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Company Law in the European Union and the United States: A Comparative Analysis of the Impact of the EU Freedoms of Establishment and Capital and the U.S. Interstate Commerce Clause

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COMPANY LAW IN THE EUROPEAN UNION AND THE UNITED STATES: A COMPARATIVE ANALYSIS OF THE IMPACT OF THE EU FREEDOMS OF ESTABLISHMENT AND CAPITAL AND THE U.S. INTERSTATE COMMERCE CLAUSE

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ABSTRACT

Since the decision of the European Court of Justice in the Centros *case, it has become popular in company law to draw comparisons between the United States economic constitution and the Single European Market. Since then, fears of a European "Delaware Effect," which would create a "race to the bottom," have hounded the debate on European company law. In this discussion, however, the unique constitutional framework of both the EU and the U.S. is seldom regarded. This constitutional framework, nevertheless, determines the behavior of both the legislators at state level and the market participants. This Article compares the impact of two major principles of both constitutions on company law: the U.S. dormant Interstate Commerce Clause and the Freedom of Establishment and the Freedom of Capital in the EU Treaties. The Article finds that the U.S. constitutional framework is more lenient on states and thereby grants them broader discretion to regulate company law. Further, it will argue that this is rooted in the specific legal set-up of the two common markets. The European Single Market, unlike the U.S., grants explicit free movement rights to capital and direct investments, establishing a modern framework. Further, European legal doctrine is faced with the paradox that the Treaty on the Functioning of the European Union (TFEU) equates natural persons and companies, whereas in reality, companies differ from natural persons in many respects. The U.S. constitutional framework instead relies on the concept that companies are creatures of state law in order to grant states larger powers.*

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INTRODUCTION

The Single European Market has been compared to the economic constitution of the United States of America since the early days of the European common market project.[1] The U.S. and the EU, it is said,[2] share the same problem. The individual states in the U.S. and the Member States of the EU try to secure their own advantage at the cost of one another in the superstructure.[3]

Comparing the U.S. economic constitution and the Single European Market became popular in company law when the ECJ in *Centros* pronounced that regulatory competition was inherent in the system of the treaty.[4] Since then, fears of a European "Delaware Effect," which would bring about a "race to the bottom," have hounded the debate in European company law.[5] However, both common markets have a specific constitutional framework, which determines the behavior of both the legislators at state level and the market participants. These differences are decisive on the extent to which the states are limited in their ability to ensure their own policy interests at the expense of the interests of the common market. In the Single European Market, the four market freedoms prohibit the Member States from taking action against the free movement of production factors (Article 26 TFEU).[6] In terms of company law, the Freedom of Establishment and the Freedom of Capital are most important. The U.S. constitutional framework for companies is more multifaceted. At the very outset, the Privileges and Immunities Clause[7] is not applicable to companies, as the U.S. Supreme Court rejects the concept of a corporate citizen.[8] According to the case law of the U.S. Supreme Court, corporations "are creatures

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[1] P. Leleux, *Corporation Law in the United States and in the E.E.C.*, 5 COMMON MKT. L. REV. 133 (1967).

[2] Klaus Lackhoff, *Restrictions on State Interference with Commerce in the U.S.A. and the EC*, 2 COLUM. J. EUR. L. 313 (1996).

[3] *Id.*

[4] Case C-212/97, Centros Ltd. v. Erhversus-og Selkabssyrelsen, 1999 E.C.R. I-1459, ¶ 27; Case C-212/97, Opinion of AG La Pergola in Centros Ltd. v. Erhversus-og Selkabssyrelsen, 1999 E.C.R. I-1461, ¶ 20; *see* Christian Kersting, *Corporate Choice of Law—A Comparison of the United States and European Systems and a Proposal for a European Directive*, 28 BROOK. J. INT'L L. 1, 2 (2002).

[5] ERIK WERLAUFF, EU-COMPANY LAW—COMMON BUSINESS LAW OF 28 STATES 100 (2d ed. 2003).

[6] Consolidated Version of the Treaty on the Functioning of the European Union art. 26, Sept. 5, 2008 O.J. (C 115/59) [hereinafter TFEU].

[7] U.S. CONST. amend. XIV, § 1 ("No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States.").

[8] Paul v. Virginia, 75 U.S. 168, 175 (1869); Bank of Augusta v. Earle, 38 U.S. 519, 586 (1839).

of local law and have not even an absolute right of recognition in other States, but depend for that and for the enforcement of their contracts upon the assent of those States, which may be given accordingly on such terms as they please."[9] The Full Faith and Credit Clause in Article IV, Section 1 of the U.S. Constitution provides that "Full Faith and Credit shall be given in each state to the public Acts, Records and judicial Proceedings of every other State."[10] Of all constitutional principles, the dormant Interstate Commerce Clause, which restricts the states from laying burdens on interstate commerce, is most comparable to the four freedoms.[11]

Therefore, this Article will compare the impact the dormant Interstate Commerce Clause has on company law in the United States with the impact the Freedom of Establishment and Freedom of Capital have on national company law in the EU.

The Interstate Commerce Clause is worth comparing with the EU Freedoms of Establishment and Capital in respect to company law for two reasons. Firstly, the dormant Interstate Commerce Clause is able to restrict the states' abilities to regulate freely companies incorporated in their territory and therefore governed by domestic law.[12] In this regard, the question arises, to what extent do the states have to respect the Interstate Commerce Clause in company law and how much discretion remains to the states as the company's creator, as companies do not exist naturally but are "creatures of national law."[13] This question, however, is not unique to the legal framework for company law in the United States but is one of the most debated questions in European company law as well.[14] Secondly, the dormant Interstate Commerce Clause in its function limits the powers of the states, not only towards the Congress but also towards the market participants.[15] In that sense, it forms a "status negativus"—a right of every citizen against state interference in the interstate commerce of the market subjects.[16] The dormant Interstate Commerce Clause therefore is an economic freedom.

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[9] *Paul*, 75 U.S. at 170.

[10] U.S. CONST. art. IV, § 1.

[11] Erin O'Hara & Larry E. Ribstein, RULES AND INSTITUTIONS IN DEVELOPING A LAW MARKET: VIEWS FROM THE U.S. AND EUROPE 20–21 (University of Illinois Law Sch. Law & Economics Working Papers, No. 88, 2008), available at http://ssrn.com/abstract=1100277.

[12] *See* Gibbons v. Odgen, 22 U.S. 1 (1824).

[13] Case C-81/87, The Queen v. H.M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust PLC, 1988 E.C.R. 5483 at ¶ 19.

[14] Case C-210/06, Cartesio Okató és Szolgáltató Bt., 2008 E.C.R. I-9641 at ¶ 104; *Daily Mail,* 1988 E.C.R. 5483 at ¶ 19.

[15] *See Gibbons*, 22 U.S. 1.

[16] Western Union Tel. Co. v. Kansas, 216 U.S. 1, 2 (1910).

This function brings the dormant Interstate Commerce Clause in close agreement with the freedoms of movement of the EU Treaties.[17]

First, this Article will discuss the basic principles of the constitutional set-up of the dormant Interstate Commerce Clause and the Freedom of Establishment and Freedom of Capital. The second section will address more precise problems. It will compare the inbound situation—the approach of both constitutional frameworks toward the regulation of foreign companies by host states. The third section will assess the so-called outbound situation, namely, how far the two principles force the states to create their companies in a common-market friendly way and thereby limit the discretion of the states in regulating domestic company law. In the light of the results of the assessment, a further section will argue that the U.S. constitutional framework is more lenient on states, thereby granting them broader discretion to regulate company law. By offering an explanation for this more lenient approach, this Article will consider the lessons that may be drawn for European company law from U.S. American experience and legal debate. It will present the argument that this result is rooted in the specific legal set-up of the two common markets; unlike the U.S. constitutional framework, Europe's different minimum capital requirements offer incentives to create pseudo-foreign companies. The Single European Market, unlike the U.S., grants explicit free movement rights to capital and direct investments, establishing a modern framework. Finally, European legal doctrine is faced with the paradox that the TFEU equates natural persons and companies, whereas companies differ from natural persons in reality in many respects. The U.S. constitutional framework instead relies on the thought that companies are creatures of state law in order to grant states larger powers.

I. CONSTITUTIONAL SET-UP OF COMPANY LAW

Like every field of law, company law exists within a constitutional framework. In the United States, company law evolved at a time when the federal constitutional framework was already in place.[18] In Europe, it was national constitutional law and national legal tradition in opposition to European law that determined the development of company law.[19] Later, the

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[17] *See* Case 26/62, van Gend en Loos v. Nederlandse Administratie der Belastigen, 1963 E.C.R. at ¶ 5 (precluding the direct application of the four freedoms).

[18] *See* RICHARD M. BUXBAUM & K. J. HOPT, LEGAL HARMONIZATION AND THE BUSINESS ENTERPRISE, 28–29 (Cappalletti et al. eds., 1988).

[19] *See* Brian Cheffins, *European Community Company and Securities Law: A Canadian Perspective*, 36 MCGILL L. J. 1282, 1294 (1991).

European integration formed a new constitutional framework for company law, first in the form of the Treaty of Rome provisions, and today in the Treaty of the European Union and the Treaty on the Functioning of the European Union.[20] This European constitutional framework of company law co-exists with the constitutional frameworks at a national level.[21] This section will describe the constitutional frameworks of the U.S. and the EU and evaluate their differences and commonalities.

A. Balance of Power

1. The Dormant Interstate Commerce Clause

The Constitution of the United States provides for a division of powers, not only in regard to the traditional state powers but also vertically between the federation and the states.[22] First of all, the residual legislative powers are given to the states, and the powers of the federation are limited to those delegated by the constitution.[23] Article I, Sections 8 and 10 delegate these limited powers to the Congress as the federal lawmaker.[24] The Tenth Amendment of the United States Constitution explicitly states: "[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."[25] Additionally, the federation has to ensure that the residual power given to the states is not used by the states to render meaningless the powers of the federal lawmakers.[26] In this regard, Article VI, Clause 2 of the U.S. Constitution explicitly states that the laws made in accordance with the Constitution shall be the supreme law of the land.[27] The Constitution does not explicitly prohibit the states from using their legislative power in relation to subjects over which the Congress has not yet exercised its powers.[28] However, case law established that the competences given to the Congress entail a negative effect on the ability of states to regulate in that area.[29]

One of the most hard-fought,[30] and at the same time most important, powers of the Congress is laid down in Article I, Section 8, Clause 3, which

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[20] *Id.* at 1286–88.
[21] *See* BUXBAUM & HOPT, *supra* note 18, at 174–75.
[22] *See* LAURENCE TRIBE, AMERICAN CONSTITUTIONAL LAW 132–36 (3rd ed. 2000).
[23] Leleux, *supra* note 1, at 134.
[24] U.S. CONST. art. I, §§ 8, 10.
[25] U.S. CONST. amend. X.
[26] *See* Marbury v. Madison, 5 U.S. 137, 174 (1803).
[27] U.S. CONST. art. VI, cl. 2.
[28] U.S. CONST. amend. X.
[29] *See infra* note 34.
[30] Lackhoff, *supra* note 2, at 313–14.

states: "Congress shall have power ... to regulate commerce ... among the several states ...."[31] This clause is commonly called the Interstate Commerce Clause.[32] In accordance with the two principles of the vertical division of power in a federation, the Interstate Commerce Clause prohibits the Congress legislating on commerce within the states.[33] Secondly, the Interstate Commerce Clause prohibits states from imposing regulatory burdens on interstate commerce.[34] With respect to this second function, the Commerce Clause is called the "dormant" Interstate Commerce Clause.[35] The aim of centralizing the power over interstate commerce was twofold: the efficient allocation of goods, labor, and investment as well as the allaying of the fear of trade wars.[36]

2. The Four Freedoms in the EU

A division of power between the institutions of the European Union and the member states exists in a strikingly similar manner. Most prominently, the principle of conferral of powers is a basic principle of European Union Law.[37] The European Union has no section similar to Article I, Section 8 of the U.S. Constitution, in which all the competences of the EU are framed, but rather these are scattered throughout the TFEU. One of the central competences can, however, be found in Article 114 TFEU, giving the legislative institutions of the EU the power to form a common market.[38] As in the U.S. Constitution, the positive power of the legislative organs and the economic freedoms are connected like two sides of one coin. Article 114 TFEU is explicit in regard to Article 26 TFEU, which defines the internal market as an area without internal frontiers in which the free movement of goods, persons, services, and capital is assured in accordance with the provisions of this Treaty.[39] The four freedoms of movement are thus directly linked to the competences. The scope of the freedoms defines the scope of the competences.[40] More specific competences can be found right next to

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[31] *Id.* at 313.

