Gaining Access to Fortress Europe—Recognition of U.S. Corporations in Germany and the Revision of the Seat Rule

Whether the Federal Republic of Germany recognizes the legal status of foreign companies depends upon the effective place of business or the so-called "seat rule." The "seat rule," which has not yet been codified in German law, claims that the legal status of a company is governed by the laws of the country where business is primarily transacted, that is, where management is located and principal decisions are made and

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1. Germany, as used here, designates Federal Republic of Germany.
3. The "seat rule," as used here, means the doctrine of the effective domicile of the corporation, the effective place of business and/or the main place of administration.
4. See Ebenroth, Commentary, supra note 2, annot. 155 (1st ed.); Grossfeld, Commentary, supra note 2, annot. 166.
announced. Whereas Rabel considers the effective place of business to be wherever "the central management and control are exercised," for Beale the main criterion is "where the directors usually meet or the general meetings of the stockholders are."  

Despite some opposing views in German jurisprudence, the "seat rule" can be virtually considered established law. The application of the rule to foreign companies involves significant legal problems. Since German corporate law governs the legal status of business enterprises in Germany, a foreign firm incorporated according to foreign law that shifts its effective place of business to Germany automatically falls into liquidation. The transfer of operations to Germany is only possible by liquidating the original company and reincorporating in accordance with German law. The same situation also applies to business enterprises incorporated under German law that shift their effective place of business to a country where the "seat rule" is also in effect.

As can be readily seen, the "seat rule" can have a far-reaching and restrictive influence on corporations whenever business operations are transferred to another country. Since in Germany there are only limited possibilities for the public supervision of companies, control is largely exercised by the mechanisms of private corporate law. At the moment, however, it is being debated whether the "seat rule" in Germany may not be supplanted in certain cases by supranational law or by bilateral agreements on the protection of foreign investments concluded between Germany and other countries. Such agreements generally contain provisions concerning commercial relations, the right to set up and conduct business, and the recognition of a corporation's legal status. Among these treaties, the most important is the Treaty of Friendship, Commerce and Navigation (TFCN) between the Federal Republic of Germany and the United States, dated October 29, 1954. The present article concerns the question of whether, and to what extent, this U.S.-German agreement affects the role the "seat rule" plays in the interpretations of German jurisprudence and case law.

6. 2 J. BEALE, A TREATISE ON THE CONFLICT OF LAWS 765 (1935).
7. G. GRASMANN, SYSTEM DES INTERNATIONALEN GESELLSCHAFTSRECHTS 470 (1970); H. KOPPENSTEINER, INTERNATIONALE UNTERNEHMEN IM DEUTSCHEN GESELLSCHAFTSRECHT 105, 121 (1971); see also Behrens, Commentary, M. HACHENBURG, GMBHGESETZ, vol. 1, Allgemeines – Einleitung, annot. 87 (7th ed. 1975); O. SANDROCK, LIBER AMICORUM BEITZKE 690 (1979).
10. Ebenroth, Commentary, supra note 2, annot. 193 (2d ed.); Grossfeld, Commentary, supra note 2, annot. 85, 374; Ebenroth & Bippus, supra note 9, at 339.
I. Recognition of U.S. Corporations by Article XXV(5) of the TFCN

Article XXV(5) of the TFCN provides:

As used in the present Treaty, the term "companies" means corporations, partnerships, companies and other associations, whether or not . . . for pecuniary profit. Companies constituted under the applicable laws and regulations within the territories of either Party shall be deemed companies thereof and shall have their juridical status recognized within the territories of the other Party.

Article VII(1) of the TFCN is also relevant in this context:

Nationals and companies of either Party shall be accorded, within the territories of the other Party, national treatment with respect to engaging in all types of commercial, industrial, financial and other activity for gain, whether in a dependent or an independent capacity, and whether directly or by agent or through the medium of any form of lawful juridical entity. Accordingly, such nationals and companies shall be permitted within such territories . . .

Finally, item no. 9 of the Additional Protocol in the TFCN provides: "The provisions of Article VII do not obligate either Party to permit nationals and companies of the other Party to carry on business in its territories without fulfilling the requirements which are generally applicable by law."

A. Legal Nature of the TFCN

Article 25 of the Constitution of the Federal Republic of Germany (GG) states that the general principles of public international law take precedence over German national law. There is, however, no general principle that determines whether one country is obliged to recognize the legal status of companies incorporated in another country. It is, of course, possible that a bilateral agreement may affect the legal status of foreign companies. Such an agreement would then derogate German law. Such friendship, commerce, and navigation treaties are agreements under International Law, which only develop legal effects inter partes (among the contracting Parties). Once ratified, they obtain the status of Federal Law. If such treaties define the legal status of foreign corporations differently from national German Law, they suspend this law lex specialis derogat legi general. The point is that if the TFCN between Germany and the United States of America is based upon the conflict of laws provisions in
the so-called "internal affairs rule" (principle of incorporation), then the
question of the legal status of American corporations in Germany is not subject
to the "seat rule."

B. INTERPRETATION OF ARTICLE XXV OF THE TFCN

Article XXV(5), sentence 2, of the TFCN declares that "companies . . . shall
have the juridical status recognized within the territories of the other party." Thus
the legal definition of "recognized" becomes crucial. If recognition only
designates a rule relating to aliens, it has no effect on the "seat rule": Such laws
regulate the different treatment to be afforded aliens and nationals. As a matter
of fact, law that regulates the status of aliens is substantive national law and
hence part of special administrative law. If, on the other hand, "recognize"
means a rule regulating the conflict of laws, then the "seat rule" in Germany
could be suspended since provisions regulating conflicts are not substantive laws,
but laws relating to other laws. Thus, if "recognized" in article XXV(5) of the
TFCN transfers conflicts of law concerning the recognition of American
corporations in Germany to U.S. corporate law, following the "internal affairs
rule," then the "seat rule" does not apply to U.S. corporations intending to
relocate in Germany.

1. Recognition

The word "recognized" as used in the text of article XXV(5) allows three
different possible interpretations. "Recognize" could mean permitting a U.S.
corporation to establish its main base of operation in Germany. But it could also
mean that a U.S. corporation requires permission as defined by a special national
regulation act in order to acquire a legal status subject to the same rights and

16. Contrary to the "seat rule" this doctrine means that a corporation incorporated and
registered in one country is recognized by the state or country in which it has established its effective
place of business and/or administration.

17. G. MEIER, GRUNDSTATUT UND SONDERANKNÜPFUNG IM IPR DES LIECHTENSTEINISCHEN
GESSELLSCHAFTSRECHTS 8 (1979); Ebenroth, Commentary, supra note 2, annot. 202 (1st ed.);
Grossfeld, Commentary, supra note 2, annot. 559.

18. G. MEIER, supra note 17.

19. R. WILSON, UNITED STATES COMMERCIAL TREATIES AND INTERNATIONAL LAW 191 (1960);
(1956); Wilson, A Decade of New Commercial Treaties, 50 AM. J. INT'L L. 927 (1956).

20. C. EBENROTH, VERMÖGENSZUWENDUNGEN, supra note 2, at 336; Ebenroth, Commentary, supra
note 2, annot. 107 (1st ed.), annot. 114 (2d ed.); Grossfeld, Commentary, supra note 2, annot. 127.

