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ARTICLE

Free Movement of Companies After the *Polbud* Case

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Abstract
On the 25th of October 2017, the CJEU rendered a ruling in the *Polbud* case. The ruling shows that the CJEU is determined to embrace a further liberalization of the free movement of companies in the internal market. The Court's confidence and no-compromise approach brings with it a number of effects. First of all, the Court has detached the transfer of the registered office from the traditional notion of establishment. The registered office can be relocated by 'will alone', irrespective of whether it is justified by the actual conduct of business or the company's structure. Secondly, the author discusses in detail the fate of the real seat in the light of the *Polbud* judgment. After the *Polbud* ruling, the real seat has lost most of its functionality that had already been diminished by the Court's earlier case law. Now a company incorporated in a real seat jurisdiction can easily 'contract out' by performing a cross-border conversion. Hence, the real seat mainly preserves its role as a precondition for incorporation. Finally, the ruling underlines more than ever that the CJEU focuses on the protection of the private interests of companies by allowing them to choose a favourable legal order. Economic interests of the Member States are of lesser importance under the Court's approach.

Keywords Freedom of establishment · Cross-border conversion · Real seat theory · Contractual theory of companies · Cross-border mobility

1 Introduction

In the recent *Polbud* case,[1] the Grand Chamber of the Court of Justice of the European Union (CJEU) had an opportunity to continue developing its jurisprudence on the free movement of companies. The case is an important precedent as it modifies

1 CJEU 25 October 2017, C-106/16 *Polbud*, EU:C:2017:804.

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the *Vale* judgment,[2] rendered by the Third Chamber, and opens the doors for the greater movement of companies within the European Union (EU). Currently, it is the decisive judgment that liberalizes the framework for cross-border conversions—a relocation of the registered office—within the EU.

Companies have two offices (or seats). The most important of them is the registered office. This is a fictional address found in the official registry and the company's statutes.[3] This fiction serves as a connecting factor for the jurisdiction of the commercial register.[4] Thus, normally a commercial register cannot contain an entry for a company having its registered office abroad. This means that the registered office determines the place of incorporation. In turn, the state of incorporation determines the connecting factor with the applicable substantive law in the state of incorporation.[5] Usually, states require companies to have their registered offices in the state of incorporation,[6] making the notion of the registered office universally important.

The notion of the real seat (or the head office) is only important in some Member States that preserve the real seat as their connecting factor. For Member States that use the incorporation theory, the substantive law that is applicable to the company is always the law of the state of incorporation. In these Member States, the notion of the real seat has no conflict-of-laws effect.[7] Other Member States use the real seat theory—the law of the Member State where the real seat is located is applied to the company. Usually, this means that a company is obliged to have its real seat in the state of incorporation.[8] If the state of incorporation and the state where the real seat is located do not coincide, the company may lose its legal personality because its corporate form does not exist under the applicable substantive law.[9]

For decades, the CJEU has been dealing directly or indirectly with the problem of the relocation of the real seat. The end result so far has been that a company incorporated in a Member State must be recognized in other Member States irrespective of the connecting factors used.[10] The state of incorporation, however, preserves the right to choose the appropriate connecting factor.[11] The *Polbud* case takes matters further. This case makes it clear that companies are allowed to move their registered

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[2] CJEU 12 July 2012, C-378/10 *Vale*, EU:C:2012:440.

[3] Edwards (1999), pp 334–335; Kotzur (2015), Article 54, p 376.

[4] Behrens (2002), p 505.

[5] For practical purposes, 'the law of the state of incorporation' and 'the law of the state where the registered office is located' are synonyms. In the words of Garcimartín: 'The registered office and the law of constitution of the company are usually interchangeable: the law of all Member States requires that companies must locate the registered office in the territory of the State under the law of which those companies are constituted.' Garcimartín Alférez (2008), p 154.

[6] Myszke-Nowakowska (2014), p 66. Compare, Behrens (2002), p 505.

[7] Compare, Behrens (2002), p 505; Borg-Barthet (2012), p 51. Hence, a company once incorporated in a state may preserve its legal personality and the applicable law, irrespective of the place of factual activity. Compare Lutter (2000), p 63.

[8] Garcimartín Alférez (2016), p 953.

[9] Garcimartín Alférez (2008), p 60.

[10] See in particular, CJEU 5 November 2002, C-208/00 *Überseering*, EU:C:2002:63.

[11] Meeusen and Myszke-Nowakowska (2016), pp 115–116.

offices[12]: just as chameleons change their colour, companies may change the applicable legal order. By changing the legal order, the companies simultaneously change the applicable law. Moreover, the company may execute this change of the legal order—the cross-border conversion—without moving its establishment or having any economic connection with the state of destination.

By allowing companies to change the applicable legal order without any real movement, the CJEU has expressed its fervent support for a very liberal construction of the free movement of companies. In this sense, the case rejects some of the statements made in the *Vale* case and continues the path of the extensive liberalization of the internal market started by the Court in the *Centros* and *Inspire Art* cases.[13]

The author will analyse certain important novelties arising from the *Polbud* case. After a brief description of the facts and the ruling in the *Polbud* case, the author will discuss the evolution of the jurisprudence, from the prohibition of discriminatory restrictions to all-around protection of cross-border conversions. Thereafter, the author will analyse the fictitious free movement authorized by the CJEU, followed by an analysis of the putative effects of the ruling on the real seat theory. The final section will be devoted to the fate of the real seat theory in the EU, once again affected by the Court's jurisprudence.

