

Incorporation theory vs. real seat theory

EU Company Law

Exam question

Discuss the two opposing theories: incorporation theory v. real seat theory.

Introduction

Why is the subject interesting?

Incorporation theory

Definition

- Determines the applicable company law by reference to the country in which the company was incorporated (and registered).
 - The connecting factor being the country of incorporation.

Real seat theory

Definition

- Determines the applicable company law by reference to the country in which the company has its actual real seat (head office).
 - The connecting factor being the actual corporate seat.

“Background”

Incorporation theory used in UK, Scandinavia and the Netherlands

Real seat theory developed in France and used in most continental countries.

- The doctrine was developed in Belgium and France in the nineteenth century,
- and according to it, a conflict of company laws must be settled in accordance with the law of **the state in which the central administration is located**.
- The doctrine is **traditionally considered protective** because the main philosophy behind it is that a company must be subject to the law of the state in which its corporate centre of gravity is located.
 - This is because it is *assumed* that the **majority of the corporate stakeholders will be located there**.
 - Such stakeholders include shareholders, creditors, employees, and suppliers.
 - It is also *assumed* that **societal interests are best served** when a company is subject to the law of the state where its central administration is located.
 - These **assumptions** seem to be somewhat **outdated**.
 - Information technology now makes it possible for management to be located geographically somewhere other than where the economic activity of a company is centred, and the members of the supervisory board do not have to be in the same country when meeting.
 - Many companies do a great deal of business outside the state of incorporation,
 - and creditors, suppliers, and investors today are spread over many countries.

What are the impacts of either theory?

Administration – how easy is the theory to administer?

Incorporation theory

- The primary advantage of the incorporation state doctrine is that it is easy to determine the jurisdiction to which a company is subject.
- It is not necessary to make a factual evaluation of the location of any of the business activities;
 - where a company is incorporated can be easily and objectively established.
- It **might be harder** for a state in which a company is incorporated but in which it has no economic activity to have the necessary insight into the affairs of the corporation **to maintain the same level of control**, than for real seat countries.
 - There is also a **risk** that such a **state will not have any particular interest in companies** that only keep their registered office in the state, and therefore, it will **not allocate the resources** necessary to maintain control.

Real seat theory

- The real seat doctrine is *criticised* because **the use of the central administration (“corporate seat”) as the decisive factor** gives rise to *a number of problems*.
 - When the central administration is used as the connecting factor, it is of great importance to determine where it is located.
 - **How to interpret the concept** of the “central administration.”
 - Today there is *no general agreement*.
 - In most cases, it is defined as the management of the company.
 - But who is the management and where can it be said to have its seat?
 - It seems to be generally recognised that the management is the **board of directors** of a company or management board
 - not the person who has de facto control and influence, such as a controlling shareholder or a parent corporation.
- It must be recognised that it is probably easier for the state in which a company has its central administration to ensure that it complies with its law. (Control)

Forum shopping / Impact on free movement

Incorporation theory

- The use of the incorporation state doctrine **does not restrict freedom of establishment in any way**
 - because the company is free to locate its registered office in the state that seems most advantageous.
 - It is also possible to transfer the central administration out of the state of incorporation.
 - The decisive factor is whether the company has been formed in accordance with the legal requirements of that state,
 - and the company will still be subject to the laws of that state after the transfer of its central administration.
- Thus allows for forum shopping.

Real seat theory

- The doctrine is criticised because of its implications on freedom of establishment.
- In all MS, a national company is required to have its registered office within the state of incorporation.

- This means that when a state that applies the real seat doctrine, such as Germany, finds that a company must comply with German law because its central administration is located there, it will require that company to have its registered office in Germany as well.
 - Because of this, it is **not possible to separate the central administration from the registered office**.
 - Therefore, the widespread application of the real seat doctrine **severely restricts the scope for forum shopping**.

Examples

UK (inc. theory) incorporated company moves real seat to the Netherlands (inc. theory)

- No problem.
- Centros case

UK (inc. theory) company moves real seat to German (real seat theory)

- UK would still recognize the company as a UK company.
- Germany would recognize the company.
 - Germany would say it's now a German company, but unproperly incorporated.
 - => owners directly liable.
- Überseering was this situation.

German (real seat theory) company moves real seat to UK (inc. theory)

- Germany would no longer recognize the company as a German company.
- => UK would not either, as it is no longer a company in Germany.

Centros – Case 212/97

Facts

- Danish couple established a private limited company (ApS) in the UK.
- Wanted to establish a branch in Denmark, but this was declined.
 - The secondary establishment was only to circumvent the Danish capital requirements.
 - UK £ 0 – DK 125.000 kr.

Rulings

- It is contrary (ikke lovligt) to refuse registration of a branch in a member state, if the company is legally formed in another member state.
- It does not matter that
 - the company conducts no business in the member state, but all business is intended for the branch.
 - The formation was done to circumvent the capital requirements of the member state of the branch.

Corporate mobility after Centros

- Recap:
 - Danish authorities had refused to register a branch of Centros Ltd on the grounds that the branch structure was chosen with a view to evading the Danish rules on minimum capital for private companies.
 - Arguments of DK authorities were rejected by the ECJ.
 - ECJ no doubt opened new doors to cross-border activity.

- BUT
 - Most important question of the judgment
 - The extent to which it affects national rules on the question of a company's nationality.

Is the Real seat Doctrine Dead?

- Different interpretation of Centros
 - There is an unconditional requirement for all MS to recognize any company which is validly incorporated in a MS as a legal person,
 - even though the company's actual head office (real seat) was relocated to another MS.
 - the real seat doctrine could no longer be used to deny recognition of a company, which is covered by the Treaty rules on freedom of establishment.
 - The real seat doctrine is compatible with Community law.

Arguments for Maintaining the Real Seat Doctrine

- The Centros case Involved two 'Incorporation Doctrine' States
 - It should be possible for a company from one incorporation state (fx. UK) to move its real seat to a branch in another incorporation state (fx. DK).
- Argument: Centros did not affect MS whose international company law is based on the real seat doctrine.

Überseering

Überseering

Facts

- Überseering was founded in the Netherlands.
- It bought a piece of land (garage and motel) in Germany (Düsseldorf) and engaged NCC to refurbish the buildings.
- The shares of Überseering was bought by two german citizens.
- Überseering filed against NCC because of alleged defects.
- The german Landesgericht dismissed the action, because it found it Überseering had moved its **real seat** to Germany. Thus it were no longer a company of the Netherlands, and it was not registered in Germany.

Rulings

- Überseering was correctly incorporated in the Netherlands. Art 43 and 48 thus allowed for freedom of establishment in Germany.
- Subsequently purchasing of all shares by german citizens, did not cause to cease the legal status of a company of the Netherlands.

The special case of the SE company

The SE regulation has dealt with the real seat- and incorporation theory

- Registered office and real seat must be in the same MS.
 - No problem since SE can move around the MS's freely.