progressed and Delaware succeeded in attracting companies for incorporation voices of both criticism as well as praise has been raised in regard to the competition between states. It has even been suggested that there is no real competition between the states at all. In the next section the discussion on whether or not a race for company law is detrimental is presented and then in the following section the suggestion that there is no such race. Although the discussion from the early commentators stems from the 1970s23 they are still commonly referred to in more recent discussions.24

2.3.2 Damaging or healthy competition?

Cary, being one of the early commentators argued in 1974, that the regulatory competition, lead by Delaware, was a “deterioration of corporation standards”25 leading to a decrease in the protection of shareholders and that this regulatory competition between states is “a race to the bottom”.26 27 28 One example of the deterioration of corporate standards pre-

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22 Hanks, James J Jr, Playing with fire: Nonshareholder constituency statutes in the 1990s, Stetson Law Review, Volume 21, 97, Fall 1991, p. 105 - 106
24 See for example
27 Macey, Van Gorkom and the Corporate Board: Problem, Solution or Placebo?, p 622 – 623.
sented is a rule that meant that after that rule came in to play “shareholder meetings then could be dispensed with if a consent is signed by the number of votes necessary to take the intended action, thus offering a technique to avoid disclosure”\(^{29}\) to the shareholder minority. There were some protection of abuse of this rule but that protection did not apply to companies which were unlisted or had less than 500 shareholders. Other changes made to modernise Delaware’s company law dealt with

“[r]estrictions on the longevity of a corporation, the business in which it may engage, the issuance of stock, the classes of stock issued, dividend policy, discretion as to the holding of shareholder’s meetings, charter amendments, means of electing directors, sales of assets, mortgaging, and the indemnification of officers”\(^ {30}\)

The result of these changes was that restrictions were “eliminated or diminished”\(^ {31}\). Also the possibility for the management to carry out its will in different matters was increased.\(^ {32}\)

Cary suggests that in order to prevent this development of a race for company law between states the USA should create minimum legislation through federal lawmaking. This federal legislation would according to Cary ensure more confidence in American corporations and this confidence or trust would in turn generate further investments and raise the value of the companies’ shares.\(^ {33}\) Cary even says that “[s]uch confidence can be sustained only by a combination of high standards coupled with disclosure and management accountability coupled with vulnerability to derivative or direct shareholder action”\(^ {34}\).

On the other hand, another of the early commentators, Winter, argued in 1977 that federal lawmaking, and the development originating from it would in fact be more detrimental than the development originating from state law.\(^ {35}\) He does neither agree with the proponents for federal lawmaking and their argument that this competition for company law is detrimental to the shareholders and that the competition would be a race to the bottom, instead he argues that it would be a race to the top.\(^ {36,37}\)

Winter argues that law created by the state, through competition, is preferable, and starts his argumentation by saying that if the development in Delaware were so detrimental or risky for the shareholders they would not be very interested in investing in companies incorporated in Delaware. This decrease in interest would result in lower values of the companies’ stock. And also “if Delaware permits corporate management to profit at the expense of shareholders and other states do not, then earnings of a Delaware corporation must be less than earning of\(^ {38}\) a company incorporated in another state. The decrease in


\(^{34}\) Cary, Federal and Corporate Law: Reflections upon Delaware, p. 671.


\(^{37}\) Macey, Van Gorkom and the Corporate Board: Problem, Solution or Placebo?, p 624.

earnings and of the value of the stock would in turn make it more difficult for the company to raise debt or equity capital and all in all the companies would seek other states to incorporate themselves in and Delaware and its incorporated companies would lose out to other states and their companies. As this development seemingly has not taken place the shareholders of companies incorporated in Delaware does not regard this development as too detrimental to themselves and their investment, compared to benefits they gain from Delaware’s company law.  

Winter also argues that since the race to the bottom argument certainly is not “a carefully guarded secret”\textsuperscript{39} and as this information has been widely accessible for at least a generation this adds to the fact that there is little chance that investors would continuously be unaware of this idea. According to Winter “investors must be attracted before they can be cheated”\textsuperscript{40} and as such it is not possible for the management to abuse its dominant position over shareholders, because if they did the potential shareholders would not invest in companies in Delaware and therefore there would be no shareholders who’s’ rights could be abused. Also the management has an incentive to keep the share price high, to prevent hostile takeovers, which is achieved by making the company an attractive investment.\textsuperscript{41}

It is important to note how the power of the management and the power of the shareholders are two sides of the same coin. As the possible influence, or power, of the shareholders lessens there is an increase of the influence and power available to the management. It is furthermore argued, and Winter quotes Richard A Posner whom in essence says that the management usually is most well suited to manage and control the company; therefore they can best make use of the power they are handed whilst the shareholders have more a financial interest rather than an interest in running the company.\textsuperscript{42}

It is important for companies, regardless of origin, that the company law enables them to attract investors as the investors can choose other investments such as investing in “stock of companies incorporated in other states or countries, bonds, bank accounts, certificates of deposit”\textsuperscript{43} and so forth. Winter says in regard to the issue of protection of investors that Delaware cannot “facilitate the monopolization of the capital market”\textsuperscript{44} as the capital market “involves an undifferentiated product with no transportation cost.”\textsuperscript{45} Essentially Delaware cannot create and maintain a monopoly on the capital market as it is far too easy for an investor to choose companies from other states or even other types of investment altogether to invest in if the investors consider that there are better options.\textsuperscript{46}

Winter also takes a closer look at the idea that a stricter legal system would be less cost efficient than a lax one. The development in Delaware, which has been criticised, has been to-

\textsuperscript{40} Winter, \textit{State Law, Shareholder Protection, and the Theory of the Corporation}, p. 257.
\textsuperscript{44} Winter, \textit{State Law, Shareholder Protection, and the Theory of the Corporation}, p. 257.
wards a less stringent company law but Winter says that since the proponents of a stricter legal system, such as Cary, “stresses only expected benefits while ignoring costs”\(^ {48} \) they misses out on the additional costs that comes with additional legislation. The increase of costs can be such as the “efforts of accountants and lawyers”\(^ {49} \) but also come from that the participants are prevented to optimise how they arrange their business. Winter also claims that “a ‘lax’ legal system is neither intuitively nor empirically inferior to a stringent one.”\(^ {50} \) This is because all regulation imposes costs in one way or another and often in several ways.\(^ {51} \) He concludes by saying that even if fraud exists in corporate affairs and their elimination is desirable there is a point where the costs imposed by the more stringent rules cost more than the frauds themselves.\(^ {52} \)

Another aspect of the Delaware effect mentioned by both Cary and Winter is the courts of Delaware as they play a vital role for the advantage of Delaware. The courts in Delaware has been criticised by Cary for rather easily accepting the conduct of the management of companies and that the “courts have undertaken to carry out the ‘public policy’ of creating a ‘favourable climate’ for management”\(^ {53} \).\(^ {54} \) It has also been claimed that this development has resulted in a relaxation of both fiduciary standards as well as fairness standards.\(^ {55} \) Winter criticises Cary because no solution is suggested to the issue and that “no criteria”\(^ {56} \) is given as what is to be deemed as unfair but only that “traditional concepts of fairness should not be so readily dismissed”\(^ {57} \).\(^ {58} \) Winter also says that Cary implies that “whatever the Delaware Supreme Court does is unfair”\(^ {59} \).\(^ {60} \)

One example of unfairness that is brought forth by Cary is that of the Sinclair Oil Corp. v. Levien, a Delaware Supreme Court case. In that case the parent company controlled the subsidiary to 97% and at the parent’s direction the subsidiary, over a six year period, paid a total of $108 million in dividend to the parent. This lead to a decline in the activities in the subsidiary and because of this the 3% minority sought derivative actions. The court argued that since all the shareholders received the dividend pro rata “the transaction should be tested under the business judgment rule under which a court will not interfere unless there is a showing of gross and palpable overreaching”\(^ {61} \). Cary suggested in relation to this that


there should be a rule preventing the parent company to shrink a company under its control “during an era of expansion.” Winter on the other hand argued that if there is a rule “prohibiting the parent company from contracting a subsidiary during a period of expansion when there are minority stockholders,” and by that correcting the possible injustice present in this case, this rule in turn would significantly hamper the powers of a company to “make business decisions.” Winter continues, is that Cary does not consider the “greater risk” that the majority shareholder suffers compared to that of the minority shareholders. Such protective measures for the minority could also enable blackmailing of the majority by the minority as they could threaten to prevent the most favourable business decision from being made; that sort of development “cannot plausibly be in the interest of the shareholders generally.”

Through empirical studies done in more recent years the discussion on the impact of Delaware’s company law on company value has continued. Daines suggests in his 2001 study that there is empirical evidence that companies incorporated in Delaware have a higher value than non-Delaware companies. Daines also says that the result of his study suggests that Delaware is not leading a race to the bottom in regard to company law. In contrast to Daines Subramanian has extended Daines study and found that the value of small companies, defined as companies with less than $50 million in net sales, incorporated in Delaware had a higher value than non-Delaware companies during the early 1990s but that this difference disappeared during the later 1990s. For larger companies incorporated in Delaware there was no difference at all compared to companies incorporated in other states. Subramanian also means that his study indicates that there is no race to the top but instead that his study supports the argument of a race to the bottom.

2.3.3 No competition?

As mentioned above the competition is regarded either beneficial or not; however in their article Kahan and Kamar challenges “the conventional wisdom that states compete for incorporations.” They start off by examining the different reasons that a state can have

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69 Daines, Does Delaware law improve firm value?, p. 555.
70 Daines, Does Delaware law improve firm value?, p. 528.
71 Subramanian, The disappearing Delaware Effect, p. 32 & 57.
72 Subramanian, The disappearing Delaware Effect, p. 56.
75 For further mentioning’s on the competition between state se for example
in order to participate in such competition and notes that it is the benefits derived from
taxes and from the increase in legal business that is primarily mentioned.\textsuperscript{76}

Firstly concerning the taxes there are generally two different types mentioned in this de-
bate.\textsuperscript{77} The first of these is the annual franchise tax, which can be either a flat rate tax or a
variable tax, varying with the company’s turnover. The franchise tax can also be con-
structed to consist of both a flat rate tax as well as a variable tax.\textsuperscript{78} The second type of tax is
the incorporation fee; the incorporation fee is a fee paid once as the incorporation of a
company is performed in the new state.\textsuperscript{79} There is also an argument made that the increase
in legal business would be beneficial to the states. That argument is mainly founded on the
idea the tax stemming from legal firms within a state would increase with the number of
incorporated business.\textsuperscript{80}

However it seems as though that the benefits derived from any of the taxes would not
make up any significant amount of revenue for any state apart from Delaware due to the
way the taxes are structured in the different states.\textsuperscript{81} \textsuperscript{82} Also the existence of an incorpora-
tion fee added initially could be rather problematic for a state trying to compete with Dela-
ware as it imposes additional costs to the act of incorporation. Instead it would be more ef-
fective to have an incorporation fee that is low or none existing to begin with which then
over time increases; it is also over time that companies can reap the benefits from their in-
corporation and therefore should be imposed with a tax increased over time rather than an
initial fee.\textsuperscript{83} Lastly there seems like the benefits from legal business also “would be relatively
low.”\textsuperscript{84} It is of course inevitable that states will change their company law but they can do
so because of a number of reasons and those reasons are “largely unrelated to the goal of
attracting companies.”\textsuperscript{85} \textsuperscript{86}

Although there seems to be no reason for states to engage in competition for corporate
charters there is however the concept of defensive competition which means that the states

\textsuperscript{76} Kahan & Kamar, \textit{The Myth of Competition in Corporate Law}, p. 679.
\textsuperscript{78} Kahan & Kamar, \textit{The Myth of Competition in Corporate Law}, p. 687 - 689.
\textsuperscript{79} Kahan & Kamar, \textit{The Myth of Competition in Corporate Law}, p. 691.
\textsuperscript{80} Kahan & Kamar, \textit{The Myth of Competition in Corporate Law}, p. 694.
\textsuperscript{81} Kahan & Kamar, \textit{The Myth of Competition in Corporate Law}, p. 687 & 689.
\textsuperscript{82} Kahan & Kamar, \textit{The Myth of Competition in Corporate Law}, p. 691.
\textsuperscript{83} Kahan & Kamar, \textit{The Myth of Competition in Corporate Law}, p. 691.
\textsuperscript{84} Kahan & Kamar, \textit{The Myth of Competition in Corporate Law}, p. 700.
\textsuperscript{86} Kahan & Kamar, \textit{The Myth of Competition in Corporate Law}, p. 701.
could engage in competition for corporate charters but only in order to keep companies already incorporated in the state.\textsuperscript{87} It is however suggested that the incentives for a state to only try to keep companies already in that state are even smaller than for engaging in wholesale competition.\textsuperscript{88}

Kahan and Kamar then continue and look at how the existence and design of statutory state corporation law is not evidence that states compete to attract incorporations. One example given is the wide spread use of the Model Business Corporation Act, which is the foundation of much of the changes of corporate law. The usage of the Model Business Corporation Act “is hard to reconcile with the notion that states compete for incorporations”\textsuperscript{89} as it “seems more consistent with an effort to simplify the process of devising law than with competition”\textsuperscript{89} \textsuperscript{90}.

Kahan and Kamar also look at the idea that some of the competitive advantages that Delaware has over other states might constitute, from the “perspective of the competitors”\textsuperscript{93}, entry barriers preventing states from participating in the competition for company law. Kahan and Kamar argues that even though the entry barriers imposes difficulties on states seeking to engage in competition the entry barriers does not impose strong enough difficulties as to explain the “near absence”\textsuperscript{94} of competition that is present.

