THE REGULATION AND RECOGNITION OF FOREIGN CORPORATIONS: RESPONSES TO THE 'DELAWARE SYNDROME'

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I CORPORATIONS IN CONFLICT OF LAWS AND THE 'DELAWARE SYNDROME'

It is beyond dispute now that corporations have replaced states as the most important makers of waves in the world's economy. It is also firmly established that with the increasing globalisation of that economy corporations operate in many cases far beyond the borders of the country that presided over their birth. A company which crosses frontiers to operate outside its original jurisdiction can bring problems of several different kinds in its wake. A court dealing with such a company may have to ascertain which law is, or should be, the law which regulates its affairs. The company may have internal disorders or may be experiencing difficulties in its external relationships. In seeking to grapple with these problems the jurisdictions of the world are broadly divided into two camps. There are those which look to the law of the place of the company's incorporation to govern these matters, and those which look to the law of the place of the central administration of the company as being the correct law to be supreme in this field. Some jurisdictions take a variety of half-way positions in this debate.

This leads us to the separate but related question of the recognition of a foreign company by a 'host' jurisdiction in which it has begun operations. This can proliferate into disputes over the meaning and extent of the concept of recognition and its manifold consequences. How far does recognition extend? Does it mean that the foreign company is recognised in all circumstances as being fully regulated by its "own" law, perhaps even to the extent of giving such a company certain rights and privileges not accorded to companies formed in the recognising state, or only that visiting corporations are to be extended no better treatment than their domestic brethren?

One aspect of the issue of recognition involves the difficulties which arise when a company transfers its central administration, or elements of this to a jurisdiction other than that in which it was incorporated. Here the attitude of the "host" state is crucial, because it may refuse to accept that the persons operating the business on its territory are in fact a company. It may do this on the grounds that these persons have not complied with the domestic law which applies to companies with their central administration in that state, and may well treat them as an unincorporated association or just as a group of individuals. The state from which the company came can also have an interest, because it can regard it as essential that the company maintains its central administration and control - its *siège réel* or its *sitz* - in the place where it was incorporated or where it is registered.

All of these problems can arise when it is a truly foreign corporation that is doing the moving around. However, a whole new set of problems come to the fore when the corporation in question is not truly foreign, but is a manifestation of the will of persons who are linked firmly with one jurisdiction, but who seek to take advantage of what are perceived to be favourable factors of another jurisdiction by going through the process of incorporating their activities there in the form of a corporation, intent only on operating in their own home

jurisdiction. These 'pseudo-foreign' corporations[1] challenge the heart of the philosophy of recognition of corporations espoused by the 'host' state. It will need to consider what factor or factors it takes into account to determine what makes a foreign corporation 'foreign'. If a state feels threatened by these 'pseudo-foreign' corporations, it will need to decide how best to respond to this threat. Should some doctrine of *fraud a la loi* be invoked to defeat the manipulations of the incorporators, or does the whole system of recognition need to be designed to ensure that key policies of the host state are not prejudiced.

One might argue that all of these problems and more have already been solved in other jurisdictions which comprise a federation of states which have different company laws. The US experience is often cited as a potential model, with its reliance on the place of incorporation theory and other factors to facilitate the operation of companies incorporated in one state in every other state in the Union. However this system has made it possible for companies to cluster around the one state which they perceive to have the laxest or most favourable company laws, and then to operate from there in other states which have a more severe or onerous regime, which perhaps lays greater emphasis on protecting groups of interested parties other than those favoured by the incorporators of the company. This phenomenon, known as the Delaware syndrome after the state most favoured in the US for the incorporation of companies, has aroused very vehement criticism in other, particularly European countries.[2] Indeed, it is precisely to prevent this phenomenon that many European jurisdictions have emphasised the importance of the location of the central office and administration of the company in their recognition rules. It has in the past proved well nigh impossible to persuade such states of the attractions of the Delaware syndrome, and led to the failure of many schemes designed to facilitate recognition across frontiers.

In order to investigate these matters, it is necessary to examine the two major theories which determine the law which regulates a foreign corporation's affairs, and then to see how these have affected the recognition philosophy adopted by those jurisdictions. From this point it becomes possible to turn to the way in which jurisdictions have responded to the Delaware syndrome and to the perceived threat from pseudo-foreign corporations. It will become apparent that while many civil law jurisdictions have adhered to the real seat theory in an effort to defeat the Delaware syndrome, some such jurisdictions have begun to change to the place of incorporation doctrine to seek other advantages. The experience of the Netherlands and Switzerland is very instructive in this area, particularly because the Netherlands especially is experiencing problems with pseudo-foreign corporations at the present time. The ways in which this jurisdiction and other place of incorporation jurisdictions have responded to the threat, may indicate that adherence to a real seat doctrine, with all of the disadvantages that this has for the mobility of corporations, is not the only way to counter threats to what are regarded as the essential interests of the citizens of a 'host' state. Such a realisation could have a beneficial effect upon efforts to promote systems of mutual recognition of corporations and lead the way to more positive outcomes which can benefit world trade.

II. THE GOVERNING LAW THEORIES

A credo for the governing law was given by Rabel in the following terms,

> "The essential incidents of the activities of any legal entity are controlled by one municipal law, a single ubiquitous personal law, parallel to the statute personal of

[1] See E.R.Latty, "Pseudo-Foreign Corporations" (1955) 65 Yale L.J. 137.