2 The *Polbud* Case: The Facts and the Ruling

The Court's jurisprudence on company law has been a long and winding road. Since the *Daily Mail* case,[14] the CJEU has been trying to find an optimal balance between respect for the real seat theory and the need to encourage the free movement of companies. The early cases directly or indirectly dealt with the phenomenon of the movement of the real seat.[15] Recently, the focus has changed to more complicated forms of cross-border activity. Firstly, in the *Sevic* case,[16] the Grand Chamber of the Court applied the freedom of establishment to the cross-border merger. Thereafter, the Third Chamber of the Court did the same in respect of the cross-border conversion, that is, the transfer of the registered office that implies re-incorporation in another jurisdiction.[17] However, it seems that for the Grand Chamber of the Court, the ruling of the Third Chamber in the *Vale* case was not entirely satisfactory. The

[12] In this article, we use the 'cross-border conversion' and the 'transfer of the registered office' as synonyms. Whether the transfer of the registered office necessarily implies that the cross-border conversion is necessary depends on the substantive law of the Member States. However, the practice of the CJEU until now has dealt with conventional company law regimes where the transfer of the registered office implied the cross-border conversion.

[13] CJEU 9 March 1999, C-212/97 *Centros*, EU:C:1999:126; CJEU 30 September 2003, C-167/01 *Inspire Art*, EU:C:2003:512.

[14] CJEU 27 September 1998, 81/87 *Daily Mail*, EU:C:1988:456.

[15] In particular, ibid.; CJEU 5 November 2002, C-208/00 *Überseering*, EU:C:2002:63.

[16] CJEU 13 December 2005, C-411/03 *Sevic*, EU:C:2005:762.

[17] CJEU 12 July 2012, C-378/10 *Vale*, EU:C:2012:440.

Grand Chamber was given an opportunity to correct the existing case law on the cross-border conversion in the *Polbud* case.

The problem in the *Polbud* case can be summarized using the words of Advocate General Kokott:

> […] a Polish private limited liability company wishes to assume the legal form of a company governed by Luxembourg law while at the same time retaining its legal identity. However, the removal of the company from the Polish commercial register, a condition of completion of the aforementioned endeavour, is precluded by the fact that, under the law of that Member State, removal from the commercial register is subject to the requirement that the company must first be liquidated and wound up.[18]

Being faced with this factual pattern, the Supreme Court of Poland referred three questions to the CJEU. The questions can be reformulated in the following manner: (1) can the state of incorporation require the liquidation of the company willing to re-incorporate itself in another Member State and if the answer to this question was to be negative; (2) was liquidation with all the consequences it involved under Polish law suitable, necessary and proportional to the public interest of safeguarding the interests of creditors, minority shareholders and employees of the company; (3) did the freedom of establishment apply if the company only transferred its registered office, while leaving the head office in the former state of incorporation?[19]

The facts of the case were simple and so were the questions. The judgment was also straightforward and simple. The Court knew what result it wanted to achieve; it had its own clear philosophy and did not seek a compromise between different opinions. In fact, there were two possible outcomes. One—to allow the transfer of the registered office but to limit it by a number of conditions. Two—to open the gates of free movement and allow the fictitious free movement of the registered office without any additional preconditions.

The simple facts of the case allowed the CJEU to render a 'model' ruling on the cross-border conversion aligning it with the second outcome. The Court needed only six paragraphs to demonstrate the existence of the restriction. The Court began with the very broad formula that 'all measures which prohibit, impede or render less attractive the exercise of freedom of establishment must be considered to be restrictions on that freedom'.[20] Pursuant to Polish private international law, a relocation of the registered office did not entail the loss of legal personality.[21] However, in accordance with Polish substantive law, a relocation of the registered office meant the commencement of the liquidation procedure with the ensuing winding-up.[22] It

[18] Opinion of Advocate General Kokott in case: 25 October 2017, C-106/16 *Polbud*, EU:C:2017:351, para. 2.

[19] CJEU 25 October 2017, C-106/16 *Polbud*, EU:C:2017:804, para. 18.

[20] Ibid., para. 46.

[21] Ibid., para. 47.

[22] Ibid., para. 48.

was only through liquidation that Polbud could have its name removed from the Polish commercial register.[23]

The CJEU underlined the disastrous effects of liquidation. These included

> […] the completion of current business, recovery of debts owed to the company, performance of its obligations and sale of its assets, satisfaction or securing of its creditors, submission of a financial statement on the conduct of that process and indication of where the books and documents of the company in liquidation are to be deposited.[24]

These effects were sufficient to conclude that the liquidation of the company was liable to impede and possibly even to prevent the cross-border conversion of the company. Thus, it amounted to a restriction.[25]

Once the Court identified the restriction, Poland had an opportunity to vindicate itself by showing that its measures were justified. The CJEU devoted many more paragraphs to an analysis of the alleged justifications, but that effort did not bring good news for Poland. Neither of the proposed justifications passed the necessity and proportionality test.

While the analysis of the restriction was more direct and more liberal than one would expect, the Court's analysis of the justifications was less surprising. Company law is an area where Member States have been failing miserably to justify restrictions. In fact, the problem has never been to supply valid overriding reasons, but rather to prove the necessity and proportionality of the measures in question.[26] The *Polbud* case brought no surprises. The referring court mentioned three overriding reasons: protecting the interests of the creditors, minority shareholders and employees of the company transferred. All three were accepted by the CJEU as valid reasons. However, the CJEU easily found that the mandatory liquidation of the company was going beyond what was necessary to achieve these interests.[27] At the same time, the Court suggested that the Member States could protect the interests of creditors via bank guarantees or other equivalent guarantees.[28] This remark shows that the Member States have at least some tools that they may use to protect the interests of third parties that may harmed by cross-border conversions.

In addition, the Polish Government relied on the prevention of abusive practices to justify the restriction. Following the approach introduced by the *Centros*

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[23] Ibid., para. 49.

[24] Ibid., para. 50.

[25] Ibid., para. 51.