One of the entry barriers is the specialised Chancery court which provides Delaware with its “main advantage”\textsuperscript{96} over other states. The Chancery court sets itself apart from other courts by having for example a limited jurisdiction which gives the court a certain focus as it deals only with cases regarding corporate disputes. Furthermore the chancery court has no jury but instead it uses judges which mean that they over time develop expertise in the field of company law.\textsuperscript{97} The limited jurisdiction\textsuperscript{98} \textsuperscript{99} together with the lack of a jury makes for a court where “corporate disputes [are] being decided by judges who have developed expertise in corporate law”\textsuperscript{100}. The chancery court has even been identified as the top court

\textsuperscript{89} Kahan & Kamar, \textit{The Myth of Competition in Corporate Law}, p. 702.
\textsuperscript{90} Kahan & Kamar, \textit{The Myth of Competition in Corporate Law}, p. 702.
\textsuperscript{91} Kahan & Kamar, \textit{The Myth of Competition in Corporate Law}, p. 702.
\textsuperscript{92} Carney, \textit{The production of Corporate law}, p.725.
\textsuperscript{93} Kahan & Kamar, \textit{The Myth of Competition in Corporate Law}, p. 725.
\textsuperscript{94} Kahan & Kamar, \textit{The Myth of Competition in Corporate Law}, p. 725.
\textsuperscript{95} Kahan & Kamar, \textit{The Myth of Competition in Corporate Law}, p. 725.
\textsuperscript{96} Kahan & Kamar, \textit{The Myth of Competition in Corporate Law}, p. 725.
\textsuperscript{97} Kahan & Kamar, \textit{The Myth of Competition in Corporate Law}, p. 708.
\textsuperscript{98} The Delaware Code, Title 10, Ch. 3, Sub.ch. III, § 341.
\textsuperscript{99} Definition of the Court of Chancery’s jurisdiction. http://courts.delaware.gov/Courts/Court%20of%20Chancery/?jurisdiction.htm
\textsuperscript{100} Kahan & Kamar, \textit{The Myth of Competition in Corporate Law}, p. 708.
in the USA, in a survey by the U.S. chamber of commerce\textsuperscript{101}, in regard to “how fair and balanced the tort liability system”\textsuperscript{102} is in the USA.

Another advantage is the well renowned case law stemming from the Chancery court. “The extensiveness and familiarity of Delaware case law reduce the cost of planning transactions for Delaware corporations, obtaining legal advice for them, and assessing their value”\textsuperscript{103}.

Because of the importance of the Chancery court and its case law it would seem to be a strategically clever move for other states to create a similar type of specialised court if they were to engage in the race for company law and make their company law more attractive. The cost for setting up such a court would only entail “modest budgetary requirements”\textsuperscript{104} as the Chancery court in Delaware 2006 had a total disbursement of only $4.3 million\textsuperscript{105} and a competitor state and its specialised court initially would have fewer litigation due to fewer incorporated companies in that state and therefore need a smaller court. In order to further mitigate the advantage that the Chancery court and its judges have due to the specialisation of the court a competitor state could “appoint a renowned and experienced corporate jurist to the court”\textsuperscript{106}.

It seems however that this development is unlikely but instead what has happened is that “[a] small number of states have established specialized judicial tribunals for business disputes”\textsuperscript{107} and some states are planning to create business courts in the near future. However none of these planned business courts has as their objective to attract companies from other states.\textsuperscript{108} For example New York has created business divisions which differ from the Delaware Chancery court in several ways such as that business divisions are only present in some counties, they hear cases in front of a jury and they have as their outspoken goal to “shorten the long delays in the resolution of commercial disputes in New York’s overburdened trial courts”\textsuperscript{109} instead of creating a setting which attracts companies.\textsuperscript{110}

In regard to the Delaware case law a few suggestions are made that could mitigate the advantage that Delaware have in that regard. A competitor state could use a more “rule oriented corporate code”\textsuperscript{111} and thus make it less dependent on case law. The state could also write comments to the corporation statutes in order to clarify the rules further. “Most simply, a competitor state could keep its corporation code identical to the Delaware General


\textsuperscript{102} 2007 U.S Chamber of Commerce State Liability Systems Ranking Study, p. 6.

\textsuperscript{103} Kahan & Kamar, The Myth of Competition in Corporate Law, p. 725.

\textsuperscript{104} Kahan & Kamar, The Myth of Competition in Corporate Law, p. 725.


\textsuperscript{106} Kahan & Kamar, The Myth of Competition in Corporate Law, p. 725.


\textsuperscript{109} Kahan & Kamar, The Myth of Competition in Corporate Law, p. 710.

\textsuperscript{110} Kahan & Kamar, The Myth of Competition in Corporate Law, p. 710.

\textsuperscript{111} Kahan & Kamar, The Myth of Competition in Corporate Law, p. 726.
Corporation Law, continually update it to track changes adopted by Delaware, and instruct its court to interpret the code in light of Delaware precedent. By doing so the state could remove much of the advantage that the legal framework provides Delaware with.

Another entry barrier is the behavior of states. That companies wishes to maximise profits is part of the “standard economic theory”. However this standard theory is not easily applied to states. Politicians and “state lawmakers pursue political and ideological goals, rather than profit”. Also as politicians need to acquire votes they are provided with less incentives to commit themselves to long term goals, such as competition for company law. The entry barrier is because of this the fact that engaging in competition for company law is not part of the politicians’ agenda.

Another political aspect, similar to the aforementioned, is the political restraint that might even prevent politicians wishing for the state to engage in competition for company law from doing so. Kahan and Kamar mentions political opposition as one example. For example they mention that local interest groups fear that the usage of a court without a jury might spread and because of this fear they try to prevent courts without a jury to be set up.

It is interesting to note that, in regard to direct impact of Delaware’s company law, out of the fifty states there are three, Kansas, Oklahoma and Nevada, which have company law modelled on Delaware’s company law whilst twenty four states have adopted all, or a substantial part, of the Model Business Corporation act as their company law.

2.3.4 Is competition necessary?

As a final note in this chapter it is rather interesting to see that the USA is “not the only federal system in which the place of incorporation rule prevails. Both Canada and Australia have got both attributes”, but in none of those countries has there been any development of a race to the bottom. In Australia there has even been a unification of the company laws into one single company law for the entire continent and “Canadian authors generally deny that there is a race for the bottom or even a realistic market for corporate charters”.

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118 Levinson, Making government pay: Markets, politics and the allocation of constitutional costs, p.345 & 420.
120 Dooley & Goldman, Some comparisons between the Model Business Corporation act and the Delaware General Corporation Law, p 738.
2.4 Conclusion

What it took for Delaware to initially gain its position was to have a simpler and more flexible legal system than the other states which attracted companies from around the USA to incorporate themselves there. The other states soon started to change their legislations in a similar fashion and by that the development, and arguably a race, for company law between the states was set in motion.

This development has since its beginning been towards an increasingly lax legal system with less protection of shareholders and investors and has set off a discussion on whether it is a development that is beneficial to the shareholders and the companies or if it perhaps is detrimental to them. In later years attempts to identify the impact of Delaware’s company law on share value has been done but the results are seemingly inconclusive and so the discussion has continued.

The discussion on whether or not the development in Delaware is detrimental has had much of its focus on the issue of protection of shareholder and third parties. Delaware has used the lessening of the influence and protection of the shareholders in order to attract more companies to incorporate themselves there. It seems like there must be some sort of balance between the powers of the shareholders on the one side and the power of the management on the other.

Too much power to the shareholders can hamper the company and its development as the management might not always be able to make, from the company’s point of view, the most beneficial business decisions whilst too much power to the management might prevent the company from being able to raise debt and equity capital due to investors lack of interest in companies which has a too powerful management. This would, in turn, also hamper the company’s development. Seemingly too much power either way may present a risk of hampering companies’ development.

In regard to if competition is detrimental or not the argument that investors need to be attracted before they can be cheated is a rather straightforward. The argument point towards the idea that over the course of time investors would no longer seek investments in a state where they feel they do not gain enough protection compared to their possible revenue and by that the state with an unfavourable legal system would lose out to other states. The management would also lose out if they abused their power because the share value would drop and this would make their company a target for hostile take-overs. Since there are seemingly no beneficiaries from a too lax legal system, any state partaking in the competition would fear both a too lax, as well as a too strict legal system.

As it is outside the purpose of this paper to specify how the power should be divided between the management and the shareholders we simply note that it is a fine balance act when providing the management and shareholders with powers as a good balance is important for company efficiency. Also worth noting is that the development in Delaware has seemingly not been too lax and has not handed too much of the power to the management as investors are not rejecting Delaware companies as objects of investment totally.

The empirical studies carried out do not conclusively rule out any direction of the development. Seemingly it is not apparent that share value in Delaware has increased but instead

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having a company incorporated in Delaware might not affect share value at all. But if no effect on share value can be identified it is neither obvious that investors are avoiding companies incorporated in Delaware.

However, much the aforementioned discussion is based on the idea that development of the Delaware effect is derived from competition between states. Kahan and Kamar seriously question this idea as they argue that there are little or no financial gains for any other state than Delaware to partake in such competition and because of this there is also an almost complete lack of competition between the states. Add to this the entry barriers such as the Chancery court, the Delaware case law and especially, political goals and restraints and the outlook is not bright for the idea of full scale competition. Also if Delaware’s company law is so much better than those of the other states’ there would be a widespread use of it; instead the Model Business Corporation act is much more widely used.

It is none the less unmistakable that Delaware has been successful in attracting companies and that other state’s corporate charters has developed in a similar manner. Delaware has attained a unique position and this might be explained by their advantage both as one of the first acting states, the over time accumulated advantages, such as the Chancery court and its case law. The other states could perhaps change the structures of the tax systems in order to gain more revenue from incorporation but as it is not part of the political agenda this is not likely to happen. States will still change their legislation but for other reasons than to attract companies; perhaps to create a business environment as effective as possible whilst acting in accordance with their political agenda.
3 Fundamentals for Competition

3.1 Introduction

In order for there to be competition, whether it is between states in the USA or between Member states (MS) within the EC there are some fundamental aspects that need to be present. This chapter focuses on some of these fundamentals and especially on how these fundamentals utter themselves within the EC.

3.2 General

In short, for a charter race to exist the company needs to be able to

- separate the state of incorporation from where the company carries out its business and
- be able to choose the state in which it chooses to incorporate itself or be able to reincorporate itself in any state.\(^\text{125}\)\(^\text{126}\)

The first point concerns the separation of state of incorporation from the state in which the business is carried out. This means that a company can carry out its business in one or several states but be incorporated in another. “In other words, that the registered home state and the real seat can be separated”\(^\text{127}\).

The second point concerns the possibility of incorporation and reincorporation. Incorporation is when a company first is established under a MSs Law. It is an entirely new company without any prior establishment.\(^\text{128}\) Reincorporation is when a company re-establishes itself in a new state after having initially been incorporated in another and through the reincorporation essentially subjects itself to the company law of the new state.\(^\text{129}\) Reincorporation is performed without the company ever losing its legal identity.\(^\text{130}\)


\(^{126}\) Birkmose Søndergaard, *Konkurrence mellem retssystemer - Delaware-effekten I et europæiskt selskabsretligt perspektiv*, p. 47.

\(^{127}\) Birkmose Søndergaard, *Konkurrence mellem retssystemer - Delaware-effekten I et europæiskt selskabsretligt perspektiv*, p. 36, Authors’ translation from – “Det vil sige, at det regisrerede hjemsted og hovodsædet kan adskilles”.


\(^{130}\) Birkmose Søndergaard, *Konkurrence mellem retssystemer - Delaware-effekten I et europæiskt selskabsretligt perspektiv*, p. 39.
There are two main principles used, all though many variants exist, when trying to decide the state of incorporation. The two main principles or methods for deciding state of incorporation is the incorporation method and the real seat method.\(^\text{131}\)

Important to note here is that a MS can have more than one definitions of where a company is incorporated. A MS can for example use the incorporation method in regard to company law whilst it uses the real seat method in regard to the issue of taxation. Those were the circumstances in the Daily Mail case,\(^\text{132}\) dealt with by the ECJ. The case concerned the transfer of a company’s central management and according to company law the registration decided the place of incorporation but the liability of taxation was decided by the residence of the company’s central management. The case will be examined more thoroughly below in chapter 4.4.3.

### 3.3 Incorporation

Within the USA there is only the use of the incorporation method when considering the law of which state that governs the company. Companies created in one state will thus be recognised in every other state. Some additional formalities might however be needed for the company to be able to carry out business in some states.\(^\text{133}\)

In Europe however there is both the usage of the real seat method and the incorporation method. The real seat method means that the rules of the state in which the company has its real seat shall be used in order to settle an issue in regards to company law. The underlying thought is that companies should be submitted to the law of the state in which they have their principal place of business.\(^\text{134}\) This method is well suited for the state in which the company has its principal place of business as the company law of that state is applied. It could be said that the real seat method takes into consideration the “factual circumstances”\(^\text{135}\). That means that there is a connection between where the company carries out most of its business and which state’s law that the company is subjected to. MSs that use the real seat method have been quite effective in preventing the Delaware effect in the EC as it prevents the separation of where the business is carried out and which state’s company law a company is subject to.\(^\text{136} \text{137}\)

However there are some issues connected with the real seat method and they are due to the difficulty that occurs when trying to apply the connecting factors that are used in order to figure out which state that a company will be deemed too be incorporated in. For example

\(^\text{131}\) Birkmose Søndergaard, *Konkurrence mellem retssystemer - Delaware-effekten I et europæiskt selskabsretligt perspektiv*, p. 53.

\(^\text{132}\) Case C-81/97, The Queen v H. M. Treasury and Commissioners of Inland revenue, ex parte Daily Mail and General Trust plc, [1988], ECR I-05483.


\(^\text{134}\) Birkmose Søndergaard, *Konkurrence mellem retssystemer - Delaware-effekten I et europæiskt selskabsretligt perspektiv*, p. 56.

\(^\text{135}\) Birkmose Søndergaard, *Konkurrence mellem retssystemer - Delaware-effekten I et europæiskt selskabsretligt perspektiv*, p. 57, Authors’ translation – “Lovgivningen passer med andre ord på de faktiske omstændigheder”.

\(^\text{136}\) Birkmose Søndergaard, *Konkurrence mellem retssystemer - Delaware-effekten I et europæiskt selskabsretligt perspektiv*, p. 56.

if two or more states define the connecting factors in different ways, both of them might claim that the company is incorporated, having its real seat, in their respective state. The real seat method has also been criticised by the European Court of Justice in for example the Überseering case and even though the real seat theory is still present within the EU its compatibility with EC law is being questioned.