21. C. EBENROTH, VERMÖGENSZUWENDUNGEN, supra note 2, 314; Behrens, Der Anerkennungs-
begriff des Internationalen Gesellschaftsrechts, 7 ZEITSCHRIFT FÜR UNTERNEHMENS UND GESELL-
SCHAFTSRECHT [ZGR] 499 (1978); Ebenroth, Commentary, supra note 2, annot. 114 (2d ed.);
Ebenroth & Sura, Das Problem der Anerkennung im Internationalen Gesellschaftsrecht, 43

22. Behrens, supra note 21, at 501; Ebenroth, Commentary, supra note 2, annot. 115 (2d ed.);
Ebenroth & Sura, supra note 21; at 317; Grossfeld, Commentary, supra note 2, annot. 124.
duties effective in the original country. On the basis of these two interpretations one could argue that article XXV(5) only regulates law relating to aliens. The term "recognize," however, could also be construed as a provision regulating conflict of laws. Such a provision would refer to the law governing the legal status of U.S. corporations and thus either to German law (the "seat rule") or to U.S. law (the "internal affairs rule"). The text of the treaty does not seem to favor any of these three interpretations.

2. Law Relating to Aliens or to Conflict of Laws?

Comparisons with similar legal provisions in German law suggest that only one of the three possible interpretations can be excluded: the admission of foreign companies by means of a special regulating act. German law does not provide foreign corporations with a special license to conduct business in Germany. A foreign company whose legal status is recognized in Germany automatically obtains the right to act as a legal entity. This means the right to conclude contracts, to sue and to be sued according to German law.

Of the two remaining interpretations of article XXV(5), that of a provision regulating conflicts between different laws is clearly preferable to that of a provision requiring that foreign corporations first acquire permission to conduct business in Germany before they can be regarded as legal entities under German law.

a. First Argument: Section 12 of the German Industrial Code (GewO)24

Section 12 of the German Industrial Code (GewO),25 which has since been abolished, states that a license to do business in Germany is necessary in order for a foreign company to be recognized as a legal entity. In addition, section 15(2), sentence 2,26 explicitly states that a foreign company can be prevented from conducting business in Germany if its legal status has not been recognized. Here it is possible to see that this law distinguishes between the permission to do business (which is part of the administrative law relating to aliens), and the recognition of a corporation as a legal entity. Requiring that a foreign company acquire legal status as a precondition to its being granted the right to conduct business is common practice in Germany,27 and is supported by German case law.

23. Behrens, supra note 21, at 501; Ebenroth & Sura, supra note 21, at 315, 321; Grossfeld, Commentary, supra note 2, annot. 126.
26. Still effective.
27. C. EBENROTH, VERMÖGENSZUWENDUNGEN, supra note 2, at 335; G. MEIER, supra note 17, at 8; Behrens, supra note 21, at 502; Ebenroth, Commentary, supra note 2, annot. 112 (2d ed.); Ebenroth & Sura, supra note 21, at 316.
law.28 Prior to its revision, the GewO consistently distinguished between the recognition of a foreign company's legal status (which is a part of the conflict rules) and granting it permission to conduct business activities (part of the law relating to aliens). This distinction necessarily limits the way in which the term "recognize" can be interpreted.

As used in article XXV(5) of the TFCN the term "recognize" cannot mean that a license has to be granted to foreign companies under administrative law. Until section 12 of the GewO was abolished, such a restriction with respect to the rights of aliens was in full effect, so that it would not have been necessary to mention it in the TFCN. In fact, article XXV(5) of the TFCN uses the expression with respect to the conflict of laws. Although section 12 of the GewO has since been abolished, this interpretation is still valid because section 15, which makes it possible to prevent a company from conducting business if the foreign company's legal capacity has not been recognized in Germany, is still in force. If a foreign company's legal status, according to the German regulations governing the conflict of laws, cannot be recognized, then the competent authority may, according to the law relating to aliens under section 15 of the GewO, prohibit a firm from conducting business in Germany.

b. Second Argument: The Usual Meaning of the Term

It should also be kept in mind that in section 12 of the GewO, as well as in German legal terminology, the term "recognize" is commonly used with respect to the conflict of laws.29 "Recognize" means that foreign law is applicable and that Germany must accept the legal consequences ensuing from the application of foreign law.30

If article XXV(5) of the TFCN only permits the recognition of foreign companies from the United States, as the contracting party, then this means that U.S. corporations recognized as legal entities by the law of any of the fifty states also enjoy the same status in Germany. As long as they maintain their legal status according to U.S. law, Germany is obligated to recognize this status.

3. Interpretation of the Entire Article XXV(5)

The previous interpretation of article XXV(5), sentence 2, of the TFCN concerned only the second half of the sentence,31 which deals with the

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28. Judgment of July 15, 1876, Reichsoberhandelsgericht [ROHG] (Supreme Court in Commercial Matters of the Deutsches Reich), 22 OHGE 147 (1876): "in the laws of the Deutsches Reich, which are the only relevant ones here, there are no provisions which permit the interpretation that a foreign company, incorporated according to the laws of the country concerned, may not be able to appear as plaintiff within the domestic territory." See also Grossfeld, Zur Geschichte der Anerkennungsproblematik bei Aktiengesellschaften, 38 RABELSZ 344, 358 (1974).

29. Behrens, supra note 21, at 509; Ebenroth, Commentary, supra note 2, annot. 113 (2d ed.); Grossfeld, Commentary, supra note 2, annot. 127.

30. G. KEGEL, supra note 2, at 366.

31. R. WILSON, supra note 19, at 191; Baade, Multinationale Gesellschaften im Amerikanischen Kollisionsrecht, 37 RABELSZ 5, 20-31 (1973); Ebenroth, Commentary, supra note 2, annot. 119.
"recognition" of companies. Since "recognition" applies to rules governing the conflict of laws, from Germany’s point of view article XXV(5) necessarily refers to corporate law in the United States, that is, corporate law in those states where the companies in question are incorporated. If it is a state which recognizes the legal status of the company founded under its law, although its effective place of business has been transferred to another state of country, then the Federal Republic of Germany must also accept this as well and recognize the company.

Since the first half of article XXV(5), sentence 2, defines what is meant by a "company of the other Party," article XXV thus states to whom the provision applies. As is apparent from the wording, article XXV has additional legal consequences. It clearly favors applying the "internal affairs rule," because the definition of "a company of the other Party" refers only to the incorporation ("companies, constituted...") of the company under the applicable laws and regulations of one of the Parties. An effective or statutory place of business and/or administration in the country where the corporation was founded is thus not required. In the United States this only has declaratory consequence, since the United States already follows the "internal affairs rule"—though with certain restrictions. In Germany, however, the "seat rule" is suspended when dealing with U.S. corporations. Our interpretation of article XXV(5) of the TFCN shows that the mutual recognition of companies depends upon a conflict of laws rule which respects the laws of the country in which the company was incorporated.

4. Systematic Arguments Outside of Article XXV(5) of the TFCN

As long as recognizing the legal status of the other contracting party’s company involves conflict of laws rules or relates only to foreign corporations, one has to apply other articles of the treaty concerned with foreign companies, especially article VII(1) and item no. 9 of the Additional Protocol.

a. Article VII(1)

Article VII(1) of the TFCN concerns the status of foreigners and of foreign legal entities, insofar as one can speak of legal entities as "foreigners." For aliens who normally are treated differently, article VII(1) provides that companies of the other contracting party of the TFCN must not be discriminated against as far as this is possible. This article, however, functions in a way similar

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32. For the wording of article XXV para. 5, see supra text section I.
33. Such restrictions are made by several public laws. See Lüderitz, Commentary, supra note 2, annot. 200 with citation of more authorities. For other restraints, see infra text section II.
34. See supra text section I.
35. See infra text accompanying section II.A.2. for the so-called "control rule," which refers to the nationality of its owners or directors, in order to determine the legal status of foreign companies. See also Ebenroth, Commentary, supra note 2, annot. 114 (1st ed.) with citation of more authorities.
to law relating to foreign corporations\textsuperscript{36} because the mere fact of being a foreign corporation (the legal elements of the rule) involves certain legal consequences which do not affect the subjects' legal status but only the permission to set up and conduct business.

b. Item No. 9 of the Additional Protocol\textsuperscript{37}

When the TFCN was signed, both parties agreed upon the provisions of the Additional Protocol, which they intended to be part of the Treaty. This explains the significance of the Additional Protocol for the interpretation of article VII of the TFCN, which in turn affects the interpretation of article XXV(5) of the TFCN.