[26] In the previous cases dealing with company law, Member States have provided overriding reasons, but have failed to show that the measures in question were suitable, necessary and proportional. The latter two criteria were particularly difficult to satisfy. See CJEU 12 July 2012, C-378/10 *Vale*, EU:C:2012:440; CJEU 16 December 2008, C-210/06 *Cartesio*, EU:C:2008:723; CJEU 13 December 2005, C-411/03 *Sevic*, EU:C:2005:762; CJEU 30 September 2003, C-167/01 *Inspire Art*, EU:C:2003:512; CJEU 5 November 2002, C-208/00 *Überseering*, EU:C:2002:63; CJEU 9 March 1999, C-212/97 *Centros*, EU:C:1999:126.

[27] CJEU 25 October 2017, C-106/16 *Polbud*, EU:C:2017:804, para. 59.

[28] Ibid., para. 58.

judgment, the Court confirmed that Member States may take appropriate measures to counter abusive practices.[29] However, the fact that the company preferred to establish itself in a more favourable jurisdiction *per se* did not constitute an abuse.[30] Similarly, the transfer of the registered office did not presume an abuse.[31] However, the requirement of the mandatory liquidation of the company was general and necessarily presumed that every relocation of the registered office constituted an abuse.[32] The measures adopted by Poland were too broad, making their application disproportionate.[33]

All in all, the CJEU dealt with justifications within its overall liberal paradigm—Member States are rarely able to justify restrictions on companies. As usual, the CJEU confirmed that the protection of groups typically negatively affected by the free movement of companies (minority shareholders, creditors and employees) was in principle capable of justifying the restriction.[34] However, the list of overriding reasons functions mostly in theory. In practice, Member States constantly fail to demonstrate that measures aimed at the protection of these groups do not go beyond what is necessary and proportional,[35] although on this occasion the Court itself suggested some measures that could be employed by the Member States to comply with the necessity and proportionality test. These measures are not permanent restrictions on the free movement of companies but are precautionary measures that may secure the interests of third parties.

Similarly, the case once again confirmed that Member States may counteract an abuse of EU law, but this may be done only through carved out, attenuated measures. And even then, it remains unclear what the abuse is if the exercise of the cross-border conversion with the view to benefiting from a better legal order in itself falls short of an abuse.

The analysis of the justifications in the *Polbud* case does not bring much added value to the Court's earlier case law. At the same time, the Court's analysis of the restriction has important added value. Therefore, in the further sub-sections of this article we will focus our discussion on the latter, and deal with the added value given by the judgment, leaving aside the theory and practice of justifications.

[29] Ibid., para. 61. In this paragraph, the Court employed the term 'fraud' rather than the term 'abuse', however, it seems that the Court used both terms interchangeably. See also, CJEU 30 September 2003, C-167/01 *Inspire Art*, EU:C:2003:512, para. 136; CJEU 9 March 1999, C-212/97 *Centros*, EU:C:1999:126, para. 24.

[30] CJEU 25 October 2017, C-106/16 *Polbud*, EU:C:2017:804, para. 62.

[31] Ibid., para. 63.

[32] Ibid., para. 64.

[33] Ibid.

[34] Ibid., para. 54.

[35] The CJEU has been reluctant to find that measures limiting the free movement of companies satisfy the requirements of necessity and proportionality. See, Mastrullo (2009), pp 234-235; Paschalidis (2012), pp 57–58.

3 Free Movement of Companies by Will Alone

3.1 The State of Affairs Prior to the *Polbud* Case

The *Polbud* case answers an important question: Is the transfer of the registered office dependent upon the existence of the establishment in the state of destination? In other words, can companies exercise the freedom of establishment without any movement or at the very least without any intention to move the establishment or even without such an establishment altogether?

Prima facie, the question seems absurd and oxymoronic. Pursuant to the traditional dogma, the exercise of the freedom of establishment implies the existence of the establishment.[36] The CJEU has ruled that the 'concept of establishment, […] involves the actual pursuit of an economic activity through a fixed establishment in another Member State for an indefinite period'.[37] For this reason, for example,

> […] the registration of a vessel does not necessarily involve establishment within the meaning of the Treaty, in particular where the vessel is not used to pursue an economic activity or where the application for registration is made by or on behalf of a person who is not established, and has no intention of becoming established, in the Member State concerned.[38]

This line of reasoning implies that the freedom of establishment is aimed at the protection of economic activity, while actions having no real economic aim are not protected. To put it differently, '[…] if the freedom of establishment is relied upon in a case where objectively the aim not a lasting and stable integration into the economy of the Member State in question, such circumstances do not fall within the scope of [49(1) TFEU]'.[39] This also complies with the traditional understanding of the internal market as an area that ensures the free movement of resources, thus involving the actual movement of these resources and access to foreign markets.[40] Hence, the freedom of establishment should protect the transfer of the registered office only when the company has previously created or simultaneously creates an establishment in the state of destination.

This logic, however, is difficult to reconcile with the case law of the CJEU on the recognition of companies. In the *Centros* case, the CJEU ruled on the rights of

[36] See, e.g., Ehlers (2007), pp 288-289.

[37] CJEU 12 September 2006, C-196/04 *Cadbury Schweppes*, EU:C:2006:544, para. 54; CJEU 25 July 1991, C-221/89 *Factortame*, EU:C:1991:320, para. 20. See also, Edwards (1999), p 352.

[38] CJEU 25 July 1991, C-221/89 *Factortame*, EU:C:1991:320, para. 21.

[39] Ehlers (2007), p 289. Other authors simply follow the lead of the CJEU in the *Segers* (CJEU 10 July 1986, C-79/85, ECLI:EU:C:1986:308) and *Centros* cases, noting that a company is established if it is incorporated in a Member State and conducts business anywhere in the EU. Craig and de Búrca (2015), p 810. This opinion is already obsolete from the point of view of the jurisprudence. After the *Polbud* case, a company can benefit from the freedom of establishment, thus being regarded as 'established', even when it is incorporated in one Member State and conducts absolutely no business in that or any other Member State. In fact, with the *Polbud* case, we come to the point where incorporation becomes a synonym for the 'establishment' of the company.