The Überseering case is discussed more thoroughly below in section 4.4.5. In short the Überseering case means that even MSs using the real seat must “recognise the legal capacity that a foreign company enjoys under the law of its state of incorporation”. This will perhaps not prevent real seat MSs from using the real seat theory in regards to other aspects than that of legal capacity. The ECJ also states that it is not impossible that “overriding requirements relating to the general interest, such as the protection of the interests of creditors, minority shareholders, employees and even the taxation authorities, may, in certain circumstances and subject to certain conditions justify restrictions on the freedom of establishment.” As the Überseering case originated in Germany “other real seat jurisdiction might try to limit the scope to its facts.”

Some MSs, similarly to the USA, uses the incorporation method. The concept of the incorporation method is that the state, in which the company became a legal entity and thus where it is incorporated, is the state to which legal system the company shall be submitted. Worth mentioning in connection to the incorporation method is the registration method which is similar to the incorporation method and means that the company should be submitted to the legal system of the state in which the company registered.

The upside of this method is that it is easy to determine where the company is incorporated. There is no need for an assessment of the business, structure and management as they do not effect which state that is the state of incorporation as they do in the case with the real seat method. This advantage is also one of the downsides as a company incorporated in one state might not carry out any business in that state and due to this there is no real connection between the state of incorporation and the company’s principal place of business. The fear is that the incorporation method makes it possible for founders of a company to choose which state in which the company is to be incorporated in and by that avoid MSs that have legislations that are disadvantageous to the founders and their com-

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139 Case C-208/00, Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC), [2002], ECR I-09919.


143 Case C-208/00, Überseering, para. 92.


pany. The company can consequently choose a state of incorporation to which it has no connection other than that of the incorporation.\textsuperscript{146} MSs using the incorporation method have feared misuse of their recognition system and have therefore tried to create legislation that stretches out and covers companies created abroad.\textsuperscript{147} The ECJ has considered this type of legislation in case law.\textsuperscript{148}

### 3.4 Reincorporation

The issue of incorporation concerns the choice of where to initially set up a company whilst the issue of reincorporation is when a company already incorporated in a MS seeks a new MS to incorporate itself in; since it already been incorporated this is a case of reincorporation. If reincorporation is possible the company can choose the MS with the most suitable company law to be established in as the company law in its prior state of incorporation changes. What is sought after by the companies in this respect is that there should be no winding up of the company in the originating state but instead it would keep its legal identity throughout the process of reincorporation.\textsuperscript{149} Within the USA the approach is that reincorporation is possible due to the rules on fusion that they have combined with the possibility to do a fusion without any tax consequences. These tax effects within the EC can be disastrous to a company in their attempt to find the most suitable state to reincorporate in.\textsuperscript{150} \textsuperscript{151}

The possibility to reincorporate a company within the EC is limited as EC provisions stands today. “The EC treaty does neither include the right for a company to maintain its legal identity when performing a change in nationality nor a right to a cross boarder merger”\textsuperscript{152} This lack of community right to reincorporation is accentuated by the fact that there have been Community harmonisations concerning this issue, such as the 10\textsuperscript{th} Company Law Directive\textsuperscript{153}, concerning cross-border mergers, and the for now postponed development of a proposal for a 14\textsuperscript{th} Company Law Directive.\textsuperscript{154} \textsuperscript{155} The SE-company\textsuperscript{156} can,

\textsuperscript{146} Birkmose Søndergaard, *Konkurrence mellem retssystemer - Delaware-effekten I et europæisk selskabssretligt perspektiv*, p. 54 – 55.

\textsuperscript{147} Drury, *The “Delaware Syndrome”: European Fears and Reactions*, p. 719.

\textsuperscript{148} Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd, [2003], ECR I-10155.

\textsuperscript{149} Birkmose Søndergaard, *Konkurrence mellem retssystemer - Delaware-effekten I et europæisk selskabssretligt perspektiv*, p. 135.

\textsuperscript{150} Birkmose Søndergaard, *Konkurrence mellem retssystemer - Delaware-effekten I et europæisk selskabssretligt perspektiv*, p. 46.

\textsuperscript{151} Drury, *The “Delaware Syndrome”: European Fears and Reactions*, p. 738.

\textsuperscript{152} Birkmose Søndergaard, *Konkurrence mellem retssystemer - Delaware-effekten I et europæisk selskabssretligt perspektiv*, p 137, Author’s translation from – ”Traktatens bestemmelser om etableringretten omfatter hverken retten til at foretage identitetsbevarande nationalitetskifte eller grænseoverskrindende fusion”.


\textsuperscript{154} Birkmose Søndergaard, Hanne, *Konkurrence mellem retssystemer - Delaware-effekten I et europæisk selskabssretligt perspektiv*, p. 137.
through its EC regulated right, move freely within the EC without being forced to be wind-up.\textsuperscript{157}

The development on the issue of reincorporation has for some time been part of the consciousness of the EC. Evidence of this is found both in the 10\textsuperscript{th} Company Law Directive\textsuperscript{158} on cross border mergers as well as in a white paper from 1985\textsuperscript{159} where it says that “[e]nterprises must also be able to engage in cross-border mergers within the community”\textsuperscript{160} and not only be able to create subsidiaries and branches in order to “set up in another Member State”\textsuperscript{161}

As can be understood from the 10\textsuperscript{th} Company Law Directive it is not aimed at making it possible to change the nationality of a company whilst it keeps its legal identity as such but what can be achieved is a reincorporation through a merger.\textsuperscript{162} There could however exist a slim possibility for reincorporation if the legislations of both states agree on this activity.\textsuperscript{163}

\section{3.5 Conclusion}

Within the USA there is only the use of the incorporation method and by that, combined with their legislation on mergers, the mobility of companies is ensured to great extent. The fact that there are two different methods used when determining the state of incorporation within the EC complicates the freedom of establishment. The development that has been carried out by the ECJ indicates however some changes in the acceptance of the real seat method as it prevents some of the mobility that is guaranteed by the EC treaty. The 10\textsuperscript{th} Company Law Directive and the proposal for a 14\textsuperscript{th} directive are further indications of a change of the freedom of establishment for companies.

As stated above the real seat method might have worked in preventing a EC Delaware effect but as there have been some restrictions, through case law, as to the powers of the real seat method there might be that the incorporation method will prevail in the future. If the

\begin{footnotesize}
\begin{itemize}
  \item \textsuperscript{156} Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE).
  \item \textsuperscript{159} COM(85) 310 final, \textit{Completing the Internal Market}, White paper from the commission to the European Council, Milan, 28 – 29 June 1985.
  \item \textsuperscript{160} COM(85) 310 final, p. 38.
  \item \textsuperscript{161} COM(85) 310 final, p. 38.
  \item \textsuperscript{162} Birkmose Søndergaard, \textit{Konkurrence mellem retssystemer - Delaware-effekten I et europæiskt selskabsretligt perspektiv}, p. 146.
  \item \textsuperscript{163} Birkmose Søndergaard, \textit{Konkurrence mellem retssystemer - Delaware-effekten I et europæiskt selskabsretligt perspektiv}, p. 143.
  \item \textsuperscript{164} See for example Case C-81/97, Daily Mail.
\end{itemize}
\end{footnotesize}
incorporation method does prevail there can be a more widespread use of the freedom of
establishment in relation to company law as the companies, through their choice of state of
incorporation, can choose the legislation to be subjected to. However without any real pos-
sibility to reincorporate it is not possible for companies that already exist to change state to
be incorporated in and therefore seriously hampering the possibility of a Delaware effect.
4 The freedom of establishment

4.1 Introduction
As mentioned above, the possibility for companies to choose the state of incorporation is vital for an EC Delaware effect to occur.

The MSs has been quite protective and tried to prevent persons, legal and real, to exercise the freedom of establishment, and has tried to justify the preventions by using reasons such as tax purposes and the protection of creditors. The purpose of this chapter is to clarify to what extent a MSs can prevent companies to access other legal systems in the EC and to exercise the freedom of establishment.

4.2 General
Since there are differences between legal systems in MSs this can create obstacles when MSs limits companies’ rights to establish primary and secondary establishments. Differences in legal systems can for example be the minimum paid-up capital needed for a limited liability companies. Another difference of significance, previously mentioned, is if the MS uses the company’s place of registration or real seat to determine the domicile of the company’s primary establishment.

4.3 The EC treaty

4.3.1 General provisions
According to article 2 ECT, the purpose of the treaty is to establish an internal market for the purpose of creating a “harmonious, balanced and sustainable development of economic activities”. Article 3.1. (c) ECT provides that an internal market “characterised by the abolition, as between MSs, of obstacles to the free movement of goods, persons, services and capital” shall be created.

4.3.2 Community provisions of the freedom of establishment

4.3.2.1 Article 43 ECT
Article 43 ECT states that no restrictions are allowed which hampers persons’ right to perform business activities in another MS through a secondary establishment.

Article 43 ECT:

Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a MS in the territory of another MS shall be prohibited. Such prohibition shall also apply to restric-

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165 Case C-81/97. Daily Mail.
166 Case C-212/97, Centros Ltd v. Erhvervs- og Selskabsstyrelsen, [1999], ECR I-01459.
167 Art. 2 ECT.
168 Art. 3.1. (c) ECT.
tions on the setting-up of agencies, branches or subsidiaries by nationals of any MS established in the territory of any MS.

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 48, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the chapter relating to capital.

The first paragraph is negatively worded, stating that all restrictions of the freedom establishment must be abolished. The second paragraph is positively worded, entitling the freedom of pursuing economic activity in another MS.\(^\text{169}\)

The wording of article 43 ECT, “of nationals… in the territory of another MS”\(^\text{170}\), implies that nationals of a MS cannot invoke the article against their home state when they set up in a self-employed capacity.\(^\text{171}\) The set-up of secondary establishments such as subsidiaries and branches has not the same limitations; the right to pursue economic activity through a secondary establishment is granted to “nationals of any MS established in the territory of any MS”\(^\text{172}\). Hence, article 43 ECT can be invoked in a national’s home state when the issue concerns a secondary establishment in the home state.\(^\text{173}\)

Furthermore, the wording “under the conditions laid down for its own nationals”\(^\text{174}\) indicates that discrimination is prohibited and by that MSs must treat nationals from other MSs the same way as they treat their own nationals. It would seem from the wording of the article that compliance with the equal-treatment requirement is sufficient, but the article has later on been given a wider concernment through ECJ case law.\(^\text{175}\) In the Gebhard case\(^\text{176}\) which will be dealt with below in chapter 4.4.2, the ECJ stated that measures which “hinder or make less attractive”\(^\text{177}\) the fundamental freedoms are a breach of EC provisions. No direct discrimination is therefore necessary for national measures to be in breach of the provision of the freedom of establishment.

4.3.2.2 Article 48 ECT

Article 48 ECT widens the freedom of establishment to also concern legal persons such as companies.

**Article 48 ECT**


\(^{170}\) Craig & de Burca, *EU Law* p. 772.

\(^{171}\) Craig & de Burca, *EU Law* p. 772.

\(^{172}\) Art. 43 ECT.

\(^{173}\) Craig & de Burca, *EU Law*, p. 772.

\(^{174}\) Art. 43 ECT.

\(^{175}\) Craig & de Burca, *EU Law*, p. 772.

\(^{176}\) Case C-55/94, Reinhard Gebhard v Consiglio dell’Ordine degli Avvocati e Procuratori di Milano, [1995], ECR I-04165.

\(^{177}\) Case C-55/94, Gebhard, para. 37.
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.

"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.

According to article 48 ECT, legal persons shall be treated in the same way as real persons when they exercise the freedom of establishment. The definition of companies is quite wide as the only exclusion is non-profit-making legal persons. The company must however be incorporated in accordance with national law. To treat legal persons the same way as real persons cannot be easily done since there are in fact differences between them. It is for example easier to determine the difference between a company’s primary and secondary establishments than real persons’ place of practice in several different MSs. Another difference is that companies are creatures of law.

If a MS limits the freedom of establishment, it can do so through a wide range of measures which all have different consequences on the person or company exercising the freedom of establishment. A MS can for example deny a company or a person a right or impose a duty. A measure of higher restraint can be the denial of registering a branch in the state and the highest restraint a MS can impose on a company is denying the company legal capacity, for example unless the company is established in accordance with the law of the MS with the consequence that the company cannot be a part of a legal proceeding. Those were the circumstances in the Überseering case which will be examined more in depth in chapter 4.4.5.

### 4.3.2.3 Possibilities to limit the freedom of establishment

The freedom of establishment is a major principle of the EC provisions but it is not without exceptions. According to article 46 ECT a MS can impose rules which limit the rights for persons from another MS on the grounds of public policy, public health and public security. Article 46 ECT shall however be used and interpreted strictly since it restricts one of the most important principles of the EC provisions. The ECJ has stated that there is a requirement of a threat against a public interest if a MS shall be able to invoke article 46 ECT in a successful way, economic reasons will not be sufficient.

Article 293 ECT refers to the second paragraph of article 48 ECT and says that MSs shall, “so far as is necessary” enter into negotiations for the purpose of mutual recognition of legal persons and their legal capacity. The ECJ has given article 293 ECT a quite subservient role in the EC provisions as MSs cannot negotiate on their own behalf when adequate EC

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178 Craig & de Burca, EU Law, p. 793.
179 Case C-81/97, Daily Mail, para. 19.
181 Case C-208/00, Überseering.
183 Art. 293 ECT.
provisions are at hand. The ECJ has also stated that the freedom of establishment cannot exist depending on agreements due to such negotiations between MSs.

### 4.4 ECJ case law regarding the freedom of establishment

#### 4.4.1 Introduction

The ECJ has on several occasions dealt with MSs’ attempts to limit the freedom of establishment in the articles 43 and 48 ECT. The ECJ has also widened the scope of articles 43 and 48 ECT to also concern measures which are not directly discriminating in case law examined in the chapter below. The cases concerning this paper in specific that have protruded throughout the discussion concerns the primary establishment, the possibility to choose legal system for the primary establishment and MSs’ possibilities to regard a company as have incorporated or re-incorporated the primary establishment there.

