

## **Registry Disclosure in Europe. Towards a European Registry Space**

Dr. Rafael Arenas García  
Universitat Autònoma de Barcelona

The main purpose of my talk today is to show up that the recent developments in company law in Europe demand a certain evolution and change in Registry law. As you know, however, this evolution does not actually exist. I would like to point out the dangers of its absence and to show some of the guidelines or principles that we must take into consideration in the definition of the future and unavoidable European Commerce Registry Law.

First of all I think that it is necessary to make a reference to the terminology I will use. I will talk about business Register or commerce Register that is a general term that means nothing. With this term I will refer to the Spanish “Registro Mercantil”, the German and Austrian “Handelsregister” or the French “Register du commerce”. These institutions are, of course, different –and this is one of the problems we are going to deal with- but I think that all of them have in common at least one thing: this institutions have some kind of role during the birth of companies and during their lives. As we will see this role will be a key element in the evolution of company law in Europe.

Well, the question is: what has changed in the last years in European Company Law that is so important for commerce Registers? The answer is, in one word, recognition. The date is 9<sup>th</sup> March 1999. That day, the European Court of Justice gave a judgment in the *Centros* case. The problem that was in the origin of the case was a Register problem, as you know. Two Danish citizens had incorporated a limited company in England. The company carried out no activities in the United Kingdom; its only purpose was to create a branch in Denmark. The whole activity of the company would take place through the Danish branch. Why create, then, an English company and not a Danish one? Well, the Danish founders wanted to elude the Danish requirement about minimum share capital. As they did not create a Danish but an English limited company, the requirements of minimum capital were the English ones and not the

Danish ones. The Danish law establishes a paying-up of minimum capital fixed at 200.000 Danish crowns (about 27000 €). The English law imposes no requirement to the provision for and the paying-up of minimum share capital (that was only 100 £, about 142 €).

The founders created the English company and applied for the Registration of a branch of this company in Denmark. The Danish authority refused to register the branch. I am not interested now in the reasons for this refusal. I just want to point out that the European Court of Justice established that it is contrary to the EC Treaty for a member State to refuse to register a branch of a company formed in accordance with the law of another member State in which it has its registered office; even in the case –as it was the situation in the *Centros* case- that this company conducts no business in the country of the registered office.

The consequence of this judgment is that there is no possible refusal of recognition in a member State of a company incorporated in another Member State. For example, the recognition of a company on the bases that it was not incorporated in the country where the real seat of the company (its main administration) is located is not possible. That means the refusal of the real seat theory in international company law and the free movement of companies in Europe.

That result is not really surprising if we consider that the principle of mutual recognition is broadly admitted in Community Law. There is a perceptible tendency to use this principle as a corner-stone in many areas of European Law.

Probably, the reason of this increasing importance of the principle of mutual recognition is that it is able to integrate the Market without unifying the law. Every State recognizes the products, services... judgments and companies that are legally “produced” in the State of origin. That means that everybody trusts the other European legal systems, judges and administrative bodies. Everybody acts as if what has been done in other country has been done correctly.

The consideration of mutual recognition in company law implies certain relevant consequences. Till now the “Real seat theory” has been applied in many European countries. The result was that a foreign company was only recognized if it had been incorporated in the country where the company had its real seat. This meant that every State applied its own company law to all the companies that had their real seat in its own territory. This law was applied particularly to the incorporation of the company.

That is important because usually the regulation of the incorporation is verified by the competent administrative or judicial bodies of the State of incorporation. These authorities also assume responsibilities with respect to the annual accounts, the transformation of the company, the changes of the share capital, etc. Nowadays we must admit that all these functions should be carried out by foreign administrations even in cases where the company has a strong connection with our own State and that could become a problem.

This problem arises because there is not a common tradition in Europe in relation with the role of the public power in company law. There are two main traditions: a “liberal” tradition and a tradition of control. To understand the differences between these two traditions I think that we must go back some years, to the middle of the XIX century and take a look at the situation in some European countries.

In the middle of the XIX century the modern limited company is born: Aktiengesellschaft, sociedad anónima, société anonyme, etc. These companies were an evolution from the public companies created during the XVII, XVIII and XIX centuries by the kings and other authorities in order to organize the commerce with America, Asia and Africa. These companies were created by a public authorisation. The king was not binded by the law in giving this authorisation, so the incorporation of a company was a discretional and political decision. The right to create a limited company did not exist.

At the middle of the XIX century it was obvious that it was necessary to make the incorporation of companies easier. The economy needed limited companies and law provided them. In France and Germany new laws raised the requirement of a specific authorisation to incorporate a company. To create a limited company it was just necessary to follow the steps provided by the law. That was called with a French word system d’octroi. The company founders needed to elaborate a document of constitution, usually a public document, with the information and agreements established by the law. This document had to be recorded in the court of commerce (France) or in the register of commerce (Germany). This registration did not mean a real control of the veridty of the contents of the document or even of the legality of the incorporation. The principle was that of trust. The law trusted the company founders.