[40] Compare, Mörsdorf (2017), p 2384.

a company incorporated in the UK to open a branch in Denmark. The company was owned by Danish nationals, who did not hide their intention to pursue their business in Denmark. It was a letterbox company, incorporated in the UK, with the sole purpose of benefiting from the local legal order. The CJEU nevertheless ruled that the right to open a branch was covered by the freedom of establishment, notwithstanding that the company lacked any economic links with the UK. Indirectly, this implied the recognition of the said letterbox company.[41]

The solution was confirmed by the *Inspire Art* case. Here again a national of another Member State—The Netherlands—incorporated a company in the UK and opened a branch in the Netherlands. This time the CJEU specified that mandatory provisions of Dutch law that required additional capital and higher directors' responsibility restricted the free movement of companies. Just like in the *Centros* case, the company in question was a letterbox company with no economic activity in the UK. And once again it benefited from the freedom of establishment.

The *Sevic* case posed a similar problem. In that case, the CJEU ruled that a Member State could not prohibit cross-border mergers if such mergers were allowed domestically. In the given case, the company incorporated in Luxembourg was willing to merge with a company incorporated in Germany. The language used by the Court alluded to economic activity as an element of the freedom of establishment. The Court observed that

> […] the right of establishment covers all measures which permit or even merely facilitate access to another Member State and the pursuit of an economic activity in that State by allowing the persons concerned to participate in the economic life of the country effectively and under the same conditions as national operators.[42]

This formula seemingly emphasized that the exercise of the freedom of establishment was closely related to the pursuit of economic activity in the Member State.[43] However, other than this theoretical statement, the CJEU showed no interest in the question of whether any of these companies involved had any genuine economic activity in their states of incorporation.[44] Notably, since the state of destination was Germany, it might have seemed important to assess whether any of these companies pursued or planned to pursue genuine economic activity in that Member State. The Court did not bother to mention any of these questions, thereby creating an impression that the existence of the establishment was anything but important for the freedom of establishment.

The case law was puzzling as it was not clear why companies having no economic activity in the state of incorporation were benefiting from the freedom of establishment. Could there be freedom of establishment without any establishment to begin with? By the late 2000s it seemed that the CJEU had noticed the problem.

[41] Behrens (2002), p 511.

[42] CJEU 13 December 2005, C-411/03 *Sevic*, EU:C:2005:762, para. 18.

[43] Compare Meeusen (2017), p 316.

[44] Verbrugh (2014), p 518.

The notion of establishment was emphasized in the *Cadbury Schweppes* case, dealing with the determination of the tax jurisdiction. In that case, the CJEU underlined the well-known definition of establishment:

> […] the concept of establishment within the meaning of the Treaty provisions on freedom of establishment involves the actual pursuit of an economic activity through a fixed establishment in that State for an indefinite period. Consequently, it presupposes actual establishment of the company concerned in the host Member State and the pursuit of genuine economic activity there.[45]

Interestingly, in the given case, the reference to this definition was not made at the stage of identifying the scope of the freedom. The Court reverted to the definition while assessing the anti-abuse nature of the measures adopted by the UK. The solution seemed surprising. If the existence of establishment was the precondition for freedom of establishment, it should have been analysed in the context of the scope of the freedom of establishment. Nevertheless, the case brought the definition of the establishment back into the spotlight.

The next important step was the *Vale* case. Just like the *Polbud* case, it dealt with the problem of the transfer of the registered office. VALE Építési was a company incorporated in Italy, wanting to re-incorporate itself in Hungary. The latter refused to allow such re-incorporation. In principle, the Third Chamber ruled that the state of destination had infringed EU primary law. Nonetheless, before it came to that conclusion, the Third Chamber decided to address *en passant* the question of whether the company was willing to change the applicable legal order 'on paper' or whether the transfer had economic reasons.

The Third Chamber repeated *verbatim* the definition of the establishment used in the *Cadbury Schweppes* case, linking the concept of establishment with the pursuit of genuine economic activity in the Member State.[46] This language could be understood to mean that a simple transfer of the registered office was not protected by the freedom of establishment. On the contrary, the transfer was protected if it was either accompanied by the creation of the establishment in the state of destination or there was an already existing establishment in the state of destination.[47]

The *Vale* case was the final word on the free movement of companies before the Grand Chamber rendered its ruling in the *Polbud* case. It seemed that after the *obiter dictum* in the *Cadbury Schweppes* and the *Vale* cases, the expanding liberalism of the free movement in the *Centros*, *Inspire Art* and *Sevic* cases was to retreat and the CJEU would restore the link between freedom of movement and actual economic activity in the state of destination. The expectations were strengthened by the opinion of Advocate General Kokott.

[45] CJEU 12 September 2006, C-196/04 *Cadbury Schweppes*, EU:C:2006:544, para. 54.

[46] CJEU 12 July 2012, C-378/10 *Vale*, EU:C:2012:440, para. 34.

[47] In this case the Third Chamber decided that there were no indications that the Vale company was not seeking to establish itself in Hungary. Nevertheless, the Court left it to the referring court to make a final assessment of the issue. CJEU 12 July 2012, C-378/10 *Vale*, EU:C:2012:440, para. 35.

