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ARTICLES

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The founders of the European Community (Community) seem to have assumed that an economically integrated single European market calls for a single European company law. Accordingly, for over 30 years the Commission of the European Union has made substantial efforts to coordinate the Member States' law of business associations.[1] The Commission's efforts aim at overcoming the territorial limitations of and the fundamental differences between the Member States' law of business associations. To advance Community company law, the Commission

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1. See Peter Behrens, Krisensymtome in der Gesellschaftsrechtsangleichung, in Festschrift für Ernst-Joachim MESTMÄCKER 831(Ulrich Immenga et al. eds., 1996). For details, *see* KLAUS J. HOPT & EDDY WYMEERSCH, EUROPEAN COMPANY LAW AND FINANCIAL LAW (1991); MARCUS LUTTER, EUROPÄISCHES UNTERNEHMENSRECHT (4th ed. 1996); MICHAEL GORDON, EUROPEAN COMMUNITY LAW AFTER 1992 523-549 (Ralph H. Folsom et al. eds., 1996). *See also* RICHARD M. BUXBAUM & KLAUS J. HOPT, LEGAL HARMONIZATION AND THE BUSINESS ENTERPRISE. CORPORATE AND CAPITAL MARKET LAW HARMONIZATION POLICY IN EUROPE AND THE U.S.A. (1988); EUROPEAN BUSINESS LAW: LEGAL AND ECONOMIC ANALYSES ON INTEGRATION AND HARMONIZATION (Richard M. Buxbaum et al. eds., 1991).

adopted four different approaches.[2] First, it developed a comprehensive concept of European corporation law; the emphasis was on the internal affairs and the structure and organization of the corporation. Second, the Commission's company law program was supplemented by directives on financial reporting and disclosure of companies whose owners enjoy the privilege of limited liability. Third, the Commission proposed the creation of several new forms of business and other associations that would be subject to European as opposed to Member State law. Finally, the Commission proposed several laws to regulate various aspects of the securities market.

The body of law, tabled proposals and drafts is by now quite substantial and impressive. However, despite the Commission's untiring efforts, most of the law regulating the corporation continues to stem from its state of incorporation. Most importantly, the internal affairs and the structure and organization of the corporation are still largely governed by Member State law rather than Community law. Despite the central role of Member State law in regulating corporations, thus far there has been relatively little competition between and among the company laws of the Member States. This little competition is due primarily to the Member States' principles of choice of corporate law.[3] These principles are designed, at least in some Member States, to prevent unrestricted state competition and avoid the race-to-the-bottom problems traditionally associated with the law of Delaware in the United States.

In recent years, the European Union (EU) Commission's efforts to advance Community company law have been called seriously into question. Notably, most of the company law directives that have become law were adopted between 1968 and 1978. These directives deal with such aspects as capital,[4] mergers,[5] financial accounting of companies,[6] and consolidated financial statements.[7] Between 1978 and 1988, the Commission's company law program made relatively little progress. Many of the Commission's proposals that were adopted during this decade

2. *See* Werner F. Ebke, *Unternehmenskontrolle durch Gesellschafter und Markt, in* INTERNATIONALE UNTERNEHMENSKONTROLLE UND UNTERNEHMENSKULTUR 7, 14-33 (Otto Sandrock & Wilhelm Jäger eds. 1994).

3. *See infra* notes 36-59 and accompanying text.

4. *See* Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent, 1977 O.J. (L 26) 1-13 [hereinafter Second Council Directive].

5. See Third Council Directive 78/855/EEC of 9 October 1978 based on article 54(3)(g) of the Treaty concerning mergers of public limited liability companies, 1978 O.J. (L 295) 36-43 [hereinafter Third Council Directive].

6. See Fourth Council Directive 78/660/EEC of 25 July 1978 based on article 54(3)(g) of the Treaty on annual accounts of certain types of companies, 1978 O.J. (L 222) 11-31 [hereinafter Fourth Council Directive].

7. *See* Seventh Council Directive 83/349/EEC of 13 June 1983 based on article 54(3)(g) of the Treaty on consolidated accounts, 1983 O.J. (L 193) 1-17 [hereinafter Seventh Council Directive].

amended existing directives. The directives concerned, for example, branches,[8] qualifications of auditors,[9] and the financial accounting and disclosure of limited partnerships having a corporate general partner.[10] Another directive introduced the concept of a single-shareholder corporation,[11] which is not uncommon in corporate practice but was not recognized by all Member States.

Since 1988, the Community company law program has not only slowed down, but has come to a virtual standstill. For example, in 1989, the first genuine European form of association, the European Economic Interest Grouping (EEIG), was created.[12] The EEIG is a partnership-like association designed to facilitate the EU-wide cooperation of professionals and others.[13] However, the important proposal of a Fifth Directive on the structure and organization of the corporation[14] was blocked by the EU Council. The draft of a European tender offer law has been under discussion since its publication on February 16, 1989.[15] The draft directive of groups of affiliated companies[16] did not even get off the ground. The proposed Statute of a European Company, which would create a supranational corporation subject to European law, is not likely to soon become law either.[17] In addition, the Commission's ambitious proposals of a European cooperative society,[18] a European mutual company,[19] and

8. *See* Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of companies governed by the law of another State, 1989 O.J. (L 395) 36-39.

9. *See* Eighth Council Directive 84/253/EEC of 10 April 1984 based on article 54(3)(g) of the Treaty on the approval of persons responsible for carrying out the statutory audits of accounting documents, 1984 O.J. (L 126) 20-26 [hereinafter Eighth Council Directive].

10. Council Directive 90/605/EEC of 8 November 1990 amending Directive 78/660/EEC on annual accounts and Directive 83/349/EEC on consolidated accounts as regards to the scope of those Directives, 1990 O.J. (L 317) 60-62.

11. *See* Twelfth Company Law Directive 89/667/EEC of 21 December 1989 on single-member private limited liability companies, 1989 O.J. (L 395) 40-42.

12. *See* Council Regulation 2137/85/EEC of 25 July 1985 on the European Economic Interest Grouping (EEIG), 1985 O.J. (L 199) 1-9.

13. For details of the EEIG, *see, e.g.*, DIRK VAN GERVEN & CAREL A. V. AALDERS, EUROPEAN ECONOMIC INTEREST GROUPING (1990).

14. *See* Second Amendment to the Proposal for a Fifth Council Directive based on article 54 of the EEC Treaty concerning the structure of public limited companies and the powers and obligations of their organs, 1991 O.J. (C 7) 4-6.

15. *See* Proposal for a Thirteenth Council Directive 88/823/EEC on Company Law, Concerning Takeover and other general bids, 1989 O.J. (C 64) 8-14. *See also* Proposal for a 13th European Parliament and Council Directive on Company Law concerning takeover bids, 1996 O.J. (C 162) 5-8. For a thorough discussion of the 1996 proposal, *see* Klaus J. Hopt, *Europäisches und deutsches Übernahmerecht*, 161 ZEITSCHRIFT FÜR DAS GESAMTE HANDELSRECHT (ZHR) 368 (1997).

16. *See* Draft proposal for a Ninth Directive based on article 54(3)(g) of the EEC Treaty on Links between undertakings, and in particular on groups (not published).

17. *See, e.g.*, Proposal for a Council Regulation on the Statute for a European Company, 1989 O.J. (C 263) 41-68 [hereinafter European Company Statute]. For details, *see, e.g.*, *Gordon, supra* note 1, at 544-48.

18. *See* Amended Proposal of 6 March 1992 for a Council Regulation on the statute for a European cooperative society, 1993 O.J. (C 236) 17-36.

19. *See* Amended Proposal of 6 March 1992 for a Council Regulation on the statute of a European mutual society, 1993 O.J. (C 236) 40-56.

a European association[20] have met such strong opposition that they are unlikely to be adopted by the Council.

The present article will deal with the historical development of European company law, its present state, and the possible future of the Commission's company law program. The purpose of this article is to develop answers to the still unsettled question of how much uniformity in corporate law is needed and how much state regulation of corporate affairs is desirable to accomplish the objectives of the EU. For this purpose, the article will first briefly explain the relationship between company law and EU law. In the second part, the article will address some choice of corporate law questions that have a substantial impact on the development of coordinated laws of business associations in the European Union. The third part of the article will focus on the development of European company law. In the fourth and final part, the article will try to discern some of the most important reasons behind the present stagnation of the Commission's company law program.