This system of freedom and trust was dominant in many European countries for tens of years; but in a very important and influent country, Germany, there were a significant change in the 80’s near the end of the XIX century. The problem was that very few years after the establishment of the system of freedom and trust a serious

economic crisis blew up in Germany. The dominant opinion linked this crisis with the freedom of incorporation of limited companies. It was argued that freedom of constitution allowed limited companies to be used in a fraudulent way in order to damage share holders and creditors. That consideration led to a revision of the company law in order to establish a certain control during the incorporation. The result was the German law of 1881, that became the first modern company law. The new law's system relied on the person in charge of the register of commerce, who had to verify the legality of the incorporation and the fulfilment of the requirements provided by the law in order to assure the rigour of the project. That German law was used as a model by other countries and the "system of control" was introduced in other European countries during the XX century.

Now I would like to discuss the consequences of the situation I have just drawn for our subject. First of all, we are faced –first in Germany, later in other countries- with a system of incorporation with a strong public intervention. This intervention should be considered in two different ways: Firstly, the law establishes the requirements for incorporation; the guarantees that must be fulfilled in order to assure the straightness of the company. Secondly, the law regulates the preventive control of the fulfilment of these requirements. It is important to notice this distinction because it is key to understand the need for harmonization in Europe. The difference between one and the other national system comes not only from the differences in the legal requirements to incorporate a limited company (minimum share capital, definition of this social activity, requirements related to domicile, etc.), but also in the way of controlling the fulfilment of these requirements. It is possible to trust the founders of the company and to relinquish at the establishment of a strict *a priori* verification of the correction of incorporation or it is also possible to entrust an administrative or judicial body with the duty of verifying the correct incorporation of the company.

It is necessary to consider these two ways of public intervention during the incorporation of a limited company . Company law differs, as we have just seen, not only in the requirements of the incorporation but also in the way of controlling the regularity of that incorporation. This appreciation is not only relevant in domestic company law, but also in international company law. We will now take this into consideration.

We have just seen that each company law system could be considered as a system based on trust (trust in the founders) or a system based on control (public preventive intervention during the incorporation). Now let's consider the problems of international company law from a "controller State" point of view. That State "thinks" that it is important to verify during the incorporation the correction of this operation. Whatever, the question is what companies must be controlled. Of course, the answer is the national companies, the companies ruled by the law of the "controller State" but, as you know, there is no common criteria to fix the relevant link between each company and a national law. The two main criteria are the "theory of constitution" and the theory of real seat. Following the first one, the *lex societatis* (the proper law of the company) is the law of the country where the company was incorporated. Following the second one (the theory of the real seat) the *lex societatis* is the law of the State where the administration of the company is located. That means that the "incorporation theory" considers a formal link between the company and the State. The real seat theory considers a material link; a company is ruled by the law of the State where the centre of gravity of the company is based.

I think that it is not surprising that the "real seat theory" appears as dominant in the countries that establish a preventive control of incorporation. If a "controller State" follows the theory of constitution, even in cases where the company has a strong connection with the country the preventive control of incorporation could be avoided through the incorporation in a country where that control does not exist. If that State follows the "real seat theory" that manoeuvre does not work. If the founders incorporate the company abroad, this incorporation will be invalid from the perspective of the country where the administration of the company is located. The company will not be recognized.

As we can see, there is a connection between private international law and domestic law in the field of company law. When a legal system establishes a preventive control of incorporation it is logical that international company law follows the real seat theory. There is no freedom for the founders in the election of the incorporation law. The company must be created following the steps provided by the law of the country where the real seat of the company lies. It could be said that certain options in domestic law (preventive control of incorporation) imply certain consequences in private international law (real seat theory instead theory of incorporation). Taking this into consideration we can wonder what it is going to happen in Europe now that, as we have

seen, it is no longer possible to maintain the real seat theory, at least in relation to the companies incorporated in a European country. That is: what are the consequences in domestic law of the *Centros* and *Überseering* decisions of the European Court of Justice?

The first answer would be: it is not possible to maintain the preventive control during incorporation. The founders of a company may emigrate to countries where this control does not exist and that implies the failure of the system. When it is not possible to avoid fraud, a strict public control during incorporation has no sense. I do not think, however, that this the only possible answer. I think that we must take into consideration two factors: the balance between mutual recognition and harmonization and the tendencies in European company law. I will now discuss these factors.

First I will discuss, the requirements of the principle of mutual recognition. We have seen that the introduction of mutual recognition in company law carries with it the need to recognize the companies incorporated in European countries. We must accept companies created abroad, in the same way that we accept the goods produced in and introduced into the market in another European country; but it is important to notice that mutual recognition implies the need for, at least, a minimal harmonization. If the legal systems are widely different it is not possible to use mutual recognition as an instrument of integration.

