Freedom of establishment after Polbud: Free transfer of the registered office

Bastian Brunk, research assistant and doctoral student at the Institute for Comparative and Private International Law at the University of Freiburg (Germany), has provided us with the following first thoughts on the CJEU's groundbreaking *Polbud* judgment.

The Judgment

In its judgment in *Polbud* (C-106/16), the CJEU again took the work out of the EU legislature's hands while further developing the freedom of establishment provided for in Articles 49 and 54 TFEU. The case was heard following a request for a preliminary ruling under Article 267 TFEU by the Sad Najwyzszy (Supreme Court of Poland). In short, the CJEU had to decide on the following questions:

(1) Are Articles 49 and 54 TFEU applicable to a transfer of the registered office of a company incorporated under the law of one Member State to the territory of another Member State with the purpose of converting its legal form, when the company has no intention to change the location of its real head office or to conduct real economic activity in the latter Member State?

(2) Is a national legislation that makes the removal of a company from the commercial register and, accordingly, the out-migration of that company conditional upon its liquidation compatible with the freedom of establishment?

Answering these questions, the CJEU made *Polbud*, the company at stake, a liberal gift and strengthened the mobility of companies within the European Single Market. First, the CJEU stated that the freedom of establishment applies to the transfer of the registered office of a company from one Member State to another even if no real business is intended to be conducted in the latter Member State. Secondly, the CJEU ruled out national legislation providing for the mandatory liquidation of a company if the company requests the removal from the initial commercial register in cases of outward migration.

The facts

In September 2011, the shareholders of *Polbud*, a limited liablity company established under Polish law, decided to transfer the company's registered office from Poland to Luxembourg. The resolution made no reference to a simultaneous transfer of either the real head office or the place of real economic activity. Based on that resolution, the registry court in Poland recorded the opening of the liquidation procedure. In May 2013, following a resolution adopted by a shareholder meeting in Luxembourg, the registered office of *Polbud* was transferred to Luxembourg. *Polbud* was renamed to *Consoil Geotechnik* and its legal form was changed to the *Société à responsabilité limitée (S. à r. l.)*, the Luxembourgish private limited liability company. Subsequently, *Polbud* lodged an application with the Polish registry court for its removal from the commercial register. This application was refused to be registered because, as the registry court stated, *Polbud* failed to provide evidence of the successful execution of a liquidation procedure. *Polbud* appealed against this decision, arguing that no liquidation was needed because the company continued to exist as a legal person incorporated under Luxembourgish law.

The precedents

Articles 49 and 54 TFEU provide for the freedom of establishment. According to the CJEU case-law, the concept of "establishment" within the meaning of these Articles is a very broad one, allowing a Union national to participate, on a stable and continuous basis, in the economic life of another Member State and to profit therefrom (CJEU in *Gebhard*, C-55/94, para. 25 and *Almelo*, C-470/04, para. 26). It involves the actual pursuit of an economic activity through a fixed establishment in another Member State for an indefinite period (CJEU in *Factortame and Others*, C-221/89, para. 20 and *Commission v. United Kingdom*, C-246/89, para. 21). In order to claim freedom of establishment, it is generally necessary to have secured a permanent presence in the host Member State (CJEU in *Centro di Musicologia Walter Stauffer*, C-386/04, para. 19 and *Schmelz*, C-97/09, para. 38). This case law can, generally speaking, be translated as "no freedom of establishment without establishment".

On the other hand, the CJEU generously extended the application of Articles 49 and 54 TFEU to letterbox companies without "fixed establishment" and/or "permanent presence" in their home Member State. In *Centros* (C-212/97) the

Court ruled that EU law is applied to the set-up of subsidiaries, branches and agencies in other Member States and, in that regard, it is immaterial that the company was formed in one Member State only for the purpose of establishing itself in another Member State, where its main, or indeed entire, business is to be conducted (*Centros*, para 17).

The CJEU then used its 2009 *Cartesio* judgment (C-210/06) as an opportunity to, *obiter dictu*, set guidelines for cross-border transfers of seat. It stated that, on the one hand, a Member state has the power to define both the connecting factor required of a company if it is to be regarded as incorporated under the law of that Member State and, as such, capable of enjoying the right of establishment, and that required if the company is to be able subsequently to maintain that status (thus treating companies as legal creatures of their country of origin). On the other hand, freedom of establishment comprises the right of a company to move from one Member State to another. If domestic legislation of the Member State of origin requires the liquidation of the company, thereby preventing it from converting itself into a legal person governed by the law of the target Member State, such a measure cannot be justified under the rules on freedom of establishment (*Cartesio*, paras. 110 ff.).

This jurisdiction was complemented by the CJEU in *Vale* (C-378/10) where the Court clarified the legal position of the Member State of destination. If a Member State allows for the conversion of companies governed by national law, it must also grant the same possibility to foreign EU companies (*Vale*, para. 46). In the absence of relevant EU-law, the target Member State may set up procedural rules to cover the cross-border conversion but must ensure that they are not less favourable than those governing similar domestic situations (principle of equivalence) and that they do not render impossible in practice or excessively difficult the exercise of rights conferred by the European Union legal order (principle of effectiveness) (*Vale*, para. 48).