One of the "requirements . . . generally applicable by law" mentioned in item no. 9 of the Protocol could be the "seat rule," which is normally applicable in Germany.\textsuperscript{38} The Treaty does not explicitly regulate the extent to which U.S. corporations are subject to German substantive law,\textsuperscript{39} although a minority opinion in the German legal literature considers that the phrase "generally applicable law" in item no. 9 of the Protocol also concerns the "seat rule"\textsuperscript{40} when the U.S. corporation transfers its effective place of business to Germany. This opinion, however, is not widely held and has been criticized in several ways.\textsuperscript{41}

The text of item no. 9 of the Protocol already reveals the nature of the law relating to aliens when it cites the "permission to carry on business" and not the recognition of the corporation's legal capacity. As explained above,\textsuperscript{42} in German legal terminology the word "permission" generally means that licenses have to be issued to aliens by the appropriate authorities. These licenses require in turn that a foreign corporation be recognized as having legal rights and duties.

Furthermore, item no. 9 also refers to the "requirements . . . generally applicable by law." It is, however, doubtful, whether "law" in the terms of the Treaty also designates the noncodified\textsuperscript{43} "seat rule," which in Germany is only a legal construction and for these reasons does not possess the same binding authority as codified law. In our opinion an interpretation which argues that the

\textsuperscript{36} See supra text section I.A.

\textsuperscript{37} See supra text section I.


\textsuperscript{39} On the question of national public policy restrictions, see infra text section III.C.1.

\textsuperscript{40} Lehner, \textit{Die Steuerliche Ansässigkeit von Kapitalgesellschaften-insbesondere zur Doppelten Ansässigkeit}, 34 RIW 201, 208 (1988).


\textsuperscript{42} See supra text section I.B.2.b.

\textsuperscript{43} For the reasons of the noncodification, see Hartwig, \textit{Der Gesetzgeber des EGBGB Zwischen den Fronten Heutiger Kollisionsrechts-Theorien}, 42 RABELSZ 431, 444 (1978); Lüderitz, \textit{Commentary}, \textit{supra} note 2, annot. 202.

VOL. 24, NO. 2
German "‘seat rule’" is a "‘requirement . . . generally applicable by law’ in the terms of item no. 9, has to be rejected because German legal terminology distinguishes very clearly between written law\textsuperscript{44} and the general legal system.\textsuperscript{45} This means that the German legislature (Bundestag) can suspend the seat rule when negotiating international business agreements.

Arguments concerning the background of item no. 9 can also be cited against the hypothesis that item no. 9 relates to the status of aliens. Since this provision does not refer to the corporation's effective place of business,\textsuperscript{46} the rule seems not to be subject to conflict law and, in particular, to make no allowance for the "‘seat rule.’" This conclusion, however, could not be reached without the criterion of the "‘effective place of business.’" The wording of item no. 9 is at once too narrow (in referring only to business activities but not to the legal status of the corporation) and too extensive (referring to corporations with effective place of business outside Germany; but this would be a result incompatible with the fundamental idea of the Treaty).

Finally, there are also systematic reasons why item no. 9 has the character of a conflict of laws rule. On the one hand, article XXV(5) of the TFCN guarantees the legal status of U.S. companies in Germany, even when these companies transfer their headquarters to another country, as long as the country of origin still recognizes their legal status. On the other hand, there are good reasons why a company transferring its headquarters to Germany should not become subject to binding German corporate law (such as minimum capital, the legal obligation to disclose the annual financial statement and codetermination). Requiring American companies to conform to German corporate law would alter the structure of these companies to such an extent that they would have to liquidate.\textsuperscript{47} And yet according to German law, there is no statute defining the legal status of companies which could be separated from general corporate law (i.e., concerning minimum capital, management bodies, etc.).\textsuperscript{48}

This is the reason why item no. 9 is a declaratory provision relating to foreign companies and aliens that only allows the contracting parties to prevent a corporation from conducting business if the corporation does not respect domestic law in the host country.\textsuperscript{49}

\begin{itemize}
\item \textsuperscript{44} By extension this also means sentences of the Federal Constitutional Court with legal force, decrees and statutes of corporations under public law.
\item \textsuperscript{45} See art. 20(3) GG "‘. . . the executive power and the courts are bound by the [written] law and to the [general] legal system.’" In German, written law means given by the legislative power, while "‘Recht’" means the whole legal system.
\item \textsuperscript{46} For divergence of article XII of the Treaty between the Deutschem Reich and the U.S.A., see infra text section I.C.3.a.
\item \textsuperscript{47} Ebenroth & Bippus, \textit{Die Anerkennungsproblematik im Internationalen Gesellschaftsrecht}, 41 \textit{NEUE JURISTISCHE WOCHENSCHRIFT} [NJW] 2137 (1988).
\item \textsuperscript{48} Ebenroth, \textit{Commentary, supra} note 2, annot. 115 (2d ed.); Ebenroth & Sura, \textit{supra} note 21, at 317.
\item \textsuperscript{49} That is, provisions concerning industrial safety regulations, environmental protection, rules for the entry in the Commercial Register, bookkeeping laws, etc.
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C. Legal Consequences of Article XXV(5) of the TFCN

Article XXV(5) of the TFCN requires that Germany recognize U.S. corporations’ legal status and vice versa. This is of enormous significance for a U.S. corporation seeking to transfer its effective place of business from the United States to Germany.

1. No Special Legal Status

As indicated above,\textsuperscript{50} recognizing U.S. corporations according to conflict of laws rules does not mean in Germany that this corporation has legal status if it has been incorporated in accordance with U.S. corporate law. Insurmountable practical problems would arise if a corporation’s legal status were divided between American and German law.\textsuperscript{51} These problems are similar to those arising when one follows the so-called “rule of overlapping.” This doctrine, represented by a minority opinion in the German legal literature,\textsuperscript{52} maintains that the personal status of a corporation has to be separated from its other legal relations. Whereas personal status (legal capacity) is determined according to the law of the countries in which the corporation was founded, laws concerning other legal relations (such as minimum capitalization or codetermination) apply only in those countries where the effective place of business is located. Such a mixture of different laws which results from the application of this rule should, however, be avoided since it would be virtually impossible to determine which law has precedence.

The German Law of Codetermination,\textsuperscript{53} which gives employees extensive rights with nearly equal representation in the supervisory boards, is limited to German stock corporations. German corporations have, in addition to the stockholders’ meeting and the board of directors, a supervisory board as a third obligatory administrative body. Where codetermination exists, both stockholders and employees are on the supervisory board, that in turn elects the board of directors. This type of supervisory board, which fulfills very important functions within German corporations is foreign to U.S. corporations. German corporate law regulates the functions of the board of directors, the supervisory board, and the shareholder meetings. In addition, German corporate law makes the recognition of a corporation as a legal entity dependent upon the extent to which it observes these regulations. United States corporate law, by way of contrast, provides a company with considerably more autonomy through the by-laws.