The Advocate General underlined that Article 49 TFEU was only applicable to cases involving an establishment in another Member State. While the establishment was a broad notion, it entailed '[…] the right to participate, on a stable and continuous basis, in the economic life of another Member State and to profit therefrom'.[48] It presupposed 'actual establishment in the host Member State and the pursuit of genuine economic activity there'.[49] However, even an intention to execute such an establishment was sufficient.[50] In the eyes of the Advocate General, Polbud was protected by primary law if it intended to engage in economic activity in Luxembourg. If the company did not have genuine economic activity in Luxembourg or did not intend to do business there, then the freedom of establishment did not apply.[51] In other words, in this discourse, free movement had a real-life economic function.

To justify her opinion, the Advocate General dealt with reasons given in earlier cases of the CJEU in the light of her reasoning. The Advocate General noted that if Polbud intended to have no economic activity in Luxembourg, then its situation would have seemed similar to the state of affairs in the *Centros* and *Inspire Art* cases. The Advocate General succeeded in making a more or less believable distinction between the *Polbud* case and the earlier case law. In the *Centros* and *Inspire Art* cases, 'the Court assessed the facts from the point of view of a company which was formed in one Member State but intended to establish itself in another Member State, the State in which its owners were resident'.[52] In contrast, in the *Polbud* case, '[t]he account given in the request for a preliminary ruling […] suggest[ed] that at issue [t]here [was] an existing company which would simply like to change its legal clothes'.[53]

The Advocate General made a sensible argument that could unify the CJEU's case law. If the concept of establishment was a necessary precondition for the application of EU primary law, then it should have been applied in cases of cross-border conversion. The strong position of the Advocate General generated expectations that the CJEU would likewise make a clear statement limiting the transfer of the registered office and finally bringing the notion of establishment back into the spotlight. Such expectations turned out to be nothing but smoke and mirrors.

3.2 The State of Affairs After the *Polbud* Case

The CJEU found that cross-border conversion was protected by EU primary law[54] and this protection was not related to any real economic activity. In order to justify this conclusion, the CJEU analysed its own prior case law, but unlike the Advocate

[48] Opinion of Advocate General Kokott in case: 25 October 2017, C-106/16 *Polbud*, EU:C:2017:351, para. 33.

[49] Ibid., para. 34.

[50] Ibid., para. 36.

[51] Compare, ibid., para. 37.

[52] Ibid., para. 41.

[53] Ibid.

[54] CJEU 25 October 2017, C-106/16 *Polbud*, EU:C:2017:804, para. 51.

General, the Court interpreted its own case law in the most literal and simplistic way.

The ruling in the *Polbud* case can indeed be regarded as an extension of the practice of the CJEU in the *Centros* and *Inspire Art* cases. Both cases dealt with companies established in the UK while all their economic activity was located in other Member States. Nevertheless, the CJEU was willing to protect their rights to benefit from the freedom of establishment. It is more questionable whether the case complies with the *obiter dictum* remark in the *Vale* case. Most likely the Grand Chamber intentionally decided the *Polbud* case in unapologetic terms, thus eliminating any doubts about the scope of protection of the cross-border conversion that arose after the *Vale* case.[55]

What does it all mean in practice? It means that a company is in and of itself an establishment, at least for the purposes of the cross-border conversion. As soon as the company is incorporated in one Member State, the shareholders may change the corporate jurisdiction by their will alone, without seeking to establish the company in the state of destination. Therefore, such change may bring no tangible economic effects to the state of destination and be motivated by considerations of choosing better corporate law. This adds a fictitious aspect to the free movement of companies and opens a new season of corporate tourism.

4 Cross-Border Conversion Beyond Discrimination

The majority of cases touching upon the free movement of companies did not deal with discriminatory measures. In the *Centros*, *Überseering* and *Inspire Art* cases, the CJEU could not refer to the principle of non-discrimination because the Member States in question attempted to treat foreign companies just as they treated their own companies—subjecting all companies to the same requirement of keeping their social and real seat in the same state (*Überseering*), or subjecting their branches to the same rules on capital requirements and director liability (*Centros* and *Inspire Art*). However, in some recent cases, the CJEU has built its reasoning around discriminatory measures.

The operative ruling in the *Sevic* case was couched in non-discrimination terms:

[55] It is particularly interesting that Polbud requested a reopening of the oral part of the procedure before the Court in order to show that it intended to transfer both its registered office and its real head office (i.e., the real seat) to Luxembourg. However, the CJEU did not consider the reopening to be necessary. See, CJEU 25 October 2017, C-106/16 *Polbud*, EU:C:2017:804, paras. 19-25. This circumstance underlines the intention of the Court to make a ruling liberalizing the free movement of companies. In fact, it has been noted that if the Polbud company performed the cross-border conversion without transferring its real seat to Luxembourg it could fall short of the conditions of the law of Luxembourg for (re-)incorporation. In accordance with the current state of the Court's jurisprudence this would prevent the cross-border conversion from being executed. However, the Polish court posed a preliminary question concerning the cross-border conversion without the transfer of the real seat. The CJEU answered that question as it was posed, ignoring the position of the Polbud company itself. Barsan (2018), pp 8-9; Menjucq (2018), para. 14.

> Articles 43 EC and 48 EC preclude registration in the national commercial register of the merger by dissolution without liquidation of one company and transfer of the whole of its assets to another company from being refused in general in a Member State where one of the two companies is established in another Member State, whereas such registration is possible, on compliance with certain conditions, where the two companies participating in the merger are both established in the territory of the first Member State.

The reasoning was extended to cross-border conversions by the Third Chamber in the *Vale* case. Here, the company incorporated in Italy wanted to re-incorporate itself in Hungary. Hungary allowed transfers of the registered office for domestic companies but did not allow this for foreign companies. The ruling *mutatis mutandis* repeated almost *verbatim* that of the *Sevic* case:

> Articles 49 TFEU and 54 TFEU must be interpreted as precluding national legislation which enables companies established under national law to convert, but does not allow, in a general manner, companies governed by the law of another Member State to convert to companies governed by national law by incorporating such a company.

