Vale: Increasing Corporate Mobility from Outbound to Inbound Cross-Border Conversion?

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1. INTRODUCTION

On 12 July 2012, the Court of Justice of the European Union (hereinafter 'EU Court') rendered a judgment in the 'Vale case'.[1] With this judgment, an important further step has been taken with respect to cross-border restructurings within the European Union (EU), especially with respect to cross-border conversions (a 'CBC').[2] On the basis of the earlier judgment of the EU Court in the 'SEVIC-Systems case' in 2005,[3] certain learned writers were already of the opinion that the legal Act pursuant to which a company which is governed by the laws of an EU Member State (a 'Member State') – the 'Member State of Origin' – is converted into a company which is governed by the laws of another Member State – the 'Host Member State' –, falls within the scope of the freedom of establishment as laid down in Articles 49 and 54 TFEU,[4] which replace Articles 43 and 48 of the former EC-Treaty.

In 2008, the EU Court rendered a first specific judgment regarding a CBC in the 'Cartesio case'.[5] The EU Court concluded in an 'obiter dictum' that the cross-border transfer of the seat of a company within the Member States with a change of the applicable law to a company – the '*lex societatis*' –, whereby the company is converted into a company which is governed by the national laws of the Member State to which the seat has been transferred – i.e., the Host Member State – falls within the scope of the freedom of establishment 'to the extent that it is permitted under that law – the law of the Host Member State – to do so'.[6] Although the Cartesio case provided certainty on the possibility of implementing an 'outbound CBC', the restriction *'to the extent that it is permitted under that law'* created a certain level of uncertainty. After the judgment in the Cartesio case, questions were raised in literature and practice as to the interpretation of such restriction.[7] The EU Court has given a clear answer to such questions in the Vale case. We will further elaborate on this in paragraph 4.1 below.

The preliminary ruling of the EU Court in the Vale case deals with the possibility of implementing an 'inbound CBC' and can be seen as a logical sequence to the Cartesio case. In this publication, we will further discuss and analyse the Vale case. First, we will describe the Vale case in some more detail in paragraph 2. Thereafter, we will set out the relevant preliminary questions that were referred to the EU Court for the preliminary ruling in the Vale case in paragraph 3. In paragraph 4, we will discuss the answers to such questions. We will provide some comments to the answers in paragraph 5. Finally, our conclusions can be found in paragraph 6.

2. THE VALE CASE (SUMMARY OF FACTS)

Vale Costruzioni Srl (Vale Srl), a private limited liability company governed by Italian law, was originally established in Italy on 27 September 2000 and was thereafter registered in the Commercial Register in Rome, Italy on 16 November 2000. On 3 February 2006, Vale Srl requested to be removed from that Register on the ground that it intended to transfer its seat and business to Hungary and to discontinue its business in Italy. Further to this request, the Commercial Register in Italy deleted the entry of Vale Srl on 13 February 2006 and under the heading 'Removal and transfer of seat' reflected that 'the company had moved to

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1 Judgment of the Court (Third Chamber) of July 12, 2012, Vale Építési kft., Case C-378/10, European Court reports 2012, Page 00000.

2 To avoid any discrepancies, we have tried to use the same UK terms, wording and definitions as in the UK version of the EU Court judgment in the Vale case as much as possible.

3 Judgment of the Court (Grand Chamber) of Dec. 13, 2005, SEVIC Systems AG, Case C-411/03, European Court reports 2005, I-10805.

4 Treaty on the Functioning of the European Union (TFEU).

5 Judgment of the Court (Grand Chamber) of Dec. 16, 2008, Cartesio Oktató és Szolgáltató bt.,Case C-210/06, European Court reports 2008, I-09641.

6 Cartesio case, consideration 112.

7 See for example: G.-J. Vossestein, *Cross-Border Transfer of Seat and Conversion of Companies under the EC Treaty Provisions on Freedom of Establishment*, 3 ECL 115 (2009), H. Kussmaul, L. Richter & C. Ruiner, *Corporations on the Move, the ECJ off Track: Relocation of a Corporation's Effective Place of Management in the EU*, 6 ECL 246 (2009) and A. Wiśniewski & A. Opalski, *Companies' Freedom of Establishment after the ECJ Cartesio Judgment*, 4 EBLR 595 (2009).