[32] *See* United States v. Lopez, 514 U.S. 549, 588 (1995).

[33] Leleux, *supra* note 1, at 135.

[34] *Id.*; Cooley v. Board of Wardens, 53 U.S. 299, 319 (1852); Gibbons v. Odgen, 22 U.S. 1, 209 (1824); Freeman v. Herwitt, 329 U.S. 249, 252 (1946); Edgar v. MITE Corp., 457 U.S. 624, 640 (1982).

[35] *See Lopez*, 514 U.S. at 579.

[36] GERALD GUNTHER, CONSTITUTIONAL LAW 259, 260 (13th ed. 1997).

[37] DAMIEN CHALMERS ET AL., EUROPEAN UNION LAW 211 (2006).

[38] TFEU art. 114, at ¶ 1.

[39] *Id.*

[40] J. H. H. Weiler, *The Constitution of the Common Market Place*, in THE EVOLUTION OF THE EU LAW 371 (Craig & Burca eds., 1999).

the provisions governing the free movement right.[41] Regarding the Freedom of Establishment (Article 49 TFEU) and the Freedom of Capital (Article 63 TFEU), both limitations of member states' powers are followed by an explicit competence of the EU institutions to legislate in these areas in Article 50 and Article 64 (2) TFEU. Besides these similarities in structure and function, the aims of the rules are the same. As with the Interstate Commerce Clause, the EU freedoms are motivated by the aim to create an internal market (Article 26 TFEU), which provides for the optimal allocation of resources and production factors.[42]

B. The Scope of the Dormant Interstate Commerce Clause and the EU Freedoms

1. The Scope of the Dormant Interstate Commerce Clause

As there is no textual basis for the dormant Interstate Commerce Clause, its scope remains contested.[43] In sum, the dormant Interstate Commerce Clause restricts state law in three ways.[44] Firstly, state laws discriminating "against the transactions of out-of-state actors in interstate markets"[45] are prohibited. "Out-of-state actors are non-residents of the regulating state[s]."[46] However, the scope is broadened to include discrimination against corporations incorporated under the law of another state.[47]

Secondly, even if there is no discrimination, state laws that are discriminatory in effect and that favor local economic interests at the expense of out-of-state competitors have been invalidated under the dormant Interstate Commerce Clause.[48] Thirdly, the dormant Interstate Commerce Clause prohibits laws that have no discriminatory effects whatsoever, but place an undue burden on interstate commerce.[49]

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[41] TFEU art. 2–6.

[42] Wolfgang Schön, *The Mobility of Companies in Europe and the Organizational Freedom of Company Founders*, 3 EUR. CO. & FIN. L. REV. 122, 125 (2006); GUNTHER, *supra* note 36, at 260.

[43] Bendix Autolite v. Midwesco Enter., Inc., 486 U.S. 888, 898 (1988) (Scalia, J. concurring).

[44] GUNTHER, *supra* note 36, at 270.

[45] Exxon v. Governor of Maryland, 437 U.S. 117, 136 (1978).

[46] Lackhoff, *supra* note 2, at 320.

[47] Western Union Tel. Co. v. Kansas, 216 U.S. 1 (1910); Lackhoff, *supra* note 2, at 320.

[48] Hunt v. Washington State Apple Adver. Comm'n, 432 U.S. 333, 353 (1976); Dean Milk Co. v. City of Madison, 340 U.S. 349, 354 (1950).

[49] Bendix Autolite v. Midwesco Enter., Inc., 486 U.S. 888, 898 (1988) (Scalia, J., concurring).

From the beginning, the U.S. Supreme Court limited the application of these categories. Firstly, a distinction was made between direct and indirect impact on interstate commerce.[50] This was soon found to be only a label for actually balancing the local interests of the states with the national interest in maintaining the freedom of commerce across the state.[51] Today, a balancing test is used that takes into consideration the local interests of the state:

> Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.... If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities [(so-called Pike-Test)].[52]

Finally, the Interstate Commerce Clause does not apply when Congress approved the state legislation[53] and where the state acts as a market participant.[54]

2. The Scope of the EU Freedom of Establishment and Capital

The similarities of the scope of the EU Freedoms and the dormant Interstate Commerce Clause are demonstrative. As in the case of the Interstate Commerce Clause, the Freedom of Establishment first evolved as an anti-discrimination rule.[55] This can clearly be seen from the wording of Article 49 paragraph 2 TFEU. "Freedom of establishment shall include the right to take up and pursue activities ... under the conditions laid down for its own nationals by the law of the country where such establishment is effected ...."[56] This paragraph constitutes the original Freedom of Establishment, as it was already included in Article 52 of the Treaty of Rome (1957).[57] The ECJ then quickly broadened the scope of the Freedom of Establishment.

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[50] Wickard v. Filburn, 317 U.S. 111, 120–25 (1942).

[51] Di Santo v. Pennsylvania, 273 U.S. 34, 44 (1927) (Stone, J., dissenting).

[52] Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970) (citing Huron Cement Co. v. Detroit, 362 U.S. 440, 443 (1960), and Southern Pacific Co. v. Arizona 325 U.S. 761 (1945)); *see also* Edgar v. MITE Corp. 457 U.S. 624, 640 (1982).

[53] GUNTHER, *supra* note 36, at 268; Lackhoff, *supra* note 2, at 324.

[54] GUNTHER, *supra* note 36, at 322; Lackhoff, *supra* note 2, at 324–25.

[55] TFEU art. 49, Mar. 30, 2010, 2010 O.J. (C 83) 67 [hereinafter TFEU].

[56] *Id.*

[57] Treaty of Rome, art. 52, Mar. 25, 1957, 298 U.N.T.S. 3.

The member states adjusted the treaty to this case law with the result that the current Treaty further provides that "restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited," the wording now to be found in Article 49 TFEU.[58]

A broad understanding of the Freedom of Establishment was already introduced by the ECJ under the Treaty of Rome, in its rulings in *Klopp*.[59] Here, a regulation of the Paris bar association, which provided that an advocate may establish chambers in one place only, was held to violate the Freedom of Establishment, even though this rule applied to all advocates regardless of their nationality.[60] In *Dieter Kraus v. Land Baden-Württemberg*, the ECJ then defined the scope of the Freedom of Establishment as precluding "any national measure ... even though it is applicable without discrimination on grounds of nationality, [which] is liable to hamper or to render less attractive the exercise by Community nationals, including those of the Member State which enacted the measure, of fundamental freedoms guaranteed by the Treaty."[61]

This formula was consequently confirmed in the *Gebhard* decision.[62] However, the ECJ added a balancing test.

> [N]ational measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfill 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 is necessary in order to attain it [(so-called *Gebhard* Test)].[63]

Regarding the freedom of capital, the ECJ's judgments rely on the same principles applied to the Freedom of Establishment and the other freedoms. Since 1994, when it became directly applicable, the freedom of capital, in turn, has prohibited any restriction.[64] The ECJ repeatedly formulated: "Even though the rules in issue may not give rise to unequal treatment, they are liable to impede the acquisition of shares in the undertakings concerned and to dissuade investors in other Member States from

[58] TFEU art. 49, *supra* note 55.

[59] Case C-107/83, Opinion of AG Slynn in Ordre des avocats au Barreau de Paris v. Onno Klopp 1984 E.C.R. 2971.

[60] *Id.*

[61] Case C-19/92, Dieter Kraus v. Land Baden-Württemberg, 1993 E.C.R. I-1663, ¶ 32.

[62] Case C-55/94, Reinhard Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, 1995 E.C.R. I-04165, ¶ 36.

[63] *Id.* ¶ 37.

[64] STEFAN GRUNDMANN, EUROPEAN COMPANY LAW ¶ 667 (1st ed. 2007).

investing in the capital of those undertakings."[65] In *Commission/Belgium*, the ECJ further formulated:

> The free movement of capital ... may be restricted only by national rules which are justified ... by overriding requirements of the general interest and which are applicable to all persons and undertakings pursuing an activity in the territory of the host Member State. Furthermore, in order to be so justified, the national legislation must be suitable for securing the objective which it pursues and must not go beyond what is necessary in order to attain it, so as to accord with the principle of proportionality.[66]

The justifying tests under the EU Freedoms correlate strongly to the test applied by the U.S. Supreme Court since its judgment in *Pike v. Bruce Church, Inc.* Firstly, both tests apply only to measures that are not discriminatory in nature.[67] Secondly, the measure must aim at securing a public interest.[68] Thirdly, the measure in both jurisdictions must be suitable for achieving the public interest.[69] Finally, the proportionality test under the Freedoms of Establishment and capital provide that the measure does not go beyond what is necessary in order to attain the general interest.[70] A similar condition exists in the *Pike* test.[71] The extent of the burden on interstate commerce will thereafter depend on whether it could be promoted as well with a lesser impact on interstate activities.[72]

Besides these strong similarities, the *Gebhard* test sets a higher standard of control. First of all, the *Gebhard* test asks not only whether the state measure protects a local public interest, but also whether there is an imperative requirement of public interest.[73] This requires the ECJ to decide if the public interest pursued by the measure is compelling enough in order to justify the hindering effects on freedom. Furthermore, the U.S. Supreme Court applies the necessity test in a much weaker form than the ECJ. Whereas the ECJ controls the suitability of the measures, the *Pike* test requires only that

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[65] *See* Case C-483/99, Comm'n v. France, 2002 E.C.R. I-4781, ¶ 41; Case C-367/98, Comm'n v. Portugal, 2002 ECR I-4731, ¶ 45.

[66] Case C-503/99, Comm'n v. Belgium, 2002 E.C.R. I-4809, ¶ 45; *see also Comm'n v. France*, 2002 E.C.R. I-4781 at ¶ 45; *Comm'n v. Portugal*, 2002 E.C.R. I-4731 at ¶ 49.

[67] Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970); Case C-55/94, Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, 1995 E.C.R. I-04165, ¶ 37.

[68] *Pike*, 397 U.S. at 142; *Gebhard*, 1995 E.C.R. I-04165 at ¶ 37.

[69] *Pike*, 397 U.S. at 142; *Gebhard*, 1995 E.C.R. I-04165 at ¶ 37.

[70] *Pike*, 397 U.S. at 142; *Gebhard*, 1995 E.C.R. I-04165 at ¶ 37.

[71] *Pike*, 397 U.S. at 142.

[72] *Id.*

[73] *Gebhard*, 1995 E.C.R. I-04165 at ¶ 37.

the measure taken be rationally related to the interest pursued.[74] Lackhoff[75] concludes that only when the measure is discriminatory will the Supreme Court ask if the measure is necessary to serve the public interest.[76] In all other cases, the Supreme Court would only question whether the burden imposed on commerce is clearly excessive in relation to the local benefits. However, it is dubious if this is a general rule. First, the *Pike* test only applies to statutes that regulate local public interests even-handedly and thereby excludes direct discriminatory regulations.[77] Furthermore, the division between factual discriminatory measures and purely hindering measures is one of degree.[78] Both the case law of the U.S. Supreme Court and the ECJ demonstrate this. In opposition to the majority of the Supreme Court in *Kassel v. Consolidated Freightways Corp.*, Justice Brennan and Justice Marshall treat the case as "protectionist in nature,"[79] as it is designed to discourage interstate traffic. In European Law, Advocate General Tizziano argues in *SEVIC* in favor of a mere restriction on the Freedom of Establishment.[80] The ECJ, however, qualifies the rules governing an intrastate merger by fusion as being "differen[t] in treatment ... which is likely to deter the exercise of the freedom of establishment."[81]

Nevertheless, the criterion as to whether a local public interest can be promoted with a lesser impact on interstate commerce is less often deployed by the Supreme Court compared to the ECJ, as the U.S. judiciary highly respects the legislative authority of the states.[82]

II. The Treatment of Foreign Companies

In both jurisdictions, states have tried to apply local rules to pseudo-foreign companies, arguing that there is a closer connection of these companies to their jurisdiction.[83] Pseudo-foreign companies are such companies

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[74] Lackhoff, *supra* note 2, at 323; S.C. State Highway Dept. v. Barnwell Bros., Inc., 303 U.S. 177, 191–92 (1937).

[75] Lackhoff, *supra* note 2, at 323–24.

[76] *Id.* at 324.

