A SHIFTING PARADIGM OF EUROPEAN COMPANY LAW?

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I. THE EUROPEAN COMPANY LAW REGIME

A. The Basic Model

Traditionally, company law on the European continent has been quite different from the structures which have evolved in the U.S. The various national systems differ in many ways, but there appears to exist a common pattern that shows its own distinct features.¹ This pattern appears particularly obvious in Germany; thus I will use the German system as a starting point for my inquiry without always explaining how the rules and practices of countries like France, Italy, Spain, the Netherlands, Sweden, or Austria differ from German patterns. The basic model is characterized by three features.

1. The model follows a stakeholder philosophy.

The overall purpose of European corporate law is not maximization of shareholder wealth or return on equity investment, but the accommodation and reconciliation of conflicting interests, primarily among shareholders, creditors and employees. This basic approach is reflected on the individual firm level. First, employees are entitled to board representation;² this generally implies a two-tier board structure, separating a managing or executive board from a supervisory board that serves as the organ implementing workers’ co-determination. The other distinct feature reflecting this philosophy is a comprehensive regime of legal capital, which is designed to serve as a “cushion” for the benefit of the creditors of the corporation. It imposes minimum amounts of capital for the formation of companies, excludes certain assets like future services from being used as shareholder contributions, requires cumbersome procedures for contributions in-kind and severely restricts the distribution of dividends and corporate stock repurchases. This burdens not only the

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² Mark Roe, Political Determinants of Corporate Governance (Oxford University Press, 2003), has comprehensively described and analyzed this system, contrasting it with its American counterpart.

³ The present state is reported in contributions to Unternehmens-Mitbestimmung der Arbeitnehmer im Recht der EU-Mitgliedstaaten (Theodor Baums & Peter Ulmer eds., 2004).
2. The stakeholder approach affects the function and structure of the legal rules shaping the organization of the business enterprise.

These rules are designed to determine the relationship between shareholders, creditors, and employees. For this reason, their elaboration cannot be left to the shareholders; corporate law is generally mandatory in nature. This is true for the regulation of corporate finance, or the rules on legal capital, as well as for the organizational structure of the company, or the corporate governance regime. German law fixes the composition and the size of the supervisory board in every detail, and it strictly separates and defines the powers of the executive board, the supervisory board and the shareholders' meeting. This imposes a heavy, rigid and inflexible regime upon business entities; the law allows very little freedom to adapt the organizational structures of the enterprise to the changing incentives provided by factor and product markets.

3. Such a regime will not be effective unless companies are prevented from avoiding undesirable laws by moving into another jurisdiction, as American corporations are free to do.

Most of the continental European countries have locked companies into their national legal systems by applying the real seat theory. Under this doctrine the company is not free to choose a state for incorporation; it must incorporate according to the laws of the state where its head office is located and where most of its activities take place. Moving into another jurisdiction generally requires the dissolution of the existing company and the formation of a new company at the chosen location. This burdens corporations not only with cumbersome and costly procedures, but also with adverse tax consequences, e.g. the realization and taxation of undisclosed (or hidden) reserves.

B. The European Approach

The European Community adopted this approach from the very beginning. The American model – based on free incorporation, legislative competition, and a predominance of enabling rules – was well-known and generally rejected. It

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1 This is particularly obvious in German law; section 23, paragraph 5 of the Stock Corporation Act determines that all the provisions of the Act are mandatory; they can be amended or replaced by the articles of incorporation only when this is explicitly allowed by the statute. Gesetz über Aktiengesellschaften und Kommanditgesellschaften auf Aktien, v. 6.9.1965 (BGBI. I.S.1089).

4 This is true for Austria, Belgium, France, Germany, Greece, Luxembourg, Portugal, Spain, and – with some modifications – Italy. See Jens C. Dammann, Freedom of Choice in European Corporate Law, 29 Yale J. Int'l. 447, 479 (2004).

5 Roberta Romano, The Genius of American Corporate Law 129 (AEI Press, 1993), has called this the “enterprise approach” to the corporation.
allowed a "race of laxity," resulting in "abuse and speculative excesses;" the objective of community legislation has been "avoidance of the Delaware effect, i.e. companies relocating in Member States with least regulations." Therefore, the original Treaty of the European Economic Community authorized and required legislation "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 and firms...with a view to making such safeguards equivalent throughout the Community." At the same time, the Member States were invited "to enter into negotiations with each other"—that is, to form a convention—"with a view to securing for the benefit of their nationals:...the mutual recognition of companies or firms,...the retention of legal personality in the event of transfer of their seat from one country to another, and the possibility of mergers between companies or firms governed by the laws of different countries...." These provisions made it very clear that the right of establishment did not include the freedom to move a company from one Member State to another by merely reincorporating within the desired country.

C. Reason for Review

The purpose of this article is to show that the institutions of the European Community ("EC") have fully respected this concept for a long time; only recently could one observe its decline. This article will explain this decline in three steps. Part II describes the waning importance of harmonization of company law by directives. Part III deals with a rather dramatic change in the attitude of the European Court of Justice (ECJ). Part IV explores the impact of the recently enacted Regulation and Directive establishing a European Company, the Societas Europaea. Part V looks for an explanation of why all this happened. Part VI concludes with a few more general observations.

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6 This is the conclusion of Eric Stein, Harmonization of European Company Law, 37 L. & Contemp. Probs. 318, 324 (1972), reprinted in part in Community Law and Institutions in Perspective 606 (Eric Stein, Peter Hay, Michael Waelbroeck eds., 1976).
8 Treaty Establishing the European Economic Community [TEEC], art. 54(3)(g)(1) (1957) (now TEC at art 293).
9 TEEC art. 220 (now TEC at art 293).
10 Guaranteed by TEEC arts. 52-58 (now TEC arts. 43-48).
II. THE DECLINE OF CORPORATE LAW HARMONIZATION

A. The Scope of Corporate Law Harmonization

Step by step harmonization of substantive corporate law rules, primarily by directives, has been the preferred approach adopted by the EC. This has been at least reasonably successful in the field of capital market law, which follows the American model of federalized securities regulation. This section addresses the directives aimed at the harmonization of corporate law "as a mechanism for ensuring that a European Delaware will not emerge." Thus far, nine company law directives have been enacted. Three of them deal with accounting and may therefore be better grouped with the capital market law instruments. Others provide for features observed by each reasonably developed corporate law system; this includes the disclosure of basic documents like the articles of incorporation or the admission of single member companies. The most important and most interesting example so far is the "Second" or "Capital Directive" from 1976, described in Part B. In addition, there have been proposals and drafts for directives not yet enacted. The most important is the draft of a Fifth Directive, published for the first time in 1972, which suggests a comprehensive corporate government regime; this is to be described in Part C.

