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Freedom of establishment in EU Law with special respect to Hungarian Law and Croatian Law

I. Introduction

Freedom of establishment is in the center of attention of legal profession in EU since the ECJ judgement in Centros case. EU law rule, according to which, undertakings from one member state can perform their business activities in another member state, opened number of dilemmas, to which, EU law until nowadays didn't give proper answer.

The aim of the rules on freedom of establishment was to enable and to pursue mobility of undertakings on the internal market in the same way as it is regulated for natural persons.

But, in short time it became obvious that freedom of establishment for undertakings on EU level will be hard to achieve in practice. The reason for that are national company law rules which are often protective for domestic undertakings and hostile towards foreign undertakings. Besides that, company law rules among Member States still significantly differ, despite undertaken measures of harmonization. There are other problems too, such as tax law issues, application of laws governing companies (lex societatis), labour law provisions etc.

In this paper, authors are analysing EU rules on freedom of establishment in light of ECJ case law. Also, different implications of those rules on Croatian and Hungarian law are discussed.

II. Freedom of establishment in EU Treaty- defining the problem

Legal regulation of freedom of establishment on EU level started in 1957. with signing The Treaty of Rome¹. Article 52. of The Treaty of Rome, as legal predecessor of current article 49. of The Treaty on the Functioning of European Union², envisaged gradual abolition of national Member States rules which prohibited freedom of establishment for nationals of different Member States. Article 58. of The Treaty of Rome prescribed equal legal treatment for domestic and foreign undertakings. And finally, article 220. of the Treaty, rather ambitiously, having in mind the time in which it was enacted, demands from Member States, recognition of legal personality to all undertakings established in any Member State³. These norms, which were later on renumerated, were the cornerstone for further harmonization of company law on EU level⁴. They were principal support to European Court

¹ The Treaty Establishing the European Community, Rome 25 March 1957 (available at: http://ec.europa.eu/economy_finance/emu_history/documents/treaties/rometreaty2.pdf)

² The Treaty on the Functioning of the European Union, OJ C 115/47, 9. 5. 2008. (available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:115:0047:0199:en:PDF>)

³ See Impact assessment on the Directive on the cross-border transfer of registered office, Commission Staff Working Document, Commission of the European Communities, Brussels, 12/ 2007, SEC (2007) 1707, pp. 8-9.

⁴ See more on that S.,Deakin, Regulatory Competition Versus Harmonization in European Company Law, ESRC Center for Business Research, University of Cambridge, Working Paper No. 163, March 2000, pp. 4-22.

of Justice (EJC), who, in time, developed interesting case law on freedom of establishment⁵. Based on ECJ case law and broad interpretation of mentioned rules, it is nowadays quite clear that freedom of establishment, primarily regulated by article 49. of the TFEU, covers following: 1/ freedom of establishing a company or branch office in any Member State, 2/ freedom to provide service in the foreign Member State under the same conditions as for nationals of particular Member State 3/ transfer of the corporate seat from one Member State to another, 4/ and corporate mergers and takeovers⁶.

From above is quite clear that the concept of «freedom of establishment» covers broad range of rights and it applies to different factual situations of companies «migrations».

So for example, freedom of establishment refers to the situation of establishment of a company or branch office on a territory of foreign Member State. But it also covers situations of primary and secondary establishment⁷. Primary establishment refers to possibility of an employee in one Member State working in self-employed capacity in another Member State. Secondary establishment includes a right to maintain more than one place of work within Community. Furthermore, freedom of establishment also covers the situation of companies migrations. This includes both companies immigration and emigration. Companies immigrations refers to situations when a company is changing its corporate seat from one Member State to another. Companies emigration refers to situation where company leaves the home country (emigrates) and moves its principal place of business to another country. And finally, concept of establishment also refers to the situations of cross border mergers. In this case, at least one of companies, participating in merger operations, changes its corporate seat and moves it from one Member state to another. Realization of above rights in business practice wasn't always an easy task. Main obstacle to freedom of establishment on EU level were, and still are, Member State company law rules, which are often protective towards domestic companies. This particularly refers to the situations of transfer of central management and change of corporate seat to another Member State. This problem, according to the opinion of most legal writers, its roots has in different legal regimes for law applicable on companies. In Europe there are two main approaches regulating *lex societatis* or law applicable for companies⁸, which are part of legal legacy.

⁵ Impact assessment on the Directive on the cross-border transfer of registered office, supra note 3, pp. 10-11; see also Guide to the Case Law on the ECJ on Articles 43 et seq. EC Treaty, Freedom of Establishment, European Commission 1/1/2001

⁶ See Report of the Reflection Group On the Future of EU Company Law, European Commission, Brussels, 5 April 2011; E., Wymeersch, The Transfer of the Company's Seat in European Company Law, Working Paper No. 08/2003, European Corporate Governance Institute; March, 2003.; F., Mucciarelli, Companies' Emigration and EC freedom of establishment, School of Economics, New York Law School, October 2007 (available at: SSRN: <http://ssrn.com/abstract=1078407>);

⁷ W.-G., Ringe, No Freedom of Emigration for Companies?, 16 *European Business Law Review*, 3 (2005) pp. 2—3.