I. The EC Treaty

One of the primary objectives underlying the European Community Treaty[21] (EC Treaty) is the creation of an integrated European single market.[22] The EC Treaty sets out the means by which this single market is to be created through the elimination of internal barriers and the abolition of restrictions, both governmental and commercial, inhibiting trade flows between Member States. The EC Treaty prohibits restrictions on interstate trade through provisions dealing with the free movement of goods,[23] services,[24] capital,[25] and persons (whether wage-earners or self-employed).[26] Member State legislation that impedes these freedoms or discriminates on grounds of nationality runs contrary to Community law and is illegal under the doctrine of supremacy of Community law.[27]

The fundamental freedoms just mentioned and the general principle of non-discrimination on grounds of nationality[28] apply not only to natural persons, but also to business associations. Article 58 of the EC Treaty extends the fundamental right of free movement of persons under article 52 of the EC Treaty to all compa-

20. *See* Amended Proposal of 6 March 1992 for a Council Regulation on the statute for a European association, 1993 O.J. (C 236) 1-13.

21. TREATY ESTABLISHING THE EUROPEAN COMMUNITY, Feb. 7, 1992, 1992 O.J. (C 224) 1-130, [1992] 1 C.M.L.R. 573 [hereinafter EC TREATY].

22. *See id.* art. 7A.

23. *See id.* arts. 30-42.

24. *See id.* arts. 59-66.

25. *See id.* arts. 73B-73G.

26. *See id.* arts. 48-58.

27. For details of the principle of supremacy of Community law, *see, e.g.*, T. C. HARTLEY, THE FOUNDATIONS OF EUROPEAN COMMUNITY LAW 234-237 (3d ed. 1994).

28. *See* EC TREATY, *supra* note 21, art. 6, which reads as follows: "Within the scope of application of this Treaty, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited."

nies formed in accordance with the law of a Member State that have their registered office, central administration, or principal place of business within the EU.[29] This nexus requirement ensures that domestic and "sister state" companies within the EU benefit automatically from the free movement and nondiscrimination provisions of the EC Treaty, whereas foreign business associations fall within the ambit of the EC Treaty provisions only if reciprocity is granted. In the case of the United States, reciprocity is typically provided for in the bilateral commerce, investment, and friendship treaties that exist between the United States and most, if not all, EU Member States.[30]

The Treaty itself mentions company law in articles 54(3)(g)[31] and 220.[32] Article 54(3)(g) of the Treaty provides:

> 3. The Council and the Commission shall carry out the duties devolving upon them under the preceding provisions, in particular. . . .
>
> (g) by coordinating to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or firms within the meaning of the second paragraph of Article 58 with a view to making such safeguards equivalent throughout the Community. . . .[33]

Article 220 of the Treaty obliges Member States to enter into negotiations with each other about, inter alia, abolition of double taxation, mutual recognition of companies, and the possibility of interstate mergers of companies.[34] Taken to-

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29. Article 58 of the EC Treaty, *supra* note 21, reads as follows:

> Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.

'Companies or firms' means companies or firms constituted under civil or commercial law, including co-operative societies, and other legal persons governed by public or private law, save for those which are non-profit making.

30. For the friendship treaty between the United States and Germany, *see* Carsten T. Ebenroth & Thomas J. Dillon, *Gaining the Competitive Edge: Access to the European Market Through Bilateral Treaties and Taxation Strategies*, 28 TEX. INT'L L.J. 269 (1993). The authors suggest that Article XXV of the Treaty should be interpreted to provide that "[w]hen United States corporations come to Germany, the FNC Treaty displaces the seat theory—Germany's conflict of laws rule regarding corporations—and applies the United States theory of incorporation." *Id.* at 279. However, most German courts and commentators do not share the view of the authors. In their opinion, the "seat theory" applies to American corporations as well. *Id.*

31. *See* EC TREATY, *supra* note 21, art. 54(3)(g).

32. *See id.* art. 220.

33. *See id.* art. 54(3)(g).

34. *Id.* art. 220 provides, among others: "Member States shall, so far as is necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals:

> —. . .
>
> —the abolition of double taxation within the Community;
>
> —the mutual recognition of companies or firms within the meaning of the second paragraph of Art. 58, the retention of legal personality in the event of transfer of their seat from one country to another, and the possibility of mergers between companies or firms governed by the laws of different countries;
>
> —. . ."

gether with the right of establishment and the freedom to provide services, article 220 was the backdrop against which Member States signed, in 1968, a Convention on the Mutual Recognition of Companies.[35] This Convention seeks to ensure mutual recognition, throughout the Community, of all companies incorporated in a Member State of the EU. However, the Convention has not yet been fully ratified and is not likely ever to be ratified.

II. Conflicts of Laws

Unlike the U.S. Constitution, the Treaty Establishing the European Economic Community does not contain a full faith and credit clause. Rather, articles 52 and 58 grant businesses duly incorporated in one Member State a "right of establishment" in all other Member States.[36] In the *Daily Mail* case, the European Court of Justice observed that, as a general rule, enterprises exercise their right of establishment under the Treaty by forming subsidiaries, setting up branches, or utilizing agents.[37] Accordingly, the right of establishment does not mean that when a corporation duly incorporated in one Member State does business in another Member State, it necessarily carries with it the rights that were conferred upon it by the act of incorporation and the applicable law of its state of incorporation. Rather, each Member State must determine, as a matter of conflict of corporate laws, whether or not it wants to recognize, as a corporation, an entity incorporated in another Member State. Obviously, a Member State must not exclude another Member State's corporation altogether from engaging in intrastate business within its boundaries, but in view of the current state of Community company law, a Member State may require another Member State's corporation having its principal place of business ("seat," "siège," "Sitz") within its borders to incorporate under its own laws. Indeed, several Member States do impose such a choice-of-corporate-law requirement ("seat rule") to ensure that all corporations

35. For details and further references, *see, e.g.*, Kurt Lipstein, *One Hundred Years of Hague Conferences on Private International Law*, 42 INT'L & COMP. L.Q. 553, 631-632 (1993). An unofficial English translation of the convention is reprinted in 3 EUROPEAN UNION LAW GUIDE pt. VIII.B.0 (Philip Raworth ed. 1995).

36. *See* EC TREATY, *supra* note 21, art. 52, which provides: "Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be abolished by progressive stages in the course of the transitional period. Such progressive abolition shall also apply to restrictions on the setting up of agencies, branches, or subsidiaries by nationals of any Member State established in the territory of any Member State. Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Art. 58, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital."

37. Case 81/87, Regina v. H.M. Treasury and Commissioners of Inland Revenue *ex parte* Daily Mail and General Trust plc, 1988 E.C.R. 5483, 3 C.M.L.R. 713 (1988). For details of this case, *see* Werner F. Ebke & Markus Gockel, *Regional Developments: European Corporate Law*, 24 INT'L LAW. 239 (1990).

doing business within their boundaries are subject to the same rules of corporate law.[38] As a result, the choice of corporate law is substantially restricted by these Member States.

A. Internal Affairs

The reason for such a restriction becomes clear when one recalls that the law of the state of incorporation ordinarily determines the rules that govern the internal affairs of a corporation. Although the term "internal affairs" has no clear definition, it generally is deemed to include matters bearing on the relationship between owners (shareholders) and managers (directors and officers).[39] It also includes the relationship between different classes of shareholders, between shareholders and creditors, between shareholders and employees, and between shareholders and other stakeholders.[40] For example, under the internal affairs rule, the law of the state of incorporation governs the right of shareholders to vote, to receive distributions of corporate assets, to receive information from the management about the affairs of the corporation, to limit the powers of the corporation to specifically defined fields of activity, and to bring suit on behalf of the corporation when the managers refuse to do so.[41] It also determines the procedures by which the board of directors will act, the managers' right to be indemnified by the corporation when they are sued for their conduct, and the corporation's right to issue or repurchase stock and to merge with other companies.[42] The law of the state of incorporation also applies to rules defining the duties that the managers of a corporation owe to shareholders.[43] Perhaps most importantly, the law of the state of incorporation also governs the role that employees and other stakeholders play in the decision-making processes of the corporation.

The position that employees enjoy within the corporate governance system varies widely from one Member State to another. Germany has probably the most far-reaching body of law in this area, requiring substantial employee representation on the board of directors. Under German law, 50 percent of the members of the board of nonexecutive outside directors (*Aufsichtsrat*) of large public corporations are to be elected by the corporation's employees.[44] As a result, labor

38. The "seat rule" is applied, for example, by Belgium, France, Luxembourg, and Portugal. *See* Werner F. Ebke, *The Limited Partnership and Transnational Combinations of Business Forms: 'Delaware Syndrome' versus European Community Law*, 22 INT'L LAW. 191, 196 n.21 (1988).