#### 4.4.2 The rule of reason doctrine in the Gebhard case

##### 4.4.2.1 Introduction and background

As shown in the previous chapter; the EC treaty in general and the articles 43 and 48 ECT concerns the freedom of establishment. The articles do however focus on unequal treatment based on the nationality of the persons. The ECJ has widened the scope of the freedom of establishment so that a measure which “hinders or make less attractive” the exercise of the freedom of establishment is a breach of EC provisions, some measures can however be justified.

The ruling in the Gebhard case gave the “clearest indication” of the widening of the scope of article 43 and 48 ECT. The case concerned a German national who practiced as a lawyer in Italy. The Milan Bar Council in Italy raised disciplinary proceedings against Mr. Gebhard since the Bar Council’s opinion was that Mr. Gebhard lacked the proper educational diploma to use the Italian title Avvocato. During the disciplinary proceedings Mr. Gebhard was imposed with a suspension from professional activity for a period of six months. Mr. Gebhard appealed the decision to the national court. The national court stayed the proceedings and asked the ECJ for a preliminary ruling in accordance with article 234 ECT.

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184 Case C-208/00, Überseering, para 54.
185 Case C-208/00, Überseering, para 55.
186 Case C-55/94, Gebhard, para 37.
187 Case C-55/94, Gebhard.
188 Craig & de Burca, *EU Law*, p. 784.
189 Case C-55/94, Gebhard, para. 9.
190 Case C-55/94, Gebhard, para. 11.
191 Case C-55/94, Gebhard, para. 18.
4.4.2.2 The judgment of the ECJ

The ECJ stated that article 43 ECT provides nationals of a MS with a right to be treated equally with the nationals in the host state “under the conditions laid down for its own nationals by the law of the country”\(^{192}\), which means, according to the ECJ, that if there are no specific restrictions in the national law of the host state a person can establish in the host state that he or she wishes to.\(^{193}\) Some economic activities can however be imposed with requirements settled by national law. If so, the national must comply with the law of the host state.\(^{194}\) If such measures hinders or makes less attractive the exercise of the fundamental freedoms, the measures must comply with four conditions set out by the ECJ.\(^{195}\)

The measures must:

- be applied in a non-discriminatory manner
- be justified by imperative requirements in the general interest
- be suitable for securing the attainment of the objective they pursue
- and not go beyond what is necessary in order to attain it.

All conditions above must be complied with, if a measure is breaching one of the conditions the measure is in breach of the freedom of establishment. There is nothing mentioned about discrimination, direct or indirect, merely that a measure which “hinders or makes less attractive”\(^{196}\) the exercise of the freedom of establishment is a breach of that freedom.

4.4.3 The Daily Mail case – Transfer of primary establishment

4.4.3.1 Introduction and background

The Daily Mail case\(^{197}\) concerned a company’s right to transfer its central management to another MS. Daily Mail and General Trust plc (Daily Mail), a British company, wanted to transfer its central management to the Netherlands. According to British company law it was the registration that determined the company’s residence but according to British tax law it was the residence of the central management which determined the liability of taxation.\(^{198}\) To transfer the central management to another state required the consent of the Treasury Department. The Treasury Department refused to give this consent.\(^{199}\)

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\(^{192}\) Art. 43 ECT.

\(^{193}\) Case C-55/94, Gebhard, para. 33-34.

\(^{194}\) Case C-55/94, Gebhard, para. 35-36.

\(^{195}\) Case C-55/94, Gebhard, para. 37.

\(^{196}\) Case C-55/94, Gebhard, para. 37.

\(^{197}\) Case C-81/97, Daily Mail.

\(^{198}\) Case C-81/97, Daily Mail, para. 3-4.

\(^{199}\) Case C-81/97, Daily Mail, para. 5-7.
Daily Mail initiated proceedings in the British High Court of Justice. In the application Daily Mail claimed that the articles 43 and 48 ECT allows a company to transfer its central management to another MS. The High Court of Justice stayed the proceedings and asked the ECJ in accordance with article 234 ECT if the requirement of consent of the Treasury department was in breach of the provisions of the freedom of establishment. 200

4.4.3.2 The judgment of the ECJ

The ECJ stated that the articles 43 and 48 ECT provides companies with a freedom of establishment. Companies can therefore, through a secondary establishment in another MS, pursue economic activities in other MSs. The articles 43 and 48 ECT also prevents MSs to limit companies established in the state in question to establish themselves in another MS. 201

When examining a company’s possibility to transfer its central management to another MS whilst maintaining the legal capacity in the state of origin the ECJ stated that “companies are creatures of the law” 202 and that “they exist only by virtue of the varying national legislation which determines their incorporation and functioning” 203. The ECJ continued and recognised that there are differences between national legal systems within the EC, as to what is required for the incorporation of a company. Some legal systems require not only the registered office in their territory, they require also that the real head office must be in the territory. Since the matter has not been dealt with by EC provisions, the matter shall be dealt with in accordance with national regulations and agreements due to negotiations between MSs in accordance with article 293 ECT. 204 Articles 43 and 48 ECT cannot be interpreted as giving legal persons incorporated in a MS a right to move its central management and administration to another MS whilst keeping its legal capacity in the state of origin. 205

4.4.4 The Centros case – The possibility to choose state of incorporation

4.4.4.1 Introduction and background

The Centros case 206 is essential when examining companies’ rights to use the benefits provided with by the freedom of establishment. The circumstances surrounding the case were as follows; a Danish national purchased in 1992 a limited liability company established and registered in the United Kingdom. The company itself was established in accordance with British law but the company did not pursue any economic activity in Britain. Later the

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200 Case C-81/97, Daily Mail, para. 8.
201 Case C-81/97, Daily Mail, para. 16-17.
202 Case C-81/97, Daily Mail, para. 19.
203 Case C-81/97, Daily Mail, para. 19.
204 Case C-81/97, Daily Mail, para. 23.
205 Case C-81/97, Daily Mail, para. 25.
206 Case C-212/97, Centros.
same year, the company applied for registration of a branch in Denmark to be able to pursue economic activity in Denmark.\textsuperscript{207}

According to Danish legislation, a limited liability company in Denmark must have a minimum paid-up capital of 200,000 DKK. Foreign companies who wished to pursue economic activities in Denmark must do so through a registered branch.\textsuperscript{208} Erhvervs- og Selskabsstyrelsen, which was the authority concerning registration of branches, had developed the praxis of denying registration of branches under a company abroad if the company was established abroad for the purpose of circumventing Danish legislation. Erhvervs- og Selskabsstyrelsen argued that the Danish national had failed to provide with sufficient information concerning the British company’s economic activity in Britain. Erhvervs- og Selskabsstyrelsen argued further that the branch in Denmark was in fact the primary establishment and therefore must the establishment be in accordance with Danish law.\textsuperscript{209} The national court upheld the decision with the argument that EC regulation cannot be invoked for the purpose of circumventing national rules.\textsuperscript{210} Hence, the registration of the branch was denied and the company could not pursue any economic activities in Denmark. The decision was appealed to the Danish Supreme Court which stayed the proceedings and asked the ECJ for a preliminary ruling in accordance with article 234 ECT.\textsuperscript{211}

4.4.4.2 The opinion of the Advocate General

In the Centros case, the Advocate General La Pergola examines a company’s possibility to choose legal system when incorporating a company which is of interest for the topic of this paper. The Advocate General began with stating that the case did not concern the freedom of establishment as such since the Danish authorities did not refuse companies from abroad to establish a branch in Denmark. The case instead concerned if a person in a MS (Denmark) can circumvent legislation by establishing a primary establishment in another MS (the United Kingdom) and thereafter establish a secondary establishment in the home state (Denmark) in an attempt to circumvent the legislation in that home state. The economic activity is only pursued in the state of the secondary establishment.\textsuperscript{212}

4.4.4.3 The judgment of the ECJ

The ECJ pretty much was in line with the Advocate General and stated that the issue concerned whether or not a MS can prevent circumvention of national law.\textsuperscript{213} The ECJ continued and stated that Erhvervs- og Selskabsstyrelsen did not breach the freedom of establishment as such; the registration of the branch in Denmark would be approved of if the company in the United Kingdom had pursued any economic activity in Britain.\textsuperscript{214}

\begin{flushleft}
\textsuperscript{207} Opinion of Mr. Advocate General La Pergola delivered on 16 July 1998. - Centros Ltd v Erhvervs- og Selskabsstyrelsen. -- Case C-212/97, para. 2.
\textsuperscript{208} Opinion of Mr. Advocate General La Pergola, Case C-212/97, para. 3.
\textsuperscript{209} Case C-212/97, Centros, para. 7.
\textsuperscript{210} Case C-212/97, Centros, para. 9.
\textsuperscript{211} Opinion of Mr. Advocate General La Pergola, Case C-212/97, para. 3.
\textsuperscript{212} Opinion of Mr. Advocate General La Pergola, Case C-212/97, para. 11.
\textsuperscript{213} Case C-212/97, Centros, para. 14.
\textsuperscript{214} Case C-212/97, Centros, para. 15.
\end{flushleft}
The ECJ examined the argument that the issue was of internal character since the branch in Denmark was actually the primary establishment and therefore should be established in accordance with Danish law. The ECJ stated that the fact that the company was established in accordance with British law was sufficient for it to be an EC matter and by that be governed by the freedom of establishment, regardless of the fact that the establishment in the United Kingdom was for the purpose of circumventing Danish law.

The location of a company’s 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 nationality does in the case of a natural person”.

The ECJ continued to examine the argument that the forming of the company in the United Kingdom was an abuse of the freedom of establishment since the sole purpose with the arrangement was the circumvention of Danish law. The ECJ stated that the forming of a company in the United Kingdom is for the purpose of avoiding “rules governing the formation of companies and not rules concerning the carrying on of certain trades, professions or businesses”. The purpose of the freedom of establishment is “intended specifically” to provide with a freedom for companies established in one MS to pursue business in another MS through a secondary establishment. The possibility to seek the MS which offers the least restrictive rules is a natural consequence of the freedom of establishment, not an abuse. The ECJ then refers to the Segers case which stated that it does not matter if a company pursues any business activity in its state of origin or not when examining if the establishment is an abuse of EC provisions.

The ECJ continued to examine if the minimum paid-up capital requirement could be justified. The ECJ began with stating that protection of creditors is not mentioned as one of the exemptions in article 46 ECT. Furthermore, if measures taken by a MS can be justified they must be in line with the conditions stated in the Gebhard case. According to the ECJ, if Centros had pursued business activity in England the registration would have been approved. According to the Danish government, the capital requirement was for the protection of creditors, but the capital requirement had not concerned the branch in Denmark if the company had pursued economic activity in Britain; therefore the requirement could not be said to be for the protection of the creditors.

Combating fraud can however not

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215 Case C-212/97, Centros, para. 16.
216 Case C-212/97, Centros, para. 17.
217 Case C-212/97, Centros, para. 20.
218 Case C-212/97, Centros, para. 17-20.
219 Case C-212/97, Centros, para. 19-22.
220 Case C-212/97, Centros, para. 26.
221 Case C-212/97, Centros, para. 26.
222 Case C-212/97, Centros, para. 27.
224 Case C-55/94, Gebhard.
225 Case C-212/97, Centros, para. 35.
justify the practice of refusing to register branches under companies in other MSs.\textsuperscript{226} Centros did not however try to conceal its country of origin which mitigates the eventual increase of risks for the creditors and creditors are to some extent provided with protection through EC provisions such as some of the company law directives.\textsuperscript{227} There are also other national ways to protect creditors; a legislator can provide possibilities for creditors to require securities from a company’s directors instead of the minimum paid-up capital rule.\textsuperscript{228}

4.4.5 Überseering – Real seat versus Incorporation

4.4.5.1 Introduction and background

The Überseering case\textsuperscript{229} gave the ECJ an opportunity to further clarify the issue of the freedom of establishment. The Überseering BV Company (Überseering) established in the Netherlands, owned a property in Germany according to the German cadastre.\textsuperscript{230} In 1995, two German nationals purchased all shares in the Dutch Überseering company.\textsuperscript{231} In 1996 Überseering filed a claim against a construction company in German courts. The case was deemed inadmissible in national courts due to the fact that according to German law Überseering lacked legal capacity according to German law. According to German case law, as it uses the real seat method, it is the location of the company’s central administration which decides which legal system that governs the company and its actions.\textsuperscript{232} This includes companies established abroad which then has moved its central administration into Germany; these were the circumstances since the German nationals purchased the shares in Überseering. The German Bundesgerichtshof (Federal Court of Justice) stayed the proceedings and asked the ECJ for a preliminary ruling in accordance with article 234 ECT. The court asked in short if a MS could decide the legal capacity of a company when the company had been deemed to have moved to the state in question, arguing that the Daily Mail case had given a MS a right to decide a company’s legal capacity.\textsuperscript{233}

4.4.5.2 The judgment of the ECJ

The ECJ began with examining the circumstances in the Überseering case. The case concerned a company’s legal capacity in the host state when the law of the host state does not recognise the company since the real seat has been transferred to the host state according to the law of the host state. Überseering had not expressed a wish to transfer its real seat to Germany, only German law considered the purchase of shares in Überseering as a transfer between MSs.\textsuperscript{234} The transfer of shares from Dutch to German nationals has not led to any