B. The Capital Directive

The Second Company Law Directive is the major legislative measure regulating the basics of corporate finance. The Directive establishes a comprehensive regime of "legal capital" largely following the German example. It

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12 A directive "shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of law and methods." TEC art. 249, para. 3. This is to say that a directive has to be transformed by Member State legislation into national law.
13 Richard M. Buxbaum & Klaus J. Hopt, Legal Harmonization and the Business Enterprise 280 (De Gruyter, 1988).
14 Romano, supra note 5, at 129.
16 The article assumes that there are many better reasons for mandatory and harmonized disclosure rules than for mandatory and harmonized rules fixing corporate structures. See John C. Coffee, Jr., The Future as History: The Prospects of Global Convergence in Corporate Governance and its Implications, 93 Nw. U. L. Rev. 641, 667-671 (1999).
20 Proposal for a Fifth Directive on the coordination of safeguards which for the protection of the interests of members and outsiders, are required by member states of companies within the meaning of Article 59, Second Paragraph, with respect to company structure and to the power and responsibilities of company boards, 1972 O.J. (C 131) 49 [hereinafter Fifth Directive].
applies only to stock corporations,\textsuperscript{22} not to private limited liability companies, and provides:

(i) Stock corporations are required to have a minimum capital of 25,000 Euro.\textsuperscript{23}
(ii) The commitment to provide work or services in the future cannot be admitted as a contribution.\textsuperscript{24}
(iii) Contributions in-kind, not in cash, have to be examined and valued by independent experts.\textsuperscript{25}
(iv) The full consideration has to be transferred to the company within five years.\textsuperscript{26}
(v) The repurchase of stock by the company is limited to 10\% of its subscribed capital; and only fully paid-in shares may be bought back.\textsuperscript{27}
(vi) Whenever the company increases its capital, it must distribute pre-emptive rights to its shareholders in order to allow them to acquire the newly issued shares.\textsuperscript{28}

It has been correctly observed that this regime was set in place at a time when the U.S. Model Business Corporation Act abolished the concept of legal capital as a useless device burdening corporate activities.\textsuperscript{29} It took some time for this message to travel to Europe;\textsuperscript{30} however, there have been recent increasing indications of dissatisfaction with the rigid rules imposed by the Second Directive.

In 1996 the EC Commission launched the Simpler Legislation for the Internal Market (SLIM) initiative with the objective of developing the framework of the international market. One of the areas under consideration was and continues to be company law. A team established by the Commission following consultation with the Member States, the European Parliament, and interest groups recommended substantial changes loosening the strict regime of the Second Directive, relating in particular to contributions in-kind and pre-emptive rights. The Commission has endorsed the recommendations\textsuperscript{31} and is expected to present a draft very soon.\textsuperscript{32}

In September 2001 the Commission set up a “High Level Group of Company Law Experts” to make recommendations on a modern regulatory framework for EU company law. In its final report the Group expressed doubt that harmonizing company law through directives continues to serve the desirable development of corporate law, as directives are difficult to change and thus produce “a certain

\textsuperscript{22} Article 1 enumerates the included legal forms of the Member States like the public company limited by shares (plc) in the United Kingdom, the Société Anonyme (S.A) in France and the Aktiengesellschaft (AG) in Germany.
\textsuperscript{23} Second Directive, supra note 19, at art. 6.
\textsuperscript{24} Id. at art. 7.
\textsuperscript{25} Id. at art. 10.
\textsuperscript{26} Id. at art. 9.
\textsuperscript{27} Id. at art. 19.
\textsuperscript{28} Id. at art. 29.
\textsuperscript{29} European Union Law 703 (George Bermann et al. eds., 2d ed. 2002)
\textsuperscript{30} For an early critical evaluation, see Friedrich Kübler, Aktie, Unternehmensfinanzierung und Kapitalmarkt (1989).
\textsuperscript{31} See Report from the Commission to the European Parliament and the Council, Results of the Fourth Phase of SLIM, COM (00) 56 final, at 4 (February, 2000).
\textsuperscript{32} Das Aktienrecht soll in ganz Europa gelockert werden, Minderheitsaktionäre erhalten Anspruch auf Akauf ihrer Anteile, Frankfurter Allgemeine Zeitung, Oct. 29, 2004 at 14.
petrification" of corporate structures. With regard to "Capital Formation and Maintenance" the Group endorsed the recommendation of the SLIM proposal for immediate implementation and suggested that the Commission should, at a later stage, conduct a review of the feasibility of an alternative regime eliminating the concept of legal capital.

In the UK, an interdisciplinary working group, established by the Accounting Standards Board ("ASB") and the Company Law Center at the British Institute of International and Comparative Law ("BIICL") has engaged in an in-depth study of the present regime. The final report submitted by Jonathan Rickford concludes that it "is not widely relied on in practice by creditors, is complex, expensive and anomalous, producing inconsistent results as between companies within Member States and between different Member States within the EU." The report strongly argues against the Second Directive and against mandatory rules; it contends that in general, financing and capitalization decisions should be left to the firms, but Member States should be free to retain the present law if they wish to do so. The work of the Rickford group presents the most comprehensive evaluation of the Second Directive so far and the best argued and most vigorous attack against the regulation of capital at the European level.

Finally, the European Shadow Financial Regulatory Committee has recommended repealing the Second Directive as a whole rather than engaging in piecemeal efforts to modify some of its provisions, and leaving it to the Member States to decide for themselves to what extent they wish to retain such rules.