⁸ See E., Wymeersch, The Transfer of the Company's Seat in European Company Law, Working Paper No. 08/2003, European Corporate Governance Institute; March, 2003.; A., Frada de Sousa, Company's Cross-border Transfer of Seat in the EU after Cartesio, Jean Monnet Working Paper 07/09, The Jean Monnet Center for International and Regional Economic Law & Justice, 2009; W.-G., Ringe, The European Company Statute in the

According to the first approach, law applicable to the companies is law of the country in which company is firstly established (so called **incorporation theory**). According to the second approach, law applicable to the companies is law of the country in which company has its principal place of business (so called **real seat theory**). In countries in which theory of incorporation is in force (for example UK or Netherland) companies are allowed to move its registered office to another Member State. Transfer of registered office has no legal consequences for future life of the company. It will be subordinated to legal order of the state in which company is incorporated. In countries where real seat theory is in force, transfer a corporate seat has multiple consequences for future life of a particular company. Basic presumption is that company which transfer its corporate seat to another country «changes its nationality». It becomes a company of another Member States. It will be subordinated to legal regime of the country to which it transferred its registered office. Real seat theory is in force in Germany and most other European countries which follow German legal tradition⁹. National company law rules of those countries either prohibit corporate migration or they don't regulate corporate migration at all. In both addressed cases we face with obstacles to freedom of establishment, because companies can't move freely from one jurisdiction to another. This brings companies from some Member States in less favourable position than companies from other Member States. The problem is recognized on EU level. European Commission along with ECJ used different legal instruments and measures to diminish and minimize discussed problem. But there is no clear-cut or simple solution. As things stand, the discussed problem is far from being solved. But still, Commission didn't give up. Harmonization through directives gave some results, what will be further discussed.

III. Freedom of establishment in secondary legislation- harmonization of Company Law by means of directives and regulations- success or failure?

Harmonization of Company Law in EU started relatively early. This is quite understandable if we know that establishing a single market was one of the main goals of EU integration. For establishing a single market it was of utmost importance to remove national barriers and obstacles to free trade on EU market.

First Company law Directive was enacted in March 1968¹⁰. Until nowadays, different fields and aspects of corporate law have been covered by harmonization, such as, corporate

Context of Freedom of Establishment, University of Oxford, Legal Research Paper Series, Paper No. 25/2008, 7 *Journal of Corporate Law Studies* 185, (2007).

⁹ See J., Schmidt, *The New Unternehmengesellschaft and the Limited – A Comparison*, 9 *German Law Journal*, 9. (2008); Kuehrer, Norbert, *Cross-border company establishment in the EU and Austria*, 12 *European Business Law Review* 116 (2001).

¹⁰ First Council Directive 68/151/EEC of 9 March 1968 on co-ordination of safeguards 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 (available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31968L0151:EN:NOT>)

governance, corporate takeovers and mergers, takeover law ect¹¹. Freedom of establishment and corporate mobility is one of the issues covered by harmonization. There are few Council and Commission documents worth mentioning in context of freedom of establishment. It is Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State¹², Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies¹³, and finally Proposal for a 14th Company Law Directive on the cross-border transfer of the registered office of limited companies¹⁴. There are two company law regulations which also have significant influence for discussed topic. It is Council Regulation (EEC) No 2137/85 of 25 July 1985 on the European Economic Interest Grouping (EEIG) and Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European Company (SE).

1. Eleventh Council Directive 89/666/EEC

Eleventh Council Directive was enacted in December 1989. Although it doesn't directly cover issue of companies migration, it is important in context of this paper since it deals with the establishment of branch offices. Doing business through branch office is one of typical ways of doing business abroad. So, elimination of restrictions for setting up branch offices in foreign countries is in direct connection with exercising the freedom of establishment. Before the Directive was enacted, there were significant differences in Member State laws concerning powers of representation of branch, name and other legal requirements for setting up a branch, disclosure requirements, financial reports, ect. All this was a serious burden for the undertakings with international business. It took lots of time and efforts to find out what are formal requirements and legal standards for establishing a branch office in a particular Member State. So what Directive aimed at is, to harmonize Member States laws concerning formal requirements for setting up and running up a branch office in any EU Member state. In that sense, 11th Directive cannot be considered as

¹¹ See on that K., Hopt, Modern Company Law problems: A European Perspective, Max Planck Institute, Hamburg, Germany, December 2000.; See also Report of the Reflection Group On the Future of EU Company Law, European Commission, Brussels, 5 April.

¹² Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State, OJ L 395., 30. 12. 2989.

¹³ Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border merger of limited liability companies OJ L 310, 25. 11. 2005.

¹⁴ In February 2004 the Commission launched an open consultation (that is to say, a consultation on the basis of an on-line, largely multiple choice questionnaire) on an outline of the planned proposal for a 'Directive on the right of limited companies to transfer their registered office from one Member State to another'. See IP/04/270 of 26 February 2004 (Company law: Commission consults on the cross border transfer of companies' registered offices). The outline was not laid down in a separate consultation document.

The outline was only published as an integrated part of the Commission's internal market website: http://ec.europa.eu/internal_market/index_en.htm. The consultation closed in April 2004. See IP/04/270. The results of the consultation have been published on the Commission's internal market website.

an ambitious document or project which will have major impact or significant influence on domestic legislation of EU Member States. It just tried to establish common standards and common rules for doing business through branch office on EU level.

2. Directive 2005/56/EC

Directive 2005/56/EC or Directive on cross border mergers is another piece of EU legislation regulating corporate migration. Creation of internal market encouraged cross border mergers and acquisitions. Since this area of law was mainly regulated on national level, it was important to enact document which will deal with the mergers with European dimension. In that sense, the main aim of Directive 2005/56/EC¹⁵ was to create conditions and facilitate mergers between companies from different EU Member States. Directive applies only to the merger of limited liability companies as the most represented company type in business practice. Other form of companies were not covered by the Directive.

As stressed in article 4. of the Directive, it regulates conditions relating to the cross-border merger¹⁶ in particular it regulates following: publication requirements, duties of management or administrative organs in case of cross-border merger, independent report of merger, approval of merger by the general assembly, pre-merger certificate, entry into the effects of the cross-border merger, consequences of the cross-border merger, employee participation and other relevant issues. Directive doesn't directly deal with the transfer of corporate seat, which is typical consequences of cross-border merger. But Directive comes to that effect indirectly. Regulating cross border merger it creates conditions change of corporate seat, in order to enforce a cross-border merger in practice.