[77] *Id.* at 323.

[78] Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

[79] Kassel v. Consolidated Freightways Corp., 450 U.S. 662, 664 (1981).

[80] Case C-411/03, Opinion of AG Tizziano in SEVIC Systems AG, 2005 E.C.R. I-10805, ¶¶ 43–51.

[81] Case C-411/03. SEVIC Systems AG, 2005 E.C.R. I-10805, ¶ 22.

[82] *Kassel*, 450 U.S. at 692; Bibb v. Navajo Freight Lines, Inc., 359 U.S. 520, 524 (1959); Raymond Motor Transp., Inc. v. Rice, 434 U.S. 429, 449 (1978).

[83] *See* B.E. Witkin, 9 WITKIN, SUMMARY OF CALIFORNIA LAW, § 239 1005 (10th ed., 2005); CAL. CORP. CODE § 2115 (West 2010); N.Y. BUS. CORP. LAW § 1320 (McKinney 2012); Spector v. Brandriss, 144 Misc. 848, 849 (1932).

which are incorporated in one state, but do all of their business or most of all of their business in another state.[84] In the U.S., in principle, the internal affairs doctrine is applicable, which corresponds to the incorporation doctrine in European terminology.[85] This choice-of-law doctrine provides that the law of the state in which the corporation is incorporated governs the internal affairs of the company.[86] However, laws in California and New York provide for the application of their state law on selected internal affairs to companies incorporated in another state, as long as these companies mainly do business in their territory.[87]

In the EU, two choice-of-law doctrines coexist. The incorporation doctrine provides for the application of the law of the state of incorporation, whereas the real seat doctrine provides for the application of the law of the state in which the head office of the company is situated and the main business decisions are put into practice.[88] The main argument in favor of the real seat doctrine is that the place in which the main business decisions are made is the place in which the main contracting parties and the most important creditors are situated and, therefore, these stakeholders are safeguarded.[89] This, however, creates obstacles to the company's mobility. If the main place of business changes, a different law governs the internal affairs of the company, which can lead to deprivation of legal personality. The ECJ ruled on the treatment of foreign companies under the Freedom of Establishment three times.[90] First, Danish authorities refused to register a branch of an English limited company trying to prevent the circumvention of minimum capital requirements.[91] In the second case, the German version of the real seat doctrine, which leads to denial of legal personality, was held to be in violation of community law.[92] Finally, taking a position similar to that in Section 2115 of the California Corporations Code, the

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[84] Kersting, *supra* note 4, at 1.

[85] *Id.* at 2.

[86] Mark E. Kruse, *California's Statutory Attempt to Regulate Foreign Corporations: Will It Survive the Commerce Clause?*, 16 SAN DIEGO L. REV. 943, 947 (1979).

[87] Compare these provisions with Werner F. Ebke, Centros—*Some Realities and Some Mysteries*, 48 AM. J. COMP. L. 623, 628 (2000).

[88] Group of High Level Company Law Experts, *A Modern Regulatory Framework for Company Law in Europe*, ¶¶ 4–5, *available at* http://ec.europa.eu/internal_market/company/docs/modern/consult_en.pdf.

[89] Werner F. Ebke, *The "Real Seat" Doctrine in the Conflict of Corporate Laws*, 36 INT'L LAW. 1015, 1027–28 (2002).

[90] *See infra* Part II.B.

[91] *See* Case C-212/97, Centros Ltd. v. Erhvervs-og Selskabsstyrelsen, 1999 E.C.R. I-01459, ¶¶ 2, 7.

[92] *See* Case 208/00, Überseering BV v. Nordic Constr. Co. Baumanagement GmbH (NCC), 2002 E.C.R. I-09919, ¶¶ 1–2.

Netherlands applied a law imposing additional requirements on pseudo-foreign companies to the English company Inspire Art Limited.[93] The following section will assess the ability of states to legislate foreign companies under both constitutional frameworks.

A. Foreign Companies Under the Interstate Commerce Clause

It is a commonplace that companies in the U.S. are governed by the internal affairs doctrine.[94] This enables companies to choose their legal forum and choose the most suitable state law to govern their company irrespective of their main place of business.[95] But a closer look at company law in the United States reveals a slightly different picture[96] regarding the choice-of-law in the U.S. Inter alia, Section 2115 of the California Corporations Code led to an ongoing discussion about the treatment of pseudo-foreign companies under the Interstate Commerce Clause.[97] Section 2115 of the California Corporations Code provides that corporations incorporated in another member state are subject to certain internal governance rules if they operate substantially in California.[98] A company operates substantially in California if more than 50% of the average of a corporation's property, payroll, and sales factors are allocated to California *and* more than one-half of its voting securities are held by persons having addresses in California pursuant to the books of the corporation.[99] Foreign companies with outstanding securities listed on a national securities exchange are excluded.[100]

The objective of the law is to "prevent foreign corporations from circumventing Californian law while" their ties to California are stronger than to any other state.[101] Therefore, the provision is applicable even if it is clear from the circumstances of the case that the company does not want to apply the California Corporations Code to its internal affairs.[102] California is not the only state that enacted provisions of special treatment of foreign

[93] *See* Case 167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd, 2003 E.C.R. I-10155 ¶¶ 1–2.

[94] WERLAUFF, *supra* note 5, at 4.

[95] Matt Stevens, *Internal Affairs Doctrine: California Versus Delaware in a Fight for the Right to Regulate Foreign Corporations*, 48 B.C. L. REV. 1047, 1064 (2007).

[96] For an overview of state laws, see generally DeMott, *Perspective on Choice of Law for Corporate Internal Affairs*, 48 LAW & CONTEMP. PROBS. 161 (1985).

[97] Kruse, *supra* note 86, at 946–47.

[98] CAL. CORP. CODE § 2115 (West 2010).

[99] *Id.*

[100] *Id.*

[101] Kruse, *supra* note 86, at 945.

[102] In Western Air Lines, Inc. v. Sobieski, 12 Cal. Rptr. 719, 727–28 (1961), a company reincorporated in Delaware in order to circumvent cumulative voting requirements.

companies and thereby derogated the internal affairs doctrine. Sections 1319 and 1320 of the New York Business Corporation Law (NY BCL) provide that domestic rules, inter alia, on shareholder rights and mergers are applicable to foreign unlisted companies that conduct more than one-half of their business income activities in the State of New York.[103] There has not been a U.S. Supreme Court decision on these statutes, even though the constitutionality under the Interstate Commerce Clause is largely contested.[104] While Californian courts argued that Section 2115 of the California Corporations Code was constitutional under the Interstate Commerce Clause,[105] Delaware's courts refused to apply the Californian law and deemed it in violation of the Interstate Commerce Clause.[106]

In *Ross A. Wilson v. Louisiana-Pacific*,[107] the Court of Appeal of California addressed the issue of the constitutionality of Section 2115 of the California Corporations Code.[108] Ross Wilson sought a declaratory judgment that Louisiana-Pacific Resources, Inc., a company incorporated in Utah, fulfilled the qualification of a pseudo-foreign company under the California Corporations Code and therefore cumulative voting was mandatory.[109] Except for being incorporated in Utah, the corporation had no business connection with Utah.[110] The principle place of business has been in California since 1971, the meetings of shareholders and directors took place in California, and all employees and all bank accounts have been in California.[111] After declaring that the Californian law was constitutional under the Full Faith and Credit Clause, the Court turned to the Interstate Commerce Clause.[112] The balancing test, as established in *Pike v. Bruce Church, Inc.*, is stated as the relevant standard under the Commerce Clause.[113] The Court found that the Californian statute regulates evenhandedly as it applies the same rules, which apply to corporations domiciled in California, to pseudo-foreign corporations.[114] The Court denied

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[103] N.Y. BUS. CORP. LAW §§ 1319, 1320 (McKinney 2012).

[104] *See* J. Thomas Oldham, *Regulating the Regulators: Limitations upon a State´s Ability to Regulate Corporations with Multi-State Contacts*, 57 DENV. L.J. 345, 368–70 (1980); DeMott, *supra* note 96, at 183–85, 197; Kruse, *supra* note 86; *infra* note 127.

[105] Wilson v. Louisiana-Pacific Res., Inc., 187 Cal. Rptr. 852, 861 (1982).

[106] *See* VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108, 1116 (Del. 2005).

[107] *Wilson*, 187 Cal. Rptr. at 852.

[108] *Id.* at 854.

[109] *Id.* at 855.

[110] *Id.*

[111] *Id.*

[112] *Id.* at 858.

[113] *Wilson*, 187 Cal. Rptr. at 858–59.

[114] *Id.*

that the law placed undue burdens on interstate commerce.[115] It would deter corporations from reincorporating elsewhere "for the purpose of avoiding California's protective corporate legislation, and thus to diminish the practice of 'charter-mongering' among states."[116] This would not contradict the Commerce Clause.[117] Furthermore, there was no direct evidence that Section 2115 of California Corporation Code caused foreign companies to reduce property, payroll, and sales in California.[118] Thus, the law would not have the purpose of deterring foreign corporations from doing business in California. Addressing the question of whether the law places undue burdens on interstate commerce by creating legal uncertainty, the Court held that the Californian law would minimize uncertainty, since "[a] corporation can do a majority of its business in only one state at a time."[119] The potential for conflicting regulations applying to the same company would be "speculative and without substance."[120] The Court did not consider the public interest requirements and their proportionality but concluded that the effects on interstate commerce were "incidental, and minimal in relation to the purpose which that requirement is designed to achieve."[121]

In contrast to the Californian courts, Delawarean courts repeatedly held that the internal affairs doctrine would be mandated by the Interstate Commerce Clause.[122] Consequently, in *McDermott Inc. v. Harry Lewis and Nina Altmann*,[123] the Supreme Court of Delaware held the Panamanian law to be applicable to a company incorporated in Panama.[124] The issue in the case was that Panamanian law allowed cross voting of shares between parent companies and their subsidiaries.[125] However, this did not cause the Delaware Supreme Court to derogate from the internal affairs doctrine, since its application would be not only a question of conflict of laws, but also one of "serious constitutional proportions."[126] The Court relied heavily on the U.S. Supreme Court case *CTS Corp. v. Dynamics Corp. of America*,[127] which did not, however, involve the treatment of foreign companies by the

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[115] *Id.*
[116] *Id.*
[117] *Id.* at 859.
[118] *Id.*
[119] *Wilson*, 187 Cal. Rptr. at 860.
[120] *Id.*
[121] *Id.* at 861.
[122] McDermott Inc. v. Lewis, 531 A.2d 206, 216 (Del. 1986).
[123] *Id.* at 219.
[124] *Id.*
[125] *Id.* at 209.
[126] *Id.* at 216.
[127] CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987).

internal affairs doctrine, but the discretion of states to govern domestic corporations.[128] Nevertheless, the Delaware Supreme Court derived from this case that "the internal affairs doctrine is mandated by constitutional principles except in 'the rarest situations.'"[129]

In the case *VantagePoint Venture Partners 1996 v. Examen, Inc.*,[130] the Delaware Supreme Court held that the internal affairs doctrine is comprehensively safeguarded as a constitutional principle.[131] VantagePoint, a venture capital firm, was a majority shareholder of a preferred class of shares of Examen, Inc., a company incorporated in Delaware.[132] Examen, Inc. planned to merge with Reed Elsevier.[133] If there had been a class vote, as mandated by Californian law, VantagePoint would have been able to block the merger.[134] Therefore, VantagePoint argued that pursuant to Section 2115 of the California Corporation Code, Californian law would apply.[135] Both the Delaware Chancery Court and the Supreme Court of Delaware, however, applied the internal affairs doctrine with the result that Delawarean law was applicable.[136] In its decision, the Supreme Court of Delaware argued that the internal affairs doctrine is mandated by constitutional principles such as the Due Process Clause and the Interstate Commerce Clause.[137] Under the Commerce Clause, the court held, a state had no interest in regulating the internal affairs of foreign corporations.[138]

The issue of whether the laws on pseudo-foreign companies are constitutional under the Commerce Clause is just as unresolved in legal debate. Stevens[139] has criticized *VantagePoint*, arguing that the Delaware Supreme Court misinterpreted the U.S. Supreme Court's case law.[140] Kruse[141] and DeMott[142] have argued that Section 2115 of the California Corporate Code violates the dormant Interstate Commerce Clause. They argue that the rule would place undue burdens on the free flow of interstate commerce, as