\textsuperscript{50} See supra text section I.B.4.b.
\textsuperscript{51} See C. EBENROTH, VERMÖGENSZUwendungen, supra note 2, at 341; Ebenroth & Bippus, supra note 13, at 848; Ebenroth & Sura, supra note 21, at 320.
\textsuperscript{52} G. GRASMANN, SYSTEM DES INTERNATIONALEN GESELLSCHAFTSRECHTS annot. 60; Sandrock, 18 BERICHTE DER DEUTSCHEN GESELLSCHAFT FÜR VÖLKERRECHT [BERDGesVolKRI 73, 113 (1978); Contra Ebenroth, Commentary, supra note 2, annot. 141 (1st ed.).
\textsuperscript{53} Mitbestimmungsgesetz (Codetermination Act) of 1976, [1976] BGB1.I 1153.
2. **Consequences for Conflict of Law Rules**

From a German point of view article XXV(5) of the TFCN has the following effects on conflict of law rules:

a. **German Companies**

   The "seat rule" is still valid for German companies since article XXV(5) of the TFCN only covers those corporations which were founded according to German laws and regulations. The TFCN refers to substantive law; it does not alter substantive law. From the German point of view the Treaty is designed to make it possible for U.S. firms to transfer their headquarters to Germany. At the same time it effectively prevents German companies from leaving the country. In addition to the requirements of private and public law, one of the criteria for recognizing a German corporation's legal status is that it must have its effective place of business and its registered office in Germany. If a German firm does not meet this criterion, its legal status will not be recognized in Germany, and if relocating abroad, it will have to liquidate.

b. **United States Corporations**

   The situation differs considerably for U.S. corporations. Most states in the United States, although there are important exceptions, have adopted the "internal affairs rules." In order to acquire legal status, it is sufficient for the U.S. corporation to have been founded in accordance with the law of one of the fifty states. If the company then transfers its effective place of business to another country, Germany will still recognize its legal status. The most important practical consequence is that Germany recognizes the legal status of a corporation founded in the United States (for example, according to the law of the state of Delaware) not only when it moves its effective place of business from Delaware to another state, but also when it transfers its headquarters to Germany. The German "seat rule," which requires that the effective place of business be located in the country where the company was founded, is no longer in effect insofar as U.S. corporations are concerned.

3. **Further Arguments**

   The conflict of laws rule in article XXV(5) of the TFCN is of considerable significance for Germany since it places virtually no restrictions on U.S. companies. 

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54. See also Ebenroth, Commentary, supra note 2, annot. 162 (2d ed.); Ebenroth & Bippus, supra note 9, at 338; Grossfeld, Commentary, supra note 2, annot. 37;

55. Effective articles of incorporation.

56. Correct in registration.

57. Ebenroth, Commentary, supra note 2, annot. 171 (1st ed.).

enterprises seeking to relocate in Germany.\textsuperscript{59} There are, however, some indications that the contracting parties wanted these consequences to be subject to the Treaty.

a. Comparison with the Treaty of Friendship, Commerce and Consultation between Deutsches Reich and the United States of America, December 8, 1923

Article XII of the Treaty,\textsuperscript{60} which corresponds to article XXV(5) of the TFCN, is worded as follows:

Limited liability and other corporations and associations, whether or not for pecuniary profit, which have been or may hereafter be organized in accordance with and under the laws, National, State or provincial, of either High Contracting Party and maintain a central office within the territories thereof, shall have their juridical status recognized by the other High Contracting Party provided that they pursue no aims within its territories contrary to its laws. . . . The right of such corporations and associations of either High Contracting Party so recognized by the other to establish themselves within its territories . . . shall depend upon the consent of such Party.

The first paragraph of this provision is generally considered to refer to a conflict of laws rule and not alien status.\textsuperscript{61} The important difference between article XXV(5) of the TFCN and this provision lies in the fact that, in order to be recognized, a company had to be incorporated ("organized") in accordance with the laws of one of the contracting parties and had to maintain a central office within the territories of that country. Subsection 2, however, also permitted the contracting parties to place further restrictions on the business activities of corporations "so recognized." From this one can draw two conclusions.

As article XII shows, the early treaty clearly distinguished between the recognition of foreign corporations (the conflict of laws rules) and the permission to conduct business (an aspect of law relating to aliens). This is a further indication that the term "recognize" as used in article XXV(5) of the TFCN represents a conflict rule. This interpretation, moreover, suggests that in 1954 the contracting parties of the TFCN wanted to make extensive use of the mutual recognition of the other party's corporations by waiving the effective place of business as a requirement.\textsuperscript{62} In the United States it was sufficient for the recognition of a corporation's legal status that the registered office be established within the state or country of incorporation; the effective place of business was not required. Wilson\textsuperscript{63} describes this as follows:

A "company" is defined simply and broadly to mean any corporation, partnership, company or other association which has been duly formed under the laws of one of the

\textsuperscript{59} For the restraints, see infra text section II.

\textsuperscript{60} Ratified by Law on Aug. 17, 1925, [1925] RGBI.II 795.

\textsuperscript{61} Behrens, \textit{supra} note 21, at 499; Ebenroth & Bippus, \textit{supra} note 47, at 2137; Grossfeld, \textit{supra} note 28, at 344.

\textsuperscript{62} Ebenroth & Bippus, \textit{supra} note 47, at 2137; Ebenroth & Bippus, \textit{supra} note 13, at 843.

\textsuperscript{63} R. Wilson, \textit{supra} note 19, at 191.
contracting parties; that is any "artificial" person acknowledged by its creator, as
distinguished from a natural person, whether or not for pecuniary profit. Every
association meeting this simple test of valid existence must be accounted by the other
party of a company of the party of its creation, and have its juridical status recognized
without any reservation for the laws of the forum.64

b. Comparison with the Convention of Establishment

between the Federal Republic of Germany and Spain65

Comparing the TFCN with this agreement between Germany and Spain provides a further indication that article XXV(5) of the TFCN, with respect to
the conflict of laws rule, does indeed have a considerable effect on the
recognition of the legal status of U.S. corporations in Germany. The correspond-
ing article of this Treaty states:

The legal status of the companies of either contracting party will be recognized within
the territories of the other party. The other party is authorized to refuse this recognition
only if the aims and activities of the company concerned represent an offense against
the principles or rules, which this party considers part of public policy in terms of
private international law.66

This provision regulates the legal conditions for recognizing the contracting
party's companies. As Spain also follows the "internal affairs rule,"67 the agree-
ment suspended the "seat rule."68 Article XV(2) of the Treaty between Germany
and Spain, like article XXV(5) of the TFCN, requires for the recognition of the
other party's corporation only that it be incorporated under the laws of the other
party and not that the effective place of business be within the country.69

Article IX of the Treaty between Germany and Spain,70 which is similar in
content to article VII of the TFCN, regulates the conduct of professional and
economic activities as stated in the provision of article IX.71

The distinction made in this Treaty between recognizing legal status and
permitting companies to set up and conduct business also indicates that the
conflict of laws rule was intended as a means of determining the legal status of
a foreign company. Indeed, article XV refers explicitly to Spanish law, which

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64. Emphasis added.
66. Convention, supra note 65, art. XV(2) (translation by the author—not official).
67. Lüderitz, supra note 2, annot. 200; Von Hoffmann & Ortiz-Arce, Das neue spanische
68. See also Ebenroth & Bippus, supra note 13, at 844; H. WIEDEMANN, supra note 41, at 796;
Grossfeld, Commentary, supra note 2, annot. 208; Lüderitz, Commentary, supra note 2, annot. 208.
69. For the public policy restrictions, see infra text accompanying section II.C.1.
70. "Nationals of either contracting party may exercise within the territories of the other party
economic and professional activities of any kind under the same conditions as natives; if therefore a
permission is required, this will be conceded under the same conditions as natives. This is
analogously valid for companies." Convention of Establishment, supra note 65, art. IX (translation
by the author).
71. See BGBI.II 1041, 1046.
only requires incorporation under Spanish law for acknowledging the company's legal status. Whether and under which circumstances the company so recognized is allowed to exercise business activities within Germany is regulated by provisions relating to aliens in article IX of the Treaty. These provisions also favor a strict separation between the conflict of laws rule—recognition of legal status—and the law relating to aliens—permission for foreign companies to set up and conduct business.