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Hungary'. Thereafter, on 14 November 2006, the director of Vale Srl, *inter alia*, adopted the Articles of Association of Vale Epítesí Kft (Vale Kft), a private limited liability company governed by Hungarian law, with a view to registering Vale Kft in the Commercial Register in Hungary. Also on the latter date, the share capital was paid up to the extent required under Hungarian law for such registration. On 19 January 2007, the representative of Vale Kft applied to the Commercial Court in Budapest to register the company in accordance with Hungarian law, stating that Vale Srl was the predecessor in law of Vale Kft. Such application was rejected twice (first by the Commercial Court, and, after an appeal, by the Regional Appeal Court of Budapest). Subsequently, Vale Kft appealed to the Supreme Court of Hungary seeking the following: (i) the annulment of the order to reject the registration and (ii) an order that the company be entered into the Commercial Register on the basis that the contested order infringes Articles 49 and 54 TFEU. Furthermore, it was argued by Vale Kft that the contested order fails to recognize the fundamental difference between the international transfer of the seat of a company without changing the law governing a company – the *lex societatis* – on the one hand, and the international conversion of a company with a change of the law governing such company, on the other hand.

Ultimately, the Supreme Court upheld the rejection by the Regional Appeal Court stating that 'the transfer of the seat of a company governed by the law of another Member State (GvE/ER: the Member State of Origin, i.e., Italy in this case) entailing the reincorporation of the company in accordance with Hungarian law and a reference to the original Italian company, as requested by Vale Kft, cannot be regarded as a conversion under Hungarian law, since the (GvE/ER: Hungarian) law on conversions only applies to domestic situations (GvE/ER: conversions within the borders of Hungary)'. As the Hungarian Supreme Court apparently had some doubts as to the compatibility of Hungarian legislation with the freedom of establishment as laid down in Articles 49 and 54 TFEU, it referred certain preliminary questions to the EU Court.

3. THE QUESTIONS WHICH WERE REFERRED TO THE EU COURT

The following questions were referred to the EU Court for a preliminary ruling:

(1) Must the Host Member State pay due regard to Articles (49 TFEU and 54 TFEU) when a company established in another Member State transfers its seat to that Host Member State and, at the same time and for this purpose, deletes the entry regarding it in the commercial register in the Member State of origin, and the company's owners adopt a new instrument of constitution under the laws of the Host Member State, and the company applies for registration in the commercial register of the Host Member State under the laws of the Host Member State?

(2) If the answer to the first question is yes, must Articles (49 TFEU and 54 TFEU) be interpreted in such a case as meaning that they preclude legislation or practices of such a (host) Member State which prohibit a company established lawfully in any other Member State (the Member State of origin) from transferring its seat to the Host Member State and continuing to operate under the laws of that State?

(3) With regard to the response to the second question, is the basis on which the Host Member State prohibits the company from registration of any relevance, specifically as follows:
   – *If, in its instrument of constitution adopted in the Host Member State, the company designates as its predecessor the company established and deleted from the commercial register in the Member State of origin, and applies for the predecessor to be registered as its own predecessor in the commercial register of the Host Member State?*
   – *In the event of international conversion within the Community, when deciding on the company's application for registration, must the Host Member State take into consideration the instrument recording the fact of the transfer of company seat in the commercial register of the Member State of origin, and, if so, to what extent?*

(4) Is the Host Member State entitled to decide on the application for company registration lodged in the Host Member State by the company carrying out international conversion within the Community in accordance with the rules of company law of the Host Member State as they relate to the conversion of domestic companies, and to require the company to fulfil all the conditions (e.g., drawing up lists of assets and liabilities and property inventories) laid down by the company law of the Host Member State in respect of domestic conversion, or is the Host Member State obliged under Articles (49 TFEU and 54 TFEU) to distinguish international conversion within the Community from domestic conversion and, if so, to what extent?

4. ANSWERS TO THE PRELIMINARY QUESTIONS

4.1 The First and Second Question

First, the EU Court rephrased the first and second question of the Hungarian Supreme Court as follows:

> Whether Articles 49 and 54 TFEU must be interpreted as precluding national legislation which, although enabling a company established under national law to convert, does not allow a company established in accordance with the laws of another Member State to convert to a company governed by national law by incorporating such a company.