Although these initiatives enjoy increasing academic support, it is not expected that the Second Directive will be repealed or radically amended in the near future. However, they do still have another impact. As mentioned before, the Second Directive applies only to stock corporations. For a long time it was expected that its approach would be extended to the private limited company, which is a legal form exposing creditors to the same if not a higher amount of risk. As of today it is certain that this will not happen; the Commission is no longer interested in such a project, and there would be no (qualified) majority in the Council supporting it. For this reason, there will be no further harmonization of mandatory legal capital rules, and the existing system will be deregulated, though it is not possible to forecast when this will happen.

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34 Id. at 78-93.
36 Id. at 966-996.
C. The Fifth Directive

In 1972 the Commission published the proposal for a Fifth Company Law Directive, 39 "concerning the structure of public limited companies and the power and obligations of their organs." 40

The original version closely followed the German model. It was to impose a two-tiered structure of corporate governance, mandating the separation of a "management organ responsible for managing and representing the company" and a "supervisory organ responsible for controlling the management organ." In addition, for companies with 500 or more employees, it required that no less "than one-third of the members of the supervisory organ shall be appointed by the workers or their representatives." 41

This proposal immediately faced stiff opposition. 42 Member States that normally used the unitary board approach rejected the two-tiered model. And, not surprisingly, the imposition of employee representation proved to be still more controversial, although in the 1970’s the basic idea was broadly discussed throughout Europe. 43 The Commission responded a decade later by presenting an amended proposal. 44 Now the Member States would have the option either to impose the two-tier system or to offer the choice between a two-tier and a one-tier board. 45 The same approach was adopted for the participation of employees, 46 where the proposal offered no less than four alternatives. First, a Member State could still require that the employees would appoint between one-third and one-half of the members of the supervisory or other board. 47 As an alternative, a Member State could allow co-optation to a supervisory organ. 48 Or, the Member States could refer employee participation to collective bargaining. 49 Finally, each Member State could instead require the establishment of a separate body — something like a works council — to represent the employees in their dealings with the management. 50

This proposal suffered a similar fate: the Commission was unable to get the votes necessary to get a draft adopted by the Council. In 1991 the Commission amended the proposed directive again, allowing the Member States still more choices. 51 Even this did not achieve the desired effect, and thereafter the

39 Fifth Directive, supra note 20 at 49.
40 Id. at art. 2 para. 1.
41 Id. at art. 4 paras 1 and 2.
42 See Buxbaum & Hopt. supra note 13, at 199.
43 This has been true even in the UK. See Paul Davies, The Bullock Report and Employee Participation in Corporate Planning in the UK, 1 J. Comp. Corp. L. & Sec. Reg. 245 (1978).
44 Amended Proposal for a Fifth Directive founded on Article 54(3)(g) of the EEC Treaty, 1983 O.J. (C 240) 2. 9 [hereinafter Amended Proposal].
45 Id. at art. 2 para. 1.
46 Id. at art. 4 para. 1 (raising the employment threshold from 500 to 1000).
47 Id. at art. 4B para. 1 & 2 (reflecting the German model).
48 Id. at art. 4C (following the Dutch approach).
49 Id. at art. 4E, para. 1; Id. at art. 21F, para. 1 (referring to the Swedish practice).
50 Id. at arts. 4D & 21E (following the French solution).
Commission did not renew its efforts. Today it is generally assumed that the proposal is dead.

D. A Preliminary Conclusion

Studies made years ago had observed that the process of corporate law harmonization within the EU was facing increasing difficulties. The recent developments indicate that this is even more accurate today. The fate of the Fifth Directive suggests that there will be no harmonization of rules fixing the organization of companies. The recent history around the Second Directive allows the conclusion that the process of harmonization may be reversed. Even if it is unlikely that the Directive will be repealed in the near future, we may see some moves toward partial deregulation. It would come as a surprise if the imposition of a mandatory regime of legal capital were ever to extend to private limited companies.

III. THE EUROPEAN COURT OF JUSTICE: DECLINE OF THE REAL SEAT THEORY

A. The Traditional Regime: Daily Mail

For a long time EC law did not interfere with the power of the Member States to regulate the migration of companies from one country to another. This issue has two separate features. First, a Member State can burden the exit of a company wishing to transfer its statutory domicile by prescribing its dissolution under home country rules and thus requiring its reincorporation under the laws of its new location. The ECJ held that the exercise of this power does not interfere with the freedom of establishment clause. When the Daily Mail company wanted to move its registered head office to the Netherlands, while remaining incorporated in the UK, the UK Treasury was allowed to require Daily Mail to sell its assets and pay UK capital gains tax before moving them to the Netherlands; the Court held that the EC Treaty regards rules preventing the transfer of the registered office of a company from one Member State to another as a problem which is "not resolved by the rules concerning the right of establishment."

B. The New Case Law

Second, after this decision it was generally assumed that the same would be true for the admission of pseudo-foreign companies. The EC Treaty emphasized from the very beginning that the freedom of establishment protected not only individuals but also companies formed under the law of another Member State. But it was also assumed that this rule applied only to truly foreign corporations and not to entities set up abroad for the sole or primary purpose of circumventing home country regulation.

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53 TEC art. 43 (formerly art. 52).
55 TEC art. 43 (ex. art. 52).
56 Id. at art. 48 (ex. art. 58).
The decision rendered in the *Centros* case dealt the first blow to this conviction. Denmark requires the equivalent of circa $25,000 to be paid in when a private limited company is formed. A Danish couple set up Centros in the UK as a British company without any paid-in capital, as there is no such requirement in the UK. Centros did not intend and was not intended to do any business in the UK. Instead it applied to the Danish Companies Board to register a Centros branch in Denmark in order to conduct a wine trading business there. The Board rejected the application, deeming the project to be an evasion of Danish capital requirements. On appeal, the Danish Court referred the case to the ECJ asking if the rejection violated the right of establishment. The ECJ answered that it did. Member States are allowed to take measures to prevent improper circumvention of their national legislation, but “the fact that a national of a Member State who wishes to set up a company chooses to form it in the Member State whose rules of company law seem to him the least restrictive and to set up branches in other Member States cannot, in itself, constitute an abuse of the right of establishment.” The Danish Company Board had stated that the branch would have been admitted if Centros had conducted any business in England or Wales. The Court held that in this case Danish creditors would have been exposed to no lesser risk from Centros’ activities.