\textsuperscript{226} Case C-212/97, Centros, para. 38.
\textsuperscript{227} Case C-212/97, Centros, para. 36.
\textsuperscript{228} Case C-212/97, Centros, para. 33.
\textsuperscript{229} Case C-208/00, Überseering.
\textsuperscript{230} Case C-208/00, Überseering, para. 2.
\textsuperscript{231} Case C-208/00, Überseering, para. 7.
\textsuperscript{232} Case C-208/00, Überseering, para. 8-9.
\textsuperscript{233} Case C-208/00, Überseering, para. 20.
\textsuperscript{234} Case C-208/00, Überseering, para. 62.
questions about the company’s legal existence in the company’s country of origin (the Netherlands).\textsuperscript{235} The ECJ continued and said that the Daily Mail case did not concern the freedom of establishment in the host state, but in the country of origin. In the Daily Mail case, the ECJ came to the conclusion that companies are “creatures of the law”\textsuperscript{236}, the ECJ did however not express its opinion on whether or not a MS can deny a company legal capacity when the law of the host state states that the company has moved its real seat to that state. The ECJ has never had the intention of granting MSs a right to require that companies exercise of the freedom of establishment in compliance with domestic company law.\textsuperscript{237} One cannot, from the Daily Mail case, draw the conclusion that MSs can limit the freedom of establishment by denying legal capacity because of national rules concerning transfer of seat.\textsuperscript{238} Überseering had been established in accordance with Dutch law and has a right to establish itself through a secondary establishment in other MSs in accordance with the article 43 and 48 ECT.\textsuperscript{239}

The ECJ continued and examined if the requirement of reincorporation in Germany could be justified. The ECJ do recognise that the freedom of establishment can be limited in the public interest and sometimes justified if it is done in accordance with the requirements stated in the Gebhard case.\textsuperscript{240} The German attempt to refuse a company legal capacity can however never be justified as such a procedure is “tantamount to an outright negation of the freedom of establishment conferred on companies by Articles 43 ECT and 48 ECT”\textsuperscript{241}. Some MSs argued that article 293 ECT gives MSs competence to legislate about seat transfers and furthermore to adopt conventions concerning the same matter. The ECJ stated that article 293 ECT do provide MSs with a right to enter into negotiations concerning problems arising from discrepancies between legal systems, but only to “so far as is necessary”\textsuperscript{242}. According to the ECJ MSs can only enter into negotiations when “treaty provisions do not enable its objectives to be attained”\textsuperscript{243}. The freedom of establishment cannot be dependent on conventions due to negotiations between MSs.\textsuperscript{244}

\begin{itemize}
\item \textsuperscript{235} Case C-208/00, Überseering, para. 63.
\item \textsuperscript{236} Case C-208/00, Überseering, para. 67.
\item \textsuperscript{237} Case C-208/00, Überseering, para. 72.
\item \textsuperscript{238} Case C-208/00, Überseering, para. 73.
\item \textsuperscript{239} Case C-208/00, Überseering, para. 80.
\item \textsuperscript{240} Case C-208/00, Überseering, para. 92.
\item \textsuperscript{241} Case C-208/00, Überseering, para. 93.
\item \textsuperscript{242} Case C-208/00, Überseering, para. 52.
\item \textsuperscript{243} Case C-208/00, Überseering, para. 52.
\item \textsuperscript{244} Case C-208/00, Überseering, para. 60.
\end{itemize}
4.4.6 Inspire Art – Member states’ limitations

4.4.6.1 Introduction and background

The Inspire Art case concerned what a MS can impose on a company acting through a secondary establishment. The company Inspire Art Ltd was established in Britain in accordance with British law and pursued economic activity in the Netherlands only. The company had a branch in Amsterdam and was registered in the Netherlands, but nothing in the registration said that the company was of British origin.

This was not allowed according to Dutch law; an amendment should be made in which the company’s origin should be stated. According to that law the company did not only have to show that it was a formally foreign company in its registration but as a formally foreign company it had to have a minim paid-up capital. Inspire Art Ltd argued that its registration was not incomplete because it was not a formally foreign company. Inspire Art Ltd also argued that if it were to be considered a formally foreign company according to the Dutch law, the law itself was contrary to EC law and especially articles 43 and 48.

4.4.6.2 The judgment of the ECJ

The ECJ stated that the articles 43 and 48 ECT preclude MSs from imposing requirements on companies such as those in the circumstances of the case. If a company is established in accordance with national law and the company exercises the freedom of establishment through a secondary establishment, a MS cannot impose requirements from national law of the host state relating to minimum capital.

The ECJ continued to examine if the requirements could be justified. The Dutch government argued that the requirement in national law, in particular the requirement of a minimum paid-up capital, was for the protection of creditors and others. The ECJ stated that it is clear for the creditors that Inspire Art Ltd is not a Dutch company and as such it is not governed by Dutch law; furthermore creditors can rely on EC provisions such as the 4th and 11th Company Law Directives. Another argument put forward by the Dutch government was that the arrangement was of abusive intent since the purpose with the arrangement was to circumvent national law. The ECJ referred to the Centros case and stated that it is granted by the freedom of establishment that a person can chose the MS with the most suitable legislation to establish a company in and thereafter pursue economic activity in any MS through a secondary establishment.

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245 Case C-167/01, Inspire Art.
246 Case C-167/01, Inspire Art, para. 22-24.
247 Case C-167/01, Inspire Art, para. 37.
248 Case C-167/01, Inspire Art, para. 105.
249 Case C-167/01, Inspire Art, para. 110.
250 Case C-167/01, Inspire Art, para. 135.
251 Case C-167/01, Inspire Art, para. 86.
252 Case C-212/97, Centros.
253 Case C-167/01, Inspire Art, para. 137-138.
4.5 Community regulations concerning the freedom of establishment outside the EC treaty

4.5.1 Introduction

A possible Delaware effect is dependent on companies’ possibilities to move between states. As EC provisions stands today, a company cannot transfer its primary establishment, registered office or central management without doing so in compliance with national law in the states concerned and suffering the risk of being forced to wind-up in the home state. However, the EC has through secondary legislation and regulations provided with, or at least seek to provide, some means for companies to move between MSs. The 10th Company Law Directive as well as the proposal for a 14th Company Law Directive both aims at simplifying the transfer of an economic activity between states. The statutes for the SE-company already provides with a company form with a regulated right to transfer the company between MS without being wind-up. The two directives and the statutes for the SE-company are of special interest for the possible Delaware effect and will be examined below.

4.5.2 The 10th Company Law Directive

The 10th Company Law Directive\textsuperscript{254} concerns cross-border mergers between limited liability companies, both public and private. The requirement for a merger to be governed by the directive is that the companies concerned in the merger are incorporated in accordance with national law of two different MSs. The preamble of the directive states that the freedom of establishment requires EC regulation concerning cross-border mergers since obstacles still remains in national law. Information concerning the merger shall be disclosed for the protection of company members and third parties.

The 10th Company Law Directive describes three types of mergers in article 2. One or more companies can dissolve, without going into liquidation, and transfer all assets and liabilities to another existing company. Furthermore can one or more companies dissolve without liquidation and transfer their assets and liabilities to a company that they form. A company can also dissolve without liquidation and transfer assets and liabilities to a company which holds all shares or securities representing the capital of the dissolving company. Article 4 states some requirements in national law that the companies involved must comply with. One example is that the merger can only be done between companies which can merge according to national law of the companies.

According the article 12 the date of which the merger takes effect is to be determined by the law of the MS of which the company resulting from the merger is subject to.

4.5.3 The proposal for 14th Company Law Directive

The Commission has issued a proposal for a 14th Company Law Directive which, if it enters into force, will regulate the transfer of a company’s registered office between MSs, when the transfer is governed by the freedom of establishment.

\textsuperscript{254} Directive 2005/56/EC.
According to a public consultation issued by the Commission\(^{255}\), there is a need for companies to transfer their registered office between MSs without losing its legal capacity and identity.\(^{256}\) Since the 14\(^{th}\) Company Law Directive is still a proposal, although put on hold, a deeper examination will not be done and only a brief overview will be provided with.

If the 14\(^{th}\) Company Law Directive enters into force and is done so in accordance with the proposal it will provide companies with a possibility to transfer its real seat in a way which is not possible as EC provisions and ECJ case law stands today. The 14\(^{th}\) Company Law Directive should, according to the consultation, provide a company with a possibility to transfer its registered office between MSs without being forced to be wound-up in the home state.\(^{257}\) The transfer will be dealt with in both the state of origin and in the new state. The state of origin will have to deregister the company whilst the new state will have to register the company.\(^{258}\) Each MS must recognise a company’s right to transfer its registered office to another MS and its right to acquire legal capacity in that new state. As EC provisions stands today, a MS cannot regard a company as have moved to the state on the mere fact that the company has done so in accordance with the national law in question, see chapter 4.4.5 concerning the Überseering case\(^{259}\). The company cannot keep its legal capacity in the state of origin after the transfer; instead it must acquire legal capacity in the new state. Furthermore the new MS cannot deny registration of a company which decision of transfer taken by the general meeting and articles of association is in compliance with the law of the new state.\(^{260}\) The company must comply with the law of the new state and “should”\(^{261}\) therefore transform itself into a form recognised in the new state. This requirement probably means that a MS that uses the real seat method when deciding a company’s residence can prescribe the transfer of the company’s real seat to the new state during the transfer.\(^{262}\)\(^{263}\)


\(^{256}\) Public consultation relating to the outline of the planned proposal for a 14th Company Law Directive, p. 1.

\(^{257}\) Public consultation relating to the outline of the planned proposal for a 14th Company Law Directive, p. 3-4.

\(^{258}\) Public consultation relating to the outline of the planned proposal for a 14th Company Law Directive, p. 4.

\(^{259}\) Case C-208/00, Überseering.

\(^{260}\) Public consultation relating to the outline of the planned proposal for a 14th Company Law Directive, p. 4.

\(^{261}\) Public consultation relating to the outline of the planned proposal for a 14th Company Law Directive, p. 4.

\(^{262}\) Public consultation relating to the outline of the planned proposal for a 14th Company Law Directive, p. 4.

\(^{263}\) Werlauff, EU Company Law, Common business law of 28 states, p. 94.
4.5.4 The present situation of the 14th Company Law Directive

European Commissioner Charles McCreevy has postponed the proposed 14th Company Law Directive for an indefinite period of time. McCreevy’s opinion is that the benefits of the 14th Company Law Directive have not been shown and that companies already have sufficient means to transfer the registered office between MSs. McCreevy says that the statutes concerning the SE-company provides with a possibility to transfer the registered office. McCreevy also says that the 10th Company Law Directive concerning cross-border mergers provides companies with a possibility to transfer their registered office. This is possible since a company can incorporate a subsidiary in the state the company wishes to transfer its registered office to and then perform a merger between the parent company and the subsidiary. According to McCreevy the SMEs will benefit more from a new company form adapted for the SME, on EC level, instead of the regulations in the proposal for 14th Company Law Directive.

4.5.5 The SE-company

In an effort to harmonise company law on EC level a new company-form was issued, the statutes of the SE-company is found in the SE-regulation. The SE-regulation enables a company form which is “as uniform as possible” within the EC and that furthermore can change state of incorporation within the EC.

According to article 1 and 3, the SE-company is a limited liability company with legal capacity. The SE-company can be incorporated by two or more companies; those companies must be governed by the law of two or more different MSs, see article 2. Article 4 states that the SE-company must have a minimum paid-up capital of € 120 000. The SE-company can transfer its registered office within the EC without a requirement of winding up or the creation of a new legal person according to article 8.

Even though the SE-company is an EC governed company-form it is just a frame-work, the most issues concerning the SE-company are governed by national law. Examples are the maintenance of the company’s capital in article 5, article 10 concerning the treatment of the company from the MS, article 15 concerning the formation of the company and article 18 concerning formation of the SE-company through merger between the forming companies. This can mean that there can be as many types of SE-companies as there are MSs.

4.6 Conclusion

The freedom of establishment provides with a right to pursue economic activity in another MS through a secondary establishment. The articles 43 and 48 ECT also prevent MSs to limit persons’ rights to leave their home states. When concerning legal persons such as companies, the ECJ has stated that if they want to move between MSs they must do so in

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compliance with national law. As EC provisions stand at present time, an established company suffers the risk of being forced to be wound-up in the home state when wanting to move to another MS. A possible Delaware effect in which established companies move between MSs is clearly hampered by this fact. The benefits of the law in the new state must be weighed and compared to the disadvantages of leaving the home state. When concerning the establishment of a new company, according to the Centros case, a person can choose the MS with the most suitable legislation to incorporate the company in and then pursue economic activity in his home state through a secondary establishment. The only requirement, established through case law, is that the primary establishment is incorporated in accordance with national law. The Centros case opens the possibility to divide the place of incorporation and the place of economic activity from each other. To be able to separate the state of incorporation from the place of economic activity is necessary for competition between MSs, for company law, to occur. The branch must however still comply with some regulations on both EC as well as national level, see chapters 5.3.8 and 6.

Furthermore, a MS cannot regard a company as have moved to that MS as is shown in the Überseering case. Instead it is the law of the MS which the company is governed by originally, which decides which state the company is incorporated in. This fact will probably hamper MS possibilities to use the real-seat method when deciding place of incorporation. The ECJ has also stated that even though some measures hindering the exercising of the freedom of establishment can be justified; however depriving a company its legal capacity can never be accepted.

Companies’ possibilities to move within the EC have been dealt with in EC regulations concerning company law. One possibility to transfer a company between MS is a cross-border merger in accordance with the 10th Company Law Directive. A company can, when wanting to move to another MS, establish a subsidiary in the new state and merger the parent company into the subsidiary. The fact that the product of the merger is a new company and not a transfer of the previous established company might provide with some problems. Two examples of such problems could be that the credit rating belonging to the old company could not be applied to the new; furthermore the company might not be able to keep its old, and perhaps well known, name. Those issues will probably, if not solved, hamper companies’ efforts to move between states and therefore the EC Delaware effect.

The SE-company is a small step forward for the benefit of larger companies who wants to exercise the freedom of establishment; however as the SE-company is highly governed by national law there can be as many different types of SE-companies as there are MSs. The requirement of a minimum paid-up capital together with the need of two companies from two different legal systems will probably hamper SMEs from forming a SE-company. It is good that the SE-company can transfer its registered office freely within the EC, but SMEs should be provided with a more suitable but similar possibility. Why should SMEs not be provided with the same possibility as the larger companies?