[2] See Grossfeld, Rabels Z., 1967, 1; Caflisch, Ann. Suisse de Dr. Int. 1967; Grasman, System des Internationalen Gesellschaftesrechts 1970; Steiner and Vagts, *Transnational Legal Problems*, 1968; Baade, *Rabels Z.* 1973, at p.34.

individuals. .... This law governs existence, capacity, internal structure, external legal relations, modifications of the charter and dissolution of the legal entity."[3]

While most states would agree on the desirability of having these matters determined by a single municipal law, there is little agreement on the selection of the connecting factor which links a company to a particular legal system. This connecting factor is crucial in a number of other important areas. It permeates the whole issue of the recognition of companies from other jurisdictions, because it is first necessary to specify how the fact that a company does hail from another jurisdiction is to be determined. What factor does a state use to classify a company as “foreign”. It is also highly relevant when states consider regulating foreign corporations wanting to do business on their territory. The matter again rears its head when states feel the need to discriminate against “foreign” corporations for any purpose. [4]

There are a number of concepts which have been used by conflicts of laws rules in different countries in the world as a connecting factor, but in today’s world there are really only two theories of any widespread practical significance. These are the place of incorporation theory and the real seat theory.

A. The Place of Incorporation Theory

It is worth investigating the application of this theory first of all in jurisdictions where it has long played a characteristic role. Those which seem particularly apposite for this purpose are those of England and the United States. [5] One of the major advantages of the place of incorporation theory in practice is its certainty. It is a relatively simple matter to discover where a corporation has been incorporated,[6] and upon proof that this incorporation was validly carried out, the court of the forum applying this conflicts rule can feel free to recognise the entity, in so far as recognition merely acknowledges the attribution of corporate personality. In respect of England, the authors of Dicey and Morris express this view in Rule 155, which holds that, “The existence or dissolution of a foreign corporation duly created or dissolved under the law of a foreign country is recognised in England.”[7] Thus if a corporation is duly created under the law in force in its place of incorporation it is recognised as a corporation in England, and can sue and be sued in its corporate capacity. The place of incorporation theory goes further than this, and in providing rules for dealing with the consequences of recognition permits a court applying this conflicts rule to determine many of the attributes of the corporation by this law. This aspect of the theory and

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3 Ernst Rabel, *The Conflict of Laws A Comparative Study*, 2nd. ed. 1960, Vol II p.3

4 Consider the criteria used initially by the British Government when it wanted to protect its nationals from “quota hopping” by Spanish owned British registered fishing vessels. It redefined eligibility to register as a British fishing vessel in the Merchant Shipping Act 1988 in terms of the vessel needing to be British owned, a concept which referred to the legal and beneficial ownership of vessels being vested in “qualified persons or companies”. Qualified companies for this purpose were defined as those which were incorporated in the United Kingdom, had their principal place of business there, had a defined percentage of their shares legally and beneficially owned by “qualified persons” and had such “qualified persons” as a defined percentage of its directors. “Qualified persons” were in turn defined as British citizens resident and domiciled in the United Kingdom. This legislation used quite a number of connecting factors in a cumulative way, but was held to fall foul of Articles 52 and 221 of the Treaty of Rome in the Factortame decision. See *Factortame Ltd and others v. Secretary of State for Transport (No. 2)* (Case C-213/89) [1991] 1 All E.R. 70.

5 It is interesting to note that Swiss law has recently adopted the place designated in the articles or contract of association as the test for determining the seat, and hence the domicile, of a company in its private international law (see below).

6 This may not always be such an easy matter where, for example, two states lay claim to the same territory, or where there are both de facto and de jure authorities competing for international recognition. For an explanation of the way in which some of these problems are resolved under UK law see the Foreign Corporations Act 1991 and the comments in Dicey and Morris, *The Conflict of Laws*, 12th ed. 1993 ed. L. Collins, at pp. 1109-1110.

7 *Op. cit.,* at p. 1107.

some of the problems in its application are exemplified by Dicey and Morris' Rule 156 which states,

"(1) The capacity of a corporation to enter into any legal transaction is governed both by the constitution of the corporation and by the law of the country which governs the transaction in question.

(2) All matters concerning the constitution of the corporation are governed by the law of the place of incorporation."[8]

Thus, although the place of incorporation can determine many things, it is not always appropriate to determine all things by reference to it. The capacity of a company is limited by the law regulating the constitution of the corporation because this law must govern the overall limits on the capacity of the legal entity which is its creation. It can also be further limited by the law governing the transaction in question. Dicey and Morris gives an example to the effect that a corporation could not invoke a capacity to hold land given by the law of its place of incorporation in the teeth of the law applicable at the *situs* of the land which declared that land may not be held by a corporation.[9] It is necessary to remember in this context that common law systems often regard capacity not as a separate issue, but as something regulated, for example, by the law of contract. Civil law systems on the other hand tend to regulate capacity as part of the general law dealing with persons and their status, and hence refer to concepts such as nationality to determine contractual capacity.

English conflicts law, in so far as it has considered the issue, also seems to refer matters relating to the internal management of a corporation to the law of its place of incorporation. Hence matters such as the identity of the corporation's officers authorised to act on its behalf, or the extent of a member's liability for the corporation's debts, have been referred to this law in English judgements.[10] However, it should be noted that, as has been mentioned earlier, under the 1968 Brussels Convention on Jurisdiction and the Enforcement of Judgements in Civil and Commercial Matters and the Lugano Convention, jurisdiction over many company law matters is vested in the courts of the country in which a company has its seat. As this may not always be in the country where the corporation was incorporated, English courts may have further opportunities to think about this area of conflicts law.

In the United States, a corporation is generally recognised as being governed in many things by the law of its domicile. This concept refers to the law prevailing at the place of incorporation of the corporation.[11] However, it may be necessary to separate out acts that can be performed by both individuals and by corporations, such as making contracts, committing torts etc. Another way of putting this might be to refer to conduct by the corporation which affects third persons. Here the general choice of law rules will apply regardless of whether the actor is or is not a corporation.[12] Hence a corporation's capacity to bind itself by contract will, as in the case of an individual, be determined by the law which governs that particular contract.[13] Reese and Kaufman take the view that US cases , "hold that a corporation may receive, hold and dispose of land if it is permitted to do so by the law of the situs, even though it is denied such power by the

8 *Ibid.,* at p. 1111.