39. LEWIS D. SOLOMON, DONALD E. SCHWARTZ, JEFFREY D. BAUMAN & ELLIOT J. WEISS, CORPORATIONS. LAW AND POLICY 205 (3rd ed. 1994).

40. *Id.*

41. *Id.*

42. *Id.*

43. *Id.*

44. *See* Act Concerning Co-Determination of Employees of May 4, 1976, Mitbestimmungsgesetz [MitbestG], 1976 BGBl. I 1153. For details of the German labor representation system, *see, e.g.*, Klaus J. Hopt, *Labor Representation on Corporate Boards: Impacts and Problems for Corporate Governance and Economic Integration in Europe*, 14 INT'L REV. L. & ECON. 203 (1994); Walter

representatives play a central role in the supervision of the board of executive directors (*Vorstand*), who manages the business and affairs of the corporation.[45] However, to avoid deadlocks, the chairperson of the board of nonexecutive outside directors has the right to a tie-breaking vote. By contrast, under English law, employees do not have a formal position in the decision-making processes of the corporation.[46]

While the role and position of employees in the corporate governance system is probably the single most significant difference between and among the Member States' corporation law, numerous other fundamental differences exist as to the internal affairs of business associations in general and corporations in particular. These differences result from different legal traditions, regulatory philosophies, economic and social policies, and constitutional provisions. The differences go far beyond the previous but still existing differences between and among the corporation laws of the 50 states and the territories in the United States.

B. "Seat Rule"

Fundamental differences in the Member States' laws of business associations explain why some, but not all, Member States continue to require corporations having their "seat," meaning their principal place of business, within their borders to incorporate under their laws. In the *Daily Mail* case, the European Court of Justice concluded that, in view of the current state of Community company law, the seat principle is consistent with Community law as long as the seat requirement is reasonable and necessary to protect legitimate state interests. In *Daily Mail*, the Court hinted that such a rule does not impede the corporation's right of establishment as long as the other Member State's corporation is not excluded altogether from engaging in intrastate business in the Member State, but rather is permitted to do business there through subsidiaries, branches, or agents. In the opinion of the Court, companies exercise their Community right of establishment through agents, branches, and subsidiaries.

Kolvenbach, *EEC Company Law Harmonization and Worker Participation*, 11 U. Pa. J. Int'l Bus. L. 709 (1990); Paul Windolf, *Codetermination and the Market for Corporate Control in the European Community*, 22 Econ. & Soc'y 137 (1993); Thomas J. André Jr., *Some Reflections on German Corporate Governance: A Glimpse at German Supervisory Boards*, 70 Tul. L. Rev. 1819, 1826-1828 (1996); Works Councils. Consultation, Representation, and Cooperation in Industrial Relations (Joel Rogers & Wolfgang Streeck eds. 1995). *See also, generally*, Comparative Corporate Governance (Klaus J. Hopt & Eddy Wymeersch eds. 1997).

45. For details of the two-tier board system in Germany, *see, e.g.*, Bernhard Grossfeld & Werner F. Ebke, *Controlling the Modern Corporation: A Comparative View of Corporate Power in the United States and Europe*, 26 Am. J. Comp. L. 397 (1978); André, *supra* note 44; Heinz-Dieter Assmann, Barbara Lange & Rolf Sethe, *The Law of Business Associations*, *in* Introduction to German Law 137, 147-149 (Werner F. Ebke & Mathew W. Finkin eds. 1996).

46. *See* N. Fox Bassett & S.J. Hood, *United Kingdom*, *in* Business Law in Europe 555, 601 (Maarten J. Ellis & Paul M. Storm eds. 1982).

In its *Factortame* decision, the Court confirmed its views.[47] The case involved a practice known as "quota hopping." To be eligible to fish for quotas allocated to the United Kingdom, Spanish fishermen bought vessels registered in the United Kingdom or re-registered their own vessels in the United Kingdom. In the 1980s, this practice became quite common, much to the irritation of British fishermen and the British Government. In order to put a stop to such quota hopping, the British Parliament, in 1988, established a new system of registration for fishing vessels that was separate from the registration system of other vessels. To qualify as a British fishing vessel (and thus to be eligible to fish for quotas allocated to the United Kingdom), a fishing vessel had to fulfill three conditions: first, the vessel had to be British owned; second, the vessel had to be managed, and its operations directed and controlled, from within the United Kingdom; and third, any charterer, manager, or operator of the vessel had to be a British citizen, a resident of the United Kingdom, or domiciled in the United Kingdom. The European Court concluded that the first condition, the provisions on the nationality of owners of fishing vessels, were contrary to article 52 of the EC Treaty in relation to Community nationals (whether individuals or companies) established in the United Kingdom.[48] Likewise, the condition that owners, directors, and shareholders as well as operators and managers of fishing vessels had to be resident in the United Kingdom was held to be a violation of article 52 of the EC Treaty in relation to Community nationals.[49] The requirement that a fishing vessel had to be managed and its operation directed and controlled from within the United Kingdom was, however, held to be compatible with Community law. The Court observed that such a requirement "essentially coincides with the actual concept of establishment within the meaning of articles 52 *et seq.*"[50]

C. Pseudo-Foreign Corporations

American lawyers will wonder why the European Court of Justice went as far as it did in the *Daily Mail* and *Factortame* cases. American choice of corporate law principles illustrate how legitimate state interests can be protected in multi-

47. Case C-221/89 Regina v. Secretary of State for Transportation *ex parte* Factortame, [1991] E.C.R. 3905.

48. *Id.* at paras. 22-23.

49. *Id.* at para. 32. *See also* Case C-55/94 Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, 1996 ALI ER (EC) 189, [1996] 1 C.M.L.R. 603. In this case, the European Court of Justice applied its four-factor test to the freedom of establishment provision of article 52 of the EC Treaty and the free-movement-of-services provision of article 59 of the EC Treaty, holding that "[n]ational measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfil four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what it necessary in order to attain it." *Id.*

50. *Id.* at para. 34.

jurisdictional legal systems without sacrificing the basic principle of free choice of corporate law.

1. *United States*

In the United States, when a corporation incorporated in one state does business in another state, it carries with it whatever rights were conferred upon it by the act of incorporation and the applicable law of the state of incorporation (subject, of course, to local qualification requirements).[51] However, to protect its citizens, a state, in principle at least, may apply some or all of its own corporate law rules to corporations that have substantial contacts with the state even though they are incorporated elsewhere. Thus, for example, New York[52] and California[53] have chosen to exercise this power over what have been called "pseudo-foreign" corporations, meaning corporations that carry on most of their activities or have a majority of their shareholders in the state but are incorporated in another state. Section 2115 of California's Corporation Code makes certain provisions of California law governing corporate affairs applicable to a foreign corporation if (1) more than 50 percent of its property, payroll, and sales are within California, and (2) more than 50 percent of its voting securities are held on record by persons with California addresses. A corporation falling within this class becomes subject to, among others, the California provisions on dividends and other distributions of corporate property, election and removal of directors, directors' standard of care, indemnification of directors and officers, and the regulation of mergers and sales of assets. Most importantly, the statute makes applicable the requirement that cumulative voting be used in the election of directors rather than straight voting. This provision thus mandates a form of voting which is at least optional in most other states.[54]

51. SOLOMON, SCHWARTZ, BAUMAN & WEISS, *supra* note 39, at 205. *See* also LEWIS D. SOLOMON & ALAN R. PALMITER, CORPORATIONS. EXAMPLES AND EXPLANATIONS 39 (2d ed. 1994); EUGENE F. SCOLES & PETER HAY, CONFLICT OF LAWS 913-15, 918-20 (2d ed. 1992). For an excellent analysis of the origins of the internal affairs rule, *see* Richard M. Buxbaum, *The Origins of the American Internal Affairs Rule in the Corporate Conflict of Laws*, in FESTSCHRIFT FÜR GERHARD KEGEL 75 (HANS-JOACHIM MUSIELAK & KLAUS SCHURIG eds. 1987). The "internal affairs" rule is applied not only to sister state corporations, but also to corporations formed outside the United States. *See, e.g.*, McDermott Inc. v. Lewis, 531 A.2d 206, 209 (Del. 1987).

52. *See* McKinney's Business Corporation Law §§ 1306, 1315-1320.