[128] *McDermott*, at 217 n.12.
[129] *Id.* at 217.
[130] *VantagePoint*, 871 A.2d 1108, 1113 (Del. 2005).
[131] *Id.*
[132] *Id.* at 1110–11.
[133] *Id.* at 1111.
[134] *Id.*
[135] *Id.* at 1112.
[136] *VantagePoint*, 871 A.2d at 1115.
[137] *Id.* at 1116.
[138] *Id.*
[139] *See* Stevens, *supra* note 95, at 1086.
[140] *See id.*
[141] Kruse, *supra* note 86, at 954.
[142] DeMott, *supra* note 96, at 186.

uniformity of corporate internal affairs would be necessary to ensure certainty in the companies' dealings.[143] The Californian law would leave a company in an unstable situation since its applicability would depend on the annual statements.[144] Furthermore, Section 2115 of California Corporate Code would not regulate companies even-handedly since it excluded listed corporations.[145] DeMott points out that the application of Californian law in itself does not constitute a public interest, at least in those cases, as significant business by the company is allocated outside the state of California.[146] Kruse[147] acknowledges that the Californian law safeguards public welfare interests, but argues that no special creditor protection is needed as creditors usually can protect themselves in arm's-length transactions.[148] Regarding the protection of minority shareholders, such as in mandatory cumulative voting, the law would be excessive, as other states would view one share-one vote rules as sufficient in order to protect minorities.[149]

Oldham[150] argued, on the contrary, that laws on pseudo-foreign companies were constitutional under the Interstate Commerce Clause, as long as legal certainty was safeguarded in the long run.[151] Even though these laws would create a burden on interstate commerce, they would be justified under the balancing test. The states would have a public policy interest in protecting creditors and resident shareholders from fraudulent or unfair practices. The laws on foreign companies would promote these interests.[152] Furthermore, there would be no less burdensome alternative to pseudo-foreign corporation laws.[153]

In sum, the question of whether the internal affairs doctrine is a constitutional principle mandated, inter alia, by the dormant Interstate Commerce Clause remains unresolved in the U.S. While the Delaware Supreme Court does not apply the Californian rule on foreign companies, arguing it is unconstitutional under the Commerce Clause, the Californian courts apply Californian law to Delawarean companies.[154] The fear that this will lead to a

143 *See* Kruse, *supra* note 86, at 956; DeMott, *supra* note 96, at 189.
144 *See* Kruse, *supra* note 86, at 956; DeMott, *supra* note 96, at 189.
145 *See* Kruse, *supra* note 86, at 962.
146 *See* DeMott, *supra* note 96, at 190.
147 Kruse, *supra* note 86, at 954–55.
148 *See id.*
149 *See id.* at 955.
150 Oldham, *supra* note 104, at 346.
151 *See id.*
152 *See id.* at 375.
153 *See id.* at 377.
154 Stevens, *supra* note 139, at 1049–50, 1061, 1069.

"race[] to the courthouse[s]" in crucial cases seems to be well founded.[155] However, it must be remembered that both laws have existed in New York and California for several decades and, so far, no profound signs can be found that they are impeding interstate commerce.[156] Moreover, the mere fact that the constitutional question remained unresolved for so long even though the legal arguments are obvious shows that the rules in question play a minor role in practice. The reason is that small companies have little incentive to incorporate in a state in which they do no business.[157] The mandatory internal governance rules do not seem to offer incentives for incorporation in another state.

B. Foreign Companies and the Freedom of Establishment

The American debate about the constitutionality of rules on foreign companies finds its European counterpart in the discussion around the ECJ's decisions in *Centros*, *Überseering*, and *Inspire Art*. Here, the ECJ held that restrictions on foreign companies were inapplicable under the Freedom of Establishment. In *Centros*,[158] the ECJ held that a Member State cannot refuse to register a branch of a company formed in accordance with the law of another Member State, even if it was obvious from the facts of the case that the company was formed in order to circumvent minimum capital requirements.[159] Centros Limited, a private limited company registered in England and Wales, wanted to register a branch in Denmark.[160] The Danish authorities refused to register the branch, arguing that Centros was in fact seeking to establish a principal establishment in Denmark, since it does not trade in the UK.[161] In the proceedings, the founders and shareholders of the company did not deny that the purpose of the formation of the company under English law was to avoid Danish legislation requiring that a minimum capital be paid up.[162] The ECJ decided

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155 *See* Andy G. Olree, *Delaware's* VantagePoint*: The Empire Strikes Back in the Post-Post-Enron Era*, 102 NW. U. L. REV. 91, 135 (2008).

156 *See* Jason S. Haller, Comment, *The Constitutionality of Outreach Statutes Under the Dormant Commerce Clause*, 37 SETON HALL L. REV. 597, 606, 620 (2007).

157 *See* Nellie Akalp, *Where Is the Best State to Incorporate Your Business?*, SMALLBUSINESS TRENDS (June 23, 2011), *available at* http://smallbiztrends.com/2011/06/best-state-incorporate-business.html.

158 Case C-212/97, Centros Ltd. v. Erhversus-og Selkabssyrelsen, 1999 E.C.R. I-1459 at I-1497.

159 *Id.*

160 *Id.* ¶ 2.

161 *Id.* ¶ 7.

162 *Id.* ¶ 39.

that it violated the Freedom of Establishment to refuse to register a branch of a company formed in accordance with the law of another Member State in which it was registered, even if it conducted no business in the state of registration.[163] The refusal of registration constituted an obstacle to the exercise of the Freedom of Establishment.[164] Most importantly, according to the court, the circumvention of the minimum capital requirements did not constitute an abuse of European law.[165] Instead, the Court stated, "the fact that a national of a Member State who wishes to set up a company chooses to form it in the Member State whose rules of company law seem to him the least restrictive ... cannot, in itself, constitute an abuse of the right of establishment."[166] This statement is seen as the signal for regulatory competition in European company law, which would lead to a "Delaware Effect."[167]

Unlike in the EU, in the U.S. a right to choose the most suitable regulatory framework is not seen as a right granted by the Interstate Commerce Clause.[168] In contrast to *Centros*, the Court of Appeal of California states in *Ross Wilson v. Louisiana-Pacific Resources, Inc.*[169] that reducing the "practice of 'charter-mongering'" among states is not offending the policies of the Commerce Clause.[170]

Furthermore, in *Centros* the refusal to register the branch because it did not pursue any business in England was held to be disproportional and could therefore not be justified by mandatory requirements of public interest, such as to safeguard the interests of creditors.[171] The measure was held to be unsuitable for protecting creditors, because creditors would not be more protected if the company pursued business in England.[172] Secondly, creditors would be on notice that Centros Limited was a company governed by English law.[173] According to the ECJ, there are less restrictive measures to protect creditors than refusing the registration of the branch; for example, it could be made "possible in law for public creditors to obtain the necessary guarantees."[174] These last arguments are in line with the

[163] *Id.* ¶ 19.
[164] *Centros*, 1999 E.C.R. I-1459 at ¶ 19.
[165] *Id.* ¶ 30.
[166] *Id.* ¶ 27.
[167] *See* Grundmann, *supra* note 64, at ¶ 99.
[168] Wilson v. Louisiana-Pacific Resources, Inc., 187 Cal. Rptr. 852, 858 (Cal. Ct. App. 1982).
[169] *Id.*
[170] *Id.* at 859.
[171] *Centros*, 1999 E.C.R. I-1459 at ¶ 35.
[172] *Id.*
[173] *Id.* ¶ 36.
[174] *Id.* ¶ 37.

argument put forward by Kruse, in relation to the Californian Corporate Code, that creditors can protect themselves in arm's-length transactions.[175]

Finally, according to the ECJ, the refusal to register a branch is held to be an excessive measure in order to combat fraud. A member state could adopt appropriate measures where the attempt of fraudulent behavior has been established in fact.[176] In *Überseering*, the ECJ applied the reasoning of *Centros* to the primary Freedom of Establishment.[177] Here, the real seat doctrine was contested.[178] The proceedings involved a company registered in the Netherlands, Überseering BV, which pursued business in Germany.[179] According to the real seat doctrine, which is applicable in Germany, the law of the state in which the economic decisions are put into practice and the company's actual center of administration is located determines the legal capacity of a company.[180] The German courts found that the company's center of administration was in Germany and that the company lacked legal capacity since it was not registered in Germany and did not fulfill the conditions of German company law.[181] The ECJ distinguishes between inbound situations, in which a company formed and registered under the law of one Member State sees its right of establishment infringed by the law of the host Member State, and outbound situations, in which a company formed and registered under the law of one Member State sees its rights of establishment infringed by the law of the state in which it was founded.[182] Accordingly, the ECJ held that the

> refusal by a host Member State ("B") to recognise the legal capacity of a company formed in accordance with the law of another Member State ("A") in which it has its registered office on the ground ... that the company moved its actual centre of administration to Member State B ... constitutes a restriction on freedom of establishment ....[183]

This statement rendered the real seat doctrine inapplicable to European companies in inbound situations.

The ECJ is tight-lipped when it comes to the question of whether the real seat doctrine could be justified by mandatory requirements. "[T]he

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[175] *See* Kruse, *supra* note 86, at 955.

[176] *Centros*, 1999 E.C.R. I-1459 at ¶ 38.

[177] Case C-208/00, Überseering BV v. Nordic Constr. Co. Baumanagement GmbH, 2002 E.C.R. I-9919, ¶ 58.

[178] *Id.* ¶ 22.

[179] *Id.* ¶ 2.

[180] *Id.* ¶ 4.

[181] *Id.* ¶ 9.

[182] *Id.* ¶ 65.

[183] *Überseering*, 2002 E.C.R. I-9919 at ¶ 82.

protection of the interests of creditors, minority shareholders, employees and even the taxation authorities, may, in certain circumstances and subject to certain conditions, justify restrictions on freedom of establishment."[184] However, none of these objectives could justify the denial of legal capacity in a host Member State.[185] "Such a measure is tantamount to an outright negation of the freedom of establishment."[186] On a national level, the courts of jurisdictions that apply the real seat doctrine have reacted by applying the incorporation doctrine in relation to foreign companies from other EU Member States.[187]

The situation in *Centros* and *Überseering* is significantly different from the situation concerning the laws on pseudo-foreign companies in the U.S. In *Centros* and *Überseering*, the states barred foreign companies completely from their territory so long as they would not incorporate according to local law.[188] A situation more comparable with the laws on foreign companies is the situation the ECJ had to deal with in *Inspire Art*.

Inspire Art, a private limited company by shares, was formed under English law and registered in the United Kingdom.[189] The Dutch authorities applied a law on formally foreign companies (wet op de formeel buitenlandse venootschappen—WFBV) and required registration as a formally foreign company and compliance with minimum share capital requirements.[190]

> Article 1 of the WFBV defines a "formally foreign company" as "a capital company formed under laws other than those of the Netherlands and having legal personality, which carries on its activities entirely or almost entirely in the Netherlands and also does not have any real connection with the State within which the law under which the company was formed applies."[191]

Netherland had argued that these companies "are fully recognised ... and are not refused registration," but have to comply solely with a number of additional obligations.[192]

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[184] *Id.* ¶ 92.
[185] *Id.* ¶ 93.
[186] *Id.*
[187] *See Überseering* main proceedings: BGH VII ZR 370/98 Neue Juristische Wochenschrift 2003, 1461.
[188] *See Überseering*, 2002 E.C.R. I-9919 at ¶ 95; Case C-212/97, Centros Ltd. v. Erhversus-og Selkabssyrelsen, 1999 E.C.R. I-1459 at I-1497.
[189] *See* Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd., 2003 S.L.G. I-10155, ¶ 34.
[190] *Id.* ¶ 23.
[191] *Id.* ¶ 22.
[192] *Id.* ¶ 99.