9 *Ibid.,* at p. 1112.

10 See the cases cited *ibid.,* at p. 1113.

11 For example, in the case of *Russian Reinsurance Co. v. Stoddard* 240 N.Y. 149, 147 N.E. 703 (1925) the Court of Appeals stated, "If the existence of the [foreign] corporation, its capacity to sue, or the authority of its directors to represent it or to bring the action is challenged, we look to the charter and the law of its corporate domicile for the data upon which we may rest our determination of such questions."

12 The Restatement (Second), Conflict of Laws, § 301 (1971) provides: "The rights and liabilities of a corporation with respect to a third person that arise from a corporate act of a sort that can likewise be done by an individual are determined by the same choice-of-law principles as are applicable to non-corporate parties.".

13 W. Rees and E. Kaufman "The Law governing Corporate Affairs: Choice of Law and Full Faith and Credit", (1958) 58 Colum. L. Rev. 1118, 1121.

state of incorporation..."[14] This indicates an interesting difference from the English position which would regard the two limitations on such capacity as acting cumulatively.

In matters that are peculiar to corporations, regarding especially their "internal affairs", reason and corporate efficiency would seem to demand reference to a single law.[15] Here Reese and Kaufman state that these matters, "have been consistently held to be governed by the law of the state of incorporation in the absence of a local statute to the contrary".[16] This applies to foreign corporations from outside the US as well as to corporations formed in another state in the Union.[17] However, American courts have had their own problems with the "Delaware Syndrome", and have had to take steps to counter it. There may be separate rules which apply in the case of so-called "tramp" or "pseudo-foreign" corporations which are incorporated in one state (usually Delaware) but conduct all or nearly all of their business and activities in another. The case of *Western Airlines Inc. v. Sobieski* [18] exemplifies both the point and the response. Western Airlines was a company, incorporated in Delaware, which took over the shares of a California corporation by way of a share exchange. The corporation did more business in California than in any other state, and apparently did none in Delaware. It wished to amend its articles of incorporation to dispense with cumulative voting provisions, a matter which was possible under Delaware law. However, under California's Blue Sky law a permit was required from the State Corporations Commissioner. The Californian court held that this law should be enforced, at least for the benefit of the California stockholders. Leflar comments on the case that, "The virtue of having internal corporate affairs regulated solely by some single law, for the sake of unity of operation, is evident, but it is hard to see why Delaware should have any better claim to dominance, on facts such as these, than California."[19] In cases other than those of pseudo-foreign corporations, where the company in question does business and carries out activities in several different states, local state statutes may provide that certain activities are to be governed by this local law rather than that of the state of incorporation. In such cases the question can be posed as to whether the 'full faith and credit' clause of the US constitution requires the application of the law of the state of incorporation rather than that of the local statute. The matter has not been definitively settled by the courts in the US. Reese and Kaufman express the following opinion,

> It is hazarded, however, that the law of the state of incorporation need not be applied in these situations where application of a single law is not essential, as, for example, where the question affects only a few, rather than all, of the shareholders. On the other hand, it is thought that the law of the state of incorporation must be applied when it is important that the matters at hand be governed by a single law and the interest of other states are not seriously affected.[20]

These jurisdictions then favour a liberal policy on the issue of recognition, but in the US, where necessary, steps will be taken to prevent this liberal policy working to the disadvantage of

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14 *Op. cit.,* at p. 1122.

15 The Restatement (Second), Conflict of Laws, § 302 (1971) provides:- "(1) Issues involving the rights and liabilities of a corporation, other than those dealt with in § 301, are determined by the local law of the state which, with respect to the particular issue, has the most significant relationship to the occurrence and the parties ...(2) The local law of the state of incorporation will be applied to determine such issues, except in the unusual case where, with respect to the particular issue, some other state has a more significant relationship to the occurrence and the parties, in which event the local law of the other state will be applied."

16 *Op. cit.* at p. 1125

17 See for example the case of *Hausman v. Buckley*, 299 F.2d 696, 93 A.L.R. 2d 1340 (2d Cir.), cert. denied, 369 (US) 885 (1962) concerning a Venezuelan corporation.

18 *Western Airlines Inc. v. Sobieski*, 191 Cal. App. 2d 399, 12 Cal. Rptr. 719 (1961). See also Weede *v. Bechtel,* 239 Iowa 1298, 31 N.W. 2d 853, 8 A.L.R. 2d 1162 *cert. denied* 337 U.S. 918 (1948)

19 R. Leflar, *American Conflicts Law* 3rd ed. 1977 at p.512, see also Latty, "Pseudo Foreign Corporations" and the case of *Mansfield Hardwood Lbr. Co. v. Johnson* 268 F.2d 317 (5th Cir.), *cert. denied*, 361 U.S. 885, 926 (1959).

20 *Op. cit.,* at p. 1144.

interests within the forum state which it deems necessary to protect. Generally though, reference to the law of the place of incorporation of the corporation will determine the governing law for the internal affairs of the corporation.