3. Proposal for a 14th Company Law Directive on the cross-border transfer of the registered office of limited companies

The last, and in context of this paper, the most important Commission's document dealing with the corporate migration is Proposal for a 14th Company Law Directive on the cross-border transfer of the registered office of limited companies¹⁷. Enactment of this document, which until nowadays didn't enter into force, is surrounded with number of controversies¹⁸. Adoption of a Directive¹⁹ on cross-border transfer of the registered office of limited companies was part of the Commission's Action Plan on Modernising Company Law (2003).

¹⁵ More about directives: András Kecskés: Felelős társaságirányítás (Corporate Governance); HVG Orac, Lap- és Könyvkiadó KFT, Budapest, 2011. p.181

¹⁶ Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border merger of limited liability companies, Article 4.

¹⁷ See G.J.Vossestein, Transfer of the registered office The European Commission decision not to submit a proposal for a Directive, 4 *Utrecht Law Review* 1 (2008).

¹⁸ See Impact assessment on the Directive on the cross-border transfer of registered office, Commission Staff Working Document, Commission of the European Communities, Brussels, 12/ 2007., SEC (2007) 1707.; See also P., Vargova, The Cross -Border transfer of a Company's Registered Office within the EU, Central European University, March 29, 2010, pp.38-40.

¹⁹ More about directives: Vendel Halász-András Kecskés:Társaságok a tőzsdén; HVG Orac, Lap- és Könyvkiadó KFT, Budapest, 2011. p.74.

In implementation of this Action Plan, the Commission published an outline of the planned proposal (draft proposal). According to the draft proposal, a company transferring its registered office would be registered in the host Member State and would acquire a legal identity or legal personality there, while at the same time being removed from the register in its home Member State and giving up its legal identity (personality) there. If necessary, companies would have to adapt their structures and assets in order to meet the substantive and formal conditions required for registration in the host Member State. However, they would not be obliged to go through liquidation proceedings in their home Member State or to create a new company in the host Member State. The essence of the transfer of a company's registered office would be that the applicable company law changes. It should be noted that the Commission, in describing transfer of the registered office, regularly refers to the 'acquisition of a legal identity or legal personality' in the host Member State. This expression is not entirely accurate for the operation the Commission has in mind. In the case of transfer of the registered office – as envisaged by the Commission – the company in question ceases to be a company under the law of the home Member State and becomes a company under the law of the host Member State. During this operation, legal personality is retained; the assets and liabilities of the legal person, therefore, are not transferred in any way, but remain belonging to it. In other words, there is a change in nationality (of the legal form), not in the (identity of the) person as such.

As we can see from above, draft proposal of the Directive dealt with all the most problematic issues concerning transfer of corporate seat. Therefore it came as surprise, when in July 2007 Commission announced that it has decided not to proceed with the 14th Company Law Directive. This is remarkable in view of the fact that adoption of this Directive was a short term priority of the Commission Action Plan on Modernising Company Law. Commission explained his decision using following explanations. Firstly, it said that there is no economic arguments to pursue the idea of enacting separate legal document dealing with the transfer of registered office only. Secondly, Directive on Cross –Border Merger was enacted, so Commission concluded that companies can in cross –border transactions use possibilities offered by that directive. And finally Commission stressed that companies already have legal means to effectuate cross-border transfer, by the Statute for a European Company²⁰.

4. Statute for a European Company (SE)²¹ and European Economic Interest Grouping (EEIG)²²

Creation of, what is nowadays called as "European law"²³, was one of the major outcome of European integration. Statute for European Company and European Economic Interest

²⁰ Vossenstein, Gert-Jan, supra note 16. at pp.58-61.

²¹ Council regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE), OJ L 294/1, 10. 1. 2001. (SE)

²² Council regulation (EEC) No 2137/85 of 25 July 1985 on the European Economic Interest Grouping

Grouping belong to the group of codes which are considered to be genuine EU law²⁴. Both regulation enable the creation of originally European companies with the main purpose to contribute to the achievements of Community objectives such as creation of common market, free movement of goods and capital. Firstly in year 1985. European Council enacted a Regulation on the European Economic Interesting Grouping (EEIG). EEIG was at the time, new form of legal entity based on European law, created with the purpose to facilitate and encourage cross-border cooperation. Today most, if not all, Member States Company Law codes have incorporated rules on EEIG in it's national legislation. Since EEIG is in all Member States formed in accordance with the rules prescribed by Council Regulation, there is no significant difference between EEIG established in different Member State. EEIG must have at least two members from different Member States. The contract for the formation of an EEIG must include its name, its official address and objects, the name, registration number and place of registration, if any, of each member of the grouping and the duration of the grouping, except where this is indefinite. The contract must be filed at the registry designated by each Member State. Registration in this manner confers full legal capacity on the EEIG throughout the EU. When a grouping is formed or dissolved, a notice must be published in the Official Journal of the EU (C and S series). A grouping's official address must be within the EU. It may be transferred from one Member State to another subject to certain conditions. Each member of an EEIG has one vote, although the contract for its formation may give certain members more than one vote provided that no one member holds a majority of the votes. The Regulation also lists those decisions for which unanimity is required. The EEIG must have at least two organs: the members acting collectively and the manager or managers. The managers represent and bind the EEIG in its dealings with third parties even where their acts do not fall within the objects of the grouping. An EEIG may not invite investment by the public. An EEIG does not necessarily have to be formed with capital. Members are free to use alternative means of financing. The profits of an EEIG will be deemed to be the profits of its members and will be apportioned either according to the relevant clause in the contract or, failing such a clause, in equal shares. The profits or losses of an EEIG will be taxable only in the hands of its members. As a counterweight to the contractual freedom which is at the basis of the EEIG and the fact that members are not required to provide a minimum amount of capital, each member of the EEIG has unlimited joint and several liability for its debts.