The ECJ had to decide if this law violated the Freedom of Establishment. The ECJ held that the Dutch law on formally foreign companies "has the effect of impeding the exercise ... of the freedom of establishment."[193] As far as the mandatory public interest of creditor protection being a possible justification, the ECJ repeated that "potential creditors are put on sufficient notice" that the company is not governed by Dutch law but by English law.[194] A Member State would be entitled to prevent improper or fraudulent exercise of the Freedom of Establishment.[195] This, however, would not be the case in the situations envisaged by the "WFBV."[196]

C. Comparative Conclusions

Even though there are strong similarities between the cases decided by the ECJ and those by the U.S. Supreme Court, the issues differ. The cases decided by the ECJ involved either the total denial of legal personality as in *Überseering* or the creditor protection by minimum capital requirements.[197] The laws of California and New York in contrast are more concerned with the protection of minority shareholders rights by specific local governance rules, which seem to have less disruptive effects on the common market.[198] Secondly, in *Inspire Art*, the Dutch authorities forced Inspire Art to comply with the rules in order to keep on pursuing business in the Netherlands and thereby created a market entry barrier.[199] The laws on foreign companies in the U.S. simply apply local law in disputes between shareholders.[200] On another level, the laws on foreign companies in the U.S. states are broader in scope than the European laws under consideration by the ECJ. The European case law involved companies that pursued no business at all in the state of incorporation and almost all of their business in the host Member State.[201] The laws on foreign companies in California and New York apply to situations in which the contact of the company with the state of incorporation includes real economic existence.[202] In sum, the ECJ takes a stricter stand in comparison to the legal discussion in the

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[193] *Id.* ¶ 101.
[194] *Inspire Art*, 2003 S.L.G. I-10155, at ¶ 135.
[195] *Id.* ¶ 136.
[196] *Id.* ¶ 140.
[197] *See* Case C-208/00, Überseering BV v. Nordic Constr. Co. Baumanagement GmbH, 2002 E.C.R. I-9919, ¶ 9.
[198] DeMott, *supra* note 96, at 164.
[199] *Inspire Art*, 2003 S.L.G. I-10155 at ¶ 101.
[200] DeMott, *supra* note 96, at 167.
[201] *See, e.g.*, *Inspire Art*, 2003 S.L.G. I-10155 at ¶ 22.
[202] DeMott, *supra* note 96, at 166–67.

U.S. The ECJ upholds high standards when it comes to proportionality but leaves some scope for rules preventing fraud and protecting creditors and shareholders, as the protection of their interests are recognized as mandatory requirements of public interests.[203] However, this scope has so far played no role in legal discussions, as the European case law led to the unlimited application of the incorporation doctrine in inbound cases at Member State level.[204] Whereas the ECJ focuses on the question of proportionality, the discussion in the U.S. is focused on the deterring effects of legal uncertainty arising from the application of the rules on foreign companies by the host state.[205] Thus, the discussion in the U.S. is concerned with the scope and limits of intervention by the host state when it comes to foreign companies, while the European discussion seems decided in favor of the unlimited application of the incorporation doctrine.

III. LIMITS ON STATE POWER TO REGULATE DOMESTIC COMPANIES

While the last section dealt with the treatment of foreign companies in states different from their state of incorporation, the following section will focus on the constitutional limits on the states' ability to regulate companies incorporated under domestic law.

In this regard, both the ECJ and the U.S. Supreme Court emphasize that companies are creatures of the law and that they only exist by virtue of the sovereignty by which they are created and that thereby determine their functioning.[206] This argument is used in both jurisdictions to broaden significantly the states' discretion in regulating companies. The U.S. Supreme Court thereby gave the states significant scope to enact laws that have prohibiting effects on take-overs.[207] The ECJ on the other hand gave Member States the right to require from companies that they keep their head office and the place of registration in the same place.[208] Two lines of comparison can be drawn. Firstly, the use of the creature argument under the outbound Freedom of Establishment is compared to the U.S. case law. Secondly, it can be questioned

[203] WERLAUFF, *supra* note 5, at 23.
[204] *Id.*
[205] DeMott, *supra* note 96, at 189.
[206] CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69, 90 (1987); Bank of Augusta v. Earle, 38 U.S. (1 Pet.) 519, 588 (1839); Tr. of Dartmouth Coll. v. Woodward 17 U.S. (1 Wheat.) 518, 562 (1819); Case C-81/87, The Queen v. Treasury & Comm'rs of Inland Revenue, Ex Parte Daily Mail & Gen. Trust P.L.C. 1988 E.C.R. I-5505,¶ 19; Case C-210/06, Cartesio Okató és Szolgáltató Bt., 2008 E.C.R. I-9641, ¶ 104.
[207] *Bank of Augusta*, 38 U.S. (1 Pet.) at 535.
[208] *See Daily Mail*, 1988 E.C.R. I-5505 at ¶ 20.

if the ECJ would come to the same conclusions as the Supreme Court in respect to the Freedom of Capital and Establishment, when it comes to possible restrictions of foreign investors' access to capital markets.[209]

A. Domestic Companies and the Interstate Commerce Clause

Two cases of the U.S. Supreme Court are central when it comes to states' discretion to regulate domestic companies under the Commerce Clause. Firstly, in *Edgar v. MITE Corp.*, the Illinois Business Take-Over Act was declared invalid under the Commerce Clause.[210] Second, in *CTS v. Dynamics Corp. of America*, significant discretion was given to the states.[211] Both state laws in question included provisions, which had deterring effects on take-overs and share acquisitions.[212] In *Edgar v. MITE Corp.*,[213] the Illinois Business Take-Over Act required the tender offeror to notify the Secretary of State and the target company, but not the shareholders of the target company of its intended offer, twenty days before the offer became effective. In that way the management of the target company could inform its shareholders about the offer, without the interference of the offeror.[214]

The rule should apply not only to target companies incorporated in Illinois, but also to companies of which shareholders from Illinois own 10% of the class of securities subject to the take-over offer, have their principal office in Illinois, or have at least 10% of their state's capital represented in the state.[215] The law therefore regulated foreign companies as well. However, the regulation on foreign companies was not the decisive reason for the U.S. Supreme Court declaring the rule invalid under the Commerce Clause.

Instead, the Court held the Illinois Act was already invalid, since it directly regulated interstate commerce.[216] Since the transactions of shares in a take-over normally take place across state lines or even wholly outside the State of Illinois, and the Act would apply even if not a single shareholder were a resident of Illinois, the Act constituted a direct restraint on interstate commerce.[217] Additionally, the invalidation under the *Pike* test did not rely heavily on the reasoning that the Act regulated foreign companies.[218] Rather,

[209] Grundmann, *supra* note 64, at ¶ 670.
[210] Edgar v. MITE Corp., 457 U.S 624, 640 (1982).
[211] *CTS Corp.*, 481 U.S. at 88.
[212] *See Edgar*, 457 U.S at 644; *CTS Corp*., 481 U.S. 69.
[213] *Edgar*, 457 U.S. at 624.
[214] *Id.*
[215] *Id.*
[216] *Id.* at 640.
[217] *Id.* at 642.
[218] *Id.* at 643.

the Supreme Court used this as a counter-argument to the alleged interest in regulating companies incorporated in Illinois.[219] The Court rejected the argument that Illinois has an interest in regulating the internal affairs of a corporation incorporated under its law by stating that this would be "somewhat incredible, since the Illinois Act applies to tender offers for any corporation for which 10% of the outstanding shares are held by Illinois residents."[220] Illinois would not have an "interest in regulating the internal affairs of foreign corporations."[221]

The Court stressed the burdens on interstate commerce created by the power of the Illinois Secretary of State to block a nationwide tender offer.[222] "The reallocation of economic resources to their highest valued use, a process which can improve efficiency and competition, is hindered."[223] The Court then goes on to reason that the rule was excessive in two aspects, of which only one was the effect on foreign companies.[224] The other was that the Court was unconvinced that the Act enhanced the position of the shareholders;[225] the Court, therefore, did not accept there was a legitimate interest of resident shareholder protection.

In *CTS v. Dynamics Corp. of America*, the U.S. Supreme Court held that a state has no interest in protecting non-resident shareholders of non-resident companies, but rejected that a state has no interest in providing for shareholder rights in domestic corporations.[226] Thus, the U.S. Supreme Court itself narrowed the interpretation of *Edgar v. MITE Corp.* to the decisive argument that the Illinois Act regulated foreign companies as well as Illinois companies.[227] *CTS v. Dynamics Corp. of America*[228] dealt with Chapter 42 of the Indiana Business Corporation Law (BCL), which applies to corporations that are incorporated in Indiana,[229] and which have specified levels of shareholders within Indiana,[230] and have not opted out of the chapter.[231] This law provides that the acquisition of shares above a specific threshold (control shares) does not confer voting rights unless a

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[219] *Edgar*, 457 U.S. at 644.
[220] *Id.* at 645.
[221] *Id.* at 646.
[222] *Id.* at 643.
[223] *Id.* at 643.
[224] *Id.* at 644.
[225] *Edgar*, 457 U.S. at 644.
[226] CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69, 93 (1987).
[227] *Id.*
[228] *Id.* at 72.
[229] IND. CODE ANN. § 23-1-17-3 (West 2010).
[230] IND. CODE ANN. § 23-1-42-4 (West 2009).
[231] IND. CODE ANN. § 23-1-42-5 (West 1986).

majority of all pre-existing disinterested shareholders so agree at the next regularly scheduled meeting. The thresholds are 1/5, 1/3, and 1/2 of the voting shares.[232] Dynamics Corp. of America tried to increase their shareholding in CTS, which was subject to Chapter 42 of Indiana BCL, from 9.6% to 27.5%, by announcing a tender offer.[233] Holding that Chapter 42 was not pre-empted by the Williams Act, the Supreme Court addressed the question of whether the Chapter violates the Interstate Commerce Clause.[234] Thereby, the Court first of all denied there were any discriminatory effects of the Chapter.[235] The Court rejected the position that the rule discriminates against interstate commerce, as "nothing in the Indiana Act imposes a greater burden on out-of-state offerors than it does on similarly situated Indiana offerors."[236] Furthermore, the law would not create undue burdens on interstate commerce.[237] Since "[a] corporation is an artificial being, invisible, intangible, and existing only in contemplation of law ... it possesses only those properties which the charter of its creation confers upon it."[238] Therefore, Indiana would have the authority to regulate domestic corporations, including the authority to define the voting rights of shareholders.[239] The Court recognized the need for a liquid capital market and the ability of companies to draw foreign companies to them.[240] However, "[t]his beneficial free market system depends ... upon the fact that a corporation—except in the rarest situations—is organized under, and governed by, the law of a single jurisdiction, traditionally the corporate law of the State of its incorporation."[241] It is "an accepted part of the business landscape ... for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares."[242] The Court's reasoning was based upon the tremendous trust reposed in the states as the creators of companies.[243] According to this reasoning, interstate commerce of shares takes place within the framework established by state law to regulate companies.[244] Therefore, the hampering effects the rule has on tender offers and, thereby, on take-overs in general do not stand in contrast to the

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[232] IND. CODE ANN. § 23-1-42-1 (West 1986).
[233] *CTS Corp.*, 481 U.S. at 75.
[234] *Id.* at 87.
[235] *Id.*
[236] *Id.* at 88.
[237] *Id.*
[238] Tr. of Dartmouth Coll. v. Woodward, 17 U.S. (1 Wheat.) at 636.
[239] *CTS Corp.*, 481 U.S. at 89.
[240] *Id.* at 90.
[241] *Id.*
[242] *Id.* at 91.
[243] *Id.*
[244] *Id.*

Interstate Commerce Clause.[245] "[T]he very commodity that is traded in the 'market for corporate control'—the corporation—is one that owes its existence and attributes to state law."[246] The U.S. Supreme Court does not see it as its task to liberalize the market in this respect. Instead, it is stressed that "[t]he Constitution does not require the States to subscribe to any particular economic theory"[247] and that the Court is "not inclined 'to second-guess the empirical judgments of lawmakers.'"[248] The Supreme Court thereby gives states an almost unlimited discretion to regulate companies which are incorporated in their state.[249]

The decision correlates to the earlier decision to exclude companies from the Privileges and Immunities Clause.[250] In both situations, the Court relies heavily on the argument that corporations are creatures of local law and, therefore, have only the rights given to them by the law as its creator.[251] Accordingly, shareholders do not have a natural right of voting power in a company, just as a company has only the rights which are given to it by the state's legislation.[252] Even more remarkable is that the U.S. Supreme Court did not address the fact that companies under Chapter 42-5 of the Indiana BCL could opt out of the provisions.[253] The Court could have reasoned that the burdens on the foreign shareholder in the Indiana Corporation could be regarded as having been imposed, not by the state, but by the shareholders of the corporation. The application of the Commerce Clause would then be limited to mandatory state law.

B. Domestic Companies and EU Freedoms

Constraints on the power of Member States to regulate domestic companies under the legal framework of the EU are a result of the outbound Freedom of Establishment and the Freedom of Capital.[254] Both freedoms

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245 *CTS Corp.*, 481 U.S. at 93.

246 *Id.* at 94.

247 *Id.* at 92.