It is also instructive to look at a jurisdiction that has considered the relative merits of the place of incorporation and real seat theories, and changed its rules in consequence. Switzerland used to use the criterion of the real seat of a company as its connecting factor. Before the new private international law statute came into effect in 1989, in situations where the statutory seat of a company was different from its administrative seat, and it appeared to a Swiss court that the reason for this dichotomy was to evade certain provisions of the law of the country of the real or administrative seat, there was a tendency to declare the statutory seat (or registered office) a "fiction", and in consequence the law applicable at the administrative office was applied.[21] However, the new law, the *Bundesgesetz über das Internationale Privatrecht* of 18 December 1987 now provides in article 21 as follows:-

1. Companies are domiciled at their seat.
2. The seat of a company is at the place designated in the articles or the contract of association. If there is no such designation, the seat is at the place where the company is in fact administered.[22]

This represents a considerable change in Swiss law. As Vischer has said, "The law allows the founders the possibility of choosing a place of incorporation ... irrespective of the motives for so doing. The fact that this choice is driven by a desire to circumvent (the application of certain laws) is not sufficient reason for Swiss law to call the choice into question. However, that is not to say that this circumvention of laws by the company incorporated abroad will not lead to some corrective order."[23]

As Swiss law now basically adopts the place designated in the company's articles or the contract of association as the law determining a company's domicile, it can be seen as a place of incorporation country.[24] The law of the domicile, or specifically the law of the country according to which the company is organised, is the generally applicable law, and hence covers the recognition of the company, and its status, formation, capacity to have rights, internal relations (in particular between the company and its members), liability and the authority of its representatives.[25] However, although a foreign company may well have to be recognised on the ground that it is properly incorporated according to the law of its domicile, it has been asserted that Swiss law retains the ability to take action where a company chooses a particular law of incorporation for dubious motives. Vischer has stated the opinion that,

> "although a company incorporated abroad must *a priori* be recognised, there might be "*ordre public*" grounds for not giving effect to some of the consequences which flow from this. For instance, if the foreign law were to crassly ignore the rights of the minority shareholder and allow the expropriation of his property in the company this would not be enforced by a Swiss court."[26]

However, in a case in 1991[27] the Swiss Bundesgericht recognised a Panamanian company whose shares were held by a *Stiftung* in Liechtenstein on behalf of a Lebanese individual. It overruled the lower Geneva court's decision based on *fraud a la loi*, stating that the Swiss Private

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21 The author is indebted to Mark Farrell, a lawyer working with the legal department of ABB, for this information on Swiss law.

22 This translation of the Swiss text is taken from, P. Karrer and K. Arnold, *Switzerland's Private International Law Statute of December 18 1987.*

23 Vischer III *Der fraus legis - Vorbehalt unter der Herrschaft des IPRG* p. 1346 - translation by Mark Farrell see n.21 above.

24 See art 21 of the Swiss Private International Law Statute of December 18 1987 set out above.

25 Swiss Private International Law Statute Arts. 154 and 155.

26 Vischer III - *op. cit.* p. 1346 translation by Mark Farrell see n. 21 above.

27 *Bundesgericht*, 17 December 1991, *BGE*, II, 7, 494 *et seq.*

International Law Statute of 1989 does not contain a *fraus legis* exemption clause.[28] It thus appears that validity in the place of incorporation or under the law of the country according to which the company is organised, is the sole factor to be taken into account in terms of recognition. Protection against the consequences of abuse now has to be sought through other means (see below).

B. The Real Seat Theory.

In France and some other civil law countries the concept of nationality is apparently the major one used to link a company to a particular jurisdiction. This is discussed both in terms of the State regulating the collective activity that is carried on within its territory, and in terms of diplomatic protection of its 'nationals' including companies. There is the idea that there should be a link of allegiance between the State, and the groups, such as companies, which concentrate their collective activity within its borders. However, the concept of nationality in fact uses the idea of the real seat of the company as its determining criterion. Authors agree that a company must necessarily be subjected to the law of one specific country, the law of which will regulate the relations of the company, through its organs, with the outside world, and will equally regulate the relations of the members and organs of the company internally under its constitution. It is felt that this law should be the one which reflects a real attachment of the company to a territory. After favouring initially the place of the company's *siège d'exploitation*, theoretical and practical difficulties led the courts to prefer the law of the company's seat. By this is meant the place where the directors meet, where the general meeting assembles and where the company's administrative centre is located. This is the solution adopted for purely domestic application by French law. Article 3 of law no. 66-537 of 24 July 1966, the principal piece of legislation on French companies, states, "Companies whose seat is situated in French territory are subject to French law." *(author's translation)* The same concept is used in French conflict of laws to determine the law governing a foreign company. One justification used by Loussouarn and Bourel[29] is that a company which has its managing organs in France can be presumed to have French preoccupations and to revolve around French interests. Hence French law is the most appropriate one to govern its affairs.

However, it is considered necessary by many jurisdictions that this must be the real seat of the enterprise, and that it is not just conducting its business through what is effectively a post box in another country. Therefore many continental European jurisdictions including Germany (although some authors favour the registered office), Austria, Belgium, Portugal and Greece reject the idea of using the statutory or registered office as the determining criterion of the seat, and require that it represents the real centre of direction of the enterprise. This is the thinking which lies behind the continuation of Art. 3 of the law of 1966 regulating French companies referred to above, which reads, "Third parties can rely on the statutory seat *(registered office),* but this cannot be relied on by the company against them if its real seat is situated in another place" *(author's translation)*. The disapproval of an attempt to have a seat in a place other than where the company's direction in actuality takes place can be seen as a use of the concept of *fraude à la loi.* However, this doctrine does give rise to certain practical problems, especially where the company's direction and administration is carried on in more than one country. According to Batiffol and Lagard[30], "*Le siège social est là où se trouvent "la direction supérieure et le contrôle de la société", "et non celui où elle a seulement son exploitation et une direction de caractère*

[28] See Chapter by S. Rammeloo in J.Wouters and H.Schneider (eds.), *Current Issues of Cross-Border Establishment of Companies in the European Union* (1995, Antwerp), at p.65.