²³ W., Weidenfeld, *Europe from A to Z: A Guide to European Integration*. Office for Official Publications of the European Communities, 1997.; W. Cairns, *Introduction to EU Law*, (Cavendish Publishing Ltd. 2002) pp. 71.

²⁴ J., McCahery, E., Vermeulen, Does the European Compan Prevent the Delaware Effect, 11 *European Law Journal*, 6 (2005) pp. 785-801.

Fifteen years later, in year 2001 a new form of company was introduced in EU law. Enactment of Statute for a European Company was again surrounded by number of controversies²⁵.

The European Company also known as "Societas Europea" came into force 30 years after the initial proposal was presented to the public. The first proposal failed to obtain the countries approval since it threatened the Member States lawmaking autonomy. So, it took until 1989. before the Commission published a new draft Statute in order to expedite its adoption. A report, produced by a group of experts outlined a compromise solution regarding labour participation, which was a major obstacle to enactment of Statute. The Council finally adopted the SE Statute in December 2000, and it entered into force in October 2004. In main outlines Statute for a European Company regulates following: company formation, minimum capital, registered office, law applicable, registration and liquidation, statute requirements, annual accounts, taxation and finally provisions on winding-up SE.

a) Company formation

Concerning company formation there is provision for four ways of forming a European Company: merger, formation of a holding company, formation of a joint subsidiary, or conversion of a public limited company previously formed under national law. Formation by merger is available only to public limited companies from different Member States. Formation of an SE holding company is available to public and private limited companies with their registered offices in different Member States or having subsidiaries or branches in Member States other than that of their registered office. Formation of a joint subsidiary is available under the same circumstances to any legal entities governed by public or private law²⁶.

b) Minimum capital

The SE must have a minimum capital of EUR 120 000. Where a Member State requires a larger capital for companies exercising certain types of activity, the same requirement will also apply to an SE with its registered office in that Member State²⁷.

c) Registered office

The registered office of the SE designated in the statutes must be the place where it has its central administration, that is to say its true centre of operations. The SE can easily transfer

²⁵ See on that W.G.Ringe, Wolf-Georg, The European Company Statute in the Context of Freedom of Establishment, University of Oxford, Legal Research Paper Series, Paper No. 25/2008, (2007) 7 *Journal of Corporate Law Studies* 185 (2008); W., Bratton, W., McCahery, E., Vermeulen, How Does Corporate Mobility Affects Lawmaking? A Comparative Analysis, European Corporate Governance Institute, Law Working Paper No. 91/2008, January 2008, (available in electronic version at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1086667)

²⁶ Statute for a European Company, Article 1 to 4, and articles 15 to 38.

²⁷ Statute for a European Company, Article 4.

its registered office within the Community without - as is the case at present - dissolving the company in one Member State in order to form a new one in another Member State²⁸.

d) Registration and liquidation

The registration and completion of the liquidation of an SE must be disclosed for information purposes in the Official Journal of the European Communities. Every SE must be registered in the State where it has its registered office, in a register designated by the law of that State²⁹.

e) Statutes

The Statutes of the SE must provide as governing bodies the general meeting of shareholders and either a management board and a supervisory board (two-tier system) or an administrative board (single-tier system). Under the two-tier system the SE is managed by a management board. The member or members of the management board have the power to represent the company in dealings with third parties and in legal proceedings. They are appointed and removed by the supervisory board. No person may be a member of both the management board and the supervisory board of the same company at the same time.

However, the supervisory board may appoint one of its members to exercise the functions of a member of the management board if a vacancy arises. During such a period the function of the person concerned as a member of the supervisory board shall be suspended. Under the single-tier system, the SE is managed by an administrative board. The member or members of the administrative board have the power to represent the company in dealings with third parties and in legal proceedings. The administrative board may delegate only the management to one or more of its members. Statute also regulates which operations require the authorisation of the supervisory board or the deliberation of the administrative board³⁰.

f) Annual accounts

The SE must draw up annual accounts comprising the balance sheet, the profit and loss account and the notes to the accounts, and an annual report giving a fair view of the company's business and of its position; consolidated accounts may also be required³¹.

g) Taxation

In tax matters, the SE is treated the same as any other multinational, i.e. it is subject to the tax regime of the national legislation applicable to the company and its subsidiaries. SE' are subject to taxes and charges in all Member States where their administrative centres are situated. Thus, their tax status is not totally satisfactory as there is still no adequate harmonisation at European level.

²⁸ Ibidem, Article 7.

²⁹ Ibidem, Article 12.

³⁰ Statute for a European company, Article 38 – 51.

³¹ Ibidem, Article 61-63

h) Winding-up

Winding-up, liquidation, insolvency and suspension of payments are in large measure to be governed by national law. An SE which transfers its registered office outside the Community must be wound up on application by any person concerned or any competent authority³².

IV. ECJ case law on freedom of establishment

In exploring the issue special attention must be given to European Court of Justice (ECJ) case law. ECJ has in a series of decisions established some principles of law in the context of freedom of establishment and the transfer of company's de facto office to other Member State.

The first such decision was brought in year 1986. in so called Segers case. It is later on followed by number of landmark decisions³³. Therefore, it is often argued that the ECJ had profound impact in developing Community history. It is seen as having undertaken the task of giving a «flash and substance» to an outline Treaty and as having developed a particular vision of the kind of Europe it sought to promote³⁴.