The *Centros* decision triggered a lively debate as to the survival of the real seat theory. In part, this debate became obsolete with the Court’s ruling in the *Überseering* case. Überseering, a Dutch limited liability company, had acquired real estate in Germany and entered into a project-management contract to have it refurbished. Then two German nationals, both residing in Germany, bought all the shares in Überseering. Thereafter Überseering brought an action before a German court seeking damages for breach of the contract. The lower courts dismissed the action, finding that Überseering had transferred its actual center of administration to Germany once its shares had been acquired by German nationals; not having been registered in Germany, it did not have legal capacity there and, consequently, it could not bring legal proceedings in that country. Überseering appealed and the Bundesgerichtshof, the highest German Civil and Commercial Court, referred to the ECJ and asked for a preliminary ruling. The hearing before the Court can be described as a controversial debate between Germany, Italy and Spain on the one side and the UK and the Netherlands on the other side over the compatibility of the real seat doctrine with the freedom of establishment. The Court decided against Germany, distinguishing and thus confirming *Daily Mail*: this decision “did not concern the way in which one Member State treats a company which is validly incorporated in another Member State and which is exercising its freedom of establishment in the first Member State.” Überseering, being validly incorporated in the Netherlands, was protected by Articles 43 and 48 of the EC Treaty. It is not

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58 TEC art. 234 (ex. art. 177).
59 Supra note 57, at para. 24.
60 Id. at para. 27.
61 Id. at para. 35.
64 *Überseering*, 2002 E.C.R. 1-9919, para. 66.
65 Id., para. 80.
inconceivable that an overriding interest, such as the protection of creditors, minority shareholders, employees, or the tax authorities, could justify restrictions on the freedom of establishment, but they would not support denial of “the legal capacity and, consequently, the capacity to be a party to legal proceedings of a company properly incorporated in another Member State in which it has its registered office.”

Less than a year later the Court had the opportunity to return to the issue. Inspire Art was a private company limited by shares incorporated and registered in the UK. It operated an art dealing branch in Amsterdam; there were no other activities, and in particular none in the UK. The sole director was a Dutch resident. It was uncontested that Inspire Art was set up in the UK in order to avoid the legal capital regime imposed by the Netherlands. The branch was registered in the Netherlands, but the Dutch authorities required it to follow WFBV, a statute requiring pseudo-foreign companies to form and maintain capital in the same way and to the same amount; a Dutch company is obliged to do. Inspire Art complained, and the Dutch Court referred the case to the ECJ. This time the Netherlands sided with Germany, Italy and Austria against the UK, and this time they lost. The ECJ affirmed its ruling in the Centros case and extended it to the regulation of pseudo-foreign companies. The imposition of the legal capital regime and other provisions of WFBV impeded the exercise of the freedom of establishment and therefore violated Articles 43 and 48 EC Treaty. Again Daily Mail was distinguished: there the UK was impeding the exit of a company established under its own law.

Moreover, there was no justification for WFBV, either under the “public policy, public security or public health” exception of Art. 46 EC Treaty or for any other “overriding reason relating to the public interest.” The Court confirmed that under Art. 43 and 48 “a national of a Member State who wishes to set up a company can choose to do so in the Member State the company-law rules of which seems to him the least restrictive and then set up branches in other Member States....” It did not matter if the firm had no other link to the Member State of its incorporation: “...the fact that a company does not conduct any business in the Member State in which it has its registered office and pursues its activities only or principally in the Member

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166 Id., paras. 92 and 93.
168 Wet op de Formeel Buitenlandse Vennootschappen (Netherlands Law on Formally Foreign Companies), Stb. 1997, 697 (Neth.) [hereinafter WFBV].
169 Id. at art. 1 (WFBV defines as formally foreign a company formed under laws other than those of the Netherlands and having legal personality which carries on its activities entirely or almost entirely in the Netherlands and also does not have any real connection with the State within which the law under which the company was formed applies).
170 For Inspire Art this would have been 18,000 Euro. See Inspire Art, 2003 E.C.R. I-10155, at para. 27.
171 See supra note 54.
173 Id. at para. 103. This can be viewed as an application of the “internal affairs doctrine”. See European Union Law, supra note 27, at 111.
175 Id. at para. 138.
State where its branch is established is not sufficient to prove the existence of abuse or fraudulent conduct.

C. Another Preliminary Conclusion

In Germany these decisions have sparked controversy as to which components of German law can still be applied to German business operations incorporating in another Member State. Although not generally admitted, it is obviously no longer true that the rules establishing the legal capital regime may be applied to such operations. Yet the line of ECJ precedent cannot be understood as a complete victory for the incorporation theory. Member States have lost the power to keep their national business people from incorporating abroad and operating as British or Luxembourger companies, but under the Daily Mail doctrine they can still block exit moves of firms incorporated under their laws. However, the question remains whether the most recent legislative innovations have opened this alley.

IV. THE SOCIETAS EUROPÆA: A NEW VEHICLE FOR CHANGE?

A. A Long History

The European Company, or Societas Europaea (“SE”), has a long history quite similar to that of the Fifth Directive. The Commission published a first draft in 1970 and presented an amended and enlarged version in 1975. This proposal suggested a comprehensive and exhaustive codification of more than 400 articles, again following the basic pattern of German law. It mandated separate executive and supervisory boards, works councils, and generous employee representation on the supervisory board, and included detailed regulation of conglomerates (Konzernrecht). For obvious reasons this was not acceptable for many Member States. The Commission in fact dropped the draft by 1982, and came back with a completely new proposal in 1989, including both a regulation and a directive to address the matter. The regulation presented a mere framework of no more than 137 articles, referring frequently to the corporate laws of the Member States. Employee participation was reserved for the Directive which would allow Member States the choice between three models: codetermination in a corporate board (following the German model); representation of workers’ interests through a separate works council (as suggested by French law); or patterns of representation fixed by an