[29] Y Loussouarn and P. Bourel, *Droit International Privé* (1993 Paris) at p. 657.

[30] H. Batiffol and P. Lagard, *Droit International Privé* 7th ed. (Paris 1981-3) Vol II at p. 232.

secondaire””.[31] They say that normally there is but one place where final decisions are taken, and these are precisely those matters which should be determinative of the link. The matter is dealt with in French courts as a matter of fact for the judge to decide. Where there is a difference between the location of the meetings of the board of directors and that of the general meetings, Batiffol and Lagarde take the former as being more influential.[32] Loussouarn and Bourel take the same line, but do add that where a business does have contact with several jurisdictions, *a priori* the company's constitution can provide for the real operation of the direction of the company in one or in another of these countries. For Germany, Wulf-Henning Roth states that the, "Supreme Court (*Bundesgerichthof*) has defined the real seat of a company as the place where the internal management decisions of a company are transformed into the day-to-day activities of a company."[33] He refers to problems caused by the multi-state activities of certain companies, and says that if difficulties in determining the real seat do arise, German courts could be expected to equate the real seat with the seat specified in the company's constitution.

[31] *Ibid.,* citing Req. 28 Oct. 1941, G.P. 1942.1.18; and Req. 22 Dec. 1941, S. 1942.1.31. They also cite Greek decisions to the same effect.

[32] *Op. cit.,* at p.233 n.5.

[33] Wulf-Henning Roth in his contribution to *Current Issues of Cross-Border Establishment of Companies in the European Union* at p. 32, referring to the decision reported at BGH, 21 March 1986, BGHZ, 97, 269, 272.

III THE RECOGNITION OF FOREIGN CORPORATIONS

In this section we need to examine the bases adopted in various countries for the recognition of a foreign corporation. The nature of the consequences or effects of this recognition will be examined under the two principal theories mentioned above and the two conflicting philosophies which underlie them will be considered.

A. The Basis for Recognition

There has been a debate about whether states ought to recognise foreign corporations at all. In both Europe and the US, in the last century, views were put forward to the effect that a company, being a creature of the legal system which created it, can have no existence outside the ambit of that law.[34] These views , in part based upon the concession theory of corporate personality, have long been refuted. They have been replaced by what Rabel describes as the International Theory based upon the idea that corporations are analogous to individuals,[35] and if created by a competent state they need no particular recognition in other states. The imperatives of increasing capitalism and the demands of international commerce have led the way towards a more open attitude to the recognition of foreign corporations. Rabel states that recognition, "signifies that the authorities of a state affirm a foreign created legal person as existent for all purposes, applying the law considered to be the personal law."[36] Today corporations are generally recognised upon two distinct bases. Some countries use the concept of the real seat to determine the suitability of the foreign corporation for recognition. If the corporation is validly established according to the law of its real seat, then, subject sometimes to certain conditions, it will be recognised. The other school of thought, beginning perhaps in the common law world, uses the concept of the place of incorporation. If a company is validly formed in accordance with the law of its place of incorporation, then it will be recognised. In this area though, France has followed its own particular path, dictated in this instance perhaps more by accidents of history than a respect for any particular theory.

B. The Real Seat Approach

Countries like Belgium, Luxembourg, Greece and Germany use the concept of the real seat of the company to determine the link between the company and its system of law. What seems to be required is that in order to be recognised, there must be an appropriate link between the company and the country from which it comes. This link will usually be the same as that which is ultimately used to determine the governing law. Hence, while nationality may be the apparent criterion for determining the governing law in some countries, its actual basis, that of the real seat, is the determining factor in terms of recognition. Therefore a company will be recognised in these countries if it is validly incorporated under the law of its real seat.

One matter which is slightly surprising is that many of the texts or authorities usually cited in respect of the recognition of foreign corporations are rather unclear on the matter. In Greek law for example, art 10 of the Civil Code states that, "The capacity of the legal entity is

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[34] See for example the views of Laurent in *Droit Civil International* IV n.100, 119; Weiss, *Traité Théoretique et Practique de Droit International Privé,* Vol II p.448, and vol IV p.695, Judge Taney in *Bank of Augusta v. Earle* (1839) 13 Pet. S. C. 519 at 588, and Field J. in *Paul v. Virginia* (1868) 8 Wall. 168. See generally Rabel, *The Conflict of Laws: A Comparative Study* at pp. 124-128.

[35] See for example the views on the 'real will' and the 'real' existence of corporations and other associations put forward by Otto Gierke in *Die Genossenschaftstheorie und die Deutche Rechtsprechung* (1887) 5, 604.

[36] Rabel *op. cit.,* at p.132.

regulated by the law of its seat".[37] This is enough for legal commentators to hold to the real seat recognition theory. Italian law is scarcely more helpful. Article 16 of the General Principles of Law preceding the Civil Code states that, "Aliens enjoy the civil rights attributed to citizens on condition of reciprocity and subject to the provisions contained in special statutes. This provision also applies to alien legal persons."[38] This is subject to article 31 of the General Principles, which says that, "Notwithstanding the provisions of the preceding articles, in no case can the laws and acts of a foreign state ..... be effective within the territory of the State, when they are contrary to public policy or morals."[39] On this apparently slender basis, it is possible for a commentator to say that, "Foreign corporations and other entities are recognised in Italy on a reciprocal basis if they are recognised in the country of their incorporation, provided the foreign law is not contrary to Italian public order or public morals."[40] It is different however, if the foreign corporation has its head office or principal place of business in Italy, for then they are as subject to Italian law as if they were incorporated in Italy (Art. 2505 Civil Code). Hence we must say that Italy has adopted a compromise position because, while the place of incorporation has an important part to play, the real seat of the company is taken into account in determining the law applicable to the company and thus also in the context of recognition. However the notion of reciprocity does pose potential problems.