1. Segers³⁵

In the situation at stake, Mr. Segers, a Dutch national, had set up a private limited company in the UK, of which he was the sole shareholder and director. This company did not carry out any business activity in the UK, where it had its registered office, and all the business activity was carried on by a subsidiary established in the Netherland. The relevant Dutch authority had rejected Mr. Segers's application of a sickness insurance scheme which, according to Dutch legislation, was reserved to directors of companies established in the Netherland. Following the rejection by the court of first instance, who supported the arguments of relevant Dutch authority, Mr. Segers appealed to the Centrale Raad Van Beroep. Centrale Raad Van Beroep took the view that the Courts arguments had some force and that an interpretation of Community law was required. Therefore it referred to the ECJ for a preliminary ruling. On that request, the ECJ found that the fact that the company did not carry out any business activity in the Netherland was immaterial on the ground that the company, having its registered office in the UK, met one of the conditions established by Art. 5436 for enjoying the right of establishment. Furthermore the ECJ concluded that "legal conditions for affiliation to such a scheme must be the same for employees of a foreign company as for employees of companies formed under the law of Member State concerned. To refuse to apply to the security legislation to the directors of companies formed in another

³² Ibidem, Articles 63-66

³³ See on that for example A., Frada de Sousa, Company's Cross-border Transfer of Seat in the EU after Cartesio, Jean Monnet Working Paper 07/09, The Jean Monnet Center for International and Regional Economic Law & Justice, 2009.

³⁴ P., Craig,, G., DeBurca , EU Law, (Oxford University Press 2003) pp.87.

³⁵ D.H.M.Segers v Bestuur van deBedrijfsvereniging voor Bank, Case 79/58 of 10 July 1986

Member State must therefore be regarded as contrary to the principle of freedom of establishment³⁶.

But in his explanation, the ECJ raised another dilemma. Against the Dutch authority's arguments according to which Mr. *Segers* intended to circumvent Dutch national rules, the ECJ - by using both the word "abuse" and the word "fraud", and by concluding that "the need to combat fraud may...justify a difference of treatment in certain circumstances..." but "the refusal to accord a sickness benefit...cannot constitute an appropriate measure in that respect" - indirectly suggested that there could be, in certain circumstances, cases of circumvention amounting to abuse or to fraud and which could be contrasted through appropriate measures. Whereas the *Segers* ruling did not offer a reply to the question as to what would be the "certain circumstances" and the "appropriate measures", the subsequent *Centros* and *Inspire Arts*³⁷ rulings showed transactions which the ECJ regarded as representing circumventions without abuse of rights and offered indications as regards the circumstances when the circumvention would amount to abuse.

2. *Centros*³⁸

In *Centros*, Danish nationals had set up again a private company in the UK and this company had opened a branch in Denmark, where all business activity was deemed to be carried out. Although the relevant Danish authority had refused to register the branch on the ground that the Danish founders of the UK company had circumvented provisions of Danish company law requiring a minimum share capital for the purpose of protecting creditors, the ECJ rejected this position. The ECJ found that the refusal to register the branch would prevent the company established in the UK by the Danish nationals from exercising its freedom of establishment guaranteed by the Treaty, but – in its reasoning leading to this conclusion – it highlighted two decisive points. First, the ECJ, on the basis of its previous case-law concerning both the exercise of fundamental freedoms and the access to rights granted by EU law, specified that Member States "are entitled to take measures designed to prevent some of their nationals from attempting, under cover of the rights created by the Treaty, *improperly* to circumvent national legislation or to prevent individuals from improperly or fraudulently taking advantage of provisions of Community law". The wording "*improperly* to circumvent" indirectly suggests that, indicate cases of abuse – there may be cases of "*proper*" (intended as *not abusive*) circumvention of national rules via the fundamental freedoms. As a result, it could also suggest that individual Member States should not contrast these cases without contravening the purpose of the Treaty's provisions granting the fundamental freedoms themselves. In fact, in this respect, the ECJ held that national courts, whilst able to take account of the abuse or fraudulent conduct on the part of the persons concerned to deny them the benefit the EU law provisions on which they seek

³⁶ *Segers*, supra note 26, pp. 4 at 11.

³⁷ See on that more *Kamer van Koophandel en Fabriken voor Amsterdam v Inspire Art*, Case C-167/01, (2003)

³⁸ *Centros Ltd v Erhvervs-og Selskabsstyrelsen*, Case C212/97 (1999)

to relay, must assess such conduct in light of the purpose pursued by the EU law provisions at stake.

Second, the ECJ took into consideration the fact that the rules which the parties sought to avoid were rules concerning the formation of companies and not rules concerning the carrying on of certain trades, professions or businesses and had regard to the specific purpose of the Treaty's provisions granting the right of establishment. On these grounds, it held that the fact that a national of a Member State wishing to set up a company chooses to form it in a Member State whose rules of company law seem to him the least restrictive and to set up branches in other Member State cannot, in itself, constitute an abuse of the right of establishment. Moreover, by restating a conclusion of the *Segers* ruling, the ECJ also found that the fact that a company does not conduct any business in the Member State in which it had its registered office but only in the Member State where the branch is established is not sufficient to prove the existence of abuse or fraudulent conduct which would entitle the latter Member State to deny the company the benefit of the right of establishment.