248 *Id.*

249 An overview of state legislation is provided in Martin Lipton and Morris Panner, *Takeover Bids and United States Corporate Governance*, in CONTEMPORARY ISSUES IN CORPORATE GOVERNANCE 122, 127 (D. D. Prentice & P. R. J. Holland, eds., 1993).

250 *See* Paul v. Virginia, 75 U.S. 168, 168 (1869); Bank of Augusta v. Earle, 38 U.S. 519, 586 (1839).

251 *Compare Paul*, 75 U.S. 168, *and Bank of Augusta*, 38 U.S. at 586, *with CTS Corp.*, 481 U.S. at 71.

252 *See generally CTS Corp.*, 481 U.S. 69.

253 *Id.*

254 *See, e.g.*, Case 81/87, The Queen v. H.M. Treasury and Comm'rs, ex parte Daily Mail and Gen. Trust Plc., 1988 E.C.R. 5483 ¶¶ 19–21.

give rise to comparison between the described case law of the U.S. Supreme Court and the judgments of the ECJ. In *Cartesio*, the ECJ restated the argument already used in *Daily Mail*, that companies are "creatures of national law," in order to give Member States the discretion to require companies formed under local law to keep their head office at the place of registration.[255] It is questionable, however, whether the creature argument works in a similar manner in the constitutional framework of the United States and the European Union. Further, it has to be questioned if the Freedom of Capital and Establishment prevent states from creating barriers to the market for corporate control, which are allowed under the *CTS Corporation* case law in the U.S.[256] The European framework would then be considerably more market integrating than would the U.S. framework.

1. The Creature Doctrine in European Law

The argument that, unlike natural persons, companies are creatures of the law can be found not only in the U.S. constitutional decisions on state company law, but in the legal doctrine of the Freedom of Establishment in one of the early cases of the ECJ on that matter.[257] Neglected and disdained in the decade after the *Centros* decision, the argument found a great renaissance in *Cartesio*.[258] Both decisions touch on the issue of the relationship between Freedom of Establishment and choice-of-law doctrines in outbound situations.[259]

In *Daily Mail*, a public limited company incorporated in England transferred its head office to the Netherlands, which did not result in a loss of legal personality.[260] However, English law requires the application of the tax regime of the place where the company's central management is located.[261] Yet, the UK Treasury would not accept the movement of the head office, proposing that Daily Mail should at least pay a part of the taxes to the British authorities.[262] The ECJ, while acknowledging an outbound Freedom of Establishment for companies in principal, nevertheless concluded that the measures in question imposed no restriction on the outbound Freedom of Establishment of companies.[263] The Court stressed that

[255] Case C-210/06, Cartesio Oktató és Szolgáltató Bt., 2008 E.C.R. I-9641 at ¶ 104.
[256] *See CTS Corp.*, 481 U.S. at 94.
[257] *Daily Mail*, 1988 E.C.R. 5483 at ¶ 19.
[258] *Cartesio*, 2008 E.C.R. I-9641 at ¶ 104.
[259] *See* Case C-212/97, Centros Ltd. v. Erhversus-og Selkabssyrelsen, 1999 E.C.R. I-1459, at ¶ 18; *Cartesio*, 2008 E.C.R. I-9641 at ¶ 109.
[260] *Daily Mail*, 1988 E.C.R. 5483 at ¶ 3.
[261] *Id.* ¶ 4.
[262] *Id.* ¶ 8.
[263] *Id.* ¶ 18.

the consent of the Treasury is only needed when a company transfers its central management out of the United Kingdom while maintaining its status as an English company.[264] "In that regard it should be borne in mind that, unlike natural persons, companies are creatures of the law and, in the present state of Community law, creatures of national law. They exist only by virtue of the varying national legislation which determines their incorporation and functioning."[265] By referring to the different rules of the Member States concerning the movement of the head office, the ECJ gave Member States the right to restrict the movement of the head office in situations where companies are and want to remain governed by the law of their home jurisdiction.[266]

It remained unclear, however, if the real seat doctrine had similarly been excluded from the scope of the outbound Freedom of Establishment.[267] In its extreme manifestation, the real seat doctrine leads to the dissolution of the company if the head office is moved to another real seat jurisdiction.[268] Therefore, Advocate General Maduro, in his opinion in *Cartesio*, argued that the real seat doctrine should be found inapplicable under the outbound Freedom of Establishment.[269] The ECJ, however, did not follow his opinion.[270] *Cartesio* dealt with a company formed under Hungarian law, which transferred its head office to Gallarate, Italy.[271] Following the real seat doctrine, Hungarian law prohibited a company incorporated in Hungary from transferring its head office abroad while continuing to be subject to Hungarian law as its personal law.[272] The Court governing the commercial register therefore rejected the motion to enter Gallarate as the new location of the head office.[273] "[S]uch a transfer of [the head office] would require first, that the company cease to exist and, then, that the company re-incorporate itself in compliance with the law of the country where it wishes to establish its

[264] *Id.*

[265] *Id.* ¶ 19.

[266] *Daily Mail*, 1988 E.C.R. 5483 at ¶ 20. Also take regard to the yet hardly discussed similar ruling of the ECJ in C-371/10 National Grid Indus BV vs. Inspecteur von de Belastingdienst Rijnmond / kantoor Rotterdam at 25. Here the court seems to take an opposite stand.

[267] *See* WINTER ET AL., REPORT OF THE HIGH LEVEL GROUP OF COMPANY LAW EXPERTS 102 (Nov. 4, 2002).

[268] *Id.*

[269] Case C-210/06, Opinion of AG Maduro in Cartesio Okató és Szolgáltató Bt., 2008 E.C.R. I-9641 at ¶ 30.

[270] *Cartesio*, 2008 E.C.R. I-9641.

[271] *Id.* ¶ 2.

[272] *Id.* ¶ 24.

[273] *Id.*

new seat."[274] The ECJ addressed this issue, repeating its statement made in *Daily Mail*: "[C]ompanies are creatures of national law and exist only by virtue of the national legislation which determines their incorporation and functioning."[275] In accordance, the Member States have the right to define the connecting factors that make the legal entity a company under the law of the Member State.[276] The definition of the legal entities as companies, which enjoy the Freedom of Establishment, is therefore a "preliminary matter which ... can only be resolved by the applicable national law."[277] It is thus national law, which defines under what conditions a company is "formed in accordance with the law of a Member State" (Article 54 (1) TFEU).[278] This includes the power of a Member State to prohibit a company formed under local law from moving its head office abroad.[279] The ECJ recognizes in return the right of a company to convert itself, "without prior winding-up or liquidation," into a company governed by another law.[280] In this respect, European company law is approaching the situation found in the U.S. The states have large defining powers; however, companies enjoy the possibility of reincorporating in another state.[281]

2. Comparative Conclusions

Firstly, one has to note a paradox: the reasoning used in the American legal discussion to explain the internal affairs doctrine is used by the ECJ to justify the existence of the real seat doctrine under the Freedom of Establishment.[282] Secondly, as pointed out earlier, in the American context the creature argument can rely on a consistent distinction between natural persons and companies.[283] Companies under the constitutional framework of the U.S. are treated unlike natural persons, as they cannot rely on the

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[274] Press Release, Eur. Ct of Just., Judgment of the Court of Justice in Case C-210 /06 (Dec. 16, 2008), *available at* http://curia.europa.eu/en/actu/communiques/cp08/aff/cp 080089en.pdf.

[275] *Cartesio*, 2008 E.C.R. I-9641 at ¶ 104 (citing Case C-81/87, The Queen v. H.M. Treasury and Comm'rs, ex parte Daily Mail and Gen. Trust Plc., 1988 E.C.R. 5483 at ¶ 19).

[276] *Id.* ¶ 110.

[277] *Id.* ¶ 109.

[278] SCHÖN *supra* note 42, at 133.

[279] Case C-210/06, *Cartesio*, at ¶ 110.

[280] *Id.* ¶ 113.

[281] Toste Farm Corp. v. Hadbury, Inc., 882 F. Supp. 240, 245 (D.R.I. 1995), *aff'd*, 70 F.3d 640 (1st Cir. 1995). Also take regard to the recent Case ECJ, C-378/10, VALE Építési kft.

[282] *Compare* Case C-210/06, *Cartesio*, at ¶ 104, *with* CTS Corp.v. Dynamics Corp. of Am., 481 U.S. 69 (1987).

[283] *See* Paul v. Virginia, 75 U.S. 168 (1868); Bank of Augusta v. Earle, 38 U.S. 519, 586 (1839).

Privileges and Immunities Clause, nor are similar rights granted by the Interstate Commerce Clause.[284] In contrast, the EU Treaties and the ECJ emphasize the correlation of natural persons and companies.[285] The EU Treaties treat companies, as defined in Article 48, "in the same way as natural persons who are nationals of Member States."[286] Therefore, an argument beginning with the words "unlike natural persons" must force contestation in the European Law context.[287]

C. The Indiana Corporation from a European Law Perspective

From a comparative point of view, it is interesting to assess if the rule upheld by the U.S. Supreme Court as constitutional in *CTS* would comply with the EC Freedom of Capital and Establishment, if a European member state were to enact such a rule. To reiterate, Chapter 42 of the Indiana Business Corporation Law provides that the acquisition of shares above a specific threshold does not include voting rights unless a majority of all preexisting disinterested shareholders so agree at their next regularly scheduled meeting.[288] This rule applies to companies incorporated in Indiana that have not opted out of the provision.[289]

1. Freedom of Capital

The ECJ decided on similar laws in its so-called golden share judgments.[290] These judgments involved special rights granted mostly to state authorities in former state-owned enterprises. In *Commission/France*,[291] a rule applicable to the Société National Elf-Aquitaine provided that any shareholding exceeding the ceiling of 1/10, 1/5 or 1/3 of a company's capital or of its voting rights must first be approved by the Minister of Economic Affairs.[292]

The ECJ states that direct investment in the form of participation in an undertaking by means of shareholding or securities acquisition constitutes

[284] *See Paul*, 75 U.S. 168; *Bank of Augusta*, 38 U.S. at 586.
[285] *See* Case C-210/06, Cartesio, at ¶ 109.
[286] SCHÖN, *supra* note 42, at 133.
[287] *Id.*
[288] IND. CODE ANN. § 23-1-42-9 (West 2009).
[289] IND. CODE ANN. § 23-1-42-5 (West 2009).
[290] *See* Johannes Adolff, *Turn of the Tide?: The "Golden Share" Judgements of the European Court of Justice and the Liberalization of the European Capital Markets*, 3 German Law Journal (2002), *available at* http://www.germanlawjournal.com/index.php?pageID=11&artID=170.
[291] Case C-483/99, Comm'n v. France, 2002 E.C.R. I-04781.
[292] *Id.* ¶ 1a.

capital movement.[293] Further, the rule constitutes a restriction on the free movement of capital.[294]

> Even though the rules in issue may not give rise to unequal treatment, they are liable to impede the acquisition of shares in the undertakings concerned and to dissuade investors in other Member States from investing in the capital of those undertakings. They are therefore liable, as a result, to render the free movement of capital illusory.[295]

Concerning justification for the restriction of the freedom of capital, the ECJ recognized the public interest of maintaining a consistent supply of petroleum in the event of a crisis.[296] However, the requirement for general approval of the Minister was held to be disproportionate, as there was no indication under what circumstances the authorization could be refused.[297]

The facts in *Commission/Portugal*[298] were similar. Here, the relevant law provided that the shareholding of all non-Portuguese investors should be limited to 25% of the capital.[299] Furthermore, the prior authorization of the Minister of Financial Affairs was required for every acquisition of shares representing more than 10% of the voting capital.[300] The ECJ decided that the limitation of 25% of capital for foreign investors was discriminatory and, therefore, violated the free movement of capital.[301] Regarding the requirement for authorization by the Minister of Financial Affairs, the ECJ repeated the same ruling as in *Commission v. France*.[302]

In *Commission/UK*,[303] the Articles of Association of the privatized British Airport Authority provided for a general voting cap of 15%.[304] Secondly, a special share was created which could only be held by the Secretaries of State.[305] This special share involved special decision rights on important transactions.[306] The ECJ came to the conclusion that the measures restricted the free movement of capital, as it limited the acquisition

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[293] *Id.* ¶ 37.
[294] *Id.* ¶ 42.
[295] *Id.* ¶ 41.
[296] *Id.* ¶ 47.
[297] *Comm'n v. France*, 2002 E.C.R. I-4781 at ¶ 50.
[298] Case C-367/98, Comm'n v. Portugal, 2002 E.C.R. I-04731.
[299] *Id.* ¶ 13.
[300] *Id.* ¶ 14.
[301] *Id.* ¶¶ 24, 26.
[302] *Id.* ¶¶ 25–26.
[303] Case C-98/01, Comm'n v. United Kingdom, 2003 E.C.R. I-04641.
[304] *Id.* ¶ 11.
[305] *Id.* ¶ 10.
[306] *Id.*

of shareholdings and restricted "the scope for participating effectively in the management of a company or in its control."[307] Even though the restrictions would be non-discriminatory in nature, "they affect the position of a person acquiring a shareholding as such and are thus liable to deter investors from other Member States from making such investments and, consequently, affect access to the market."[308]

In *Volkswagen*,[309] the Volkswagen Law provided for a 20% voting cap, a qualified majority of 80% instead of 75%, and special board nomination powers for the Federal Republic of Germany and the state of Lower Saxony.[310] The ECJ qualified these measures as a state measure, even though Germany argued that the law should historically be viewed as a private law contract.[311] The exercise of legislative powers is a manifestation of state power par excellence.[312] The Court held that the qualified majority together with the voting cap would limit the possibility of other shareholders participating effectively in the company and, therefore, "deter direct investors from other Member States."[313] The same was held with regard to the special board nomination powers.[314]

In the European case law, unlike Chapter 42 of the Indiana BCL, a state entity was directly involved.[315] The companies in question were partly state-held and there was either a general voting cap or the requirement that a special state authority be granted in the case of a share acquisition.[316] In contrast, the decision to attach voting rights to the acquired shares is left to the remaining shareholders in the Indiana Corporation.[317] However, this Article ventures to argue that a rule like Chapter 42 of the Indiana BCL would violate the Freedom of Capital and Establishment, considering that the case law describes it as constituting a state measure that deters direct investors.