53. CAL. CORP. CODE § 2115 (West 1995).

54. A constitutional challenge to Cal. Corp. Code § 2115 was rejected by a California appellate court in Wilson v. Louisiana-Pacific Resources, Inc., 138 Cal. App. 3d 216, 231, 187 Cal. Rptr. 852, 859 (1982). *But see* Nedlloyd Lines B.V. v. Superior Court, 3 Cal. 4th 459, 472 n.13, 11 Cal. Rptr. 2d 330, 351 n.13, 834 P.2d 1148, 1169 n.13 (1992). A constitutional challenge to § 2115 could result from the U.S. Supreme Court's decision in CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1987). For details of the constitutional limitations on applying the law of the forum state to the internal affairs of a foreign corporation, *see* SCOLES & HAY, *supra* note 51, at 924-925; Deborah A. DeMott, *Perspectives on Choice of Law for Corporate Internal Affairs*, 48 L. & CONTEMP. PROBS., Summer 1985, at 161; Richard M. Buxbaum, *The Threatened Constitutionalization of the Internal Affairs Doctrine in Corporation Law*, 75 CAL. L. REV. 29, 44-48 (1987); Norton P. Beveridge, *The Internal Affairs Doctrine: The Proper Law of a Corporation*, 44 BUS. LAW. 693 (1989).

2. *European Union*

One might be tempted to argue that, in the EU, a Member State could adopt a similar approach by applying some or all of its mandatory rules of corporate law to corporations having substantial contacts with the Member State even though they are incorporated in another Member State. While at first glance such an argument seems to be sound, numerous legal questions and practical problems arise. Legally, such an approach would require Member States to give up the "seat" rule and adopt the liberal state-of-incorporation principle. Under the "seat" rule, a Member State will not recognize a corporation as a corporate entity if the corporation has not been incorporated in the Member State in which it has its principal place of business. If it does not have its principal place of business in its state of incorporation, the enterprise will be treated legally as a partnership or some other form of unincorporated association. Consequently, in Member States following the "seat" rule, the pseudo-foreign corporation concept does not exist.

Yet, even if all EU Member States applied the state-of-incorporation principle, there would be a lot of practical problems in dealing with pseudo-foreign corporations. These problems result from structural differences between the Member States' company laws. Thus, for example, the German model of employee representation on the board of nonexecutive outside directors (Aufsichtsrat) can be effectuated only if the corporation has a two-tier as opposed to a unitary, American-style board of directors.[55] A formal institutional separation between executive (inside) and nonexecutive (outside) directors as required by German law is unknown in most EU Member States, including the United Kingdom. Consequently, imposition of employee board representation requirements on another Member State's corporation presents almost intolerable practical consequences to the corporate enterprise and its managers if the law of the state of incorporation does not provide a two-tier board structure. In view of the significant structural and other differences that exist in the corporation law of the EU Member States, such differences cause substantial and, in the end, insurmountable hurdles.

Perhaps most importantly, unlike in the United States, in the EU, the choice of the state of incorporation is not considered a right or privilege under Community law but rather primarily a question of conflict of laws, subject only to Community law limitations. These limitations are, of course, not static, but dynamic.[56] In this context, it should be noted that in *Daily Mail*,[57] the European Court of Justice made reference to the "current state of Community company law." This reference seems to suggest that, in the Court's opinion, restrictions of an enterprise's choice of corporate law will no longer be legal under Community law once the Member

55. *See* Grossfeld & Ebke, *supra* note 45, at 427-430.

56. Bernhard Grossfeld, *The Internal Dynamics of the European Community Law*, 26 INT'L LAW. 125, 138-139 (1992).

57. *See supra* note 37.

States' laws of corporations have been coordinated to such an extent that they are of the same standard or at least functionally equivalent.[58]

The Court did not say what the Community law limitations on applying the law of the forum Member State to the internal affairs of another Member State's corporation would be in such a case. It is reasonable to assume that the Community law issues presented in such a case would be as complex and controversial as the issues regarding the constitutionality of pseudo-foreign corporation laws in the United States.[59] However, in the European Community, this question is not likely to arise soon. For some 30 years, the Commission has made substantial efforts to coordinate the Member States' laws of business associations and to advance Community company law. Yet, as mentioned before, the Commission's company law program thus far has not succeeded in bringing the Member States' law regarding the internal affairs and the structure and organization of the corporation on a par. Thus, the situation envisioned by the European Court of Justice is not likely to arise soon.

III. The Commission's Company Law Program

Since the EC Treaty is currently interpreted to permit reasonable limitations on the choice of corporate law and since the 1968 Convention on the Mutual Recognition of Companies was not ratified,[60] the Commission, whose role is to initiate Community legislation and to serve as guardian of the Treaty,[61] felt substantial pressure. Leading Member States, such as France and Germany, continued to apply the rule that corporations having their principal place of business within their borders are to be incorporated under their law. This requirement in effect limits state competition in corporate law. While the reincorporation of a duly incorporated enterprise in another Member State is legally permissible, it may have undesirable tax consequences that increase the costs of such a transaction.[62] Not surprisingly, therefore, corporations in the Community are rarely reincorporated. Rather, if a corporation duly incorporated in one Member State, say Germany, wishes to do business in another Member State, say France, it will normally form a branch or subsidiary in the other Member State. Under those circumstances, true state competition in company law, like that in the United States, is unlikely to occur.[63] Also,

58. *See* Ebke, *supra* note 38, at 203.

59. *See* authorities *supra* note 54.

60. *See supra* note 35.

61. Werner F. Ebke, *Enforcement Techniques Within the European Communities: Flying Close to the Sun with Waxen Wings*, 50 J. AIR L. & COM. 685, 694 (1985).

62. For details, *see, e.g.*, VIOLA KRUSE, SITZVERLEGUNG VON KAPITALGESELLSCHAFTEN INNERHALB DER EG (1997); ANNETTE SCHLENKER, GESTALTUNGSMODELLE EINER IDENTITÄTSWAHRENDEN SITZVERLEGUNG VON KAPITALGESELLSCHAFTEN ÜBER DIE GRENZE (1997).

63. For details, *see, e.g.*, ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (1993); Lucian A. Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1437 (1992); William J. Carney, *The Political Economy of Competition for Corporate Charters*, 26 J. LEG. STUD. 303 (1997).

legal changes, for better[64] or worse,[65] resulting from such competition are unlikely to arise. Consequently, the limitations on an enterprise's choice of corporate law, along with the lack of Community company law regarding the internal affairs of a corporation, perpetuate the coexistence of fundamentally different Member State laws of business associations within the Community.

In the 1970s, the lack of a body of coordinated company law within the European Community was increasingly considered undesirable. As the integrated European market developed, cross border dealings between companies, their shareholders, creditors, and others increased. The fact that such relations were governed by different rules in different Member States was viewed as a material obstacle to the growth of such integration. Thus, cross-border mergers of companies within the Community were rather complicated. Similarly, the liability for pre-incorporation business activities varied from Member State to Member State. Also, some Member States did not require corporations to prepare financial statements and to have them audited by an independent professional accountant or an accounting firm, and the information contained in corporate financial statements was not always comparable because accounting principles varied from Member State to Member State. In addition, securities regulation varied from Member State to Member State which impeded, to some extent at least, the integration of the European capital markets. For instance, tender offers were regulated by law in some, but not all, Member States.[66] Likewise, insider trading was prohibited in some, but not all, Member States.[67]

A. The Successful Part

To remedy this situation, the Commission, beginning in the late 1960s, launched an ambitious company and capital market law program.[68] Initially, the Commission proposed a number of directives under article 54(3)(g) of the Treaty

64. Proponents of state competition in corporation law view it as a race for the top. *See, e.g.*, Peter Dodd & Richard Leftwich, *The Market for Corporate Charters: "Unhealthy Competition" versus Federal Regulation*, 53 J. Bus. L. 259, 282 (1980); Frank H. Easterbrook, *Managers' Discretion and Investors' Welfare: Theories and Evidence*, 9 Del. J. Corp. L. 540, 571 (1984); Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporation Law*, 76 Nw. U. L. Rev. 913, 919-20 (1982); Ralph K. Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. Legal Stud. 251, 256-57 (1977).

65. The critics of state competition in corporation law regard it as "the race for the bottom." *See, e.g.*, William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 Yale L. J. 663, 665-66 (1974); Melvin A. Eisenberg, *The Modernization of Corporate Law: An Essay for Bill Cary*, 37 U. Miami L. Rev. 187, 188-91, 196-98, 202-09 (1983); Donald E. Schwartz, *Federalism and Corporate Governance*, 45 Ohio St. L. J. 545, 548-51 (1984).