[76] Id. at para. 139.
agreement between enterprises and unions (reflecting practices in Sweden and Ireland). Germany rejected this approach. In 1996 the Commission established a group of experts, chaired by the former Commission President Etienne Davignon. Its report recommended retaining only the agreement option.\footnote{Final Report of the Group of Experts on European Systems of Worker Involvement (with Regard to the European Company Statute and other pending proposals), May 1997 (generally referred to as the Davignon Report), available at http://europa.eu.int/comm/employment_social/labour_law/docs/davignonreport_en.pdf.} The deliberation in the EC Council added “Standard Rules”, incorporating the “before and after” principle which is designed to prevent the foundation of a Societas Europaea from depriving employees of their participation rights without their consent. This compromise provided the foundation for the “miracle of Nice” at the end of 2000: the heads of governments unanimously adopted the proposal; a year later the EC Council enacted the Regulation\footnote{EC Council Regulation 2157/01(CE) on the Statute for a European Company, 2001 O.J. (L 294) 1 [hereinafter SE-Reg].} and the Directive.\footnote{EC Council Directive 2001/86/EC, Supplemen\nting the Statute for a European Company with Regard to the Involvement of Employees, 2001 O.J. (L 294) 22 [hereinafter SE-Dir.].} 

B. The Regulation on the Statute for a European Company (SE)

The SE-Regulation consists of 70 articles; it is much shorter than the earlier proposals and drafts. It provides for a mere fragment of the proposed initiatives of the original concept. Employee participation has been outsourced to the SE-Directive, and the text regularly refers not only to the corporate law statutes of the Member States but also to “the provisions of laws adopted by Member States in implementation of Community measures relating specifically to SEs.”\footnote{SE-Reg, supra note 83, at art. 9, para.1(c)(i).} The result is a highly complex regulatory pattern, which cannot be described here in all of its details.\footnote{Id. at art. 2, para. 4.}

The SE “shall have legal capacity;”\footnote{Id. at art. 4, para. 2.} it must have a “subscribed capital” of not less than 120,000 Euro.\footnote{Id. at arts. 7 & 8.} More importantly, the SE must have its registered office within one of the Member States of the EC.\footnote{Id. at art. 2, para. 1.} This Member State is important, as its laws will determine all the issues not resolved by the SE-Regulation. From this it follows again that there will be not one type (or legal form) of the SE, but a considerable number of differing institutions. This opens the possibility of choice between these variations.

This choice is limited by several rules restricting the use of the SE. Such a company cannot be formed by natural persons but only by existing corporations, and only by a merger,\footnote{Id. at art. 2, para. 4.} by a transformation,\footnote{Id. at art. 2, para. 2.} as a (common) holding company,\footnote{Id. at art. 2, para. 2.} or as a subsidiary.\footnote{Id. at art. 2, para. 3.} All participating corporations have to be “formed under the law of a
and they must either be registered in different Member States or operate through a subsidiary or branch outside the home country.  

A particularly significant feature of the SE relates to its legal complexity: the structure of a specific SE is governed by a hierarchy of norms including no less than nine different levels.  

At the top of the pyramid are the mandatory provisions of the SE-Regulation. The next level consists of the provisions of the articles of incorporation, which are based upon an explicit authorization by the Regulation. The most important example is the choice between the two-tier system and the one-tier systems. Another step down we find the enabling provisions of the Regulation; at the next level reside the mandatory provisions authorized by the Regulation and enacted by the Member State. These are followed by the agreement, to be formed by the participating enterprises and their employees in order to determine the participation or codetermination by the employees.  

If such an agreement cannot be reached, it is substituted with the "standard rules" provided for in the Annex to the Directive. At the next level we find the mandatory rules of the stock corporation laws of the Member States; they are to be applied where the Regulation does not provide for its own rules, require specific rules to be enacted for the SE, or specifically authorize regulation by agreement or by the articles of incorporation.  

Step eight is composed of the provisions of the articles of incorporation (as far as they are not based upon a specific authorization by the Regulation). At the bottom we find the enabling or default rules of the stock corporation laws of the Member States, which give way to deviating charter provisions.  

The remaining content of the Regulation deals primarily with the formation of the SE and with the structure of the two-tier and the one-tier systems. A particularly important provision appears towards the end of the text: two years after its registration in its Member State of incorporation, an SE can be transformed into a public limited liability company governed by the law of this Member State; the Regulation emphasizes that such a conversion shall not result in the winding up of the company or in the creation of a new legal person.  

C. The Directive Supplementing the Statute for a European Company with Regard to the Involvement of Employees  

The Directive establishes a regime that is hardly less complicated than the institutional arrangement provided by the Regulation. The core is a "negotiating
procedure," designed to achieve “arrangements for the involvement of employees in the SE.” The formation of such an arrangement or agreement is essential; it is a condition for the registration of the SE, which entails legal capacity. The agreement is to be negotiated between the companies involved in the formation of the SE and a “special negotiating body” representing the employees of these companies. Whenever the agreement reduces the participation rights of any workers, it has to be adopted by a qualified majority of the special negotiating body. If such an agreement cannot be reached, the “Standard Rules” contained in the annex to the Directive apply. Part 1 and Part 2 of these Rules provide for a works council-type body representing the employees and endowed with rights of information and consultation. Part 3 requires that the most comprehensive regime of codetermination of any of the participating companies will be applied to the SE.

D. The Practical Impact of the SE

The Regulation and the Directive present a regulatory framework of unusual complexity. The Member States should have transformed and implemented the Directive “no later than 8 October 2004.” However, only five of the 25 Member States were able to achieve this in time. Some firms have indicated some interest in making use of the new legal form, but at present it remains unclear when and to what extent such a transition will happen.

Nevertheless, the adoption of the SE can and should be understood as another event signaling institutional change. Compared with the traditional systems of the Member States, the SE offers new opportunities for choice and presents corporations with new strategic challenges. Businesses, that is managers and investors, can move a company to a jurisdiction which will present an (at least somewhat) more attractive regulatory environment. Moreover, national legislators can provide incentives for such a decision by either making their laws more inviting or establishing rules that impede the move to another Member State.