While it is arguable whether domestic mergers and conversions that do not involve any change of the corporate jurisdiction and the applicable law are even comparable to their cross-border counterparts, the said cases raised doubts about the applicability of the reasoning to non-discriminatory restrictions. Commenting on the *Vale* case, Eck and Roelofs stated that

> [i]n the absence of any such provisions with respect to national conversion, a [cross-border conversion] will also not be possible on the basis of the freedom of establishment [that] prohibits a Member State from only allowing domestic conversions—in a broad sense—by companies which are governed by the law of that Member State. The freedom of establishment only has 'negative effect' however and will not result in the introduction of conversion as a new method of restructuring in the laws of a Member State.[56]

Other scholars have dissented, predicting that general non-discriminatory prohibitions on cross-border mergers and conversions were contrary to the freedom of establishment.[57]

The *Polbud* case did not assess the measures adopted in the state of destination, but only those of the state of incorporation. However, it does not follow from the judgment that the Polish regulation was infringing upon the freedom of establishment because it required the liquidation of the company only in the case of the conversion with the cross-border element. The Court did not analyse whether a domestic relocation of the registered office had similar effects. It showed that non-discriminatory restrictions were capable of impeding cross-border conversion and

[56] Van Eck and Roelofs (2012), pp 322-323.
[57] Timmermans (2010), p 558.

there were no remaining doubts that a refusal to accept the cross-border conversion would equally infringe upon EU primary law. This fully accords with the very broad test used by the CJEU that prescribes that all measures which prohibit, impede or render less attractive the exercise of the freedom of establishment must be regarded as restrictions.

5 The Future of the Real Seat Theory After the *Polbud* Case

The real seat theory in the EU is like Schrödinger's Cat—simultaneously alive and dead. The *Daily Mail* case created an impression that the real seat theory was respected by the CJEU.[58] After the *Centros* case, things started to go downhill for this 'jewel' of Continental conflict of laws. The *Centros* case was regarded by some as an unexpected end of the real seat theory,[59] even though it did not deal directly with the choice of the connecting factor and some authors even speculated that it only applied to jurisdictions using the incorporation theory.[60] However, the supporters of the real seat theory were doomed to suffer new disappointments when the CJEU made the rulings in the *Überseering* and *Inspire Art* cases. Notably, the first of them made it clear that only the state of incorporation could apply the real seat theory to its fullest extent.[61] In other words, each Member State was allowed to implement substantive effects arising from the non-coincidence of the real seat and registered office (the effects of the real seat theory), but only in respect of its own companies.[62] All other Member States had to recognize a company irrespective of the real seat theory, even if the company in question would not have been considered to be validly incorporated pursuant to the applicable law in the host state.[63]

Does the *Polbud* case change anything? The *Polbud* case allows companies to move their registered offices, provided that they comply with the condition for incorporation in the state of destination. In other words, it allows companies to change their place of incorporation. This is not a simple change of the applicable law; it is a change of their corporate jurisdiction, that is, the change of the legal order. Prior to the *Sevic* case, a company once incorporated in the state using the real seat theory was usually bound by that connecting factor. A cross-border movement of the real seat meant the legal death of the company. The company could not avoid this fate by moving its registered office abroad unless the national law of the state of incorporation (and also necessarily the state of destination) allowed the transfer of the registered office or the performance of a cross-border merger.

[58] Rammeloo (1995), pp 51-52.
[59] Ebke (2000), p 627; Sandrock (1999), p 1342.
[60] Behrens (2002), p 511.
[61] Meeusen and Myszke-Nowakowska (2016), p 110.
[62] Garcimartín Alférez (2016), pp 956–957.
[63] Ibid., p 957; Kieninger (2005), p 749; Lau Hansen (2013), p 11; Timmermans (2003), pp 17–18. Compare, Poillot-Peruzzetto (2008), p 196.

After the *Sevic* case, the functioning of the real seat theory further deteriorated. A company incorporated in the real seat jurisdiction could create a subsidiary abroad and then merge with it, thus changing the applicable legal order.[64] The *Sevic* case made the transfer of the registered office possible, but only by means of a detour. After the *Polbud* case, the detour is no longer required. Now a company may simply move its registered office and fully escape the application of the real seat theory.

While the central principle of the freedom of establishment remains the recognition principle, it is supplemented by another rule—Member States cannot prevent a company from changing its state of origin, that is, its re-incorporation. A company may re-incorporate itself in another Member State, thus changing its state of origin. This implies: (1) while pursuant to the *Daily Mail* and *Cartesio* cases, the Member State of incorporation can decide the life and death of its companies, the powers of the Member State are limited to 'its' companies; it is unable to decide the life and death of foreign companies, that is, ones that have been re-incorporated abroad[65]; (2) it follows that the real seat theory used in the initial state of incorporation no longer applies to that company and, thanks to the recognition principle, the company will be able to rely on the legal status obtained via the cross-border conversion in the state of re-incorporation. At the same time, each Member State preserves the right to impose conditions for incorporation, be it an initial one or a re-incorporation. The only element of recognition at this stage is that the state of destination must treat the company as a continuation of its prior legal personality.

Since Member States preserve their right to set conditions for the initial incorporation and re-incorporation of companies, they preserve their rights to advance their company law policies, for example, policies on minimum company capital. If at this stage the Court had requested that the state of re-incorporation allows foreign companies to re-incorporate themselves while preserving their legal statuses (for example, refusing to comply with the minimum capital requirements or requirements on the formation of the board), then the powers of the Member States to preserve their company law policies would have been greatly reduced, if not dismantled altogether. Hence, it is only reasonable that such requirements are not seen as restrictions.