66. *See, e.g.*, European Takeovers—Law and Practice (Klaus Hopt & Eddy Wymeersch eds., 1992).

67. *See, e.g.*, European Insider Dealing—Law and Practice (Klaus Hopt & Eddy Wymeersch eds., 1991).

68. Eric Stein, Harmonization of European Company Law 5 (1971); The Harmonization of European Company Law (Clive M. Schmitthoff ed., 1973).

to coordinate the Member States' company laws. A directive is one of the two primary types of Community legislative acts.[69] A directive is not the same as a federal statute in the United States. Rather, a directive establishes Community policy. It is then left to the Member States to implement the directive in whatever way is appropriate to their legal system.[70] This implementation may require a new statute, a Presidential decree, an administrative act, or even a constitutional amendment. Sometimes, it may require no action at all. For instance, if a Member State's law is already in line with the Community policy set forth in the directive, no action would be required.

The following are among the company law directives proposed by the Commission and finally adopted by the Council:

- The First Directive sets out requirements for standardization of corporate liability (including pre-incorporation liability) and seeks to protect third parties by limiting the doctrines of constructive notice and ultra vires;[71]
- the Second Directive lays down minimum standards for the formation of companies and the maintenance, increase, and reduction of their capital;[72]
- the Third Directive concerns the merger of public corporations;[73]
- the Fourth Directive seeks to coordinate the Member States' laws of financial accounting and disclosure (i.e., the contents and presentation of financial statements, the valuation of assets and liabilities, and the disclosure of financial information);[74]
- the Sixth Directive governs sales of assets of public corporations and contains specific provisions for the protection of shareholders, creditors, and employees in case of a division;[75]
- the Seventh Directive concerns consolidated financial statements of groups of affiliated companies;[76]
- the Eighth Directive provides certain minimum standards and qualifications of corporate auditors.[77]

69. *See* EC Treaty, *supra* note 21, art. 189. For details, *see, e.g.*, T.C. Hartley, *supra* note 27, at 107; Ralph H. Folsom, European Community Law in a Nutshell 27-28 (2d ed. 1992); D. Lasok, Law and Institutions of the European Union 122-31 (6th ed. 1994).

70. *See* EC Treaty, *supra* note 21, art. 189 (3), which reads as follows: "A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods."

71. *See* First Council Directive of 9 March 1968 on co-ordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community, 1968 O.J. (L 65) 8-12.

72. *See* Second Council Directive, *supra* note 4.

73. *See* Third Council Directive, *supra* note 5.

74. *See* Fourth Council Directive, *supra* note 6.

75. *See* Sixth Council Directive of 17 December 1982 based on Article 54(3)(g) of the Treaty, concerning the division of public limited liability companies, 1982 O.J. (L 378) 47-54.

76. *See* Seventh Council Directive, *supra* note 7.

77. *See* Eighth Council Directive, *supra* note 9.

These directives were by and large relatively uncontroversial. All of them were eventually implemented by the Member States.

B. The Controversial Part

By contrast, other company law proposals are more controversial. Perhaps the single most controversial proposal is the proposed Fifth Directive on the structure of corporations.[78] This proposal has long been delayed due to differing views about the functions of the unitary and the two-tier board systems and the role and position of employees at the board level of large public corporations. The proposed European Company Statute[79] is equally controversial.[80] If adopted, the European Company Statute would make it possible for two or more companies from different Member States to form a new company by means of a merger. The newly formed company would be a genuinely supranational corporation subject primarily to Community, as opposed to Member State, law. Member State law would come into play only if no European law on point exists.[81] In such a case, the law of the Member State in which the European Company has its principal place of business would apply. The first proposal of a European Company Statute was submitted in 1970[82] and then amended in 1975[83] and 1989.[84] The proposal takes the form of a Regulation based upon article 235 of the Treaty.[85] Unlike a Directive, a Regulation binds everybody to whom it is directed and lays down directly applicable rules of law.[86] In this respect, it compares to a federal statute in the United States, such as the Securities Act of 1933 or the Securities Exchange Act of 1934. However, the proposal of a European Company Statute and the proposed Fifth Directive have virtually no chance of adoption soon.

78. *See* Second Amendments, *supra* note 14.

79. *See* European Community Statute, *supra* note 17.

80. *See* EU Commissioner Mario Monti, *Statut der Europäischen Aktiengesellschaft*, 51 WERTPAPIER-MITTEILUNGEN (WM) 607 (1997).

81. *See* European Company Statute, *supra* note 17, art. 7, which provides, among others: "1. Matters covered by this Regulation, but not expressly mentioned herein, shall be governed: a) by the general principles upon which this Regulation is based; b) if those general principles do not provide a solution to the problem, by the law applying to public limited companies in the State in which the SE has its registered office. . ."

82. *See* 1970 O.J. (C 124) 1.

83. *See* Proposal for a Council Regulation on the Statute for European Companies, Bulletin of the European Communities Supplement 4/75.

84. *See* Proposal for a Council Directive complementing the statute for a European company with regard to the involvement of employees in the European company, 1989 O.J. (C 263) 69-72.

85. Article 235 of the EC Treaty, *supra* note 21, provides: "If action by the Community should prove necessary to attain, in the course of the operation of the common market, one of the objectives of the Community and this Treaty has not provided the necessary powers, the Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, take the appropriate measures."

86. *See* EC TREATY, *supra* note 21, art. 189(2) which provides: "A regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States." For details *see, e.g.*, HARTLEY, *supra* note 27, at 206-10; FOLSOM, *supra* note 69, at 27 & 70.

IV. The Current Crisis

The fate of the Fifth Directive and the European Company Statute is indicative of the conceptual crisis facing the Commission's company law program.

A. Conceptual Problems

Many of the Commission's proposals regarding the internal affairs and the structure and organization of corporate entities are too closely associated with the law of certain Member States.[87] The early proposals concerning the structure of the board of directors and the role of employees in corporate governance are the best examples in support of this proposition. The proposals were patterned after the German model and, if adopted, would have fundamentally changed the law and practice of corporations in Belgium, Italy, and others of the initially six Member States of the EC. In my view, the Commission has not really succeeded in developing a comprehensive body of corporate law rules that are truly European in nature.[88] Rather, the Commission borrowed heavily from the legal systems of a few Member States in the hope that the other Member States would follow suit. However, with the accession of common law countries, such as the United Kingdom and Ireland, and the Southern and Northern expansion of the EU, new legal cultures entered the market and many of the new Members were not willing simply to follow the direction suggested by the Commission.

This unwillingness is particularly true with respect to labor representation on the board of directors.[89] As early as 1975, the EU Commission itself posted the question of whether it should continue to address controversial issues such as the role and position of employees in the decision-making processes of the corporation.[90] The Commission noted that within the European Community the need for Community law in this area had been called seriously into question. A number of Member States were criticizing the Commission's attempts to add a social dimension to the existing body of company law by developing company law towards an enterprise law that would not only take into account the interests of the owners (shareholders) of the business but also the interests of employees, creditors, and other stakeholders. Resistance to this concept came mainly from two opposite sides. To some Member States, the concept of a stakeholder-oriented enterprise law (which was inspired by German law) was unacceptable because it would radically change the law and practice of the corporation in those countries.[91] To Germany, by contrast, a harmonization of the law regarding the internal

87. *See* Ebke, *supra* note 2, at 21. *Accord* Wolfgang Schön, *Mindestharmonisierung im europäischen Gesellschaftsrecht*, 160 ZHR 221, 249 (1996).

88. For a more detailed exposition of this view, *see* Ebke, *supra* note 2, at 35.

89. Wedderburn of Charlton, *Companies and Employees: Common Law or Social Dimension*, 109 Law Q. Rev. 220 (1993); Hopt, *supra* note 44; Kolvenbach, *supra* note 44.

90. *See* Behrens, *supra* note 1, at 837.

91. *See* Marcus Lutter, Europäisches Unternehmensrecht 40 (2d ed. 1984).

affairs of the corporation without a coordination, at EU level, of the role of labor in corporate governance was equally unacceptable because it was assumed that German companies might reincorporate their business in another Member State to avoid labor representation on the board. Consequently, proponents and opponents of the Commission's concept blocked each other in the EU Council.