In answering these questions, the EU Court first referred to consideration 19 of the SEVIC-Systems case in which it confirmed

that 'company transformation operations are, in principle, amongst those economic activities in respect of which Member States are required to comply with the freedom of establishment'.[8] This is also the case if a CBC leads to the incorporation of a new company.[9] Furthermore, the EU Court clarified the restriction 'to the extent that it (GvE/ER: a 'CBC') is permitted under that law (GvE/ER: the law of the Host Member State) to do so', which was introduced in consideration 112 of the Cartesio case. According to the EU Court in the Vale case, such 'restriction' cannot be understood as seeking to remove, from the outset, the legislation of the Host Member State on company conversions from the scope of the TFEU governing the freedom of establishment, but only as reflecting the mere consideration that a company established in accordance with national law only exists on the basis of the national legislation which 'permits' the incorporation of a company, provided that the conditions laid down to that effect are satisfied.[10]

In summary, this clarifies – in essence – that there is no restriction to 'travel into' a Member State by way of a CBC. A Host Member State cannot obstruct an inbound CBC. The corporate and/or actual seat after the CBC becomes effective, must, however, comply with the governing law of the Host Member State. If, for example, the real seat theory is applicable in the Host Member State (like in Luxembourg), a CBC into a company in such a Host Member State cannot be implemented by only transferring the corporate (or official) seat to such Host Member State. For that purpose, (at least) also the actual seat must be transferred to the Host Member State. Furthermore, such a company must comply with all requirements of the laws of the Host Member State, such as minimum share capital. For a more detailed analysis of the applicable requirements, reference is made to paragraph 4.2.

Moreover, the EU Court considers that freedom of establishment applies to the national legislation of the Member States on the conversion of companies. If and when such legislation treats companies differently *according to whether* the conversion is of a domestic, national, or of a cross-border nature, this is likely to deter companies which have their seat in another Member State from exercising the freedom of establishment and must be qualified as a restriction within the meaning of Articles 49 and 54 TFEU.[11] As a consequence, not only outbound CBCs, but also inbound CBCs are allowed. According to the EU Court, the different treatment of companies as referred to in the previous paragraph cannot be justified by the absence of rules (for that purpose) in secondary EU law, such as a Directive or Regulation on Community level. The existence of such rules is not a precondition for the implementation of the freedom of establishment (although the absence of such rules can of course lead to problems when implementing a CBC).[12] The only indication with respect to the applicable rules given by the EU Court in the Vale case is that CBCs presuppose (require) the consecutive application of two national laws (first, the law of the Member State of Origin and, then, the law of the Host Member State).

Finally, the EU Court recognized that the 'classic' justifications for a restriction on the freedom of establishment also apply to a CBC. Overriding reasons in the public interest, such as the following: (a) the protection of the interests of these: (i) creditors, (ii) minority shareholders and (iii) employees, and (b) the preservation of the effectiveness of fiscal supervision and the fairness of economic transactions may justify a measure restricting the freedom of establishment, provided that such a measure is appropriate for ensuring the attainment of the objectives pursued and does not go beyond what is necessary to attain them.[13] Such a restriction was also lacking in the Vale case as Hungarian law precludes, in a *general manner*, CBCs, with the result that it prevents such operations from being carried out even if the interests referred to above are not threatened.[14]

4.2 The Third and Fourth Question

The third and fourth question of the Hungarian Supreme Court have been rephrased by the EU Court as follows:

> Whether Articles 49 and 54 TFEU must be interpreted, in the context of a CBC, as meaning that the Host Member State is entitled to determine the national law applicable to such an operation and thus to apply the national law provisions on domestic conversions governing the incorporation and functioning of a company, such as the requirements of drawing up lists of assets and liabilities and property inventories. More specifically, it seeks to determine whether the Host Member State may refuse, for CBC's, the designation 'predecessor in law', such a designation in the commercial register being laid down for domestic conversions, and whether and to what extent it is required to take account of documents issued by the authorities of the Member State of Origin when registering the company.

In answering these questions, the EU Court first noted that secondary law of the EU, as it currently stands, does not provide for specific rules governing CBCs. At this moment, no Fourteenth directive on CBC or cross-border transfer of seat has been

8 Vale case consideration 24.
9 Vale case consideration 25.
10 Vale case consideration 32.
11 Vale case consideration 36 and SEVIC-Systems case consideration 22 and 23.
12 Note that the same reasoning was also followed by the EU Court with respect to cross-border mergers in the SEVIC-Systems case, consideration 26.
13 SEVIC-Systems case, consideration 28 and 29.
14 Vale case, consideration 40.

adopted. On 2 February 2012, the European Parliament adopted a resolution requesting the European Commission to prepare a proposal for such a Fourteenth directive.[15] To our knowledge, no follow-up has been given yet to that request. As a consequence, a CBC can only be effectuated with respect to an SE by way of transferring the official (corporate) seat and office address of an SE to another Member State pursuant to and in accordance with Article 8 SE Regulation.[16,17] In the absence of any supranational rules on a Community level, the provisions which enable a CBC of other limited liability companies must be found in national law, i.e., (i) the law of the Member State of Origin and (ii) the law of the Host Member State.[18] When implementing a CBC, such national laws must be applied consecutively.[19] This may cause problems as such national laws are generally not designed to apply to cross-border transactions, but must pass the test of the freedom of establishment as laid down in Articles 49 and 54 TFEU.[20]

On the basis of case law of the EU Court, two general principles must be taken into consideration when applying national laws on CBCs:

(i) the 'principle of equivalence':
the national rules which are designed to ensure the protection of rights which individuals acquire under EU law may not be less favourable than those governing similar domestic – national – situations.