3. Cartesio³⁹

The last, and one of the most recent ECJ cases on freedom of establishment, which is particularly interesting in context of this paper since it deals with Hungarian limited partnership is ECJ judgement in *Cartesio* case, delivered on 17 December 2008. *Cartesio* was a company which was incorporated in accordance with Hungarian legislation and which, at the time of its incorporation, established its seat in Hungary, but transferred its seat to Italy and wished to retain its status as a company governed by Hungarian law. Under the relevant Hungarian Law, the seat of a company governed by Hungarian law is to be the place where its central administration is situated. Because of that, *Cartesio's* request for transferral of the de facto head office was refused. In this case, the ECJ discussed whether Articles 43 EC and 48 EC are to be interpreted as precluding legislation of a Member State under which a company incorporated under the law of that Member State may not transfer its seat to another Member State whilst retaining its status as a company governed by the law of the Member State of incorporation. On the issue the ECJ ruled that: "As Community law now stands, Articles 43 EC and 48 EC are to be interpreted as not precluding legislation of a Member State under which a company incorporated under the law of that Member State may not transfer its seat to another Member State whilst retaining its status as a company

³⁹ *Cartesio Oktató és Szolgáltató Bt.* Case C-210/06; See also, Korom, Veronika, Metzinger, Peter, Freedom of Establishment for Companies: The ECJ confirms and refines its Daily Mail Decision in the *Cartesio* Case, *European Company and Financial Law Review*, vol. 6, No. 1., 2009.

governed by the law of the Member State of incorporation". A critical part of the judgment reads as follows:

110 Thus a Member State has the power to define both the connecting factor required of a company if it is to be regarded as incorporated under the law of that Member State and, as such, capable of enjoying the right of establishment, and that required if the company is to be able subsequently to maintain that status. That power includes the possibility for that Member State not to permit a company governed by its law to retain that status if the company intends to reorganise itself in another Member State by moving its seat to the territory of the latter, thereby breaking the connecting factor required under the national law of the Member State of incorporation.

111 Nevertheless, the situation where the seat of a company incorporated under the law of one Member State is transferred to another Member State with no change as regards the law which governs that company falls to be distinguished from the situation where a company governed by the law of one Member State moves to another Member State with an attendant change as regards the national law applicable, since in the latter situation the company is converted into a form of company which is governed by the law of the Member State to which it has moved.

112 In fact, in that latter case, the power referred to in paragraph 110 above, far from implying that national legislation on the incorporation and winding-up of companies enjoys any form of immunity from the rules of the EC Treaty on freedom of establishment, cannot, in particular, justify the Member State of incorporation, by requiring the winding-up or liquidation of the company, in preventing that company from converting itself into a company governed by the law of the other Member State, to the extent that it is permitted under that law to do so⁴⁰.

4. Case in progress: Reference for a preliminary ruling from the Magyar Köztársaság Legfelsőbb Bírósága (Hungary) lodged on 28 July 2010 — VALE Építési Kft. (Case C-378/10)

In this case, the VALE CONSTRUCIONI Srl. founded in Italy, with a registered seat in Rome, wanted to transfer its seat to Hungary and it also wanted to abolish its economic activity and existence in Italy and intended to operate furthermore in Hungary under the name of. The owners wanted to represent VALE CONSTRUCIONI Srl. as a predecessor of the VALE Építési Kft. The Hungarian Court of Registry rejected the application for registration of the VALE Építési Kft. stating that according to the Hungarian act of company registration, it is not possible to register a company which was founded under the Italian law as a predecessor of a Hungarian business association. The case was transferred to the Supreme Court of Hungary, which asks the European Court whether Articles 43 and 48 EC must be interpreted in such a case as meaning that they preclude legislation or practices of such a (host) Member

⁴⁰ See *Cartesio Oktató és Szolgáltató Bt.*, Case C-210/06; <http://curia.europa.eu>

State which prohibit a company established lawfully in any other Member State (the Member State of origin) from transferring its seat to the host Member State and continuing to operate under the laws of that State. A hearing was held on the 14th of October, 2011, and the opinion of the Advocate General was presented on the 15th of December, 2011. According to the Opinion of the Advocate General: a Member State can only deny transferring the seat of a company which was established lawfully in the European Union, if this kind of restriction can be applied only without any discrimination, can be justified with a compelling reason based on public interest and it is capable to assure the aim which would be accomplished by it, and it doesn't exceed the proper measure accomplishing this aim. Niilo Jääskinen Advocate General concluded that such legislation or practices which refuse transferring the seat and the operation under the law of the host Member state, to a company which was lawfully established in another Member State, are contrary to the regulation of the European Union. However, the company is required to be able to deliver proof that the previous company is its legal predecessor. Nevertheless the phenomenon, that a company claims the registration of its predecessor in the host Member State cannot be the basis of the rejection of the application for registration.

V. Hungarian law on corporate seat and implications of EU law on Hungarian law

In Hungary, the effective rules according to freedom of establishment are in the Act IV of 2006 on Business Associations (hereinafter Gt.), and in the Act V of 2006. on Public Company Information, Company Registration and Winding-up Proceedings. The criteria which are the aim of the Hungarian act on business associations are the most important regulations according to freedom of establishment. To accomplish these aims

1. Fast and cheap establishment of the companies must be provided.
2. The regulations according to companies shall be separated but flexible too.
3. Reasonable and proportionate regulation referring to creditor and investor protection must be provided in the framework of the European Union's company law.
4. According to function and the register of the companies provide the usage of modern communication devices. (e-administration, volunteership)

On the hole, the most important principle is to provide the competitiveness of the domestic regulation according to business entities.

According to freedom of establishment the concrete legal guarantees are in the act on Business Associations namely in the rules which refer to the personal and objective scope of the Gt. According to this:⁴¹

The act shall regulate the foundation, organization and operation of business associations with a registered office in Hungary, the rights, obligations and responsibility of the founders and members (shareholders) of business associations, as well as the transformation, merger and demerger of business associations and the winding up of such associations without legal succession. The Act shall apply to cooperative societies vested with legal personality, such as

⁴¹ See: Act IV of 2006 on Business Associations, section 1-55.

groupings, furthermore, the act shall regulate the foundation and operation of recognized groups of companies. Business associations may only be founded in the forms regulated in this Act.

Associations lacking the legal status of a legal person are general partnerships (kkt.) and limited partnerships (bt.). Business associations with legal personality are private limited-liability companies (kft.) and public and private limited companies (rt.).