This can be further explained by a hypothetical. If we assume that a German stock corporation with more than 2000 employees, Widget AG (“Widget”), wants to get rid of the German regime of worker participation on the supervisory board, it can merge with a British public limited company by forming a European Company, Widget SE, to be registered in the UK. The British partner in the merger could be small and unimportant; it could be a wholly owned subsidiary of Widget. This move will not free Widget from codetermination; it will have to negotiate with its employees and their union the agreement provided for in the Directive. Due to the

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109 SE-Dir., supra note 84, sec. 2.
110 Id. at art. 3, para. 1.
111 SE-Reg, supra note 83, art. 12, para. 2.
112 Id. at art 16, para. 1.
113 For details, see SE-Dir., supra note 81, art. 3.
114 Id. at art. 3, para. 4.
115 Id. at art. 14, para. 1.
116 The Member States are Austria, Belgium, Denmark, Finland, and Sweden. Die Europa AG verzögert sich. Frankfurter Allgemeine Zeitung, Oct. 9, 2004, at 12.
117 SE-Reg, supra note 83, art. 2, para. 1.
118 SE-Dir., supra note 84, art. 4.
“Standard Rules” of the Annex, it may well be that the “special negotiating body,” which represents the employees of both merging companies, will not be inclined to settle for less than the German model allocating half of the seats in the supervisory board to the representatives to the workers. If Widget does not agree with this solution but still wants to achieve the merger it has to accept exactly this outcome under the “Standard Rules” in order to get the registration. But two years after the date of the registration Widget can make a next move: now the firm is able to transform the (British) SE into a British plc. UK law does not impose any form of employee participation on companies. Neither the SE-Regulation nor the SE-Directive require the preservation of codetermination in such a case. Following such a strategy Widget has been able to transform itself from a German Aktiengesellschaft into a British public limited company by shares without having to dissolve and liquidate in Germany and to reincorporate in the UK. This opens the door that had been previously kept closed by the Daily Mail ruling of the ECJ.

Since October 8, 2004, Germany has lost the power to prevent its stock corporations from this form of exit into another jurisdiction.

There are other strategic options for businesses: in all Member States firms now have the choice between the two-tier and the one-tier structure. But the freedom to move and thus select the preferred corporate law regime appears to be the most important innovation. There can be no doubt that such a transformation will be burdensome and time consuming. In our hypothetical, Widget will have to allow the employees at least six months for negotiations. After the registration of Widget SE, the enterprise will have to wait two years before it can start the transformation into Widget Ltd., the British plc. More time will be needed for the preparation of documents and for the process of registration. Member States implementing the Regulation and transforming the Directive into national law can establish additional barriers by legislation. This is another important feature of the SE regime: national legislation will have an impact on the incorporation and relocation decisions of companies. The Member States are faced with a comparatively simple, but fundamental alternative. They can either try to provide a desirable legal environment in order to keep their companies and to attract others. If they are unable to do this, they can increase the burden on the exit decision. As mentioned before, most of the Member States have not yet finalized their SE legislation, but the available drafts indicate sufficiently clearly in which direction they intend to move. Again, the situations in UK and Germany are particularly interesting.

In the UK, the Department of Trade, which is in charge of preparing legislation, will take “the narrowest possible view of what has to be done;” it will follow a “minimalist approach.” In effect, it will not introduce any rules implementing the two-tier system, thus preserving companies all the freedom the SE-Regulation

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115 See supra note 102 and accompanying text.
118 SE-Dir., supra note 84, art. 5, para. 1.
119 Paul Davies, Implementation of The European Company (SE) in Great Britain, in Die Europäische Aktiengesellschaft - Umsetzungsfragen und Perspektiven 10, 13 (Theodor Baums & Andreas Cahn eds. 2004).
120 Id. at 39.
offers. But it will make use of a provision in the SE-Regulation permitting Member States to require or allow companies adopting a two-tier system to provide that the members of the managing organ shall be appointed and removed at the shareholders' meeting and not by the supervisory board. This of course reduces the impact of employee participation within the supervisory board to a large extent. The UK thus will give Widget AG an additional incentive to merge into Widget SE (UK); the employees and their unions can be excluded from the decision of who should run the company.

On the other side of the spectrum, Germany will not make use of this possibility. It will stay with the tradition of heavy mandatory regulation of corporate law. Its statute for the introduction of the SE provides for no less than 30 articles for the implementation of the one-tier system. It requires the board to appoint one or more executive directors to manage the company and have the exclusive authority to represent it. The most important feature of the German approach, however, is its excessive appraisal rights. The Department of Trade and Industry in the UK thinks that the SE-Regulation provides for sufficient protection of shareholders: the formation of an SE has to be based on comprehensive disclosure of all material circumstances, and it requires a qualified majority of the shareholders of all involved companies. The German draft intends to give opposing shareholders the right to tender their shares to their company and to ask for cash compensation. The government argues that shareholders should not be forced to accept a foreign legal regime of their company. This justification is not in line with the legislative intentions behind SE-Regulation: the European Company is conceived as a basically homogenous legal form for doing business throughout the European internal market. The appraisal rights are generally viewed and rejected as a device designed to burden the transition from a German AG to a non-German SE with additional costs. Unlike the UK, Germany does not show any aspiration to become the Delaware of the EU. The two approaches to the implementation of

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121 Id. at 16.
122 See SE-Reg. supra note 83, art. 39.
123 Davies, supra note 119, at 22 (the UK will allow but not require companies to make use of this option).
125 SEAG, arts. 20 to 49. This approach is generally criticized and rejected; see Michael Hoffmann­Becking, Organe: Strukturen und Verantwortlichkeiten. Zeitschrift für Unternehmens- und Gesellschaftsrecht 335, 377 (2004); Peter Forstmoser, Monistische oder dualistische Unternehmensverfassung?, Zeitschrift für Unternehmens- und Gesellschaftsrecht 688, 718 (2004).
126 SEAG, art. 40, para. 1. It is doubted that this is compatible with the SE-Regulation; see Hoffmann­Becking, supra note 125, at 370.
127 Davies, supra note 119, at 14.
128 SE-Reg. supra note 83, art. 8, para. 6; art. 18; art. 32, para. 6; art. 37, para. 7; and 59.
130 The whereas clause (6) of the Regulation refers to the SE as a "legal unit."
the SE reflect the sharply differing attitudes of both countries in the Uberseering\textsuperscript{132} and Inspire Art\textsuperscript{133} litigations.