At this moment, there is certain harmonization in company law. We can ask, of course, if that harmonization is enough, but in any case it is obvious that there is no harmonization in the field of the control of incorporation. The European legal systems are not converging in this point. So, it is difficult to admit mutual recognition in this area. I think that it is possible to argue that each country can demand the fulfilment of the incorporation requirements that have not been verified in the country of incorporation from foreign companies. That is not against the principle of mutual recognition since what that principle forbids is the repetition of controls already carried out, but not the establishment of verifications that have not yet been carried out. So without harmonization in this field (verification) mutual recognition in company law could probably not remain.

There is another reason to demand harmonization in European register law in order to extend the application of mutual recognition. As we have just seen, the preventive control during incorporation tries to guarantee the trust of creditors and share

holders. That is broadly admitted in countries like Spain or Germany where there are strict controls during the incorporation of a company. Taking this into consideration we realize that the recognition of foreign companies without sufficient preventive controls could imply a general lack of confidence in foreign companies. This is a real problem. Some months ago I was talking about this problem with a Spanish lawyer. I explained to him the advantages of incorporating a company in England instead of in Spain and he told me that the real problem arises when the general manager visits the bank to apply for a credit and the head of the office asks: why is this company a limited company and not a Sociedad Anónima or a Sociedad Limitada? To assure a equal treatment of all companies in Europe regardless of the country of incorporation it is necessary that warranties during incorporation to be equivalent.

The need for harmonization also comes up from the requirements of international activity of companies. The cross-border structural changes of companies (international transfer of domicile, cross-border mergers) demand co-ordination between the registers of the countries involved in the operation. This coordination can only be established if there is, at least, a minimum equivalence between the registers. If the nature or function of the registers are different it is possible that the international registration procedure will not work properly.

The difficulties that arise from the miscoordination between registers have been shown up in the few international operations that have recently been completed in Europe. Let's consider, for example, an international merger. There are two main phases in the merger process. First, each company involved in the process must approve the merger proposal; second, all the companies adopt the merger agreement. When the companies are governed by laws from different countries, the approval by each company of the merger proposal must be ruled by the proper law of the company. Of course, the adoption of the merger agreement must respect the requirements of the laws of all the companies involved in the merger. Each law has its own role in the merger process; but the judicial or administrative control of the operation must also be considered. The competent authorities of the country of each company must verify the legality of the merger. I think, however, that it is not useful that all the authorities verify the legality of the whole process. So if a Spanish company and a German company enter into a merger process, the approval of the draft proposal by the German company should be ruled by the German law and verified by the German *Handelsregister*. The

Spanish *Registrador Mercantil* should verify the legality of the approval of the proposal by the Spanish company and should just check that the “German phase” of the merger process has been duly verified by the competent German authority. In this case the Spanish *Registrador* should not apply the foreign German law; instead of that he should recognize the German Handelsregister’s decision.

That implies that in international company operations recognition has an increasing significance. The whole process relies on the acceptance of the control made by foreign authorities. But, of course, this trust in foreign authorities should be based on the equivalence of functions. From the Spanish point of view, for example, it is necessary that foreign authorities perform a real control of the operation and that the effects of this control are equivalent to the effects of the control carried out by the Spanish *Registrador Mercantil*.

The consequence of this is that it is necessary to establish some common principles of Register disclosure in Europe. Of course, the definition of these principles is a political choice. There are different possibilities since there are significant differences between the European Register Systems.

I suppose that each one has her/his own idea of the way to draw up this European harmonization and in most of the cases we will try to argue that our own system has significant advantages. I am not an exception and I think that the Spanish system of Register disclosure it is a good option. There is a substantial control over the operation based on the documents required by the law; but the *Registrador* is not free to demand more documents than those established by the law. She or he can not use his/her own knowledge to control the correction of the operation either. The legal provisions and the *Registrador* work together in order to guarantee the legality of the operation without imposing requirements not established by the law on the person who applies for the registration. Finally, as the *Registrador* carries out full legality control, the content of the Register is considered as the truth. So everybody not involved in the operation can trust the Register and is not affected by the eventual differences between the contents of the Register and reality. The consequence is that the protection of the trust is well guaranteed.

And that is all. I have tried to show how the integration of the market in Europe has finally brought us the mutual recognition of companies. That mutual recognition is

now a fact that must be assumed and it is necessary to adapt company law to it. One of the consequences of the application of this principle in company law is that a minimum harmonization of the Register of commerce in Europe is unavoidable. That is the only way to ensure the trust in foreign companies.

That harmonization is also a requirement of international company operations. Cross-border mergers or international transfer of seat requires the co-operation between the different Registers and this co-operation can only work if the function of the Register and its nature are similar in all European countries.

Thank you very much.