It has to be pointed out that the judgments were not in any way swayed by the fact that a state was directly involved as a shareholder of the companies in the cases discussed.[318] In contrast, in *Commission/France*, the potential

[307] *Id.* ¶ 44.
[308] *Comm'n v. United Kingdom*, 2003 E.C.R. I-4641 at ¶ 47.
[309] Case C-112/05, Comm'n v. Germany (Volkswagen), 2007 E.C.R. I-8995.
[310] *Id.* ¶ 9.
[311] *Id.* ¶ 26.
[312] *Id.* ¶ 27.
[313] *Id.* ¶ 52.
[314] *Volkswagen*, 2007 E.C.R. I-8995 at ¶¶ 65–66.
[315] *Compare Volkswagen*, 2007 E.C.R. I-8995, *and Comm'n v. United Kingdom*, 2003 E.C.R. I-04641, *with* IND. CODE ANN. § 23-1-42 (West 2009).
[316] *See, e.g.*, *Volkswagen*, 2007 E.C.R. I-8995; *Comm'n v. United Kingdom*, 2003 E.C.R. I-04641.
[317] IND. CODE ANN. § 23-1-42-9 (West 2009).
[318] GRUNDMANN, *supra* note 64, at ¶ 674.

exercise of public security policy serves as a possible justification.[319] The issue is further considered in *Commission/UK*, as the UK Government argued that the restrictions arose as a result of the normal operation of company law.[320] The ECJ rejected this argument by treating the articles of association as a state act instead of a private party agreement.[321] In this respect, the Court relied on the fact that the articles of association had to be approved by the Secretary of State pursuant to the Airports Act 1986.[322] Similarly, in the case of the Indiana Corporation, the restriction derives from a state law, and not from a private party agreement.[323] Less clear in this respect is the *Volkswagen* decision, as the Court only held the 20% voting cap in combination with the 80% supermajority liable to hinder the free movement of capital.[324] However, the Court qualified the Volkswagen law clearly as a state measure, as "the exercise of legislative power by the national authorities duly authorised to that end is a manifestation *par excellence* of State power."[325]

A more controversial question is whether a default rule, like Chapter 42 of the Indiana BCL, can escape control under the Freedom of Capital principle. It has been argued that default rules in private law are not subject to control under the EU Freedoms in general, since private parties can escape them.[326] However, excluding default rules from control under the EU Freedoms would dilute the effectiveness of EU law. Therefore, excluding default rules from the scope of the EU Freedoms is not demonstrative, as the *effet utile* is a general principle of community law.[327] EU law even requires Member States to abstain from any measure, which could hinder the exercise of the four market freedoms.[328] In fact, default rules do not give complete freedom of choice to the contracting parties, but are biased towards a

[319] Case C-483/99, Comm'n v. France, 2002 E.C.R. I-4781, I-4804.

[320] *Comm'n v. United Kingdom*, 2003 E.C.R. I-4641 at ¶ 48.

[321] *Id.*

[322] *Id.*

[323] CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987).

[324] Case C-112/05, Comm'n v. Germany, 2007 E.C.J. I-9020, I-9030.

[325] *Id.*

[326] *See generally* Case C-339/89, Alsthom Atlantique v. Compagnie de construction mécanique Sulzer SA**,** 1991 E.C.R. I-107 (discussing the application of the freedoms in private party relations); Case C-438/05, Int'l Transp. Workers' Fed'n v. Viking Line ABP, 2007 E.C.R. I-10806; Case C-281/98, Angonese v. Cassa di Risparmio di Bolzano SpA, 2000 E.C.R. I-4161; *see also* KARL RIESENHUBER, EUROPÄISCHES VERTRAGSRECHT (2ed. 2006) § 3, ¶ 87.

[327] Nial Fennelly, *Legal Interpretation at the European Court of Justice*, 20 FORDHAM INT'L L.J. 656, 674 (1996).

[328] *See generally* Case C-265/95, Comm'n v. France, 1997 E.C.R. I-6990, ¶ 44; JONATHAN RICKFORD, *Free Movement of Capital and Protectionism After Volkswagen and Viking Line*, in ESSAYS IN HONOUR OF EDDY WYMEERSCH 77 (Michel Tison ed., 2009).

certain solution.[329] The contracting partner that wants to derogate from the default rule has to incur the burdens of alteration. This is even more so in company law, as a shareholder who wants to opt out of the regime would have to incur additional costs to initiate a coalition among other shareholders and overcome the problems of rational apathy and collective action. This controversial issue in European law was not even considered by the U.S. Supreme Court in regard to Chapter 42 of the Indiana BCL.[330] Finally, it is open to question if a European version of Chapter 42 of the Indiana BCL would be treated differently from the rules in the golden share cases, since it is for the remaining shareholders to decide whether voting rights are attached to the acquired shares.

Firstly, the factual uncertainty this rule creates, which deters investors from acquiring shares, suggests this rule's nonconformity with the freedom of capital. For the ECJ, the de facto resulting impediments on the single market are what matter the most. Secondly, in the light of the reasoning of the ECJ in *Commission/France*, it is even more unlikely that such a rule could be tolerated under the free movement of capital. The ECJ stresses the factual and legal uncertainty the investor faces, if a share acquisition is subject to the authority of a state authority.[331] This factual uncertainty is aggravated if it is for the shareholders to decide, since unlike state entities, their discretion is not even restricted by general constitutional principles such as, for instance, equal treatment.

2. Freedom of Establishment

Even though the parallel application of the Freedom of Establishment and the Freedom of Capital is still contentious, the majority of legal scholarship and the ECJ favor a parallel application of both freedoms.[332] In such a case, the above reasoning applies in the same way for the Freedom of Establishment,[333] with the result that a rule like Chapter 42 of Indiana BCL would violate the Freedom of Establishment if it were enacted by an EU Member State. A direct investment, such as an investment targeted at entrepreneurial activity in the company, constitutes an establishment under Article 49 TFEU.[334] Direct investments are concerned with the question at

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[329] RICKFORD, *supra* note 328, at 74.
[330] CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987).
[331] *Comm'n v. France*, 2002 E.C.R. I-4781 at I-4798.
[332] GRUNDMANN, *supra* note 64, at ¶ 211.
[333] *Id.* ¶ 212.
[334] TFEU art. 49, March 30, 2010, 2010 J.O. (C 83) 72.

hand, since those are the investments in which voting rights matter.[335] Doubts remain whether, here as well, the ECJ could use the argument that companies are creatures of the law. However, the application of this reasoning by the ECJ so far is limited to the choice-of-law doctrines.[336]

3. Comparative Conclusion

In sum, the European framework seems to be significantly more restrictive and leaves the Member States with less power to regulate their companies. This is mainly because the American system lacks the right of free movement of capital when it comes to investments in companies.[337] Whereas, the TFEU grants this right explicitly in the freedom of capital and implicitly in the Freedom of Establishment, the Interstate Commerce Clause does not grant a right to freedom of investments.[338] According to *CTS,* investors therefore only have the right to invest in U.S. companies as state law grants it.[339]

Further, unlike the U.S. system, the division between natural persons and companies as creatures of the law is not implemented in a consistent manner.[340] This is due to the equation of companies and natural persons in Article 54 TFEU.[341] Even though it is obvious that natural persons and companies differ in many respects, neither the ECJ nor the legislator, nor legal doctrine, has addressed the matter in broader scope.

IV. REASONS AND LESSONS

On the basis of the observations made beforehand, it has to be concluded that the ECJ's interpretation of the Freedoms of Establishment and Capital limits the powers to regulate company law at the state level more severely than does the Supreme Court's interpretation of the dormant Interstate Commerce Clause.[342] This can be seen in the three areas assessed.

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335 IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS AND OECD WORKSHOP ON INTERNATIONAL INVESTMENT STATISTICS, DETERMINING DIRECT INVESTMENT RELATIONSHIPS 2 (2004).

336 Luca Enriques & Martin Gelter, *How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law* 15 (John M. Olin Ctr. for Law, Econ., and Bus. Fellows' Discussion Paper Series, Working Paper No. 63/2006).

337 CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 90 (1987).

338 U.S. CONST. art. I, § 8, cl. 3; TFEU art. 49, March 30, 2010, 2010 J.O. (C 83) 72.

339 *CTS Corp.*, 481 U.S. at 90.

340 TFEU, March 30, 2010, 2010 J.O. (C 83).

341 TFEU art. 54, March 30, 2010, 2010 J.O. (C 83) 69.

342 RICHARD M. BUXBAUM, *Back to the Future? From "*Centros*" to the "*Uberlagerungstheorie*"* in FESTSCHRIFT FÜR OTTO SANDROCK 149, 162 (Klaus Peter Berger et al. eds., 2000).

Firstly, constitutional legal doctrine in the U.S. seems to tolerate the special treatment of pseudo-foreign companies by host states, as this treatment is seen as imposing little hindrance on interstate commerce and the common market.[343] Secondly, U.S. constitutional law consistently rejects every notion of corporate citizenship.[344] In accordance, in creating companies the states have broad discretion to restrict the abilities of the companies.[345] Finally, the Interstate Commerce Clause does not entail the right to free movement of investment.[346] What are the reasons for these differences? What lessons can the EU learn from the legal debate in the U.S.?

A. Foreign Companies

When it comes to the question of why the U.S. legal system can be more lenient as far as the special treatment of pseudo-foreign companies by New York and California statutes is concerned, two differences matter the most. First of all, the incentives for small companies to incorporate in another Member State rather than in the home state seem to be minimal in the U.S. compared to the EU.[347] In the EU, high minimum capital requirements in some Member States are a major incentive for small companies to incorporate in another Member State.[348] The U.S. has a more uniform company law in this respect. Interestingly, as regards larger companies, European law has harmonized minimum capital requirements in Article 6 of the 2nd Company Law Directive.[349] Larger firms, however, are unlikely to do business in only one state and therefore seldom conflict with the rules on pseudo-foreign companies.[350]

Hence, regulatory competition is turned upside down in the EU when compared to the U.S. Large disparities remain with regard to small companies, where the development of pseudo-foreign companies is likely, whereas the rules for larger companies are harmonized.[351] The comparison shows further that in certain areas of company law, such as the question of

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[343] *Id.* at 162–63.

[344] *See* Hertz Corp. v. Friend, 130 S. Ct. 1181, 1184 (2010), for a discussion noting that there is no singular way, if any effective way, to determine a corporation's citizenship.

[345] LEWIS S. BLACK, JR., WHY CORPORATIONS CHOOSE DELAWARE 2 (2007).

[346] U.S. CONST. art. I, § 8, cl. 3.