In Germany, the question of whether a legal entity is regarded under German Private International Law as being a properly incorporated legal entity is determined in accordance with the *Sitztheorie*, a test that uses the criterion of the actual and effective place of administration of the company.[41] This theory is used because it is said to lead to the law of the state which is most affected by the activities of the company, and by giving effective control to that state, most effectively protects the interests of potential creditors.[42] The theory was applied in one recent case with interesting results. The case[43] concerned a company formed under the law of Gibraltar as a non-resident limited company. Its business was conducted by its major shareholder from his office in Germany. The court held that when a company which was incorporated abroad has its place of administration in Germany, the legal nature of the entity had to be determined pursuant to German law, regardless of whether the company had got legal personality according to the law of the country where it was formed. To be recognised as a legal entity it would have to comply with certain mandatory legal requirements enacted to protect third parties doing business with a company of this kind. This company was not entered on the commercial register at its *Sitz* or place of administration (Germany), and so the court declined to recognise it as a legal entity. Instead it treated the transactions in question as if they had been carried out in the name of a company before its registration, and hence made the person who acted in its name personally liable for the contract that he had entered into under art 11(2) GmbHG 1980 (Law on private companies). He had acted on behalf of an entity which did not have legal personality according to German law, which under German conflict rules was the applicable law.

C. *The Place of Incorporation Approach*

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37 In their "Explanation of the Civil code", Georgiades and Stathopoulos, commenting on art. 10, state, "The formation of the legal entity is to be regulated by the law of its seat (Athens Court of Appeal 2701/1968). Even if the type of company is unknown to Hellenic law, this does not affect the acknowledgement of the legal personality within Hellas." [Translation by Grace Katsoulis]

38 M. Beltramo, G. Longo and J Merryman, *The Italian Civil Code*, (1969 Dobbs Ferry, N.Y.).

39 *Ibid.*

40 Maisto & Miscali, *Business Law Guide to Italy* (1992 Wiesbaden) § 404 at p.35.

41 See BGH, NJW, 1986, 2194, 2195; OLG München, NJW 1986, 2197, 2198; OLG Hamburg, NJW 1986, 2199; OLG Oldenburg, NJW 1990, 1422.

42 See the decision of the Bayerisches Oberstes Landgericht, (BayObLG, 7 May 1992, ZIP, 1992, 842), cited by Wulf-Henning Roth in his contribution to *Current Issues of Cross-Border Establishment of Companies in the European Union*, at p.31.

43 LG Marburg, RIW, 1994, 63.

In common law countries the liberal tradition of recognition of foreign corporations goes back a long way. One of the leading cases in England is *Henriques v Dutch West India Co.*[44], reported in 1728, which founded the rule that a "corporation duly created in a foreign country is to be recognised as a corporation in England."[45] Whether an entity is a corporation depends on the law of the country in which it is formed.[46] This same approach to recognition is taken, for example, in Ireland and Denmark. In these three countries the place of incorporation is the key factor linking a company to a system of law. It follows therefore that if a company has been properly formed in accordance with the law of its place of incorporation, then it will be recognised in these countries even if its real seat happens to be in another country, perhaps in one which adopts the real seat theory as its basis for linking a company to a system of law. For these place of incorporation jurisdictions the real seat will become a relevant factor where the company was incorporated in a country such as Germany where it is necessary for the real seat actually to be in Germany in order for the company to be properly constituted. If the central administration of such a company was, for example, in Belgium, the German authorities would not recognise the entity as being properly constituted, and hence English, Irish and Danish courts would tend not to recognise the company either. It is felt that they would take this view notwithstanding the fact that the Belgian authorities could adopt the position that the company was a valid legal entity, particularly if it had registered itself on the Belgian commercial register. These courts would look at the way in which the company was treated by the law of the place if its incorporation.

The Netherlands used to apply the theory of the *siège réel* but abandoned it by a law of 25 July 1959, which provided that the recognition of a foreign company could not be refused simply because its *siège réel* was not in the country where it was incorporated, but was in the Netherlands or in another country which took account of the company's seat. Before 1959, Dutch law had an ambivalent attitude towards recognition and governing law principles, with case law and academic writings showing adherence to both the real seat and place of incorporation doctrines.[47] Some of this hesitancy is reflected in the negative formulation of the Dutch rule, which merely rejects the *siège réel* approach but does not explicitly adopt the place of incorporation theory. However Rammeloo states that, "since the turning point in 1959, case law has looked favourably upon the incorporation theory, unless concrete appreciation forced the judge to decide otherwise".[48] He cites a decision of the Netherlands Supreme Court[49] as demonstrating an explicit and unconditional acceptance of the incorporation theory. Where a company has its central administration in the Netherlands, public policy considerations may mitigate the strict application of the theory of the place of incorporation.[50] There are in fact a growing number of complaints that companies are incorporating as private companies in the UK, where there are no minimum capital provisions for such entities, and then conducting their business both in and from the Netherlands.[51] They are there recognised under the place of incorporation theory, and are thus able to avoid compliance with the minimum capital provisions

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44 (1728) 2 Ld. Raym. 1532, 92 E.R. 494

45 See Dicey and Morris *The Conflict of Laws*, at p.1107.

46 *Dreyfus v CIR* 1929 14 TC 560 at 576-7.

47 See the discussion by Stephan Rammeloo in *Current Issues of Cross-Border Establishment of Companies in the European Union.* at pp. 52-55.

48 *Ibid.,* at p.54.