When concerning the freedom of establishment and a possible EC Delaware effect the proposal for a 14th Company Law Directive is of interest. The possibility to transfer a company without being wound-up is a central issue for a Delaware effect to occur within the EC and the 14th Company Law Directive will provide just that possibility. However, the 14th Company Law Directive is postponed, the reason being that the necessity of the directive has not been shown. European Commissioner McCreevy has said that the 10th Company Law Directive combined with the statues of the SE-company provides with sufficient means to transfer a company between MSs. This is only arguably true and one can wonder
if Commissioner McCreevy at all considered SMEs when he made the statement. The SE-company can as McCreevy said transfer its registered office between MSs.

But as the formation of a SE-company requires two or more companies from at least two different MS and a minimum prescribed capital of €120 000 we would argue that it is not a suitable form for SMEs. Also the fact that the SE-company to a high degree is governed by national law further diminishes the importance of the SE-company. McCreevy also said that a cross-border merger is a possible way to transfer a company. This is true but it is a highly impractical and expensive way which is shown above.

According to McCreevy SMEs will benefit more from a new Community-regulated company form adapted to the needs of the SME, the proposal for such a company form is planned to be presented in the summer of 2008. It is to be seen if the proposal for a new company-form will hamper or ease the smaller companies’ possibilities to move between MSs and if it will be presented during reasonable time. It seems that the possibility to transfer the registered office between MSs to reasonable costs and efforts will not be provided with at present time.
5 Development of company law in Europe and within the European Community

5.1 Introduction

This chapter examines the development of the company law within the EC. EC company law has developed through harmonisation on EC level. MS has also changed their legislation as response to other MSs.

The freedom of establishment in the articles 43 and 48 ECT is of “outmost importance” to companies, the articles has been examined above in chapter 4.3.2. The insufficiency of laying down the freedom of establishment on abstract basis in treaty articles led to the development of directives to remove some of the existing limitations of the freedom in question. A central part of the development of company law within the EC is made up by the company law directives and they are presented in this chapter to shed light on what has been done and which aspects that are considered important by the EC. In 2003 the commission put forward the 2003 Action Plan to modernise EC company law and to enhance corporate governance. The Action Plan, and the development that has followed it, shows some outlines to the development of European company law. There has also been some development on national level that will be briefly examined.

5.2 General

The discussion in the USA on the Delaware effect is about public companies and their incorporation whilst within the EC much of the discussion is focused on small and medium sized companies and how the EC legislation should develop in order to facilitate the development of SMEs. SMEs are identified as the driving force of the European economy as well as being important actors in regard to “growth, competitiveness, innovation and employment” in the European Union. Worth noting is that within the EC there are circa 20 000 000 SMEs and 40 000 LSEs (Large Scale Enterprise). It is however evi-

269 Werlauff, EU Company Law, Common business law of 28 states, p 57.
272 COM(2001) 98 final, Report from the commission to the council, the European Parliament, the economic and social committee and the committee of the regions – Creating an entrepreneurial Europe – The activities of the European union for small and medium-sized enterprises, Brussels, 01.03.2001, p. 11.
274 Observatory of European SMEs – SME statistics, 2000, http://www.eim.nl/Observatory_Seven_and_Eight/start.htm
275 The survey used the definition that SMEs are all enterprises employing less than 250 employees. In these statistics LSEs make up the complement to the SME and by that is an enterprise with more than 250 employees. This should be compared to the newer definition of a SME, used by the community since 2003, that a SME is an enterprise that “employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro” - C(2003) 1422 final, Commission Recommendations.
dent from the company law directives that public companies also have a central role to play within the EC.

The American culture provides something that is closer to the "economist’s ideal than many others"\textsuperscript{276}. The idea that "[e]verything has its price"\textsuperscript{277} and that "the market will provide a solution"\textsuperscript{278} is closer to becoming reality in the USA than in almost any other place. This in combination "with an innate distrust of the products of federal legislative intervention"\textsuperscript{279} sets a very different stage than is present within the EC; the development within the EC seems to be preventing a "purely market driven economy"\textsuperscript{280,281}.

Whilst the American legislators seems "single minded"\textsuperscript{282} in their attempt at improving legislation for companies the legislators of the EC seems to have several other objectives when creating legislation.\textsuperscript{283}

5.3 Company Law Directives

5.3.1 The 1\textsuperscript{st} Company Law directive

The 1\textsuperscript{st} Company Law Directive\textsuperscript{284} concerns both private and public companies. The purpose with the directive is, according to the title, to make protection of the company’s members and others equivalent throughout the EC.

The directive prescribes publication of company matters described in article 2. The article mentions for example the instrument of constitution, amendments to the articles of constitution and those who represent the company. Some financial information must also be disclosed such as the balance sheet and profit and loss account.

MSs must according to article 3 open a central register in which a file must be opened for each company registered in the state. A printed copy of the documents, referred to in article 2, must be obtainable at a price not exceeding the administrable costs thereof. According to article 6 it is up to the MS to determine the penalties for failure to comply with the requirement of disclosure. Article 7 states that if actions have been carried out in the company’s name before the company has gained legal capacity, the persons who carried out the action of 06/05/2003 concerning the definition of micro, small and medium-sized enterprises, Brussels, 06/05/2003, art. 2(1).

\textsuperscript{276} Drury, The "Delaware Syndrome": European Fears and Reactions, p. 13.

\textsuperscript{277} Drury, The "Delaware Syndrome": European Fears and Reactions, p. 733.

\textsuperscript{278} Drury, The "Delaware Syndrome": European Fears and Reactions, p. 733.

\textsuperscript{279} Drury, The "Delaware Syndrome": European Fears and Reactions, p. 733.

\textsuperscript{280} Drury, The "Delaware Syndrome": European Fears and Reactions, p. 733.

\textsuperscript{281} Drury, The "Delaware Syndrome": European Fears and Reactions, p. 733.

\textsuperscript{282} Drury, The "Delaware Syndrome": European Fears and Reactions, p. 731.

\textsuperscript{283} Drury, The "Delaware Syndrome": European Fears and Reactions, p. 731.

\textsuperscript{284} First Council Directive 68/151/EEC of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community.
actions are “jointly and severally” liable for the actions. Article 9 concerns the binding of
the company against a third party when actions are carried out in the name of the company.
The articles 10-12 concern the nullity of the company. The articles states that the nullity of
a company can only be done by a court of law. Examples of grounds for nullity can be that
no articles of constitution were executed or that the objects of the company are unlawful or
contrary to public policy.

5.3.2 The 2nd Company Law Directive

The 2nd Company Law Directive concerns only public limited liability companies. The
purpose with the directive is to harmonise the protection of company’s members and oth-
ers. The directive’s preamble states that the upholding of the freedom of establishment is
especially important when concerning the public limited liability companies since their ac-
tivities “predominate in the economy of the MSs and frequently extend beyond their na-
tional boundaries”. The directive has been “immensely important” concerning issues
of the maintaining and securing of share capital in public limited liability companies.

The directive prescribes the disclosure of financial information and information concerning
the amount and value of the company’s shares. Article 2 states some information which
the statutes or articles of incorporation of the company must provide with, such as the
company’s name, the objects of the company and the subscribed capital. Article 3 states
some information which must be obtainable in accordance with article 3 of the 1st Com-
pany Law Directive. Examples of such information are the registered office, the nominal
value of the shares of the company, different classes of shares and the total number of
shares. The information regarding the total number of shares must be updated at least once
every year. Article 7 states that the subscribed capital must consist of assets which can be
given an economic value; an undertaking to perform work or provide with a service cannot
be a part of the company’s assets.

The 2nd Company Law Directive has been amended with extended possibilities for compa-
nies to seek capital. The purpose has been to adapt the directive to provide efficiency and
competitiveness to companies without jeopardising the protection of shareholders and
creditors.

protection of the interests of members and others, are required by Member States of companies within the
meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited li-
ability companies and the maintenance and alteration of their capital, with a view to making such safeguards
equivalent.
Council Directive 77/91/EEC as regards the formation of public limited liability companies and the mainte-
nance and alteration of their capital.
5.3.3 The 3rd Company Law Directive

The 3rd Company Law Directive\textsuperscript{291} concerns the mergers and acquisitions of public limited liability companies. The preamble of the directive states that after having tried to harmonise the formation of companies and the company’s capital it is also vital to harmonise regulation concerning mergers of companies, the purpose being the protection of the company’s members and others. Regulation concerning mergers must be a part of the legislation of all MSs. For the protection of the shareholders of the merging companies, it is vital that they receive adequate information. Creditors must also be protected so that their interest is negatively affected by the merger.\textsuperscript{292}

Article 3-4 defines the different types of mergers and acquisitions referred to in the directive. The directive states in article 7 that the merger shall require the approval from the general meeting in at least one of the companies. Article 10 states that one or more experts shall examine the drafts of the merger and report to the shareholders. Article 13 concerns the protection of the companies’ creditors, the article does not say how this should be done but that the “laws of the MSs”\textsuperscript{293} shall provide with an adequate system to protect the interest of the creditors.

5.3.4 The 4th Company Law Directive

The 4th Company Law Directive\textsuperscript{294} concerns both private and public limited liability companies. The directive defines for example the concept of annual accounts, the principle of clarity and reliability, the continuity principle and how the balance sheet shall be set up.

The directive offers a variety of choice concerning the annual accounts but has nevertheless probably been the most important directive when concerning the harmonisation of EC company provisions\textsuperscript{295}. The “importance of the law on accounts”\textsuperscript{296} must not be underestimated.\textsuperscript{297} A harmonisation of the annual accounts is important for every company; it is hampering if the law is too dissimilar between MS when the company is exercising its freedom of establishment. The harmonisation of law concerning annual accounts is also for the benefit of shareholders and creditors since the information provided with in the annual accounts is widely accessible to them.\textsuperscript{298}


\textsuperscript{294} Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies.

\textsuperscript{295} Werlauff, \textit{EU Company Law, Common business law of 28 states}, p. 84.

\textsuperscript{296} Werlauff, \textit{EU Company Law, Common business law of 28 states}, p. 84.

\textsuperscript{297} Werlauff, \textit{EU Company Law, Common business law of 28 states}, p. 84.

\textsuperscript{298} Werlauff, \textit{EU Company Law, Common business law of 28 states}, p. 84.
5.3.5 The 6th Company Law Directive

The 6th Company Law Directive\(^{299}\) is not mandatory for MSs to follow. The directive concerns public limited liability companies. In the preamble of the directive it is stated that MSs’ regulations concerning the division of companies needs to be harmonised, depending on if the MS’s regulation allows divisions of companies or not.

If a MS chose to allow divisions of companies as described in article 1 of the directive, the divisions must be made in accordance with the articles of the directive. The purpose of the directive is to protect the interest of company members and others through prescribing proper disclosure of information.

5.3.6 The 7th Company Law Directive

The 7th Company Law Directive\(^{300}\) concerns the annual accounts between a parent company and its subsidiaries. The directive is applicable to both private and public companies and the purpose with the directive is making sure that sufficient information concerning the financial situation of a company-group is provided with.

According to article 1, a MS shall require consolidated accounts of the company and its subsidiaries. According to article 26 the consolidated accounts shall show “the assets, liabilities, financial positions and profits or losses”\(^{301}\) as if the information concerned one single undertaking.

The directive does not concern substantive group matters and the matter of liability is not dealt with either. Even if the group’s accounts are presented as being one single entity, it does not mean that the parent is liable for the subsidiary’s debts; this matter will instead be decided by national law.\(^{302}\) The European Parliament and Council have issued a regulation concerning the application of international accounting standards\(^{303}\). According to article 4 consolidated accounts of publicly traded companies shall be in accordance with international accounting standards adopted by the EC, the 7th Company Law Directive does therefore not concern public companies.

5.3.7 The 10th Company Law Directive

The 10th Company Law Directive\(^{304}\) concerns cross-border mergers between limited liability companies; the directive is examined more thoroughly in chapter 4.5.2.

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\(^{299}\) Sixth Council Directive 82/891/EEC of 17 December 1982 based on Article 54 (3) (g) of the Treaty, concerning the division of public limited liability companies.


\(^{302}\) Werlauff, EU Company Law, Common business law of 28 states, p. 888.


\(^{304}\) Directive 2005/56/EC.
The 10th Company Law Directive states some requirements which the merging companies must comply with. Article 5 prescribes the common draft of the merger and that the draft must contain information such as the names, company forms and registered office of the involved companies. Some information that needs to be disclosed can for example be: likely repercussions on employment, the date of which the companies in question shall convert their accountings to the new company, and the statutes of the company resulting from the cross-border merger. The draft must be published in accordance with the law of the MS for each company involved.

5.3.8 The 11th Company Law Directive

The 11th Company Law Directive regulates the disclosure of vital information concerning a branch under a company from another MS. The directive imposes a more “technical implementation” of the freedom of establishment. According to article 43 ECT a person can pursue economic activity in a MS through a secondary establishment such as a branch, agency or subsidiary. The lack of EC regulations concerning branches does decrease the protection of company members and others since they are not provided with the same information such as if the secondary establishment was a subsidiary. Furthermore there is a risk that differences in national legislation concerning branches affect the freedom of establishment. There was therefore a need for EC regulations concerning branches. The purpose with the directive is to achieve the same requirements of disclosure of information regardless of whether the company exercises the freedom of establishment through a subsidiary or a branch. The other directives examined in this chapter concerns the exercising of the freedom of establishment through a subsidiary and not through a branch.

Article 2 states some information which must be disclosed, for example the branch’s address, activities, the name and legal form of the company if the name of the branch is different from the name of the company. According to article 1, the information is to be disclosed in accordance with the law of the state in which the branch is situated. The directive concerns branches under companies which are defined in the 1st Company Law Directive.

5.3.9 The 12th Company Law Directive

The 12th Company Law Directive enables the one-member limited liability company. This can be done by either allowing one member business with limited liability or, preferably, to allow the one-member private company. According to article 6, the directive is applicable to both private and public limited liability companies.

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Article 2 states that the single-member company can either be formed as such or that all shares of a company can become to be held by a single person. The directive “became necessary” because several MS did not recognise the single-member limited liability company as a legal person. The company’s statutes were ignored and the owner of the single-member company was fully liable for the company’s liabilities.