V. THE MECHANICS OF CHANGE: ACTORS ON AND FORCES BEHIND THE STAGE

A. From Here to Where?

Each of the developments described in Parts II, III and IV have been and continue to be controversial. But there could be a new dimension: should – or even does – the perspective change if we consider the developments in context? If we do, it becomes more obvious that the situation has changed and it appears rather likely to continue to change. The transformation will be slow; it will take a long time to reach a state of affairs more closely resembling the American model. The question of how long this will take is of more than mere theoretical interest; the political and economic implications of such a transition are rather obvious. Any form of forecast would certainly be imprudent; but the view of the future might become less clouded if the factors generating the change could be taken into somewhat closer consideration. At the moment this cannot be more than a rough estimation; the pieces of available evidence cannot be put together without a strong element of speculative reasoning.

B. Legislation: The Decline (Harmonization) Reconsidered

Looking at the process of harmonization by directive, there appears to exist an obvious conclusion: the Member States were just not or no longer able to agree. The continuing enlargement may further explain this: with each additional member, agreement becomes more difficult to achieve.\textsuperscript{134} This is certainly not misconceived, but a few qualifying aspects should be taken into consideration. Originally, the EC Treaty required the Council to adopt directives for the approximation of law by unanimous vote.\textsuperscript{135} In 1987 the SEA granted an exception for directives designed to promote the establishment of the internal market: from that time forward, they could be adopted by a qualified majority.\textsuperscript{136} This was intended to facilitate and speed up the legislative process by depriving single Member States of their veto power. On the other hand, the Treaty on European Union ("TEU") formally adopted the subsidiarity principle, limiting the competence of the EU to measures which "cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community,"\textsuperscript{137} thus strengthening the position of Member States opposed to further harmonization. But in fact, the Regulation and the Directive establishing the SE were adopted, and the various proposals pleading for the deregulation or even the abolition of the

\textsuperscript{132} See Uberseering, 2002 E.C.R. 1-9919, and accompanying text
\textsuperscript{133} See Inspire Art, 2003 E.C.R. 1-10155, and accompanying text
\textsuperscript{134} Christian Timmerman, Harmonization in the Future of Company Law in Europe, in Capital Markets and Company Law 625: 626 (Klaus Hopf & Eddy Wymeersch eds., 2002)
\textsuperscript{135} TEU art. 100 (now art. 94).
\textsuperscript{136} Id. at art. 100(a) (now art. 94).
\textsuperscript{137} Id. at art. 3(b) (now art. 5).
Second Directive cannot be explained by the mechanics of the voting requirements.

At a closer look there appears to be a deeper and more complex history. It has several aspects that are interrelated but separable.

The first has to do with American law. It was perceived through the lens of William Cary. Delaware was a product of the "race to the bottom." It took a long time before the literature pointing to the benefits of the system was received, the psychological mechanics of selective perception obviously had an impact.

Second, the EC Commission started to work on company law harmonization in the early to mid-sixties. At that moment the German model looked very attractive. The British industries were plagued by continuing labor conflicts. In France and Italy the unions were split into Catholic, socialist, and communist organizations, the latter being strongest and fighting for the nationalization of the core industries. Germany at that time gave workers and their unions one third of the seats in the supervisory boards, labor relations looked excellent, and the major industries and the economy generated satisfying rates of regular growth. At least some of the French and Italian business leaders showed sympathy for this approach. As the European Parliament by then was limited to a merely consultative role, the Commission would discuss legislative projects in staff meetings with the most important interest groups, which in the case of company law are the federations of employees and the unions. Furthermore, the European Parliament was dominated by the Christian-Democratic and Social-Democratic groups; both could easily agree on a corporate law system emphasizing the stakeholder approach. The initial drafts of the Fifth Directive and the statute for a European company reflected not only the sincere beliefs of their framers but also the political environment which would allow them to pass through the legislative process.

Third, the slow erosion of these assumptions has been fed by many factors. One of them is certainly the growing involvement of the UK in the deliberations; for this Member State the original drafts of the Fifth Directive and of the SE Statute were equally unacceptable. But, again, there are more general reasons. With the increasing competition from newly industrialized or industrializing countries, the German model started to lose its glamour and attraction. Moreover, the internationalization of financial markets was confronted with the experience that stakeholder corporations had difficulties competing for capital on these markets.

Finally, the legislative adoption of the statute for the SE cannot be considered a late success of the program of corporate law harmonization. As we have seen, the
Regulation and the Directive harmonize only at the surface; in reality they open up a still much too rigid system. This responds to the needs and pressures of European firms to obtain better opportunities and conditions for cross-border activities and cooperations. The final compromise is designed to achieve this goal and to allow at the same time the German government and the German unions to save face. This may work for some time, but in the long run this is not likely to last. As long as German corporations continue to be burdened by employee participation, they are threatened to be left out of the reorganization of the European industries across the traditional borderlines as nobody will want to merge with them. Thus they will have to press for change, move or do both. For those who would prefer to retain the traditional German system, the adoption of the SE-Regulation is a “disaster,” the verdict appears to be based on a correct understanding of the importance of the event.

C. What Motivates the Court of Justice?

From the early years of the EC, the ECJ had played an active or even activist role in emphasizing the importance and expanding the impact of the basic economic freedoms for the benefit of the internal market. The Treaty provisions requiring the free movement of goods, the free movement of workers, the freedom to provide services, and the freedom of establishment were all given direct effect and precedence over Member State law as soon as the ECJ had the opportunity to do so. The Court did not limit itself to the elimination of only Member State laws but regulations that discriminated against goods and services coming from other Member States. Under the “Dassonville formula,” all “trading rules enacted by Member States which are capable of hindering, directly or indirectly, actually or potentially, intra-Community trade are to be considered as measures having an effect equivalent to quantitative restrictions.” This caused the elimination of long...
established elements of Member States' laws. And not only did the Member States have to abstain from enacting, maintaining and enforcing restrictive rules, but also the Court imposed the duty to oppose and remove obstacles caused by acts of their citizens.