At the same time, it would be incorrect to say that conditions for incorporation/re-incorporation fall fully outside the purview of the CJEU. In the *Cartesio* case, the CJEU observed that

> […] the question whether Article 43 EC applies to a company which seeks to rely on the fundamental freedom enshrined in that article—like the question whether a natural person is a national of a Member State, hence entitled to enjoy that freedom—is a preliminary matter which, as Community law now stands, can only be resolved by the applicable national law.[66]

This language may create an impression that conditions for incorporation/re-incorporation are fully exempt from the scope of primary law. However, in reality

64 Compare, Verbrugh (2014), p 518.

65 Zimmer and Naendrup (2009), p 547.

66 CJEU 16 December 2008, C-210/06 *Cartesio*, EU:C:2008:723, para. 109.

this is not the case. Obviously, the so-called ‘preliminary matter’ is not exempt from the scope of primary law. It cannot be regulated by discriminatory rules. Hence, when the CJEU characterized the initial incorporation of the company as a preliminary matter, it did this only for functional purposes—so as to allow Member States to preserve their company law policies and, *inter alia*, to maintain the use of the real seat theory.[67] In reality, the said rules are not immune from the review under freedom of establishment. However, once they do not discriminate, they do not restrict the freedom of establishment as every Member State may determine conditions for the incorporation of ‘its’ companies.

So, what are the main effects of the *Polbud* case on domestic company law? Firstly, both the Member States that use the real seat theory and the incorporation theory must now ensure that companies can perform a cross-border conversion even when it is not accompanied by the pursuit of genuine economic activity in the state of destination. The Member States may still protect the interests of third parties who have relied on the fact that the company has been incorporated in a specific jurisdiction and whose interests may be endangered by the fact that their debtor has changed its place of incorporation and its corporate form. Notably, the Court emphasized that the interests of creditors could be protected via bank guarantees or other equivalent guarantees.[68]

Secondly, the *Polbud* case further limits the already weak functionality of the real seat theory. Formally, the *Polbud* case does not attack the real seat theory as a valid conflict-of-laws rule and hence, pursuant to the *Daily Mail* case, the state of incorporation may continue to use the real seat theory *vis-à-vis* its own companies. However, after the *Polbud* case these companies are able to perform a cross-border conversion and re-incorporate themselves in other jurisdictions using the incorporation theory. And they can do this ‘on paper’, without any need to relocate their centre of economic activity or any assets whatsoever, so long as these operations will comply with the general requirements for incorporation in the state of destination. In practice, it means that the original state of incorporation will be able to oblige its own companies to comply with the real seat theory, but only so long as these companies wish to remain attached to the state of incorporation. The real seat theory is at its heart a protective rule and its original objective was to protect the local market against pseudo-foreign companies; this objective had already been undermined by the *Überseering* and *Inspire Art* cases. However, after the *Polbud* case, the real seat has even less of an ‘obligatory’ nature, because via re-incorporation companies may ‘contract out’ of the jurisdiction that preserves the real seat theory.

It has been correctly observed that the real seat theory ‘is mainly based on the protection of local interests: if the company has its real seat in the forum, this

[67] It has been correctly noted that from the point of view of the interests of third parties, the case law of the CJEU does not seem to be fully justified. The state of incorporation may deprive its company of its legal personality simply because it has moved its real seat abroad. At the same time, it cannot refuse the transfer of the registered office. However, in practice, third parties—creditors, minority shareholders and workers—may be more affected by re-incorporation, particularly because it presupposes a change of the corporate form. See Zimmer and Naendrup (2009), p 547.

[68] CJEU 25 October 2017, C-106/16 *Polbud*, EU:C:2017:804, para. 58.

normally implies that it is also "economically established in the forum" and, in this case, minority shareholders or local creditors should be protected vis-à-vis foreign company law rules that do not provide a level of protection equivalent to that provided by the rules of the forum'.[69] When the CJEU introduced the obligation to recognize foreign companies, the objective of the rule had already been frustrated: the Member State could only apply its protective legislation to its own companies, but all other companies, even if conducting their business in that Member State, could simply escape from this regulation.[70] Once the CJEU has fully legitimized cross-border conversions irrespective of any economic activity in the state of destination, even this effect of the real seat is diminished. In principle, the CJEU makes it clear that the protection of the local market cannot and should not be the default interest that is protected by legal orders belonging to the internal market. It is the interest of the unified market that deserves the principal protection in the eyes of the Court. Within this discourse, the preservation of the real seat by the Member States seems counterintuitive as its very purpose is frustrated.

6 Is a Company Just Another Contract?

A well-known issue of company law in general and conflict of laws in particular is the question of whether a company is just a contract.[71] In fact, in the *Powell Duffryn* case, the CJEU itself viewed the statutes of the company as a contract.[72] However, that was done in the context of jurisdictional agreements. Such a ruling could give the impression that in the eyes of the Court the company itself is just a contractual arrangement. If we were to generalize that approach and accept that it had penetrated the freedom of establishment, then would it bring with it the same degree of party autonomy to the shareholders?

In accordance with Article 3 of the Rome I Regulation,[73] parties may freely choose the applicable law. If the company is viewed as a contract, a similar solution could be justified. Prior to the *Polbud* case, it was clear that the founders of the company could choose the applicable legal order by choosing the state of incorporation. This freedom became functional after the *Überseering* judgment as a company could have been incorporated in the Member State employing the incorporation theory while other Member States were not able to impose the real seat theory upon them. However, once the company was incorporated in the Member State, the only options to modify the applicable law were through a re-incorporation or a cross-border merger; these operations were only possible if two Member States—the states of incorporation and destination—allowed them. After the *Sevic* case, the CJEU

[69] Garcimartín Alférez (2016), p 959. See also, Kieninger (2005), pp 756–757.

[70] Garcimartín Alférez (2016), p 959.

[71] Borg-Barthet (2012), p 20.