According to article 3, information of when a company becomes a single member company and of the identity of the owner shall be registered in accordance with the 1st Company Law Directive. The single owner shall according to article 4 exercise the powers of the general meeting and the decisions made at such a meeting must be recorded in minutes or drawn up in writing. Article 5 prescribes that a contract between the company and the owner must also be drawn up in writing, for evidence reasons.

5.3.10 The 13th Company Law Directive

The 13th Company Law Directive concerns takeover bids of company shares. The directive provides some protection of shareholders when trading with shares in listed companies. In the preamble to the directive it is stated that the protection of shareholders is important when the company in question is subject to a takeover or some other change of control.

The directive concerns, according to article 1 (1), companies which shares are possible to trade in a regulated market, hence the directive concerns only listed companies. Article 3 states some general principles such as equal treatment of shareholders and the board of the offeree must act in the interest of the whole company. The offeror must also provide the shareholders with necessary information and sufficient time to be able to make a sound decision. According to article 4, each MS must designate a competent authority to secure the following of the regulation in the directive.

Article 5 states that if a person, legal or real, as a result after acquisitions receives control over a company must make a bid to take over the shares of the minority-shareholders, the purpose being the protection of the minority-shareholders. The bid must be addressed to all shareholders concerning their entire holdings and the price must be at an equitable price, the price is defined in paragraph 4 of article 5. The payment of the shares can be offered in cash or securities or a combination of both. Article 6 concerns the publication of the offer as such. The publication must be done “without delay” and the article prescribes information which must be publicised such as the terms of the offer, the identity of the offeror and the time allowed for the acceptance of the bid.

310 Werlauff, EU Company Law, Common business law of 28 states, p. 91.
311 Werlauff, EU Company Law, Common business law of 28 states, p. 91.
312 Werlauff, EU Company Law, Common business law of 28 states, p. 91.
5.3.11 The proposal for a 14th Company law directive

The proposal for a 14th Company Law Directive concerns the transfer of a company’s registered office between MS. The directive is examined in chapter 4.5.3. The proposals prescribes that the company must comply with the law of the new state and also disclose the general meetings decision of the transfer along with the consequences of the transfer, unfortunately the proposal does not specify which consequences this could be.\(^\text{316}\)

5.3.12 The directive concerning the admission of shares

The directive\(^\text{317}\) concerns information which must be provided with when shares are admitted to be traded with on a stock exchange. According to the preamble of the directive, the purpose with the directive is to coordinate the admission of shares in the EC for the protection of investors. The coordination will also provide possibilities to facilitate a cross-border admission of shares.\(^\text{318}\) An admission of a company’s shares must be “conditional upon an information sheet”\(^\text{319}\), the information sheet must according to article 21 contain enough information for investors and investors advisors to make informed assessments of for example the company’s assets, liabilities and financial position. Article 23 does however provide MSs with a number of possibilities to exempt the publication of information under certain conditions.

5.3.13 The directive concerning shareholders’ voting rights

The EC has found a need for some shareholder protection in listed companies and has issued a directive\(^\text{320}\) concerning the shareholders’ voting rights. In the preamble of the directive it is stated that it is vital that shareholders can use their rights to vote and that the problems arising from cross-border voting must be dealt with. Furthermore that effective shareholder control is vital for sound corporate governance. EC provisions prior to the directive did not provide sufficient means for those matters.

Article 1 state the purpose with the directive, to establish requirements relating to shareholders rights connected with voting shares, shares which are admitted to trading on a regulated market. Article 4 states that the company must ensure equal treatment for all shareholders. Article 5 concerns information prior to the general meeting. Some examples are when the convocation to the meeting must be issued and what the convocation must include. Article 6 states shareholders rights to put items up on the general meeting’s agenda and article 9 gives the shareholders a right to ask questions on the general meeting. The directive also grants a right to participate on the general meeting by electronic means in article 8. Proxy voting and voting through correspondence is also granted according to the articles 10 and 12.

\(^{316}\) Public consultation relating to the outline of the planned proposal for a 14th Company Law Directive, p. 4.


\(^{318}\) Directive 2001/34/EC, para, 2.

\(^{319}\) Directive 2001/34/EC, art. 20.

5.4 The 2003 Action Plan and beyond - Recent and Future Development of European Company law.

There are two “Key Policy Objectives” identified within the 2003 Action Plan. The first objective is that of “[s]trengthening shareholders rights and third parties protection” and the second is that of “[f]ostering efficiency and competitiveness of business.”

Initially in the Action Plan the commission acknowledges certain initiatives that need to be taken at EC level to achieve these policy objectives. These initiatives includes “[d]istinguishing the actions in three phases (short term, medium term, long term),” that expert consultations should be an integral part of the development of company law at EC level and that an European Corporate Governance forum should be established. Also, on the major initiatives in the Action Plan, an open public consultation should be organised.

In the Action Plan it is said that “[a] self-regulatory market approach, based solely on non-binding recommendations, is clearly not always sufficient to guarantee the adoption of sound corporate governance practices.” Instead “a common approach should be adopted at EU level with respect to a few essential rules and adequate coordination of corporate governance codes should be ensured.”

The commission says that in regard to ensuring that European companies have the possibility to “reap the benefits from the unified internal market” “A proper distinction should be made between categories of companies. A more stringent framework is desirable for listed companies and companies which have publicly raised capital” but in regard to SME’s “a more flexible framework” should be allowed. In the Action Plan it is also said that “efficient protection of members and third parties will be even more important in the future, in view of the increasing mobility of companies” and that “effective and proportionate protection of shareholders and third parties must be at the core of any company law policy.”

In dealing with the issue of shareholder protection, the Action Plan focuses much on shareholders in listed companies. One part of the shareholder protection issue is to ensure access to relevant information about shareholder meetings through electronic means to the shareholders in listed companies. Another part of the issue that is identified is the “need

for enhancing the exercise of a series of shareholders’ rights in listed companies (right to ask questions, to table resolutions, to vote in absentia, to participate in general meetings via electronic means)\textsuperscript{333}. Yet another part identified in the Action Plan in regard to the same issue is that of ensuring shareholders’ knowledge of what their existing rights are as well as ensuring both that they know how to exercise them and that the rights effectively can be exercised. Also the issue of “proportionality between capital and control”\textsuperscript{334}, or in other words the ‘one vote one share’- principle, is mentioned as a way of creating a real shareholder democracy in the EC and a study is suggested in the medium to long term.\textsuperscript{335} In the Action Plan it is concluded in regard to this key policy that it is important to combat fraud in order to ensure the protection of the shareholders and the third parties.\textsuperscript{336}

In the Action Plan it is said that as the business across national borders, within the Union, increases there has been “repeatedly called for the adoption of legal instruments capable of meeting their needs for mergers between companies from different MSs and for transfer of their seat from one MS to another”\textsuperscript{337}. The Commission also said that it “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 MS to another”\textsuperscript{338}. See chapters 4.5.2 and 4.5.3 concerning the 10\textsuperscript{th} Company law Directive and the proposal for a 14\textsuperscript{th} company law directive.

Another issue mentioned in the Action Plan is that of capital maintenance and alteration stemming from the Second company law directive. Some suggestions were made in the Action Plan, suggesting that the second company law directive\textsuperscript{339} could be simplified.\textsuperscript{340} And further more an “alternative regime”\textsuperscript{341} was suggested, “which would not be based on the concept of legal capital”.\textsuperscript{342} The Commission, in the 2003 Action Plan, considers that there was a need for further work and that a feasibility study should be launched in order to find the exact benefits that a new regime would bring with in comparison to the second company law directive. The Commission also argued that there was a need to figure out what the characteristics of this eventual new regime are and how it can strengthen the protection of shareholders and third parties.\textsuperscript{343}

\textsuperscript{337} COM(2003) 284 final, p. 20.
\textsuperscript{338} COM(2003) 284 final, p. 20.
\textsuperscript{339} Second Council Directive 77/91/EEC.
\textsuperscript{341} COM(2003) 284 final, p. 18.
\textsuperscript{342} COM(2003) 284 final, p. 18.
In 2007 Theodor Baums wrote an article on the issue of European Company Law Beyond the 2003 Action Plan in which he discusses the future of the European company law and in which ways the present Commission seems willing to continue the development set out in the 2003 Action Plan. The Commission wishes to simplify the existing rules and the first, third, sixth and eleventh company law directive are specifically listed.

In regard to the issue shareholders’ rights it is said that the Commission has proposed for a Shareholders’ rights directive. However as of June 2007 the Shareholders’ rights directive has been adopted, see chapter 5.3.13. Concerning the issue of one share, one vote a study has been carried out and has resulted in an Impact assessment.

The second company law directive, dealing with capital requirements, was been amended 6 September 2006 and this amendment liberalises some of the previous requirements although the sell out and squeeze out rules that were suggested in the 2003 Action Plan were left out in the amendment.

In regards to the issue of protection for creditors the commission has initiated a survey in order to look at the feasibility of an alternative system of protection for creditors, perhaps similar to that used in the USA. The study was awarded to KPMG Deutsche Treuhand-Gesellschaft AG.

A re-evaluation of the Action Plan has been done during the 2005 – 2006 by the Commission. The Commission initiated a public consultation procedure and a report has been prepared as a result of the public consultation. The report gives an outline to the future company law agenda of the commission. In the executive summary of that report it is said that the respondents generally supported the work done since 2003 but the opinion was split in regard to the “measures suggested for the medium and long term.” A number of respondents called for a stabilisation period but also said that this “moratorium

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348 Directive 2007/36/EC.


should not cover ‘enabling legislation’, such as the directive on the transfer of registered office or the Statute for a European Private Company. See chapter 4.5.3 on the 14th company law directive. Regarding rights of shareholders there was a “slight majority of respondents that saw some added value in the EU initiatives… whilst those opposing such measures considered the existing protection sufficient on both national and EC level.

No new Action Plan is coming as it is argued that this ensures more flexibility on the one hand, but it does also “affects the public’s ability to understand and evaluate the Commissions’ future plan”.

5.5 National responses – Member States adapting to other Member States

There seems to be two aspects of the Delaware effect that can be considered necessary in order to identify the possibility of a EC Delaware effect. The first is that of the “tendency of entrepreneurs to incorporate in a jurisdiction that offers them a better deal than the one in which they intend to do business. The second is the tendency for states to lower standards or adopt other measures to make their jurisdiction attractive to incorporators”.

In the EC it is evident that some entrepreneurs have sought to make use of the differences between MSs to attain the most favourable law to apply to them and their companies. This is shown in some case law from the ECJ, such as the Centros, Seagers, and the Daily Mail case. These cases are not isolated events however as according to Drury has been shown by a Dutch survey. The survey shows that some “4000 essentially Dutch businesses had chosen to incorporate in England.”

Some national responses to this development has occurred, such as the French Société par Actions Simplifiée (SAS) that came to be in order to avert French companies from using the Dutch company form Naamlose Vennootschap which “provide a more flexible and accommodating vehicle for their joint ventures.” The French government also abolished the need for minimum capital for the société à responsabilité limitée (SARL) in order to match the United Kingdom’s offer of incorporation without any need for minimum paid-up capital. This shows that there is a real interest from entrepreneurs to find the best suited legislation but also an interest from MSs to create legislation suitable to maintain companies in that MS.

However, as the MSs are part of the harmonisation programme and also subject to other political and economic limits in regard to the legislative measures they can take, it is sug-

357 Directorate General for Internal Market and Services, Summary Report, p. 2.
358 Directorate General for Internal Market and Services, Summary Report, p. 2.
361 Case C-212/97, Centros.
gested that there is no real practical way to travel down a path similar to that of Delaware by lowering company law standards, to any great extent. However there might be some defensive behaviour on the part of the MSs as they seek to keep the companies present within the MS. 366

The state adaptation concerning company has been noticed by the Swedish legislator. The Swedish Justice department issued a memorandum 367 concerning the need for a new limited liability company form in 2006 and in September 2007 a proposal 368 for legislation for a new company form with limited liability was issued. The authors of the memo recognise that there is a tendency for a new company form with little or none minimum paid-up capital within the EC. In the proposal however the minimum paid-up capital is still recognised as important and the Swedish legislator is not, as it seems, at present time ready to completely remove the minimum paid-up capital in the Swedish limited liability company. 369

5.6 Conclusion

A series of company law directives has been issued in an attempt to provide with similar rules throughout the EC. The purpose of the directives has concerned the upholding of the freedom of establishment as well as the protection of company members and others.

The development of company law within the EC has to a large extent been focused on disclosure in one way or another and this is seemingly not about to change. The development till this day is easily shown by the different company law directives. When studying the directives the importance of information is easily identified. Information is used as means to ensure protection of shareholders and others as they, with suitable information can make sound decisions. The EC is also focused on averting abuse of the possibility that stems from the freedom of establishment.

The 2003 Action Plan shows some of the ongoing development on modernisation of company law within the EC. And although there is no outspoken goal in the 2003 Action Plan to prevent competition between states one of the key policy objectives is to protect shareholders; an issue closely related to the development of the Delaware effect in the USA.

In regard to the further development of company law a stabilisation period has been called for with two exceptions: the proposal for a 14th Company Law Directive (transfer of registered office) and the statutes for a European private company. It seems, in the companies’ point of view, that the freedom of establishment is one of the most important issues for harmonisation. It is interesting to note that the Commission is not presenting a new updated Action Plan. Because of this, the priorities of the Commission regarding company law are difficult to identify.

The MSs does not seem avert to adapt their legislation to match the offer from other states concerning for example minimum paid-up capital. However the fact that MSs change their legislation cannot be viewed as undisputable evidence that they are seeking to compete for companies. Changes in legislation can occur for a number of reasons without having as its purpose to attract companies. There can for example be political reasons or social impera-

367 Ju 2006/8869/L1, Behovet av en ny bolagsform, 2006-11-01.
itives that effect the legislation. If that was not the case all legislation would be derived from the reason of competition. Also the behavior of matching the legislation of other MS in order to avoid losing companies to them is not a competitive behavior but rather a defensive one. For a MS to actually be competing it would have to go beyond matching other MSs’ legislation and instead surpass them by creating company law even more favorable than that of the other MSs.
6 Views from reality

6.1 Interviews concerning choice of permanent establishment

6.1.1 Introduction

Since the topic of this paper is a possible Delaware effect and persons possibilities to establish companies in other MSs, it can be of interest to examine if Swedish persons actually do establish a company abroad and later pursue economic activity through a secondary establishment in Sweden. This chapter will provide with a brief overview of the usage of such arrangements, in particular with a branch under a foreign company. It has been suggested that the England is a strong proponent for the role of the EC Delaware, much due to the lack of requirement of minimum paid-up capital and has a well functioning and widely accepted corporate law. Estonia has also been mentioned as having legislation which attracts companies. When examining if Swedish companies uses the arrangement, one must consider how many companies there are in Sweden. In the beginning of this millennia, there were 271 000 limited liability companies of which 1 000 are considered large.