Each business association shall have a corporate name. Business associations lacking the legal status of a legal person also have legal capacity under their corporate names, they may obtain rights and undertake commitments, such as acquire property, conclude contracts, and may sue and be sued.

Certain specific economic activities may be restricted by law to be pursued only in specific company forms. Business associations may be founded by non-resident and resident natural persons, legal persons and business associations lacking the legal status of a legal person to jointly engage in business operations, and such persons may join these business associations as a member, or acquire participation (shares) therein.

With the exception of private limited-liability companies and public or private limited companies, at least two members are required for the foundation of a business association.

Business associations may also be created by way of transformation (converting from one company form to another, merger and demerger).

1. Special regulations according to freedom of establishment

International treaties may contain regulations in derogation from the provisions of the Gt. in respect of the participation of non-residents in business associations. Non-resident and resident natural persons, legal persons and business associations lacking the legal status of a legal person can found business associations. These persons can not only be founders of a business associations, but they can jointly engage in business operations, and such persons may join these business associations as a member, or acquire participation therein. To know who can be regarded as resident or a non-resident person we have to examine the Act XCIII. of 2001. on the Abolishing Foreign Exchange Restrictions and the modification of certain relating acts⁴². The involvement of non-resident persons in founding, international treaty can regulate otherwise than the Gt. In judicial procedure, the opinion of the authorized Ministry shall be asked according to the practice of reciprocity or international treaties. The regulations of the Law-Decree No. 13 of 1979 on International Private Law (hereinafter Nmj.) cannot be used in questions which are under the scope of 593/2008/EC Directive.⁴³ The personal law of a legal entity is the law of the state, in the territory of which the legal entity was registered. If a legal entity was registered according to the laws of several states, or no registration is required according to the law applicable at the place of the seat indicated in the charter, its personal law shall be the law applicable at the place of the seat indicated in the charter. If we are lack of this previous information, the legal persons personal law shall be the law of the state, in the territory of which its central management is located. According to the section 26

⁴² See Act XCIII. of 2001. on section 2, subparagraphs 1-2.

⁴³ See: Law-Decree No. 13 of 1979 on International Private Law, section 18.

of the Nmj., a contract of association shall be governed by the law of the country where the company pursues its activities. A memorandum of association resulting in the foundation of a legal person shall be governed by the law of the country where the founder is incorporated. According to section 27., obligations arising under equity securities shall be governed - in terms of transfer, termination and enforcement - by the law of the country where the legal person is established. Considering that although, the general partnerships and limited partnerships are lack of the legal status of a legal person, they are registered in the company register, these rules mentioned above shall be used referring to them too. According to the Act XXIV. of 1988. on the Investments of Foreigners in Hungary, foreign national' shall mean a non-resident as defined in the Act on Abolishing Foreign Exchange Restrictions. It declares the definition of investments of foreign nationals in Hungary, foreigners' economic establishment, and independent enterprise of a foreign national. The Act states, that Undertakings operating with foreign participation may take part in the foundation of other business associations, may themselves found other business associations, and may acquire holdings in existing business associations and cooperatives. Since these business associations are registered in Hungary, the legal supervisor of them is the Court of Registry. Where an international treaty or a directly applicable European Union legislation that is binding in its entirety contain provisions in derogation from the Act, the provisions contained therein shall apply.

VI. Croatian law on corporate seat and implications of EU law on Croatian law

Modern Croatian Company Law developed in early 90's, after Croatia gained its independence. Transformation from one political and economic model resulted with significant changes, particularly visible in area of corporate law.

In 1993. new Croatian Companies Act⁴⁴ was enacted. This marked the beginning of the new area of legal environment for business. 1993 Companies Act found its ideal in German company law. This influence continued until nowadays, but it also smoothed later harmonization of Croatian law with EU law.

1993 Companies Act has been changed several times in order to comply with «acquis communautaire»⁴⁵. But interestingly, those changes didn't relate the issue of corporate seat.

Rules on corporate seat in Croatian Companies Act so far have been unchanged, since the original version of Companies Act was published. According to those rules a company established in Croatia can have only one seat⁴⁶. The company seat is the place of central management or a place where company is doing most of his activities⁴⁷. This means that company founders can choose between two places, they can either choose to register in place where central management will reside or that will be the place where most of

⁴⁴ Companies Act, Official Gazzete No. 111/93

⁴⁵ Amendments have been published in OG No. 34/99, 52/00, 118/03, 137/09

⁴⁶ Companies Act art. 37 (2)

⁴⁷ Companies Act, art. 37(1)

companies activities is done. In case when it is not clear whether company seat is in one or another place, it will be considered that company seat is the one where company is registered at Court Registry⁴⁸. Companies Act also regulates that company can change its seat⁴⁹. This decision must be brought by company members and change of companies seat must be predicted by company statute. The issue of change of companies seat abroad is in Companies Act regulated by single rule. Article 38(2) says that for transfer of companies seat abroad a company needs written consent of Ministry of finance. Court Registry must be notified about that change⁵⁰. From above it is obvious that the change of corporate seat abroad is technically possible, but in practice company willing to change its seat in foreign country will face number of problems. There are number of unsolved issues such as, what happens with company who transfer its seat abroad? Is it still subordinated to Croatian law or will it become a host state company? Furthermore, it is also unclear whether a company who transfer its seat abroad must go through process of liquidation (winding-up) or it can continue its life in another member state? The question is also, where such company will in future pay tax, in home country or host country? And finally, it is important to stress that change of corporate seat in foreign country doesn't only depends on Croatian authorities, but also on legal order of foreign country. If those country rule don't allow transfer of company seat, the change of company seat will not be possible.