The Commission responded to the growing criticism by revising its original proposals and suggesting alternative models. For example, the Commission made the two-tier board structure optional.[92] Yet, even with this more flexible approach the Commission did not overcome the Member States' resistance to its company law program. Recently, the EU Commissioner Mario Monti admitted that the company law program of the EU is in a difficult situation.[93] To remedy this situation, the Commission adopted a new strategy. It decided formally to separate the labor representation provisions from the general corporate law provisions of the European Company Statute and the Fifth Directive.[94] However, it would be unrealistic to assume that such a formal separation will ultimately resolve a fundamental, substantive issue like employee representation on the board.

B. A QUESTION OF POWER

The Commission need not cope with only a conceptual crisis. The Commission is also facing jurisdictional problems. A number of the Commission's proposals are called seriously into question because they are believed to exceed the Community's legislative powers under the Treaty.

1. *Legislative Powers*

The first draft of a Fifth Directive and the original proposal of a European Company Statute contained a provision under which the auditor of the financial statements of a corporation is liable for ordinary negligence not only to the audited company but also to all generally foreseeable third parties relying on the audited financial statements. Clearly, the third-party liability proposal went beyond the scope of the law of many Member States.[95] Therefore, it is not surprising that many Member States questioned whether the Community had the power, under article 54(g)(3) of the Treaty, to harmonize the Member States' laws of contract and tort liability in general and the professional liability of accountants in particular.[96] The Commission finally gave in and withdrew the questionable third-party liability provision.[97]

92. Compare Article 3 of the proposed Fifth Council Directive of Dec. 20, 1990, *supra* note 14, with Article 21a of the proposed Fifth Council Directive of Dec. 20, 1990, *supra* note 14.

93. *See* Monti, *supra* note 80, at 607.

94. *See, e.g.*, Council Directive for European Company, *supra* note 84.

95. WERNER F. EBKE, WIRTSCHAFTSPRÜFER UND DRITTHAFTUNG 3 (1983).

96. *Id.*

97. Werner F. Ebke, *In Search of Alternatives: Comparative Reflections on Corporate Governance and the Independent Auditor's Responsibilities*, 79 NW. U. L. REV. 663, 667 (1984). *But see* Section 5 of the "Green Paper" of the EU Commission on "[T]he role, the position and the liability

2. *Principle of Subsidiarity*

The dispute over the Community's power to coordinate company law within the Community is fostered by the principle of subsidiary, which has been formally recognized as a constitutional principle of Community law by the 1991 Maastricht amendments to the EC Treaty.[98] Generally speaking, under the principle of subsidiarity, the Community shall pursue only those objectives which can be better attained by the Community than Member States acting individually. Article 3B(1) of the Treaty establishes the principle that the Community only has the powers exclusively assigned to it or previously exercised by it.[99] By the operation of this provision, all the powers of the Community are derived from the Treaty, and they are assigned powers, while the Member States hold all residual powers. However, the drafters of article 3B(1) recognized, by virtue of the rule of effectiveness (*effet utile*), the existence of implied powers vested in the Community in order to achieve the objectives assigned to it by the Treaty.

Article 3B(2) provides that in areas which do not fall within the Community's exclusive jurisdiction, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community.[100]

Thus, in the field of concurrent jurisdiction, the Community may take action only in a subsidiary capacity and perform only those tasks that can be carried out more effectively at the Community level than the Member State level because of their "scale or effects" or for more effective implementation reasons.

The Commission seems to be of the opinion that it has exclusive jurisdiction with respect to all measures—including the coordination of law—needed to accomplish the objective of a European Single Market (article 7A of the EC Treaty).[101]

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of the statutory auditor within the European Union," 1996 O.J. (C 321) 1. For comments in English, *see, e.g.*, Werner F. Ebke, *The Statutory Auditor's Professional Liability*, in EUROPEAN COMMISSION, ACT OF THE CONFERENCE ON THE ROLE, THE POSITION AND THE LIABILITY OF THE STATUTORY AUDITOR WITHIN THE EUROPEAN UNION 197 (1997); THE ROLE, POSITION AND LIABILITY OF THE STATUTORY AUDITOR IN THE EUROPEAN UNION (Fédération des Experts Comptables Européens ed. 1996).

98. The legal literature dealing with the principle of subsidiarity is vast. For details, *see, e.g.*, Nicholas Emiliou, *Subsidiarity: An Effective Barrier Against "the Enterprise of Ambition"?*, 17 EUR. L. REV. 383 (1992); Trevor C. Hartley, *Constitutional and Institutional Aspects of the Maastricht Agreement*, 42 INT'L & COMP. L. Q. 213 (1993).

99. *See* EC TREATY, *supra* note 21, art. 3B(1). It provides: "The Community shall act within the limits of the powers conferred upon it by this Treaty and of the objectives assigned to it therein."

100. *See id.* art. 3B(2).

101. *See id.* art. 7A. It provides: "The Community shall adopt measures with the aim of progressively establishing the internal market over a period expiring on 31 December 1992, in accordance with the provisions of this Article and of Articles 7b, 7c, 28, 57(2), 59, 70(1), 84, 99, 100a and 100b and without prejudice to the other provisions of this Treaty.

"The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty."

If viewed from this angle, coordination of company law falls within the exclusive jurisdiction of the Community and therefore is not subject to the principle of subsidiarity. Several Member States, by contrast, have taken the view that the Community company law program needs to meet the subsidiarity test as it falls within the concurrent jurisdiction provision.

While it is difficult to draw a clear line between exclusive and concurrent/subsidiary legislative powers, only the creation of European forms of business associations would seem to fall clearly within the exclusive jurisdiction of the Community. Yet, even then, the Commission has the burden of showing that European legislation in this area is needed to accomplish the Treaty's objective of an integrated European Single Market.[102] The proposed European Company Statute[103] would seem to meet this test only if it could be shown that a European Single Market calls for a European corporation subject to European as opposed to Member State law. Needless to say, no consensus exists within the Community as to whether or not that is the case. However, commentators agree that there are serious doubts whether the proposed regulations of a European cooperative society,[104] a European mutual association,[105] and a European association[106] meet the test because these associations are typically of local importance only, without any impact on interstate trade.[107]

The proposed Fifth Directive[108] and the proposed Tender Offer Directive[109] give rise to more complicated legal questions. Assuming that tender offers and corporate internal affairs are areas that do not fall within the exclusive, but fall within the concurrent/subsidiary, jurisdiction of the Community, will Community legislation in these areas meet the subsidiarity test? It has been argued that, in substance, the subsidiarity test established in article 3B(2) is not different from the "in so far as necessary" test contained in articles 54,[110] 100A(1),[111] and 235[112]

102. *See* EC TREATY, *supra* note 21, art. 3B(3). It provides: "Any action by the Community shall not go beyond what is necessary to achieve the objectives of this Treaty."

103. *See* European Company Statute, *supra* note 17.

104. *See supra* note 18.

105. *See supra* note 19.

106. *See supra* note 20.

107. *See, e.g.*, Marcus Lutter, *Perspektiven eines europäischen Unternehmensrechtes Versuch einer Summe*, 21 ZEITSCHRIFT FÜR UNTERNEHMENSRECHT UND GESELLSCHAFTSRECHT [ZGR] 435, 447 (1992).

108. *See supra* note 14.

109. *See supra* note 15.

110. For the text of the EC Treaty, *supra* note 21, art. 54, *see* text accompanying *supra* note 33.

111. *See* EC TREATY, *supra* note 21, art. 100A(1). It provides: "By way of derogation from Article 100 and save where otherwise provided in this Treaty, the following provisions shall apply for the achievement of the objectives set out in Article 7A. The Council shall, acting by a qualified majority on a proposal from the Commission in cooperation with the European Parliament and after consulting the Economic and Social Committee, adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market."

112. *Id.* art. 235.

of the EC Treaty, which have been relied upon by the Commission as empowering provisions for various company law proposals. While that view may be true in principle, article 3B(2) of the Treaty goes beyond the "in so far as necessary" test in that it specifically requires the Community to perform only those tasks that can be carried out more effectively at Community level than at Member State level.