Since the German "seat rule" is not a binding part of German public policy, the distinction between the conflict of laws rule and law relating to aliens is determined only in part by the public policy laid down in the Treaty. Not all binding regulations (for example, liability provisions or auditing practices), but only those principles which directly concern fundamental aspects of German law can be part of German public policy. If this were not the case, the regulations would not have been referred to in the Treaty, and recognition of legal status guaranteed by the Treaty would be impossible.

c. Comparison with the Treaty Establishing the European Economic Community (EEC) Treaty

Articles 52, 58 and 220 of the EEC Treaty also distinguish between the law relating to aliens concerning the freedom of foreign companies to set up and conduct business, and conflict of law rules relating to the recognition of their legal status.

Although the right to establish corporations in the Common Market is generally acknowledged, the mutual recognition of EEC members' corporations (in terms of the "internal affairs rule") has not yet been put into effect. Such reciprocal recognition was agreed on in the Treaty of February 29, 1968, but the Treaty has not yet been ratified in Germany.

d. Comparison with Other Agreements Concerning International Law Concluded by Germany

Treaties promoting foreign investment entered into by Germany and numerous other countries do not include such extensive recognition of a foreign company's legal status. They either require an effective place of business within the territory of the contracting party as a precondition for recognition, or they refer to the laws of the other party without suspending the "seat rule."

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72. Ebenroth & Bippus, supra note 47, at 2137.
73. For further discussion, see infra section II.C.
74. Ebenroth & Bippus, supra note 13, at 848; Kreuzer, Commentary, Münchner Kommentar, vol. 7, art. 6 EGBGB, annot. 3.
76. [1972] BGBI.II, 369 (ratified by Germany but not yet law); see C. Ebenroth, Vermögenszuwendungen, supra note 2, at 339; Ebenroth, Commentary, supra note 2, annot. 219 (2d ed.); Lüderitz, Commentary, supra note 2, annot. 206.
77. See Ebenroth & Bippus, supra note 9, at 336; Ebenroth, Commentary, supra note 2, annot. 111(a); Lüderitz, Commentary, supra note 2, annot. 207.
Common to all these treaties is the clear distinction made between recognition of legal status and permission to conduct business. The most-favored nation clause, often included in these treaties, does not nullify this distinction since this clause only guarantees equal treatment relative to law relating to aliens. As far as conflict of laws rule is concerned, a foreign company, having transferred its effective place of business to Germany, is no longer subject to the rules of the Treaty which define which kinds of companies of the other party have to be recognized by Germany. In such cases Germany would not recognize the legal status of the corporation.\textsuperscript{78}

D. Provisional Result

Germany recognizes U.S. corporations founded under U.S. law in terms of article XXV(5) of the TFCN when they transfer their effective place of business to Germany. The restrictions laid down in article VII(1) of the TFCN and item no. 9 of the Additional Protocol, however, resemble the law relating to aliens and hence do not distinguish between the recognition of legal status and an evaluation of the corporation's other legal relations.

II. Limits of Recognition

Since public control of private corporations in Germany is less strict than in the United States or Great Britain, German companies could theoretically shift their effective place of business to the United States or found subsidiary corporations there in order to take advantage of the less restrictive private regulations. They could then transfer the corporation's effective place of business back to Germany in order to avoid the restrictive nature of German private corporate law, (e.g., with respect to liability, auditing procedures, or the "troublesome" codetermination). Such activities would eventually produce a large number of pseudo-foreign corporations in Germany subject not to German regulations, but to the more liberal corporate law of the United States. The question, however, is whether there are legal principles that have priority over the TFCN and that would prevent the abuse of differences between corporate law in the United States and in Germany. Some of the factors that could possibly affect such practices are the general principles of international law, noncompliance with U.S. corporate law, or unwritten restrictions in German public policy.

A. International Law

International law represents an initial restriction since, as we have already pointed out,\textsuperscript{79} there is no general obligation to recognize a foreign corporation's

\textsuperscript{78} Besides this formal argument there are also substantive reasons for opposing recognition of such company; see, e.g., Ebenroth & Bippus, supra note 9, at 342.

\textsuperscript{79} See supra text section I.A; supra note 14.
legal status. An individual’s effective relation to a particular country is a criterion determining whether he is a member of that country. This effective relation or connection is called a “genuine link.”

1. Dogmatic Creation of a Genuine Link

The International Court of Justice (ICJ) developed the principle of an effective tie or genuine link in the well-known Nottebohm Case. Nottebohm, originally a German national, had lived in Guatemala for many years, but had “purchased” citizenship in Liechtenstein, although the ICJ did not regard Liechtenstein as being entitled to concede diplomatic protection to Nottebohm against Guatemala. Between Nottebohm and Liechtenstein there existed only the formal tie of citizenship not confirmed by any effective personal ties Nottebohm had to this country.

This decision is controversial for two reasons. First, it is not certain whether the decision established a general principle of international law. If we take into account the extensive proofs in judicial decisions and practice concerning the effective link as a requirement of dual nationality, however, it would seem as if a general principle has been established. These judicial decisions, of course, are also concerned with the principle of territorial sovereignty and other international matters. The legal status of foreign corporations, however, cannot be determined by relying on decisions and arguments made in other areas, since this would not only be inconsistent but could also open the door for considerable abuse. Secondly, it is also uncertain whether an individual’s effective link to a country, as recognized in international law, can be used to determine a corporation’s legal status, or whether the term “nationality” cannot be applied to such an artificial entity. Even the opponents of the Nottebohm decision, however, acknowledge that the principles established by the International Court may be applied by analogy to the recognition of foreign corporations. Thus, if a U.S. corporation intends to transfer its effective place of business to Germany, it should still keep

80. It is irrelevant whether this means the nationality of a natural person or the belonging to a country of a legal person; see Ebenroth & Bippus, supra note 13, at 844; B. Grossfeld, Praxis des Internationalen Privat- und Gesellschaftsrechts 539 (1975); Wengler, Die Aktivlegitimation zum völkerrechtlichen Schutz von Vermögensanlagen Juristischer Personen im Ausland, 23 NJW 1473 (1970).
84. Seidl-Hohenveldern, supra note 82, at 86.
sufficient effective ties to the United States in order not to lose its legal status and thus run the risk of being considered a pseudo-foreign corporation.  