The Opinion of AG Kokott

In her *Opinion* of 4 May 2017 (see here), AG *Kokott* took up a distinct position emphasizing the need for actual establishment for the application of Articles 49 and 54. This criterion is sufficiently met, as AG *Kokott* states, if, at least, the company *intends* to set up an actual establishment in the sense of conducting at least a nominal economic activity in the target Member State (*Opinion*, para 36).

The AG underlines her position citing the above mentioned CJEU case-law in *Factortame and Others* (C-221/89), *Commission v. United Kingdom* (C-246/89), *Centro di Musicologia Walter Stauffer* (C-386/04) and *Schmelz* (C-97/09). She concludes that the freedom of establishment "*gives economic operators in the European Union the right to choose the location of their economic activity, it does not give them the right to choose the law applicable to them*" (*Opinion*, para. 38).

Implications of the *Polbud* judgment for the internal market

The CJEU now takes a different point of view: Once formed in accordance with the legislation of a Member State, companies enjoy the full range of that freedom. Nothing new, so far, as *Geert van Calster* suggests in his comment (see here). But what makes Polbud (r)evolutionary?

First, the CJEU creates legal certainty in an area that is particularly important for the functioning of the European Single Market. In its *Cartesio* judgment, the Court allowed for the cross-border conversion of EU companies in general but did little to shape the relationship between the involved Member States. Therefore, it was widely thought, that, just like AG *Kokott* propounds, the conversion of a company from one Member State to another required a genuine economic link with the State of destination. In *Polbud*, the CJEU clarifies that the regulatory power of a Member State ends when a company converts itself into a company governed by the law of another Member state. It is for the latter State to determine the legal and/or economic conditions that have to be satisfied by the company in order to bring the conversion into effect (paras 33 ff.). Under Articles 49 and 54 TFEU, the State of origin is only allowed to provide legislation for the protection of public interests (such as the protection of creditors, minority shareholders and employees) but cannot impose mandatory liquidation.

Secondly, the CJEU obliges the State of origin to observe the *principle of equivalence*. This principle, already known from the *Vale* decision (see above), was generally considered as obliging only the target Member State in cross-border conversion cases to legally treat domestic and foreign companies equally. By contrast, the State of origin was only thought to be bound by the general prohibition of restrictions (i.e. the prohibition of rules hampering or rendering less attractive the exercise of fundamental freedoms, see CJEU in *Kraus*, C-19/92, para. 32). In *Polbud*, the CJEU, without being explicit on this point, extends the scope of application of the principle of equivalence to the Member State of origin

by stating that "*the imposition, with respect to such a cross-border conversion, of conditions that are more restrictive than those that apply to the conversion of a company within that Member State itself*" is not acceptable (para. 43).

Finally, recapitulating its jurisdiction in *Daily Mail* and *National Grid Indus* (C-371/10), the CJEU points out that exercising the freedom of establishment for the purpose of enjoying the benefit of the most favourable legislation, does not, in itself, amount to an abuse of rights (para. 62). The Court further explains its position saying that "*the mere fact that a company transfers its registered office from one Member State to another cannot be the basis for a general presumption of fraud and cannot justify a measure that adversely affects the exercise of a fundamental freedom guaranteed by the Treaty*" (para. 63).

Assessment

As already observed, *Polbud* encouragingly facilitates the cross-border mobility of companies but, on the other hand, leaves the reader with open questions.

It was high time to free cross-border conversions from the requirement of a genuine economic link with the Member State of destination. The legal situation before *Polbud*, that allowed letterbox companies to conduct their business in other Member States (which can be compared to initial choice of law) but prevented the formation of letterbox companies through the transfer of an existing company's registered office to another Member State (which can be compared to subsequent choice of law), was somewhat arbitrary from a legal and economic point of view.

On the other hand, the extension of the scope of application of the principle of equivalence to the Member State of origin can only be seen as inconsistent with the legal doctrine of the freedom of establishment provided for in Articles 49 and 54 TFEU. Heretofore, only EU-foreigners could enjoy the right to non-discrimination, whereas, in regard to EU law, Member States were free to impose (relatively) stricter rules to its own citizens. This principle finds its expression, for example, in the above-mentioned treatment of companies as creatures of their state of origin that the CJEU established in its *Cartesio* judgment. As the principle of equivalence corresponds to the prohibition of discrimination, it is even more astonishing that the CJEU permits exemptions for overriding reasons in the public interest. These unwritten exemptions generally apply only in cases of restrictions

of the freedom of movement (see Kraus, para. 32 and *Gebhard*, para. 37). On the contrary, discriminations require the strict observance of the catalogue of justifications set out in Article 52 TFEU. In future decisions, the CJEU should recall this clear distinction and cease to further the linguistic ambiguity.