3. *From the Top Down versus from the Bottom to the Top*

Obviously, the key question is whether it is fair to assume that the Member States, through legislative acts, judicial lawmaking, or otherwise, would be capable of developing, from the bottom up, a body of coordinated company law that in the end will be as effective as coordinated Community company law imposed from above. Proponents of Community legislation in this area are convinced that a coordination process from the bottom up is bound to fail. To support their proposition they point to the fact that, in the past, several Member States were unwilling to implement directives adopted by the Council. How can these and other Member States, they ask, possibly be expected voluntarily and unilaterally to take measures to bring their laws in line with those of other Member States? To support this point, the proponents of company law coordination from the top down argue that without the adoption of the First Directive, the United Kingdom would not have given up the *ultra vires* doctrine.[113] Germany's refusal to extend the financial accounting and disclosure directive to limited partnerships with a corporate general partner (GmbH & Co.KG) is also cited in support of the proposition that Member States have been and will be reluctant voluntarily to bring their law in line with that of other Member States if existing differences may provide a comparative advantage to the Member State in question.[114]

By contrast, proponents of a coordination process from the bottom to the top argue that court decisions in various Member States illustrate that substantial cross-fertilization among European legal systems exists, both directly and indirectly. For example, in its *Caparo* decision, the English House of Lords applied a common law rule to an accountant's liability case equivalent to the German and Austrian law on auditors' liability to third parties.[115] There are other examples that go even more to the core of corporate law. For example, a few years before the *Caparo* decision was handed down, the German Supreme Court recognized a shareholder's right to bring a derivative law suit for an unauthorized sale of corporate assets even though the German Business Corporation Act was silent

113. Behrens, *supra* note 1, at 837.

114. *See* LUTTER, *supra* note 1, at 143-44; Behrens, *supra* note 1, at 843-45.

115. Caparo Ind. v. Dickman, [1990] 1 All E.R. 568. For details, *see* Werner F. Ebke & Peter Bert, *Vereinheitlichung der Abschlussprüferhaftung in Europa durch Rechtsprechung*, 4 EUROPÄISCHES WIRTSCHAFTS- UND STEUERRECHT [EWS] 229 (1993); Werner F. Ebke & Martin Antonio de la Garza, *Por un Sistema Uniforme de Responsabilidad del Auditor en la Administración de Justicia Europea*, 18 REVISTA DE INVESTIGACIONES JURIDICAS 349 (1994).

on this issue.[116] The Court relied, among others, upon comparative legal literature analyzing the relevant law of several European and U.S. jurisdictions. Member State legislatures, too, are willing voluntarily to bring their laws in line with those of other Member States if they are convinced that such a step is necessary to cope effectively with modern day problems of corporation law. The classic example in support of this proposition is a 1969 French law allowing French companies to adopt the German-style two-tier board system consisting of a management board and a separate board of nonexecutive supervisors.[117]

These examples illustrate that Member States are taking seriously their obligation under Article 5 of the EC Treaty according to which they "shall take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of [the] Treaty."[118] True, the bottom-up coordination process is necessarily spontaneous and uncoordinated, yet it has proved to be capable of producing legal rules that are of the same standard as, or at least functionally equivalent to, the rules of other Member States. The results may be insufficient and the process as such may be time consuming, but the examples illustrate that there are alternatives to company law coordination from the top down, whether one likes it or not.

C. Legitimacy

In addition to the points just discussed, the very legitimacy of the coordination of company law is being called into question.

1. *Uniformity versus Diversity*

A growing number of people in the EU opine that uniformity is not necessarily desirable since the strength of the EU lies in diversity. Applied to law, this proposition calls for decentralized lawmaking. Decentralized lawmaking avoids the problems and disadvantages commonly associated with centralized lawmaking. Also, decentralized lawmaking is considered to be more flexible and responsive to changing circumstances, local needs, and different regulatory philosophies. In addition, it is argued that decentralized lawmaking leads to legislative competition, which in turn will produce more rational and in the end better and

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116. *See* Judgment of Feb. 25, 1982, Bundesgerichtshof [BGH], Ger., 83 BGHZ 122 (1982).

117. *See* Grossfeld & Ebke, *supra* note 45, at 403. For details of the two-tier system under French law, *see* BATHÉLÉMY MERCADAL & M. PHILIPPE JANIN, SOCIÉTÉS COMMERCIALES 458-490 (1992). In corporate practice, however, the two-tier board model is not particularly popular in France. *See* HANS JÜRGEN SONNENBERGER, FRANZÖSISCHES HANDELS- UND WIRTSCHAFTSRECHT 166-167 (2d ed., 1991).

118. EC Treaty, *supra* note 21, art. 5. It provides in full: "Member States shall take all appropriate measures, whether general or particular, to ensure fulfilment of the obligations arising out of this Treaty or resulting from action taken by the institutions of the Community. They shall facilitate the achievement of the Community's tasks. They shall abstain from any measure which could jeopardize the attainment of the objectives of this Treaty."

more appropriate laws. To American lawyers this discussion will sound quite familiar, and in fact both the proponents and the opponents often look to the American model for inspiration and guidance. However, it is often overlooked that in the European Community, the potential for state competition in corporate law is relatively limited as long as the Member States are permitted, under the Treaty, to restrict a corporation's choice of law by means of the "seat" rule.[119]

Companies have, of course, a right to reincorporate in another Member State, but such a transaction is rather costly, especially in view of the tax consequences.[120] Because of the costs, reincorporation is the rare exception rather than the rule. A Member State corporation that wants to do business outside its state of incorporation may set up a subsidiary in another Member State and in that context, it does have a choice among fourteen different jurisdictions within the EU. Yet, that choice is typically made not with a view to the contents of the countries' respective company laws but primarily on the basis of business, tax, strategic, or other decisions. Consequently, in the EU, state competition in company law is rather marginal. In a hardly competitive market for company law rules such as the EU, the advantages typically associated with decentralized company lawmaking are relatively small and may not necessarily support the view that decentralized lawmaking is preferable to central lawmaking.

2. *Selection*

The question of legitimacy of company law coordination from the top down has yet another aspect that should not be overlooked. A growing number of European corporate law scholars are questioning whether it is necessary to coordinate all areas of corporate law. The proposed harmonization of the law of groups of affiliated companies is often cited in support of the proposition that certain areas of company law are simply not suitable for coordination.[121] Indeed, the Commission is no longer pursuing its efforts to develop a European law of groups of affiliated companies. An important reason for the backing off of the Commission is that no consensus could be reached within the Community as to what should be the company law objectives of such coordination efforts. Specifically, who was supposed to be protected by a European law of groups of affiliated companies: the subsidiary companies, minority shareholders, creditors, or the group governance system?

119. *See supra* notes 36-38 and accompanying text.

120. For details, *see* KRUSE, *supra* note 62; SCHLENKER, *supra* note 62.

121. For details, *see* KONZERNRECHT IM AUSLAND (Marcus Lutter ed., 1994); GROUPS OF COMPANIES IN THE EEC. A SURVEY REPORT TO THE EUROPEAN COMMISSION ON THE LAW RELATING TO CORPORATE GROUPS IN VARIOUS MEMBER STATES (Eddy Wymeersch ed. 1993); DAS GESELLSCHAFTSRECHT DER KONZERNE IM INTERNATIONALEN VERGLEICH (Ernst-Joachim Mestmäcker & Peter Behrens eds., 1991) [hereinafter GESELLSCHAFTSRECHT]; DAS ST. GALLER KONZERNRECHTSGESPRÄCH (Jean N. Druey ed. 1988).

Again, the Commission's draft was patterned after the German law of groups of affiliated companies, which provides only one of many possible models with respect to regulating affiliated companies.[122] Other legal systems, including the U.K. and the U.S. systems, rely more heavily on tender offer regulations (as tender offers are often used to gain control over another company), on rules of liability for breach of fiduciary duties, and on the concept of piercing the corporate veil (of either the parent or the subsidiary company) to provide the necessary protection.[123] Germany, in turn, has found the proposed tender offer directive unacceptable.[124] However, Germany may change its attitude towards the regulation of tender offers because in the Spring of 1997, Germany witnessed a major unfriendly takeover bid by the second largest steel company, Krupp-Hoesch, for the country's largest steel company, Thyssen. While the takeover attempt was ultimately unsuccessful, the board of directors of both Krupp-Hoesch and Thyssen agreed, in November 1997, to merge both companies.

The preceding discussion illustrates that some areas of company law may not lend themselves to coordination by the European Community. Yet, the discussion also shows how important it is for the EU Commission to study, on a broad comparative basis, the legal models that exist in the various Member States before drafting its own proposal. Without such a basis, any future proposal to approximate the Member States' law of business associations and securities laws is likely to be dismissed by the Member States as unacceptable. Only a broad comparative knowledge of the Member States' law will enable the Commission to contribute to the creation of a truly European company law culture that is more than the sum of the Member States' law of business associations, which will require careful consideration of the need for European, as opposed to Member States, regulation.