The decisions in Centros, Überseering and Inspire Art can and should be read as being in line with and continuing case law that emphasizes and expands the impact of the basic freedoms of the EC Treaty. But they differ from the former cases in one important aspect. It must be remembered that the original treaty explicitly looked for company law harmonization by EC lawmaking and not by legislative competition between the Member States, and that it encouraged or even requested an agreement between the Member States regarding the transfer of companies across borderlines. This has to be understood as excluding an interpretation of the free establishment provisions which would invalidate the real seat theory and thus impose the incorporation doctrine upon all the Member States. This can be seen as a limitation of a basic freedom by reserving legislative powers for the Member States. In Centros, Überseering and Inspire Art the ECJ has disregarded these limitations. This has an interesting parallel in the Golden Share Cases. They are very similar: Portugal, France and Belgium had privatized formerly state owned enterprises but wanted to retain some control of future ownership. Portugal and France subjected the acquisition of shares in their companies to prior government authorization. Belgium introduced a more modest regime: the government would retain some "golden shares" providing the authorities with the right to block the sale of "strategic assets" of the firm. The Commission brought actions against the three Member States, blaming them inter alia for interfering with the free flow of capital. Advocate General Ruiz-Jarabo Colomer referred to Article 295, a provision which reserves to the Member States the power to determine "the rules ... governing the system of property ownership ...." This means that it is left to the Member States to determine how far they wish to nationalize or to privatize their industries. Colomer strongly argued that Article 295 had to be applied to any measure regarding ownership rights in enterprises of national interest. The "golden share" provisions "constitute means by which the public authorities may participate in the activities of certain undertakings of strategic interest for the national economy, with the purpose of imposing economic policy objectives ..." and this is what Article 295 reserves for the sovereignty of the Member States. There are good reasons to assume that this interpretation reflects the intentions of the framers of the original EEC Treaty. But the ECJ rejected this argument: Article 295 should not and does not allow a property

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155 [Commission v. French Republic, Case C-265/95, 1997 E.C.R. I-6959.]
159 See supra notes 9 – 11, and accompanying text.
161 Originally TEC art. 222.
rights regime interfering with the basic freedoms guaranteed by the Treaty. "The
free movement of capital, as a fundamental principle of the Treaty, may be restricted
only by national rules which are justified by reasons referred to in Article 73d(1) of
the Treaty or by overriding requirements of the general interest and which are
applicable to all persons and undertakings pursuing an activity in the territory of the
host Member State. 164 This is to say the Court's reasoning in the Golden Share
Cases follows the same patterns we have seen in Centros, Uberseering, and Inspire
Art: original reservations of Member State power, designed to allow the States to
retain their national systems of industrial organization, are increasingly restricted by
the enhanced importance given to the basic economic freedoms. It is evident that the
Court has been moving to an understanding of the Treaty that emphasizes a market
approach to corporate law. It is, however, much less clear what exactly motivates
the Court to follow this direction; in this respect all the opinions are silent. But it is
obvious that the Court is in line with the movements of legislation. This invites the
conclusion that the case law, too, is evidence of a broader shift in assumptions and
attitudes.

IV. A BROADER CONTEXT: CONVERGENCE RECONSIDERED

Even if there are good reasons to assume that the future evolution of corporate
law structures in Europe will be slow, piecemeal, and cumbersome, there can be no
doubt that significant changes have occurred that are moving the system towards the
more sophisticated patterns that have emerged in the U.S. Companies will have
more freedom to choose between jurisdictions; this will stimulate legislative
competition between the Member States and thus provide for incentives to further
deregulate the rigid structures that continue to constrain some of the national systems.
This happens in a time when the U.S. - in a rather surprising move - has returned to
the idea of regulating corporate law at the federal level. The Sarbanes-Oxley Act of
2002 165 may deal mostly with securities regulation, but it imposes organizational
safeguards like the establishment and the composition of an audit committee, 166
which are basically of a corporate law nature. Thus we can see some form of
convergence from both sides of the Atlantic. 167

But this convergence will hardly mean that the history of corporate law will
come to an end. 168 It is true that Europe is moving away from its traditional
stakeholder approach, but the steps are small and the pace is slow. The regime of the
SE opens up the traditional system and allows for some new options and strategies.
But the complex rules and the cumbersome and lengthy procedures are the result of
political compromises, which are very much shaped by the ideas and assumptions of

\[163\] Now TEC art. 56, para. 1.
\[164\] Id. at para. 49; see also Commission v. France. Case C-483/99 [2003] 40 C.M.L.R. 493, at para. 44 (but the Belgian rules were upheld as a proportionate protection of the public interest, at para. 46).
\[166\] Id. § 301.
\[167\] For an early prediction of such convergence, see Roberta S. Karmel, Is it Time for a Federal Corporation Law?, 57 Brook. L. Rev. 55, 90 (1991).
the past; they show specific features of "path dependence" and the stickiness of well-established institutional arrangements. Even if German-style codetermination slowly disappears, Europe will retain a mandatory regime of works councils completely unknown to the U.S. At the same time, the adoption of the Sarbanes-Oxley Act can be understood as a political reaction not only to the losses suffered by shareholders but also to the harm inflicted upon the employees of Enron. And this legislation may be interesting for still another reason. It has been convincingly argued that convergence proceeds not only by "formal" changes of corporate law but also by the "functional" effects of cross border securities transactions. Listings of non-American companies on U.S. stock exchanges provide a persuasive example: the listings agreement imposes corporate governance obligations; the listing of Daimler-Chrysler on the New York Stock Exchange "is a paradigmatic example of functional convergence."

But Sarbanes-Oxley has significantly contributed to the costs of maintaining a listing in the U.S. Therefore the interest of European companies to have direct access to the American exchanges has sharply declined; and German firms like Siemens are considering delisting their shares from the New York Stock Exchange. This could mean that we will see less of this type of "functional" convergence in the near future.

What we may see in Europe instead is a complex and perhaps confusing mixture of formal and functional elements. The legislative process and the Court of Justice have amended the formal rules, which provide the framework conditions for corporate activities and strategies. The national legislators have appeared to respond to some extent. At this moment it is unclear how the private actors - investors, managers, unions - will react. In any case: there is more room for "formal" convergence.

171 Gilson, supra note 169, at 349.
172 Coffee, supra note 16, at 681.
174 Gilson, supra note 169, at 351: "In its Centros decision, the European Court of Justice introduced regulatory competition - a hybrid between formal and functional convergence - into the European Union."
175 See supra note 120, and accompanying text.