(ii) the 'principle of effectiveness':
such national rules may not make it impossible in practice or extremely (excessively) difficult to exercise the rights conferred by the EU legal order.[21]

The EU Court confirms that the company enjoys a right granted by the EU legal order to carry out a CBC. The determination by the Host Member State of the applicable national law enabling a CBC is, in itself, not in breach with the obligations resulting from Articles 49 and 54 TFEU. Companies are 'creatures' of national law and exist only by virtue of the national legislation, which determines their incorporation and functioning.[22]

In the Vale case, the application by Hungary of the provisions of its national law on domestic conversions governing the incorporation and functioning of companies, such as the requirements to draw up a list of assets and liabilities and property inventories, cannot be called into question. The Host Member State is entitled to determine such requirements.

4.2.1. *Refusal by Authorities to Record a 'Predecessor in Law'*

The refusal by the authorities of a Host Member State, in relation to a CBC, to record in the Commercial Register the company of the Member State of Origin as the 'predecessor in law' of the converted company, is not compatible with the principle of equivalence if, in relation to the registration of domestic conversions, such a record is made of a predecessor company. According to the EU Court, such recording may be useful to inform the creditors of the converted company. Moreover, the EU Court noted that the Hungarian Government did not raise any argument to justify the recording of the names of only companies converting domestically.[23]

4.2.2. *Taking into Account of Documents from the Member State of Origin by the Host Member State*

Finally, the EU Court ordered that the refusal – in a general manner – to take account of documents obtained from the authorities of the Member State of Origin during registration procedures makes it impossible for the company requesting to be converted to show that it actually complied with the requirements of the Member State of Origin and is not compatible with the principle of effectiveness as it jeopardises the implementation of a CBC.[24]

5. COMMENTS

We have the following comments with respect to the Vale case:

The EU Court confirmed in the Vale case that the freedom of establishment applies to the *national legislation* of the Member States on the conversion of companies. As a result, the consequences of the Vale case may be different for each Member State.

The procedures on conversions in the national laws of the Member States are not harmonized by supranational rules on a Community level, by way of a directive or regulation (as is the case for legal merger, cross-border legal merger and legal division in Directive 2011/35/EU, Directive 2005/56/EC and Directive 1982/891/EEC respectively). As a consequence, it may well be that the law of a certain Member State does not contain any provisions at all with respect to national conversions, i.e., conversions within the borders of that Member State. In the absence of any such provisions with respect to national conversions, a CBC will also

15 European Parliament resolution of 2 Feb. 2012 with recommendations to the Commission on a 14th company law directive on the cross-border transfer of company seats (2011/2046(INI)).
16 Note that in some EU countries national rules with respect to CBC have already been implemented.
17 Council Regulation (EC) No. 2157/2001 of Oct. 8, 2001 on the Statute for a European company (SE), OJ L 294, Nov. 10, 2001, 1–21.
18 Vale case, consideration 43.
19 Vale case, consideration 44.
20 Vale case, consideration 45.
21 Vale case, consideration 48, also for a detailed overview of the relevant case law of the EU Court.
22 *Inter alia*, Cartesio case, consideration 104.
23 Vale case, consideration 56 and 62.
24 Vale case, consideration 60 and 62.

not be possible on the basis of the freedom of establishment. Freedom of establishment 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 a '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.

If the law of a Member State provides for a certain legal framework on conversions within the borders of that Member State, the question may arise as to what the minimum requirements of such a framework are to qualify as 'national rules on conversion' as referred to in consideration 36 of the Vale case.

The first question in this respect is to which type of companies such rules on conversion have to apply. Does a rule on conversion of an association into a foundation also qualify as 'national rules on conversion' as referred to in the Vale case, or must the scope of the relevant national rule also cover public and private limited liability companies, which are, for example, listed in Annex I and Annex II of the SE Regulation? Furthermore, national rules may only deal with the conversion of 'non-comparable' legal persons, such as the conversion of an association into a public or private limited liability company and not the conversion of 'comparable' or 'similar' legal persons, such as the conversion of a private limited liability company into a public limited liability company (and vice versa).