3. *Methods*

Once it has been determined that a certain area of company law is suitable for coordination measures, the Commission must determine what method should apply. Should it lay down minimum standards?[125] Should it give Member States

122. *See* Draft proposal for a Ninth Directive, *supra* note 16.

123. *See* Werner F. Ebke, *Die Konzernierung im US-amerikanischen Recht, in* GESELLSCHAFTSRECHT, 279, 285-327; Tom Hadden, *Die Regelung der Konzerne in Grossbritannien: Sonderbehandlung im Rahmen des allgemeinen Gesellschaftsrechts, in* GESELLSCHAFTSRECHT, 329, 330-338; Frank Woolridge, *Aspects of the Regulation of Groups of Companies in Europe, in* EUROPEAN COMPANY LAWS: A COMPARATIVE APPROACH 103 (Robert R. Drury & Peter G. Xuereb eds., 1991). Peter Hommelhoff is possibly the strongest proponent of a European law of groups of affiliated companies. *See, e.g.*, Peter Hommelhoff, *Konzernrecht für den Europäischen Binnenmarkt*, 21 ZGR 422 (1992).

124. For a more detailed exposition of this view, *see* Hopt, *supra* note 15; Gunnar Schuster, *Der neue Vorschlag für eine EG-Takeover-Richtlinie und seine Auswirkungen auf den Übernahmekodex*, 8 EUROPÄISCHE ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT [EuZW] 237 (1997).

125. *See, e.g*, Schön, *supra* note 87, at 238.

options?[126] Should it adopt a comprehensive statute-like regulation that applies in the Member States without more?[127] Or should it simply recommend a model law and leave it to the Member States to decide whether or not they want to adopt it (with or without variations)?

The proposed Fifth Directive and the proposed Statute of a European Company illustrate that, in the European Community, the idea of a wholesale adoption of a comprehensive model is bound to fail. On the other hand, the acceptance of a proposal giving Member States options will depend largely on whether the alternatives provided are of the same standard or at least equivalent. Without that, option models are likely to be rejected by the Member States as they do not lead to an equal playing field. A proposal providing only minimum standards will also face serious acceptance problems as it will not appease those Member States that already have higher standards, or at least higher aspirations, regarding the particular area of law. In sum, the situation seems to be hopeless.

V. E Pluribus Unum?

Yet, is the situation really hopeless? I do not think so. A promising alternative method of law coordination exists that is too often overlooked in the EU, that of model laws and restatements. As is well known, model laws and restatements have had considerable influence in the United States on the approximation of state laws in general and on company law in particular.[128] Legal harmonization in the area of the law of business associations is achieved not from the top down by means of federal legislation, but through the model act's or the restatement's persuasive force on both state legislatures and judges. The greatest advantage of this method is that, because of its pragmatic approach, it preserves the movement towards integration even if a Member State resists making further sovereignty or other concessions. Model laws and restatements would allow the Member States more favorably disposed to legal integration to proceed despite dissent by

126. *See* text accompanying *supra* note 92. The Fourth Directive on financial accounting, *supra* note 6, left more than 40 options open to the Member States. *See* HOPT & WYMEERSCH, *supra* note 1, at 16-17. These options have resulted in a lack of uniformity in an area of fundamental importance to the capital markets. For a thoughtful discussion of the similarities and differences between financial accounting principles in the EU, *see* EDGAR CASTAN, RECHNUNGSLEGUNG IN DER EUROPÄISCHEN GEMEINSCHAFT. BESONDERHEITEN DES JAHRESABSCHLUSSES UND LAGEBERICHTS IN DEN 12 MITGLIEDSTAATEN (1993); GERHARD KLOOS, DIE TRANSFORMATION DER 4. EG-RICHTLINIE (BILANZ-RICHTLINIE) IN DEN MITGLIEDSTAATEN DER EUROPÄISCHEN GEMEINSCHAFT. EINE ANALYSE DER VERBLIEBENEN RECHNUNGSLEGUNGSUNTERSCHIEDE AUFGRUND VON NATIONALEN WAHLRECHTS-AUSNUTZUNGEN (1993).

127. *See* HOPT & WYMEERSCH, *supra* note 1, at 16-17.

128. *See* Whitmore Gray, *E pluribus unum? A Bicentennial Report on Unification of Law in the United States*, 50 RABELS ZEITSCHRIFT FÜR AUSLÄNDISCHES UND INTERNATIONALES PRIVATRECHT [RabelsZ] 111, 117-122 (1986); Mathias Reimann, *Amerikanisches Privatrecht und europäische Rechtseinheit: Können die USA als Vorbild dienen?*, *in* AMERIKANISCHE RECHTSKULTUR UND EUROPÄISCHES PRIVATRECHT: IMPRESSIONEN AUS DER NEUEN WELT 132, 145 (Reinhard Zimmermann ed., 1995).

other Member States. The benefits achieved through such voluntary approximation of the law might then convince the resisting Member States also to adopt the model act. It will ultimately be a question of Member State loyalty, economic pressure, and legal pragmatism.

Article 189(5) of the EC Treaty empowers the Community to make recommendations.[129] A recommendation provides an alternate path to law coordination, if legally binding coordination by Directive or Regulation fails. The model forming the basis of such a recommendation does not necessarily have to be developed by the Commission. It could be developed by a variety of organizations. Admittedly, purely private model laws or restatements, like in the United States, would presently have little chance because Europe lacks a common organization of lawyers to perform the work, such as is available in the United States through the American Bar Association or the American Law Institute. Yet, there are ways and means to channel expertise that exist in both the Commission and the Member States. For example, the *Lando* project to develop a European contract law has been supported by the Commission as well as Member States.[130] The current efforts of the International Accounting Standards Committee (IASC) to develop international accounting standards is another example of how successful private, independent bodies can be with respect to the development of standards that will eventually become the law of a great number of states willing to adopt the proposed standards (with or without variations) on a voluntary basis.[131]

It is conceivable that similar projects could be launched by private bodies (*e.g.*, a European Law Institute) in the area of European company law, securities regulation, and corporate taxation.[132] The work of the IASC is a good example

129. *See* EC TREATY, *supra* note 21, art. 189. It provides, among others:

> In order to carry out their task the Council and Commission shall, in accordance with the provisions of this Treaty, make regulations, issue directives, take decisions, make recommendations or deliver opinions. . . . Recommendations and opinions shall have no binding force.

130. *See* KONRAD ZWEIGERT & HEIN KÖTZ, EINFÜHRUNG IN DIE RECHTSVERGLEICHUNG 511 (3d ed. 1996). *See* also Ole Lando, *Teaching a European Code of Contracts, in* THE COMMON LAW OF EUROPE AND THE FUTURE OF LEGAL EDUCATION 223 (Bruno De Witte & Caroline Forder eds., 1992).

131. *See* Werner F. Ebke, *Rechnungslegung und Abschlussprüfung im Umbruch*, 36 WIRTSCHAFTSPRÜFERKAMMER-MITTEILUNGEN 12, 17-20 (spec. issue June 1997). For the similarities and differences between U.S. Generally Accepted Accounting Principles (U.S. GAAP) and the IASC's International Accounting Standards, *see* THE IASC-U.S. COMPARISON PROJECT: A REPORT ON THE SIMILARITIES AND DIFFERENCES BETWEEN IASC STANDARDS AND U.S. GAAP (Carrie Bloomer ed., 1996). The EU undertook a similar comparative study; *see* Contact Committee on Accounting Directives, *An Examination of the Conformity Between the International Accounting Standards and the European Accounting Directives* (1996).

132. For the development of the Community law on corporate taxation, *see, e.g.*, JAN BRINKMANN, DER EINFLUSS DES EUROPÄISCHEN RECHTS AUF DIE UNTERNEHMENSBESTEUERUNG (1997); Jan Brinkmann & Andreas Riecker, *European Company Taxation: The Ruding Committee Report Gives Harmonization Efforts a New Impetus*, 27 INT'L LAW. 1061 (1993); PAUL FARMER & RICHARD LYAL, EC TAX LAW 246-335 (1994); FRANS VANISTENDAEL, THE FUTURE OF CORPORATE INCOME TAX HARMONIZATION IN THE E.C. AFTER RUDING AND MAASTRICHT (1992).

in support of the proposition that private bodies may respond faster and more effectively to changing needs of the international business community. It is hard to predict what the outcome of such projects will be, but it is fair to predict that the next decade will be the decade of comparative company lawyers, which should include not only European lawyers but also American lawyers as the United States has a long tradition in dealing with corporate, securities, and tax matters in a multi-jurisdictional or federal setting.