2. The Criterion of Genuine Link

The principle of a "genuine link," as applied to companies, indicates that a foreign corporation, besides the formal tie of incorporation and registration in the Commercial Register, must also have effective legal relations to the country where it was first incorporated. There must be sufficient proof that the corporation concerned still participates in the economy of the country of origin, and not just marginally, and that it was not founded with the sole intention of avoiding or abusing laws. It would probably be sufficient if a U.S. corporation, which has transferred its effective place of business to Germany, still maintains branch offices or subsidiaries in the United States. Similarly, the corporation would demonstrate compliance with the "genuine link" requirement if its main decision-making body, the board of directors, meets in the United States, where the corporation formally remains registered in the Commercial Register. It would also suffice if the board of directors delegates responsibility for daily business operations to a management committee. The board of directors, which would retain the right to act in its own name, is still responsible for making fundamental decisions, but it would be the management committee that implements them.

A proper application of the genuine link criterion should, however, make it unnecessary to rely upon the "control rule." This doctrine was developed during World War II in order to determine whether a foreign company belonged to allied or nonallied countries. The most important criterion was the nationality of the individuals who were owners or directors of the company. The control rule, according to the prevailing view, is no longer sufficient to determine a company's legal status. Instead, it only applies to the question of diplomatic protection for a corporation when the stockholders are nationals of the country which is demanding diplomatic protection.

This was the case in the ICJ's decision in *Barcelona Traction Light & Power Ltd.* The Court rejected Belgium's suit for diplomatic protection of this company. The fact that the stockholders were Belgians was not sufficient in the opinion of the board to establish an effective tie between the company and Belgium.

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85. See supra text section III.B.2.
Nonetheless, the stockholders' or directors' nationality may be another important indication of a genuine link. If, as in the example above, the board of directors of a U.S. corporation which has transferred its effective place of business to Germany, is composed at least partially of U.S. nationals, there is good reason to assume an effective connection between the corporation and the United States.

3. Summary

In conclusion it can be said that a U.S. corporation with its effective place of business in Germany still needs effective connections to the United States. These can include nonmarginal business activities in the United States, the stockholders' or directors' nationality, branch offices or subsidiaries maintained within the United States or regular meetings of the board of directors in the United States.

B. Noncompliance with U.S. Regulations for Incorporation

The recognition of a corporation's legal status under the conflict of laws rule refers, in article XXV(5) of the TFCN, only to "corporations, constituted under the applicable laws and regulations." The Treaty, in other words, exempts companies of other countries from this recognition, even when they are lawfully established in the United States, as well as such U.S. corporations which have no legal status in the United States because they violated domestic law.

1. Violations of the Law

In the United States, as well as in Germany, corporations which violate U.S. corporate law through their corporate structure, their application for entry in the Commercial Register, or their by-laws are not eligible to obtain legal status. Germany is neither obligated nor allowed to recognize such illegally constituted companies. In my opinion, however, nonappealable decisions by U.S. courts or the decision to liquidate a company made by U.S. authorities, should be binding for German courts and authorities as well. This is the conclusion I draw from section 328(1), no. 5, of the ZPO. Because the United States and the Federal Republic of Germany as contractual partners agreed to recognize each other's corporations, this agreement must also be valid for legal and administrative decisions that deny corporations legal status. If this is the case, then the reciprocity required by section 325(1), no. 5, of the ZPO is fulfilled as far as the United States is concerned.

2. Public Policy in the United States

Another point that deserves discussion is whether the recognition of a U.S. corporation's legal status can be refused when its relocation in Germany is seen

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90. ZPO is an abbreviation of Zivilprozessordnung (Code of Civil Procedure). ZPO § 328(1) states, "The recognition of foreign judgements is excluded if reciprocity is not guarantied."
as a breach of U.S. public policy. This could be the case if the transfer of the company ensues in a manner which can be considered an abuse of the law.

As far as it is possible to compare the presuppositions, the systematic organization, and the aims of German and U.S. conflict law, it would seem, from a German point of view, as if most of the states in the United States have adopted modified versions of the "internal affairs rule," whereby U.S. incorporation is sufficient for the recognition of a company. This was necessary because practice had shown that it was possible to avoid the more stringent corporate laws of some states by incorporating companies within states with "liberal or tax" corporate law. Corporations founded according to such "liberal or tax" laws, however, never conducted business in these states but in that state where they had originally planned to locate their headquarters. It was Latty who first called such corporations "pseudo-foreign corporations":

Of course a primary characteristic of the pseudo-foreign corporation would be that its main business activity takes place locally. If the main business is elsewhere, even though the shareholders or creditors may all be local residents they have undertaken to deal with an enterprise that is essentially an out-of-state one, and it would seem a little high handed to hold such an enterprise to local corporation law.

When a corporation is founded under foreign law and performs nearly all its economic transactions in the state in which its effective place of business and administration is located, it is only "superficially" a foreign corporation. If a company, for example, was incorporated in the state of Delaware according to the liberal Delaware Corporate Law but had never conducted business there or transferred its headquarters to another state soon thereafter, then the state where the effective place of business is located could consider this company a pseudo-Delaware corporation.

These criteria were applied in the famous Western Air Lines, Inc. v. Sobieski case. Western Air Lines, Inc. was incorporated according to Delaware law, but exercised its principal economic activities in California. The California Court of Appeals held the application of Delaware Corporate Law as "inequitable, unfair and unjust," because the state of California was sufficiently involved in the affairs of this out-of-state corporation. Thus, California was permitted to apply its own law relating to the internal matters of this corporation.

According to American legal thought Delaware Corporate Law is not applicable when a corporation in Delaware conducts most of its business in the state where its

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91. A. CONARD, CORPORATIONS IN PERSPECTIVE 15 (1976); DRUCKER, PRIVATE INTERNATIONAL LAW 29; Ebenroth, Commentary, supra note 2, annot. 119 (1st ed.); Grossfeld, Commentary, supra note 2, annot. 23.

92. See Latty, supra note 58, at 137.

93. Id. at 161.

94. C. EBENROTH, VERMÖGENSZUWENDUNGEN, supra note 2, at 357; B. GROSSFELD, INTERNATIONALES UNTERNEHMENSRECHT 30 (1986).

main office is located. This principle, however, should not be extended too far since it involved the claim of only one of the corporation's stockholders, and only concerned the corporation's internal operations. Whether this decision can be extended to cover corporate law also seems doubtful since the necessary consequence of a corporation being considered as a pseudo-foreign corporation would be to deprive it of its legal status in the state where it effectively conducts business. American international tax and civil law already uses the term "real seat of the corporation" (commercial domicile, principal place of business), although the corporation's legal status is not affected by this. It is questionable whether the Western Air Lines, Inc. decision was ever intended to have such extensive effects. The constitutionality of this decision, moreover, is also questionable.

In sum, if a U.S. corporation violating U.S. corporate law loses its legal status, then Germany is neither allowed nor obligated to acknowledge this corporation if it decides to transfer its effective place of business to Germany. And if the principles concerning pseudo-foreign corporations in the United States have not yet been applied to the recognition of a corporation's legal status, then Germany may not rely on these principles with respect to a U.S. corporation.

C. German Public Policy

In pursuance of article 6 of the EGBGB, the use of the "internal affairs rule" could represent a breach of German public policy if the "seat rule" and its consequences were such a fundamental legal principle that it could not be abolished by international agreements.