The discussed problems refers only to the situation of companies emigration, and that is the case when, for example, a Croatian company wants to move its company seat in foreign country. But what is with *vice versa* situations when, for example, a foreign company wants transfer its seat in Croatia (immigrate in Croatia), due to the different reasons.

Croatian Companies Act is silent on that. It doesn't regulates such situations at all. This leads us to conclusion that under the current Croatian law this is not possible.

We can not say that it is forbidden, but current Croatian legislative framework doesn't contain substantive or procedural rules which would enable foreign companies to immigrate in Croatia. Foreign undertakings, who want to do the business in Croatia, are of course able to do that, but they can do it only *via* branch office or they will have to set up a company in Croatia under the rules prescribed by Companies Act.

This situation will not last for a long. As soon as Croatia becomes a full member of EU rules on freedom of establishment along with ECJ case law will apply. As other Member States we will have to adapt rules and standards applied in EU for decades now.

This means that we will soon face another legislative change in area of Croatian corporate law.

VII. Freedom of establishment after Lisbon. „Quo vadis” right and freedom of establishment? Conclusion

⁴⁸ Companies Act, art. 37(4)

⁴⁹ Companies Act, art. 38(1)

⁵⁰ Companies Act, art. 38(3)

In a narrow interpretation, freedom of establishment means the following freedoms for business associations:

- a) the founder has the right to choose whether he founds a business association in any Member State.
- b) the owner of the business association has the right to maintain economic activity in the given Member State, through domestic or foreign associations
- c) the free choice of founding subsidiary or branch with the purpose to maintain economic activity through them.
- d) equal treatment of states according to the business association and its owners.⁵¹

The Articles 49-55 of the Lisbon Treaty (the Articles 43-48 of the former EC Treaty) are regulating the question of right of establishment.⁵² According to these provisions, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 54, 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. (Article 49)

In order to attain freedom of establishment as regards a particular activity, the European Parliament and the Council, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee, shall act by means of directives. The European Parliament, the Council and the Commission shall carry out the duties devolving upon them under the preceding provisions, in particular:

- (a) by according, as a general rule, priority treatment to activities where freedom of establishment makes a particularly valuable contribution to the development of production and trade;
- (b) by ensuring close cooperation between the competent authorities in the Member States in order to ascertain the particular situation within the Union of the various activities concerned;
- (c) by abolishing those administrative procedures and practices, whether resulting from national legislation or from agreements previously concluded between Member States, the maintenance of which would form an obstacle to freedom of establishment;
- (d) by ensuring that workers of one Member State employed in the territory of another Member State may remain in that territory for the purpose of taking up activities therein as self-employed persons, where they satisfy the conditions which they would be required to satisfy if they were entering that State at the time when they intended to take up such activities;
- (e) by enabling a national of one Member State to acquire and use land and buildings situated in the territory of another Member State, in so far as this does not conflict with the principles laid down in Article 39(2);
- (f) by effecting the progressive abolition of restrictions on freedom of establishment in every branch of activity under consideration, both as regards the conditions for setting up agencies, branches or subsidiaries in the territory of a Member State and as regards the subsidiaries in the territory of a Member State and as regards the conditions governing the entry of personnel

⁵¹ See: Tibor Nochta: Társasági jog, Dialóg-Campus Kiadó, Budapest-Pécs, 2011. p.32-33

⁵² See: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:FULL:EN:PDF>

belonging to the main establishment into managerial or supervisory posts in such agencies, branches or subsidiaries;

(g) by coordinating to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or firms within the meaning of the second paragraph of Article 54 with a view to making such safeguards equivalent throughout the Union;

(h) by satisfying themselves that the conditions of establishment are not distorted by aids granted by Member States.

(Article 50)

The provisions of this Chapter shall not apply, so far as any given Member State is concerned, to activities which in that State are connected, even occasionally, with the exercise of official authority. The European Parliament and the Council, acting in accordance with the ordinary legislative procedure, may rule that the provisions of this Chapter shall not apply to certain activities. (Article 51)

The provisions and measures taken in pursuance thereof shall not prejudice the applicability of provisions laid down by law, regulation or administrative action providing for special treatment for foreign nationals on grounds of public policy, public security or public health.

The European Parliament and the Council shall, acting in accordance with the ordinary legislative procedure, issue directives for the coordination of the abovementioned provisions.

Article 52

In order to make it easier for persons to take up and pursue activities as self-employed persons, the European Parliament and the Council shall, acting in accordance with the ordinary legislative procedure, issue directives for the mutual recognition of diplomas, certificates and other evidence of formal qualifications and for the coordination of the provisions laid down by law, regulation or administrative action in Member States concerning the taking-up and pursuit of activities as self-employed persons.

In the case of the medical and allied and pharmaceutical professions, the progressive abolition of restrictions shall be dependent upon coordination of the conditions for their exercise in the various Member States. (Article 53)

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 Union 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. (Article 54)

Member States shall accord nationals of the other Member States the same treatment as their own nationals as regards participation in the capital of companies or firms within the meaning of Article 54, without prejudice to the application of the other provisions of the Treaties. (Article 55)

The 14th Directive of the field of company law (which is now being prepared) about transferring the registered office, and the practice of the European Court probably will restrain the Member State's intention to monopolize their own company law.⁵³ Regulations according to the transfer the registered office will not be regulated in the Gt, but after the acceptance of the Directive, during the implementation period.⁵⁴

⁵³ S. GRUNDMANN, *European Company Law*, oc, p. 116

⁵⁴ See: Vossestein, Transfer of the registered office. The European Commission's decision not to submit a proposal for a Directive, in *Utrecht Law Review*, Volume 4, Issue 1, 2008, 53-65. o. or Wymeersch, Is a directive on Corporate Mobility needed?, *Financial Law Institute, Universiteit Gent* 2006.