[347] BUXBAUM, *supra* note 342, at 149, 154.

[348] EUROPEAN COMPANY LAW EXPERTS, RESPONSE TO THE EUROPEAN COMMISSION'S CONSULTATION ON THE FUTURE OF EUROPEAN COMPANY LAW 2 (2012).

[349] Council Directive 77/91, art. 6, 1977 O.J. (L 26) 3 (EC).

[350] *See* Robert R. Drury, *The Regulation and Recognition of Foreign Corporations: Responses to the "Delaware Syndrome,"* 57 CAMBRIDGE L.J. 165, 166 (2009).

[351] Susanne Braun, *The European Private Company: A Supranational Company Form for Small and Medium-Sized Enterprises?*, 5 GERMAN L. J. 1393, 1394 (2004).

minimum capital requirements, convergence is needed; in other areas such as internal corporate governance, however, diverse solutions will have fewer negative effects on the functioning of a common market.[352]

Whereas the U.S. courts leave the issue of the special treatment of foreign companies by California and New York unresolved, the ECJ has taken a strict stand. The reasons for the different approaches to the treatment of foreign companies by the host state could easily be found in historical and cultural arguments. The Single European Market is still young compared to the common market of the U.S. Moreover, the EU is culturally more diverse than the U.S. Each Member State brings with it a different legal tradition deeply rooted in cultural beliefs.[353] Accordingly, the company laws in the U.S. could evolve in an existing common market, whereas the company laws in Europe first have to be accommodated.

Buxbaum[354] argues in this context that unlike the U.S., the EU institutions need a more activist approach, as the Single European Market is still undergoing development.[355] He argues that the ECJ will in the long run take a more lenient view on the choice-of-law doctrine, resulting in a theory of super-addition in which broad exceptions, such as the Californian rules on foreign companies, are added to the incorporation doctrine.[356] It remains to be seen if the ECJ will be more lenient as integration advances. However, it is unlikely that the ECJ would tolerate laws like those of California and New York in the EU, considering the strict and clear stand it took on laws governing pseudo-foreign companies in the *Inspire Art* decision. Even more unlikely, at present, is that an EU member state would enact such laws, since it would fear the strict actions of both the EU Commission and the ECJ.[357] The ECJ has set a standard with its decisions, from which it will be hard to derogate.

The perspective this Article takes is, unlike Buxbaum's, neither historical nor cultural, but relies on the functioning of a common market. This Article argues that the legal differences matter. Certain areas of company law need to converge, whereas other areas of company law can be more diverse without creating burdens on a single market structure. The question

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[352] Peter Zumbansen, *Eurpoean Corporate Law and National Divergencies: The Case of Takeover Regulation*, 3 WASH. U. GLOB. STUD. L. REV. 867, 884 (2004).

[353] Mark Peil, *The Uneasy Fit Between Legal Traditions and the Political Economy of Regional Trade*, 8 GERMAN L.J. 547, 549 (2007) (reviewing FRANCESCO DUINA, THE SOCIAL CONSTRICTION OF FREE TRADE (2006)).

[354] BUXBAUM, *supra* note 342, at 160.

[355] *Id.*

[356] *Id.*

[357] A qualified breach of community law can lead to state liability. *See generally* Case C-479/93, Francovich v. Italian Republic, 1995 E.C.R. I-3861.

of minimum capital is especially crucial for the Single European Market in two aspects. It creates not a factual but a legal entry requirement into the markets.[358] Secondly, it affects companies in terms of formation when they are most flexible and least compliant to accepting charges and restrictions.[359] The rules in California and New York in contrast are much softer in their effect. They allow companies to enter the market and accept them as legal entities, but require the application of certain internal governance rules.[360]

More importantly, there are few incentives to create a pseudo-foreign company in the U.S. In the U.S., the problem of pseudo-foreign companies was largely resolved by the factual convergence. U.S. law accidentally avoided[361] the problem of pseudo-foreign companies. Since low capitalization requirements prevail in the company laws of the U.S., the incentives to incorporate in a state different from the main place of business are low.[362] In contrast, different minimum capital requirements in the EU provide incentives to form pseudo-foreign companies with no economic connection to the country of incorporation.[363]

On the other hand, internal governance rules, like those in California and New York, do not seem to create such incentives. Besides issues of legal certainty, there are no visible disruptive effects on the functioning of the common market.[364] The reason the U.S. constitutional doctrine is more lenient when it comes to the treatment of foreign companies by the host state can be found, therefore, not in different approaches to the functioning of the common market, but in the subject matter. This leads to the argument that convergence on the question of minimum capital requirements is needed from a common market perspective, whereas divergence in respect to governance rules can be tolerated.

What lessons can be learned from this insight? Firstly, one should be cautious in transferring the same strictness with which the ECJ rejected

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[358] John Armour, *Legal Capital: An Outdated Concept?* 1 (Ctr. for Bus. Res., University of Cambridge, Working Paper No. 320, 2006).

[359] *Id.* at 9.

[360] UNIFORM CERTIFICATE OF AUTHORITY APPLICATION, STATUTORY MINIMUM CAPITAL AND SURPLUS REQUIREMENTS 2, 11 (2012).

[361] BUXBAUM, *supra* note 342, at 149, 154.

[362] For a discussion of minimum capital requirements in United States corporate law, see generally Richard A. Booth, *Capital Requirements in United States Corporation Law* 6 (University of Maryland School of Law, Working Paper No. 2005-64, 2005).

[363] Joseph A. McCahery & Erik P. M. Vermeulen, *Does the European Company Prevent the 'Delaware Effect'?*, 11 EUR. L.J. 785, 786 (2005).

[364] *See* DeMott, *supra* note 96, at 181. *But see generally id.* (noting that on the whole, internal governance rules create legal fault lines between corporations of different states operating under various regulatory schemes).

the minimum capital requirements in other inbound cases. Secondly, convergence eventually has to be reached on minimum capital requirements across Europe.[365] Whether this is achieved by legislation via harmonization or thorough regulatory competition is merely a question of policy. As long as minimum requirements exist in some Member States, these Member States create incentives for entrepreneurs to evade the regime by founding a company in another jurisdiction.[366] This fosters regulatory arbitrage and exposes business partners and creditors to an unfamiliar legal regime.[367] Pseudo-foreign companies are created, which have no real economic contact with their state of incorporation. Convergence is therefore preferable. This insight stands in stark contrast to harmonized law in the EU, which focuses on large companies.[368] Large companies, however, normally have business contacts in many states and therefore are unlikely to be pseudo-foreign companies. Convergence has been created where it is less needed, whereas harmonization on smaller companies, which are more likely to be pseudo-foreign companies, was neglected. Finally, internal corporate governance rules such as cumulative voting rights and decision-making procedures do not have the same hampering effects on the functioning of the internal market compared to minimum capital requirements and can, therefore, be treated differently.[369]

B. Domestic Companies

The comparison shows that the states in the U.S. enjoy broad discretion when regulating companies formed and incorporated in accordance with their law. Two major differences in law can be found. The U.S. constitutional law consistently rejects every notion of corporate citizenship.[370] Further, the Interstate Commerce Clause does not entail a right to freedom of investments as the EU freedom of capital does.[371] This results in the ECJ exercising stricter scrutiny and restricting Member States' power to regulate domestic companies more than the U.S. Supreme Court.[372]

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[365] *See* McCahery & Vermeulen, *supra* note 363, at 800.

[366] EUROPEAN COMPANY LAW EXPERTS, RESPONSE TO THE EUROPEAN COMMISSION'S CONSULTATION ON THE FUTURE OF EUROPEAN COMPANY LAW 2 (2012).

[367] *See* McCahery & Vermeulen, *supra* note 363, at 801.

[368] Council Directive 77/91, art. 1, 1977 O.J. (L 26) 2 (EC).

[369] *See* Armour, *supra* note 358, at 4.

[370] For a discussion noting that there is no singular way, if any effective way, to determine a corporation's citizenship, see *Hertz Corp. v Friend*, 130 S.Ct. 1181, 1184 (2010).

[371] U.S. CONST. art. I, § 8, cl. 3.

[372] Michael Blauberger, *With Luxembourg in Mind ... The Remaking of National Policies in the Face of ECJ Jurisprudence* (Mar. 2011) (Paper presented at the EUSA Twelfth Biennial International Conference).

This Article argues that this, as well, is not because of the ECJ's activist approach, but is rooted in the very notion of the EU's constitutional set-up. Unlike the U.S. Constitution, the EU Treaty does accept the concept of a company being a normal market participant.[373] At the same time, the EU Treaty acknowledges the capital market's importance to the economic system and, therefore, grants forceful rights to the free movement of capital.[374] The reasons for these different approaches lie most obviously in the constitutional documents and the time in which they were created. Whereas corporate personality had to be introduced as a new concept in the U.S. constitutional framework, the legal capacity of companies was an established idea at the time the Treaty of Rome was signed in 1957.[375] The EU could, therefore, set up a more modern framework, relying on their experiences with the functioning of a modern market economy.

These experiences are twofold. Firstly, companies are regarded not so much as creatures of the law but as normal market participants, like natural persons.[376] Therefore, the Freedom of Establishment of companies does not enjoy special treatment under the EU Treaty.[377] Instead, it is simply stated that companies are to be treated the same way as natural persons, who are nationals of a Member State.[378] Secondly, the importance of the capital market to the economy was obvious to the founders of the European Community.[379] This led to strong rights pertaining to freedom and direct investments under the EU Treaties.

Thus, when it comes to an efficient capital market, the EU Treaty has set up a more modern constitutional framework than the U.S. does. Moreover, the EU Treaty challenges legal doctrine by the simple equation of companies and natural persons in Article 54 TFEU. In comparison to the U.S. constitutional framework under which much broader rights of freedom have to be granted to companies, the argument that companies are unlike natural persons as they are only creatures of the law finds only limited textual basis in the Treaty.[380]

The ECJ could use this argument in *Cartesio* and *Daily Mail* only with regard to the connecting factors a Member State uses to determine which companies are domestic. Here, the Court could rely on the three connecting

[373] TFEU art. 54, March 30, 2010, 2010 J.O. (C 83) 69.

[374] TFEU art. 49, March 30, 2010, 2010 J.O. (C 83) 72.

[375] Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11, *available at* http://ec.europa.eu/economy_finance/emu_history/documents/treaties/rometreaty2.pdf.

[376] TFEU art. 54, March 30, 2010, 2010 J.O. (C 83) 69.

[377] *Id.*

[378] *Id.*

[379] *See generally id.*

[380] *Id.*

factors, which Article 54 TFEU explicitly treats equally: registered office, central administration, and principal place of business.[381] Taking the simple equation of natural persons and companies into account, it is unlikely that the creature argument could be used in order to broaden the discretion of Member States in other fields of company law. On the other hand, a basic truth lies in the argument that companies do not exist naturally, but are created by rules. The pure existence of companies relies on the lawmaker. Compared to the U.S. constitutional system, the TFEU creates a tension between the equation of companies and natural persons in Article 54 TFEU and the fact that the existence of companies relies on laws.

CONCLUSION

The comparative analysis of the constitutional frameworks of the EU and the U.S. in regard to state powers pertaining to company law has shown that the U.S. constitutional framework is more lenient than the EU's. Mandatory rules on pseudo-foreign companies are tolerated in the U.S. Concerning the regulation of domestic companies, the U.S. gives broad discretion to the states by consistently rejecting the concept of a corporate citizenship.

The more lenient approach is not due to an activist approach of the ECJ or due to an activist phase of integration. Instead, these differences are rooted in the specific legal set-up of the two common markets. In respect to foreign companies, different minimum capital requirements in the EU offer incentives for the creation of pseudo-foreign companies. In contrast, the U.S. constitutional framework shows that different governance rules do not seem to create large burdens on the functioning of the common market. Concerning the discretion granted to states to regulate domestic companies, the U.S. constitutional framework rejects any notion of corporate citizenship and therefore can deploy the argument that companies are creatures of state law in order to grant states larger powers. The TFEU, in contrast, explicitly equates natural persons and companies, which has led to a stronger scrutiny of Member State law in the long run. European legal doctrine is faced with the paradox that the TFEU equates natural persons and companies, whereas in reality companies differ from natural persons in many respects. Finally, the broad discretion left to the states while regulating domestic companies can have hampering effects on the common market, as can be seen in the cases regarding the takeover market and the Indiana corporation. The EU constitutional framework is in better shape to address these problems and can thereby create an increasingly efficient capital market.

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[381] *Id.*