The freedom of establishment has a wide scope and companies other than limited liability companies can benefit therefrom (see Article 54 TFEU). On this basis, it can be argued that also the CBC of a legal person without limited liability, for example a foundation governed by the laws of the Member State of Origin into an association or even into a limited liability company governed by the laws of the Host Member State should be possible on the basis of the freedom of establishment to the extent that such a conversion is allowed under the law of the Member State of Origin as well as the law of the Host Member State.

The second question is whether the national rules on conversion must have certain characteristics and/or legal consequences to qualify as 'national rules on conversions' as referred to in the Vale case. We note that in the Vale case there was *no real succession* of the company governed by the laws of the Member State of Origin by the company governed by the laws of the Host Member State as Vale Srl was deregistered first and only after some time Vale Kft requested registration by the Commercial Court in Budapest stating that Vale Srl was its predecessor. However, such a CBC without a real succession qualified in the Vale case as a CBC, which falls within the scope of the freedom of establishment. In principle, one of the key features of a CBC is the corporate continuity of the legal person. In a perfect world, a company will – as per the moment a CBC becomes effective and the applicable law of the company changes from the laws of the Member State of Origin to the laws of the Host Member State – not cease to exist and will not be newly formed at any time.

Another comment with respect to the cross-border application of national rules on conversion is that such rules are generally not comparable to each other – they have not been harmonized on a Community level by way of a directive or regulation – and are not specifically designed for cross-border application. In practice, when implementing a cross-border conversion, certain problems may arise, such as the following: (i) uncertainty with respect to the effective date as per which the official (corporate) seat and/or office address of the company will be located in the Host Member State and (ii) the proper fulfilment of the legal requirements of the laws of the Host Member State by the converted company. Finally, a proper protection of the relevant stakeholders (shareholders, creditors and employees) may not be fully available under the laws of the Member State of Origin.

6. CONCLUSIONS

As confirmed in the Vale case, CBCs fall within the scope of the freedom of establishment as laid down in Articles 49 and 54 TFEU. With the judgment of the EU Court in the Cartesio case, it is clear that outbound CBCs fall within the scope of the freedom of establishment. After the Vale case, it also has become clear that inbound CBCs fall within this scope, if the laws of a Member State provide for rules on national conversions of companies. If the latter is the case, a Member State cannot prohibit a CBC in a general manner. Furthermore, the EU Court ruled in the Vale case as follows: (i) the Commercial Register of the Host Member State must record the company of the Member State of Origin as the 'predecessor in law' of the converted company, if such record is made with respect to domestic conversions and (ii) the Host Member State has to take account of documents obtained from the authorities of the Member State of Origin.

The question arises whether a CBC on the basis of the freedom of establishment will be an attractive instrument for the transfer of companies through the EU and thus will lead to an increase of corporate mobility within the EU. The absence of a clear and harmonized legal framework on CBCs does not provide much legal certainty. As a consequence, the relevant companies and their advisors will probably be reluctant to implement a CBC on the basis of the freedom of establishment. The other available alternatives, such as – *inter alia* – the following: (i) the formation of an SE and the subsequent transfer of the official (corporate) seat and office address on the basis of Article 8 SE Regulation, or (ii) the cross-border merger on the basis of the Directive 2005/56/EC and the national laws implementing this directive are more attractive instruments to increase the mobility of companies in the EU.

A clear legal framework should be created to make a CBC an attractive instrument to increase the corporate mobility of companies within the EU. Some Member States, such as Spain (in 2009) and Luxembourg (for outbound CBCs) have already taken action and have prepared a national legal framework for that purpose. Also recently in the Netherlands certain action has been taken. The Dutch Committee on Corporate Law (in Dutch: '*Commissie Vennootschapsrecht*') also prepared a proposal for legislation on CBC on a national (Dutch) level. This proposal has been submitted to the Dutch Minister of Safety and Justice. Although such developments can be seen as a step forward, a fully harmonized legal framework on a Community level is preferred to ensure the coordination of national legislation on CBCs in all the Member States. As long as no such action is taken on a Community level, more Member States will be tempted to follow Spain and Luxembourg, which could have an adverse effect. This may lead to the creation of a variety of national rules on CBCs in the Member States, which, in its turn, may also hinder the implementation of CBCs. To avoid this, we strongly advise the European Commission to take the action as requested by the European Parliament pursuant to and in accordance with its resolution of 2 February 2012 and to prepare a proposal for legislation on CBCs as soon as possible.