We have contacted the Bolagsverket (Swedish Company Registration Office) and two consultants which work with guidance concerning establishments abroad to seek their opinions concerning the matter.

6.1.2 General

Article 43 ECT states that a person can pursue economic activity in another MS through a secondary establishment and that this can be done through subsidiaries, agencies and branches. If a secondary establishment in Sweden is a subsidiary, the subsidiary must be established in accordance with Swedish company law. If the subsidiary is a limited liability company it must comply with the Swedish Companies Act (ABL) and its requirement of a minimum paid-up capital of 100 000 SEK in 1:5 ABL. A branch in Sweden is however not governed by the same regulation as the limited liability company and is not required to have a minimum paid-up capital. The branch is therefore the natural choice if the purpose of the arrangement is to circumvent the capital requirement in the ABL. Hence the subsidiary will not be examined any further.

If the secondary establishment is a branch, the branch in itself is not a legal person but instead a part of the foreign company. If a foreign company chooses the branch as secondary establishment, the branch must be registered with the Bolagsverket in accordance with the Swedish Branch Act. There are some requirements when registering a branch in Sweden; the branch must have an administrator with authorisation from the company abroad and

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373 The Swedish Branch Act, Lag (1992:160) om utländska filialer m.m.
374 The Swedish Branch Act, Lag (1992:160) om utländska filialer m.m, § 2.
there must be a book-keeping of the branch separated from the company. The name of the Swedish branch must include the term of the foreign company form such as BV, Ltd or GmbH and the nationality of the company must be disclosed.

### 6.1.3 The questions

When interviewing the consultants and Bolagsverket we have prepared a set of questions. The questions are made to give a wide overview rather than a providing with a thorough investigation. The questions asked were:

1. Is it common that Swedish companies chose to establish the primary establishment abroad for the purpose of thereafter establish a secondary establishment in Sweden?
2. If so, which countries do Swedish persons chose?
3. Are there any particular reasons for the arrangement with a foreign primary establishment?
4. Are there problems with the arrangement?
5. Are there any MSs who try to make them attractable to establish companies in, such as Delaware in the U.S?
6. What does the future hold; will the arrangement of establishing companies abroad to later establish a secondary establishment in Sweden increase or decrease?

### 6.2 Interview with the Swedish Company Registration Office

According to Susanne Thungren at Bolagsverket, one of the requirements when a foreign company applies for a registration of a branch in Sweden is that the company is a legal person in itself in its home state, if not the registration will not pass. It is not for Bolagsverket to examine for example owner and capital structure of the foreign company. However, when starting up a branch in Sweden the foreign company has to enclose certain documents to the application, such as certificate of registration, certificate of non-bankruptcy, articles of association and annual accounts for the foreign company. The assignment of the managing director of the branch, and for the deputy managing director and the person authorised to receive service of process if such has been assigned, also has to be certified with power of attorneys that has been sign in the original by persons authorised to do so on behalf of the foreign company.

The number of branches in Sweden under foreign companies has increased since Sweden joined the EC in 1995. In 1995 there were 317 branches under foreign companies and in May 2007 the number had reached 1416 branches.

According to Bolagsverket, England is by far the most common country when concerning Swedish nationals who establishes companies abroad to circumvent Swedish law. There are examples of other countries, but they are not as common as England at present time. The Baltic countries is said to attract companies but Bolagsverket has not seen a significant in-

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375 The Swedish Branch Act, Lag (1992:160) om utländska filialer m.m, § 11.

376 The Swedish Branch Act, Lag (1992:160) om utländska filialer m.m, § 5.
crease of branches, Estonian companies have registered seven branches during 2006-2007, compared with one branch in 1995 and none in the years between.

The most common misunderstanding when nationals had contacted Bolagsverket is that the branch is a Swedish limited liability company, the applicants believe that they can use the company-term for a Swedish limited liability company, AB (Aktiebolag). When Bolagsverket inform that the branches cannot use the term AB, the applicants often withdraw their applications.

Bolagsverket finds it difficult to say if the arrangement of a branch under a foreign company will increase. The increase of Baltic companies can be explained by other reasons than the circumventing of Swedish law such as business reasons and the fact that the Baltic countries also have joined the EC.

6.3 Interviews with consultants

6.3.1 Lindebergs Grant Thornton

6.3.1.1 The company

Lindebergs Grant Thornton is an audit and consultant firm with focus on owner controlled companies which offer services in auditing, tax issues and corporate finance. Lindebergs is a part of Grant Thornton, a world-wide network with offices in 110 countries. The Swedish company has 32 offices in Sweden with the main office located in Stockholm. Grant Thornton publishes an annual rapport in which trends and attitudes in companies worldwide are measured and analysed. When interviewing Lindebergs we have spoken to Tord Fredriksson, International Tax Partner.

6.3.1.2 The interview

According to Lindebergs, it is not especially common that Swedish persons seek primary establishments abroad; a reason for this can be that at the time, the possibility to do so is not so well known. The opinion of Lindebergs is however that it will probably be more common in the future. At present time it is the United Kingdom which is by far the most common MS to seek a primary establishment in. Advantages in the British legislation which attract the companies are, according to Lindebergs, that England does not require a minimum paid-up capital and that there are less stringent rules concerning auditing in the British limited liability company, the Ltd, than in the Swedish AB.

There are however problems with an establishment in the United Kingdom. Examples of problems are that the auditing in Sweden must be converted to British standards. Lindebergs mentions also that the Swedish rules concerning depreciation is quite dissimilar from the British rules. Tax reasons are another disadvantage with an establishment abroad, the fact that a company is registered in the United Kingdom does not automatically mean that the branch is taxed in the United Kingdom. According to Tord Fredriksson, those issues are probably not mentioned by companies who offer ready-made companies as a solution of establishing its own company in Britain.
6.3.2 SET Revision

6.3.2.1 The company

SET revision (SET) is an accounting firm with expertise in accounting, financing and taxes. The company has a broad spectrum of clients, from SMEs to multinational companies. The firm edits a newsletter with information for companies, the NEWSET, which distributes information concerning the topics of the firm’s expertise. When interviewing SET we have spoken to Christer Andersson, consultant.

6.3.2.2 The interview

According to SET, the arrangement of pursuing economic activity through a branch under a company from abroad is not commonly used in Sweden. The few companies who use the arrangement do it for the purpose of circumventing the minimum paid-up capital in the ABL. Christer Andersson’s opinion is that the reason why the arrangement is uncommon is that the arrangement is quite complicated, the arrangement requires for example bookkeeping in two legal systems. If the requirement of bookkeeping in accordance with British law is not fulfilled, the legal person in Britain will dissolve and the Swedish owner will instead have a private firm will full liability in Sweden. Furthermore, if the company is situated in Britain, the branch is liable for taxation in Sweden, but nevertheless the persons owning the company and branch exposes themselves to two different tax systems with the consequences it has.

Every MS in the EC tries to attract companies in some way; examples can be found in company law and tax law. Examples of states who are trying to attract companies are Luxembourg which has flexible rules concerning holding companies and Ireland with low taxes for companies.

6.4 Conclusion

This chapter’s purpose was to examine the degree of which Swedish persons establishes companies in another MS to thereafter pursue economic activity in Sweden through a secondary establishment, in particular a branch. The major reason for the arrangement in a Swedish context, disregarding tax purposes, is to circumvent the requirement of a minimum paid-up capital in the ABL. The benefits of the circumvention are to some extent overridden by the consequences of the arrangement such as for example the need of bookkeeping in accordance with two legal systems; even though the branch is liable for taxes in only one state, the arrangement is scrutinised by the tax authorities in both states. The arrangement in itself can be more complex than the benefits the arrangement provides. According to Bolagsverket there are 1416 branches under foreign companies, but the question is if that can be considered as a problem when there are approximately 271 000 limited liability companies in Sweden. Also worth noting is that some of the branches are probably under foreign companies owned and run from the state of incorporation and as such has nothing to do with a competition between MSs.

7 Conclusion

7.1 What is then the Delaware effect?

The undeniable aspect of the Delaware effect is the development of company law that has occurred in Delaware and that has resulted in Delaware attracting a great number of companies from other states. It has been a development of company law towards less protection of shareholders and more power to the management. This has been done as the management is better suited to manage the company than the shareholders are. This development comes from the corporation statutes in Delaware and is ensured to great extent by the courts of Delaware and maintained through their vast amount of case law. There has however possibly been a change towards a more shareholder friendly legislation compared to other state, during the 1990s.

Other aspects of the Delaware effect, such as if it is positive or not, and if there is a competition at all, are both quite inconclusive. It is however hard to dismiss the development as entirely detrimental to the shareholders as Delaware has been so successful in attracting companies and even though the empirical studies are inconclusive none of them indicate a lower value of companies in Delaware. The lack of efforts from other states and the widespread use of the Model Business Corporation act indicate that there is very little competition from other states. There is simply a lack of incentives for states to engage in competition with Delaware.

7.2 Will there be a Delaware effect within the European Community?

The issue of the possibility of a Delaware effect within the EC is twofold. One aspect is that founders of companies and already incorporated companies must have the possibility and willingness to actively choose the MS to be incorporated in, otherwise no competition can occur.

When incorporating a new company, the state with the most advantageous legal system can be chosen, by the founder, for the primary establishment. The arrangement of having a branch under a foreign company is however not without complications which lessen the interest for this type of arrangement; this has been confirmed by advisors. One example is if a British company has a branch in Sweden it must have bookkeeping in compliance with both Swedish and British law. Another example mentioned is that the Swedish branch cannot use the Swedish abbreviation AB, which is for Swedish limited liability companies only to use.

In regard to reincorporation, EC provisions do not grant rights for companies to move their primary establishment but instead they have to do so in compliance with national law of both the states involved. For example the company might suffer the risk of being forced to wind-up in the home state which is hugely interfering as the company ceases to exist. This is greatly hampering the possibility for a Delaware effect within the EC.

Whether it is incorporation or reincorporation, the company must weigh the benefits of the new legal system with the consequences connected with the law of the home state and with the move. With every risk and complication connected to the move the willingness of the company to move is reduced. EC harmonisations such as the 10th Company Law Directive
and the statutes for the SE-company have increased the possibility to move companies, but much still needs to be done in order fully facilitate the freedom of establishment. This is especially important for SMEs as they more commonly than LSEs lack the financial means to handle the costs that can be attributed to the move. The postponement of the 14th company law directive will further prevent a Delaware effect to occur as reincorporation will not be possible until then and by that already existing companies lack effective means to change state of incorporation. It has been said that SMEs will gain more from a new company-form, adapted to suit the SME, instead of the 14th Company Law Directive. It is to be seen if such company form will be presented and if it will solve the problems of moving the SME.

The other aspect is whether or not the MSs will try to attract companies and if they can do so, due to harmonisation within the EC. The EC has harmonised several areas of company law, especially in regard to protection of shareholders and others. The directives regulate some vital information which must be disclosed for the protection of shareholders and others, which in turn provides them with means to make sound decisions. The harmonisation through company law directives mitigates the differences between MSs thus both lessening the possibility for MSs to create more favourable legislation as well as it mitigates the incitements for companies to seek other legislations as it is within the differences between the MSs that the eventual benefits can be found. One example of such differences is the requirement of minimum paid-up capital in limited liability companies which today seemingly makes for the most common reason for Swedish entrepreneurs to set up the primary establishment in another MS and have a branch in Sweden.

However the harmonisation within the EC does not prevent MSs from changing much of their company law. For example MSs have been changing their company law to match other MS’s in regard to the minimum paid-up capital. This is not evidence of competition in itself as MSs can change their legislation for a number of reasons. One reason might be that the minimum paid-up capital rules are unnecessarily complex and perhaps unnecessary altogether. This corresponds to the liberalisation of the 2nd Company Law Directive that was carried out in 2006; there is also the study concerning an alternative system for creditor protection not based on legal capital. As seen from the discussion on the development in the USA political entry barriers might also provide with even further hampering effects on MSs’ efforts to engage in competition for company law. Also as the EC continues with its harmonisations the possibilities for MSs to challenge each other is further hampered.

The Commission has through its Action Plan and related developments shown that continued harmonisation and increased availability for companies to utilise the freedom of establishment is at the core of the EC company law. But also that protection of shareholders, through information exchange, and rules preventing abuse of the freedom of establishment is vital for EC company law. This development, through directives, differs from the American development as their development is carried out on state level and that there is distrust against federal law.

The fact that neither Canada nor Australia, both federal systems where the “place incorporation rule prevails”, have witnessed a race to the bottom the inevitability of Delaware effect within the EC is further diminished.

All this adds to that it is not likely that a similar development, as that seen in the USA, will occur within the European Community in the near future. However it is possible that future development of the freedom of establishment might lead to some competition for company law. This idea has been confirmed by legal advisors that as the companies’ awareness of the freedom of establishment and its benefits increase so will the number of companies that utilises the freedom of establishment. Further harmonisations, such as the 14th Company Law Directive, will remove some of the obstacles still hampering the usage of the freedom of establishment.

As a final note concerning the possibility of a EC Delaware, it is our opinion that MSs inevitably change their legislation in ways suitable to their preconditions. This leads to a variety of company laws amongst the MSs in which companies will find legislation most suitable to their needs. Because of this diversity of laws and needs, it is difficult to see that one MS will emerge as having company law which is most suitable to every company and by that make the MS as successful as Delaware.
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