1. National Public Policy Restrictions

In the Convention of Establishment between Germany and Spain it was agreed that both parties may rely on national public policy to determine the preconditions for recognizing the other party's corporations. In this case, relying on national public policy does not involve any serious problems. But it is questionable whether public policy can also be used in international agreements in which public policy has not been as explicitly determined as in the TFCN. In this Treaty, German public policy concerning the recognition of a foreign company could have been suspended. This is, of course, a question of interpretation, but it seems as if the parties involved wanted to replace public policy with special agreement. It would be inconsistent with the aims of such

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96. C. Ebenroth, Vermögenszuwendungen, supra note 2, at 349, 357.
97. EGBGB stands for Einführungsgesetz zum Bürgerlichen Gesetzbuch (Introductory Law of the German Civil Code), which contains intertemporal and international conflict of law provisions. Article 6 states, "The application of a foreign law is excluded if the application would offend the morality or the purpose of a German law."
98. Convention, supra note 65.
99. Kreuzer, Commentary, Münchener Kommentar, supra note 74, art. 30 EGBGB, annot. 28 (1st ed.).
100. Lüderitz, Commentary, supra note 2, annot. 27.
treaties (which are supposed to create legal certainty among the parties) if national law could be brought in "through the back door" and applied to foreign companies. This also explains why it is doubtful that the United States and Germany ever wanted public policy to remain a valid criterion.

2. Public Policy in the TFCN

In the absence of alternative interpretations it seems that the contracting parties wanted to suspend the German "seat rule" by means of article XXV(5) of the TFCN. German public policy consequently cannot conflict with the recognition of a U.S. corporation if this corporation violates national public policy in the United States as well. Only to the extent that German and U.S. public policy corresponds is it possible to speak of the contracting parties having preserved its validity. This, however, is public policy on a very low level.

Prohibiting the abuse of laws may be part of public policy as recognized within the framework of article XXV(5) of the TFCN. This prohibition characterizes both U.S. as well as German principles of law and is also part of international law. The incorporation of a legal entity and the subsequent transfer of the effective place of business can be considered an abuse of law affecting the relations between the United States and Germany if this action was only intended to circumvent the more stringent corporate law of the country where the company originally was founded. The absence of any "genuine link" between a corporation and the country where it was first incorporated is an indication of such possible abuse. A third indication is when a company originally founded in Germany is liquidated and then reincorporated in the United States, but soon after shifts its effective place of business back to Germany. Such a corporation would be a German modification of a pseudo-foreign corporation. But it should not be considered an abuse of law if such a company, registered in the Commercial Register as located in the United States and having its effective place of business in Germany, was created in order to avoid taxation. This would even be the case if a U.S. corporation, with its effective place of business and the larger part of its fixed assets in Germany, did not want to liquidate and reincorporate under German law in order to avoid taxation of its hidden reserves in the United States. Section 42 of the AO, which states that legal modes of organization cannot be explicated as a means of avoiding taxation, refers only to the abuse of tax laws, not of corporate law. In the example we have cited there

103. See supra text accompanying section II.A.1.
104. Ebenroth, Commentary, supra note 2, annot. 129-33 (2d ed.); Grossfeld, Commentary, supra note 2, annot. 42-44; C. Ebenroth, Vermögenszuwendungen, supra note 2, at 259; Latty, supra note 58.
105. AO stands for Abgabenordnung (German Fiscal Code), [1976] BGBl. I 1749.
will not be any real abuse since the corporation in question only aspires to equal treatment with German corporations that are not subject to taxation when they transform their legal form.

3. Binding German Corporate Law

The question remains whether German corporate law, as a fundamental principle of German public policy, could have priority over article XXV(5) of the TFCN. Two binding principles are particularly relevant here: the principles of raising and maintenance of capital (liability) within the German AG and GmbH and the law of codetermination.

a. Raising and Maintenance of Capital

A German corporation must maintain a minimum of DM 100,000 (pursuant to section 7 of the AktG). There are very strict regulations under German law controlling the acquisition and maintenance of capital. These provisions are meant to protect the stockholders and the creditors against undercapitalization of the corporation. The creditor of a German corporation has a guarantee in the form of capital stock, which is not necessarily the case with a U.S. corporation because of the lesser amount of capitalization.

Despite the possibility of an inadequate credit standing among U.S. corporations, this risk is deemed minimal when a company petitions to shift its effective place of business to Germany. The German creditor who contracts with such a corporation can calculate the risk. In fact, the risks of undercapitalization are lower if the corporation’s effective place of business is in Germany because in this case the corporation’s assets can be used more easily to guarantee its liability. The immediate availability of these assets also makes it easier for creditors to take legal action against the corporation. For creditors and investors there would be no substantial difference between a U.S. corporation having its headquarters in Germany or in the United States since the risks are the same. Anyone in Germany acquiring shares or investment fund certificates of a U.S. corporation, regardless of which country it is located in, is aware of both the higher risks and the potentially higher yields.

b. The Law of Codetermination

Under German law, there are two kinds of codetermination: codetermination in the shop council and codetermination on the supervisory board. Codeter-
mination in the shop council does not cause any problem in this context. When a shop council is set up according to German shop council law, it is the factory and not the corporation that is affected. The shop council, moreover, has no supervisory functions in the company and no connection with the company’s structure. A U.S. corporation with its effective place of business in Germany must tolerate the establishment of such shop councils if it wishes to comply with the German Shop Council Act. This is also true for the German subsidiaries and nonindependent branch offices of foreign corporations.111

The German Codetermination Act, by way of contrast, could theoretically produce a more difficult situation since it is not only binding as German corporate law but also a fundamental principle of the German economic and social order.112 In practical terms, however, codetermination can only be realized in those enterprises which already have a supervisory board constituted and elected according to German law.113 A transfer of codetermination to U.S. corporations is thus not possible because of their different structure.

The Federal Supreme Court in Civil Matters (Bundesgerichtshof)114 has argued in a controversial decision115 that foreign corporations are in violation of German public policy “if these foreign companies are not able to realize the fundamental conceptions of values determined by German lawmakers.” It would be impossible to enforce codetermination in a U.S. corporation without making substantial changes in the company’s structure. It seems scarcely conceivable that a Delaware corporation that has transferred its effective place of business to the Federal Republic of Germany could have a supervisory board in which half of the members are union-oriented employees and which elects an employee director capable of directly influencing corporate planning. The system of elections and the composition of the supervisory board are such an integral part of the German legal system that they would have a disruptive effect on foreign companies.

If a U.S. law required codetermination for employees, however, the company would not be able to evade enforcement by transferring its effective place of business into Germany. Enforcement in such cases would remain under the jurisdiction of U.S. courts.

D. VIOLATIONS OF THE EEC TREATY

Recognizing U.S. corporations with their headquarters in Germany could conflict with binding EEC regulations. The United States and Japan view with

111. K. FITTING, AUFEARTH & KAISER, Commentary, BetrVG, § 1, annot. 4 (15th ed. 1987).
112. C. EBENROTH, VERMOGENSZUWENDUNGEN, supra note 2, at 363-65.
113. Election of the board of directors.
114. 32 NJW 488 (1979).
some degree of skepticism the efforts of the European Community to create a unified common market\textsuperscript{116} in Europe. The notion of Europe as a "fortress," which has been making the rounds lately, is an expression of this skepticism. Once the borders within Europe are eliminated, foreign nationals and corporations will be confronted with a wealth of new legal problems. My concern in this article is with only a part of this enormous problem. Will the freedom to conduct business in Europe that article XXV(5) of the TFCN guarantees to U.S. corporations conflict with EEC regulations? Or will U.S. corporations be able to gain access to the Common Market through the Federal Republic of Germany?