[72] CJEU 10 March 1992, C-214/89 *Powell Duffryn*, EU:C:1992:115, para. 21.

[73] Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I) [2008] *OJ* L 177/6-16.

ensured that companies were able to perform cross-border mergers. However, the availability of cross-border conversions was less obvious. After the *Cartesio* case, it seemed that the state of incorporation was unable to prevent such a relocation if relocation was allowed in the state of destination. It seemed that the CJEU imposed upon the state of incorporation an obligation to respect the legal order of the state of destination. Following the *Vale* case, it became clear that the state of destination itself was not allowed to oppose the cross-border conversion if it allowed domestic conversions. Now, after the *Polbud* case, the company can change the applicable legal order and both the state of incorporation and the state of destination are obliged to permit such an operation, unless they can justify the restriction.

The *Polbud* case brings us very close to the contractual understanding or at least contractual treatment of the company. However, we are still some steps away from that understanding. Firstly, Member States still retain their rights to establish initial conditions for incorporation. Secondly, shareholders cannot simply change the law that is applicable to the company; they may only change the applicable legal order—jurisdiction—but within that legal order they are bound by the law applied.

Moreover, the language of the *Polbud* ruling does not seem to be contractual in nature. It seems to be a combination of two elements: (1) a rule that allows companies to relocate their registered offices and (2) the principle of mutual respect among legal orders, where each Member State must respect the rules on incorporation of other Member States. At the end of the day, it is probably not the intention of the CJEU to take a stance on the theoretical question of whether the contractual theory should prevail. In particular, this is because Articles 49 and 54 TFEU take no position on this question but aim at ensuring the free movement of companies.

To summarize, we can conclude that in practical terms, with the *Polbud* case, the freedom available to companies in the EU is slowly approaching that of the contract. Nonetheless, there are certain particularities and limitations specific to company law that are not removed via the freedom of establishment. Thus, even under the liberalizing pressure of the freedom of establishment, companies are not treated as contracts, but the gap between the two is narrower than ever.

7 Private vs. Public Interests?

Let us look at the *Polbud* case from the perspective of the balance of public and private interests. It is obvious that the free movement of companies benefits individuals who control the company. However, if the CJEU had followed the opinion of Advocate General Kokott, the free movement of companies would also function as a strong means to protect the economic interests of Member States. Had the case law required the transfer of the registered office to be always accompanied by the presence of the establishment in the state of destination (or at least an intention to have one), then the freedom of establishment would have gone hand in hand with supposed benefits to the economy of the state of destination. We could conceptualize that state of affairs in the framework of an exchange: companies obtain their freedom to change the applicable legal order because that necessarily implies certain benefits to the economy in the state of destination.

However, the CJEU has taken a different route. Its case law strengthens private interests. Companies and their shareholders may now pick and choose the jurisdiction with the aim of benefiting from its legal order, while otherwise having no connection with that jurisdiction, bringing very limited benefit to the economy of the state of destination. In this respect, the CJEU has clearly preferred the private interest over the public one. At the same time, the *Polbud* case is not a drastic change to this situation. After the trilogy of the *Centros*, *Überseering* and *Inspire Art* cases, the Member States already faced the situation where the founders of the company could choose the regulatory system they preferred and use the company incorporated in one Member State to function in other Member States, either directly or through a secondary establishment. However, the choice could have been suboptimal from the very beginning or become suboptimal due to the development of the companies or changes in the legal order, thus encouraging companies to re-incorporate elsewhere. However, there was simply no positive ruling on their rights to change the legal order after incorporation. After the *Sevic* case, companies obtained the right to execute the change of the applicable legal order, but only through a U-turn operation. We may consider that already in the *Sevic* judgment, where it did not explicitly assess the presence of the establishment in the state of destination, the Court showed its preference for private interests. This allowed companies to choose the best legal order via a reverse merger. The main contribution of the *Polbud* case is that it confirms and further develops the approach established by these cases.

8 Conclusions

The *Polbud* case is a straightforward judgment. Its radical nature appears through its non-apologetic language. In a direct manner, the CJEU has confirmed its support for the liberalization of the free movement of companies, simultaneously clarifying certain aspects of previous case law.

Firstly, the Court has made it clear that companies may transfer their registered offices without economic justifications to a Member State where they do not have and do not intend to have any economic activity. This breaks the link between free movement and any genuine economic activity. At the theoretical level, it poses a question: why in some cases is the existence of establishment a precondition for the application of the eponymous freedom, while in others it is not necessary? Whatever the reason for such a distinction, the Court's approach shows that the free movement of companies is primarily aimed at the protection of individual interests within the internal market, giving companies the right to pick and choose the best legal order even after they have already been incorporated. The immediate economic interests of Member States are of secondary importance.

Secondly, it follows from the *Polbud* ruling that any measure preventing a cross-border conversion impedes the exercise of the freedom of establishment, even when the impediment is non-discriminatory. Thirdly, the ruling further diminishes the domain of the real seat theory. In our opinion, the theory has become redundant. A company once incorporated in a real seat jurisdiction may easily eliminate restrictions of the said theory using the cross-border conversion.

Is *Polbud* a good law? If clarity is better than ambiguity, then the *Polbud* case may be seen as a positive development. The case provides more clarity on the current state of the freedom of establishment, even if it simultaneously also manages to contradict some of the prior judgments. At the end of the day, the harmony of case law is less important than the clear scope of EU primary law at any given moment. Moreover, for those who see maximum freedom of movement as an advantage brought about by EU law, the case may be seen as the highest point of the freedom of companies so far. To a great extent, companies are no longer eternally attached to their legal orders of incorporation. Now, they may 'legally' travel, while actually staying in the same place by the expression of their will alone. There is so much freedom of movement that one can move without moving whatsoever.

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