49 Netherlands Supreme Court, 20 April 1990, *RvdW*, 1990, 84, NJ, 1991, 560.

50 See Rb. Amsterdam, 6 April 1982, WPNR 5765, p.817. The matter may also be affected by the application of the doctrine of "*fraus legis*". However, in a later case before the Dutch Supreme Court, 11 November 1988, NJ, 1989, 606, known as the *Texelse Visser* case, the court showed itself to be unwilling to subject foreign companies to the provisions of Book II of the Dutch Civil Code which require Dutch companies to register, on pain of the joint and several liability of their directors.

51 There are reputed to be some 6,000 of such companies according to Prof. L. Timmerman (University of Groeningen).

applicable to Dutch private companies. There are currently new draft laws being considered in the Netherlands to deal with these problems .[52]

D. The French Approach

In the first half of the nineteenth century foreign companies were recognised in France and in Belgium without difficulty, following the real seat or other prevailing doctrines. However, in 1849 the Belgian *Cour de Cassation* refused to recognise that a French *société anonyme* or public company had legal personality in Belgium[53]. The resulting furore led to a treaty in 1854 between the two countries and subsequent amendments to their laws providing for reciprocal recognition. However, the way in which the French law of 30th May 1857 was drafted led to an unforeseen consequence. This was that as far as public companies were concerned, they could only be recognised in France if a general decree was enacted in France in favour of the *sociétés anonymes* of a particular country or if an international treaty was made between France and that country. Since that time many such general decrees have been promulgated and there are quite a number of treaties in existence, but there is still not a universal principle of recognition[54]. It seems that this rule just applies to public companies, and that other types of company (such as private companies) or associations will be governed by the previous *siège réel* basis for recognition. In all cases though, the recognition of a foreign company can be refused on public policy grounds, for example in respect of a drug-money laundering company or one formed to finance subversive political movements.

E. Treaties and Conventions

There are many treaties and conventions extant under which one nation agrees to recognise companies legally formed upon the other nation's territory, either absolutely or upon certain conditions, such as there being nothing in the company's constitution or objects which is contrary to the other nation's public policy. There is a network of bilateral treaties linking many European and other states. However the terms and the bases for recognition vary from convention to convention, and the network does not give complete coverage. There are also several multilateral conventions which have been proposed over the years, but none of them has ever been put into effect.

The problems created by the cross border operation of companies could be minimised in a number of ways. If all states adopted the same criterion for a connecting factor linking companies to a particular jurisdiction, then it would not matter where a company was located, because it would be treated in the same way by all jurisdictions. Alternatively, if all states agreed to recognise companies created in any other state (regardless of that state's adopted connecting factor) there would again be no discrimination. But many of these ideas and others like them have already been tried, either alone or as compromises between the two main approaches, and the filing cabinets of Europe and elsewhere are full of conventions and proposed agreements which have failed to obtain recognition or ratification by all of the parties. See, for example, the proposals of the League of Nations in 1929[55], the Hague Convention of 1951 which was signed by several of the participating states at the Hague Conference on Private International Law of 1956, the Institute of International Law rules of 1965[56], the Council of Europe Convention on the Establishment of Companies 1966..

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52 See section IV D below.

53 *Pasicrisie* 1849.1.221.

54 See B.Goldman and A.Lyon-Caen, *Droit Commercial Europèen*, 4th ed., (1993, Paris) at p.130.

55 See the sub-committee draft of the League of Nations for an international treaty on commercial companies.

The latest in this line is the EC's Convention on the Mutual Recognition of Companies, produced on the basis of article 220 of the Treaty of Rome, and signed on 29 February 1968. However, the Netherlands has consistently refused to ratify it, inhibited perhaps by the provisions of its law of 25 July 1959 referred to earlier. The Convention tried to effect a classic compromise between the place of incorporation and the *siège réel* theories. It provided that companies established in accordance with the law of a member state and which have their registered office within the Community, must be recognised as of right in the other member states. However, the next two articles seem to have a different approach. The first is the rule permitting member states not to apply the convention to companies which have their real seat outside the Community, and which do not have an effective link with the economy of a member state. The second, and more fundamental, derogation from the place of incorporation approach permitted member states, by a unilateral declaration, to apply their own mandatory legal provisions to companies incorporated in another member state, but having their *siège réel* in the state of reception. Hence they could say, "we recognise you, but you will have to change your constitution". This convention like all of those which have gone before, is currently gathering dust.

F. Conflicting Philosophies

None of these learned, scholarly and at times very practical solutions have ever come to fruition. Why is this? The most obvious reason is because the two conflicting philosophies in this field have never been fully reconciled. One, the place of incorporation concept, originated from trading nations, keen to adopt a liberal open approach, with freedom to trade and to do business very much in mind. Equally the perceived need for certainty in commercial transactions is capable of having been another mainspring of this approach. Hence a system which told you immediately whether the corporation was valid at its place of birth, and therefore recognised in the relevant country had a great appeal. The other approach looked for a real connection between the corporation and the legal system upon which it depended for the establishment of its legal personality. Both concepts are agreed that the company must have been properly constituted according to the legal system to which it is attached, but they differ over the nature of that attachment. The common law has taken what one can describe as the fiction theory approach to the nature of corporate personality, while many civil law systems have adopted a more realist approach to the question.