1. Formal Violations of EEC Regulations by the TFCN

According to article 113 of the EEC Treaty, Commerce and Investment Treaties such as the TFCN between Germany and the United States fall within the domain of the European Community.\textsuperscript{117} Consequently, article 234 of the EEC Treaty states that previous bilateral treaties between Common Market countries and third party countries are not to be affected, but that conflicts with EEC regulations should be eliminated. The EEC Commission, moreover, has a negative attitude toward the conclusion of bilateral Investment and Commercial Treaties. On April 27, 1987,\textsuperscript{118} the Council agreed to prolong certain friendship and commercial treaties. The agreement, however, remained in effect only until December 31, 1988, and has not since been renewed. Because this also affects the TFCN between Germany and the United States, the treaty is in formal violation of EEC regulations.

For several reasons, however, this formal violation does not lead to the automatic annulment of the TFCN. Germany’s membership in the EEC does not mean that it loses its sovereign right to conclude such agreements under international law.\textsuperscript{119} In addition, the practice of the EEC Commission to extend existing treaties shows that the European Community is intent on prolonging and not discontinuing such agreements. Finally, since the TFCN also contains regulations that do not fall within the jurisdiction of the EEC, it is impossible to annul such agreements.

2. Substantive Violations of EEC Regulations

Article XXV(5) of the TFCN, which regulates the freedom of U.S. corporations to shift their effective place of business to Germany, does not conflict with

\textsuperscript{116} Art. 8a, EEC Treaty, states, "The community will take the necessary measures in order to realize the completion of the internal market until December 31, 1992. The internal market includes an area without borders, services and capital . . . is guaranteed." (translation by the author).

\textsuperscript{117} The EEC Council, in its first decree concerning the commercial policy, already integrated explicitly the treaties of friendship, commerce, and navigation in the common commercial policy of the EEC; see Decree of the Council of Oct. 9, 1961, 710 J.O. EUR. COMM. 1264/61 (1961); see also CHR. VEDDER, DIE AUSWÄRTIGE GEWALT DES EUROPAS DER NEUN 22 (1980).

\textsuperscript{118} O.J. EUR. Comm. (No. L 111) 32 (1987).

\textsuperscript{119} I. SEIDL-HOHENVELDERN, DAS RECHT DER INTERNATIONALEN ORGANSATIONEN EINSCHLIESSLICH DER SUPRANATIONALEN GEMEINSCHAFTEN 269 (4th ed. 1984); H. KRÜCK, VOLKERRECHTLICHE VERTRÄGE IM RECHT DER EUROPÄISCHEN GEMEINSCHAFTEN 146 (1977).
EEC regulations. Of course, establishing a common market in 1993 should guarantee the free transport of goods and persons within the EEC. Freedom of movement, however, does not mean the right to transfer a corporation’s effective place of business from one member country to another.\textsuperscript{120} All that a corporation is allowed to do is establish subsidiaries in another member country. For this reason U.S. corporations cannot use article XXV(5) of the TFCN to shift their headquarters from Germany to other member countries in the EEC.\textsuperscript{121} The efforts on the part of the EEC to unify corporate law within the Common Market are still in the initial stages at the moment.\textsuperscript{122} We do not, however, expect considerable progress in the future, since opposition interest within the individual member countries is still very strong.

3. Advantages of Article XXV(5) of the TFCN for U.S. Corporations

Although article XXV(5) of the TFCN does not allow U.S. corporations to shift their effective place of business from Germany to other EEC countries, it does offer them a considerable advantage in conducting business within the Common Market. This advantage concerns law relating to aliens. The EEC considers a U.S. corporation whose headquarters has been shifted to Germany, and whose legal status is recognized, as a German corporation according to German conflict law. In order to acquire the legal status of a German corporation it is not necessary that a foreign corporation be founded according to German corporate law, but only that its headquarters be in Germany and its legal status be recognized according to conflict of laws rules.\textsuperscript{123} Since U.S. corporations that have shifted their headquarters to Germany in accordance with article XXV(5) of the TFCN have the same status as an EEC corporation, it is possible for U.S. corporations to gain access through the back door of “fortress Europe,” if indeed the EEC can be viewed as a fortress. The advantages of gaining access to the Common Market in this way are considerable.

III. Legal Competence of Basic Rights

In accordance with article 19(3) of the GG, legal persons enjoy certain basic rights, such as the right to possess private property, the freedom to choose one’s
trade or profession, and the freedom to develop one’s personality. The question is whether these rights are also guaranteed to U.S. corporations recognized by article XXV(5) of the TFCN.

A. CRITERIA FOR RECOGNIZING LEGAL STATUS OF BASIC RIGHTS

According to article 19 of the GG, only national companies enjoy basic rights. The only exceptions are the so-called basic rights of procedure, which guarantee equal and fair treatment by the German authorities and the courts of justice (articles 17, 19(4), 101(1), and 103 of the GG). This explains why foreign corporations are generally not concerned with basic substantive rights.  

B. CRITERIA FOR DETERMINING THE RESIDENCY REQUIREMENT OF A CORPORATION

There are several criteria for the residency requirement of a corporation, that is, for determining whether a corporation can be considered national or foreign. The first condition is that the corporation must have its headquarters in Germany, an indication of a very close effective relationship between the country and the corporation.

A second criterion, representing the prevailing view in Germany, requires that a company be founded and incorporated according to German law, but a substantial minority deviates from this view. It is, however, legally and factually unacceptable to consider a U.S. corporation as a national corporation when it still has effective ties to the United States (genuine link) and its legal status is based on U.S. law. Neither Germany nor the United States are interested in having U.S. corporations with their effective place of business in Germany considered as national companies. For the United States this is a matter of national sovereignty. This is also the reason why neither legal status nor recognition under the conflict of laws rule can lead to a U.S. corporation being considered a national company by meeting the residency requirement. A U.S. corporation cannot meet the residency requirement according to article 3 of the GG, which would guarantee equal treatment, since it cannot fulfill the main requirement that it be a national corporation, even though its effective place of business is located in Germany. 

124. Ebenroth & Bippus, supra note 47, at 2137; Grossfeld, Commentary, supra note 2, annot. 594.  
125. Residency requirement means the criteria that have to be met in order to be treated as a national (resident-attribute).  
IV. Summary

Germany, in contrast to the United States, follows the effective "seat rule" in matters involving the conflict of laws rule. This means Germany only recognizes a corporation's legal status if this corporation has been founded under German law and if its registered office and effective place of business is in Germany. Article XXV(5) of the TFCN forms an important exception to this rule. Germany also recognizes U.S. corporations whose legal status has been recognized in the United States when they transfer their effective place of business to Germany or to another country.

Article XXV(5) of the TFCN has to be considered as a conflict of laws rule and not as law relating to aliens. Germany is obligated to recognize a U.S. company incorporated in the United States since article XXV(5) refers to U.S. and not to German law. This is the conclusion I draw from a close examination of the TFCN and article XXV(5), and from a comparison with other international treaties concluded between Germany and other countries.

There are, however, some restrictions. If the legal status of U.S. corporations is not recognized in the United States, then Germany is neither obligated nor allowed to recognize such a corporation. Such legal defaults may include the abuse of laws, breach of U.S. public policy, or absence of any genuine link between the corporation and the United States.

Germany, moreover, is not able to recognize a U.S. corporation if this corporation is only a pseudo-foreign corporation without any genuine ties to the United States. German public policy can oppose the recognition of a U.S. corporation only if this corporation has committed what is considered to be a violation of public policy in the United States. Binding German corporate law does not prevent recognition, because it is not possible, and would be incompatible with the TFCN, to force binding German law (such as codetermination on the supervisory board) on a U.S. corporation without changing the corporation's structure. This form of recognition, however, does not mean that U.S. corporations with their effective place of business in Germany can be treated like national companies, since article 19(3) of the GG does not apply to them.