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  ○ These assumptions seem to be somewhat outdated.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,
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 unpropor incorporated.
  - =>$ owners direct 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.
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.