No satisfactory solution has been found to the overt conflict between the *siège réel* states and the place of incorporation states, despite many ingenious efforts. However other issues may underlie this inability to reach an agreement on the matter. There is a deeper diversity between the laws of the various states involved. Many laws adopt a substance approach to company law, in the sense that they are more interested in the substance of transactions than in the form in which they are couched. On the other hand there are jurisdictions such as that of England and Ireland which adopt a form-based approach *i.e.* if the company complies with the relevant formal requirements, then there is no need to insist that it also complies with the substance or spirit of the law. One classic example may serve to illustrate this point. In the paradigm case in the UK enunciating the existence of a company's separate corporate personality, *Salomon v. A. Salomon & Co. Ltd*.[57], Lord Macnaghten stated that, "There is nothing in the Act requiring that the subscribers to the memorandum should be independent or unconnected, or that they or any one of them should take a substantial interest in the undertaking, or that they should have a mind and will of their own". This classic one man company, where the other shareholders were drawn from that one man's family, was

[56] A commentary on these rules from an essentially UK perspective is provided by T.Drucker, "Companies in Private International Law", (1968) 17 I.C.L.Q. 28

[57] [1897] AC 22, House of Lords.

recognised as perfectly valid under English law. One can compare this with the refusal to accept a ‘man of straw’ (literally an *homme de paille*) as a shareholder under Belgian and in theory under French law. Before the introduction of legislation authorising one man companies, these jurisdictions required a substantial participation by each of the founding shareholders for the company to be validly incorporated and beyond attack on the basis of nullity.

Another explanation may be that these treaties have never got to grips with the legitimate interests of the various states in the matter, and always meet with the insistence on the maintenance of sovereignty as much as possible. States will just not give up their rights to refuse to recognise what they do not wish to recognise. In so far as this means that they are not willing to lose the right to protect themselves from the exploits of criminals trying to launder money, and financiers up to no good in carrying out shady deals through offshore companies, who can blame them.

One thing though remains as a profound obstacle to further development in this area. The real seat states are most reluctant to depart from their system of recognition because they feel that it offers them the best protection against the depradations feared from the Delaware syndrome. If some way is found of assuring them that there are other ways of providing the desired protection this might open doors that have been closed for many years.

IV RESPONSES TO THE 'DELAWARE SYNDROME' IN REAL SEAT AND PLACE OF INCORPORATION JURISDICTIONS

A. The US Experience

The 'Delaware Syndrome' was spawned by the adoption in the United States of the place of incorporation rule for recognising and governing 'foreign' corporations, especially those from other states in the union. The ability of the proprietors of a business to choose the jurisdiction that best suited their perceived needs has led to the emergence of one state as the most popular *situs* both for new incorporations and, especially, for reincorporations. The first contender in this corporate law beauty competition was New Jersey but, after its regime was 'tightened up'in 1913, it was overtaken by Delaware.[58] David Charny states that the law of Delaware, "drafted under the auspices of the DuPont family to protect their managerial and shareholder interests - appeared relatively favourable to managers-shareholders of other corporations as well"[59]. Delaware has seen to it that it has maintained its pre-eminence. Bebchuk reports that,

> Delaware is at present the domicile of more than half of all Fortune 500 companies and more than forty per cent. of all companies listed on the New York Stock Exchange. It is also the leading destination of companies that re-incorporate: Delaware attracted eighty-two per cent. of publicly traded firms that reincorporated in the past three decades and ninety per cent. of the New York Stock Exchange-listed Companies that reincorporated between 1927 and 1977.[60]

The phenomenon of the development of a market for corporate charters in listed companies has been extensively studied in the United States. At least three major strands of opinion can be identified in the search for explanations of the Delaware Syndrome. The first adopts the trenchant metaphor first put forward by Justice Brandeis, who described the system that led states to promote rules that attract corporations as the "race to the bottom".[61] This view, which is well argued in the seminal article by William Cary[62], takes the line that states which have rules which are particularly lax or favourable to managers will attract most incorporations to the benefit of that state's coffers and the local bar. Cary's article ends with the stirring words, "A civilising jurisprudence should import lifting standards; certainly there is no justification for permitting them to deteriorate. The absurdity of this race to the bottom, with Delaware in the lead - tolerated and indeed fostered by corporate counsel - should arrest the conscience of the American bar when its current reputation is in low estate."[63]

Since Cary's article was published other views have emerged. One of these takes the line that market forces "will discourage managers from seeking incorporation in states with legal rules that permit managers to "exploit" shareholders. Incorporation in such states would increase the company's vulnerability to takeovers (which threaten managers' jobs), lower managers' compensation and other employment-related benefits and harm managers' present and future job prospects."[64] This view, which is adopted by Frank Easterbrook, Daniel Fischel,

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58 See David Charny, "Competition among Jurisdictions in formulating Corporate Law Rules: An American Perspective on the "Race to the Bottom" in the European Communities" (1992) 32 Harv. Int'l L.J. 423 at. pp.427-8, citing *inter alia* Henry N. Butler, "Ninteenth Century Jurisdictional Competition in the Granting of Corporate Privileges", 14 J. Legal Stud. 129 (1985).

59 David Charny *ibid.*

60 Lucian A. Bebchuk, "Federalism and the Corporation: The Desirable Limits on State Competition in Corporate *Law",* 105 Harv.L.R. 1437 (1992)

61 See the dissenting opinion of Brandeis J. in *Liggett v. Lee*, 288 U.S. 517, 557-60 (1933)

62 William Cary, "Federalism and Corporate Law: Reflections upon Delaware", (1974) 83 Yale L.J. 663.

63 *Ibid.,* at p. 705.

64 Bebchuk, *op. cit.,* at p. 1445.

Ralph Winter and others[65] sees Delaware's dominance as due to its adoption of rules which are most efficient from the shareholders' point of view. In their eyes the race for the bottom actually becomes a "race for the top". Both of these views look to the substantive content of a state's rules as it major attractant feature. However, other states, especially Nevada and Wyoming, have not lagged far behind Delaware in producing attractive regimes[66], but nevertheless it retains its pre-eminence. The work of Prof. Roberta Romano emphasises the formal advantages of the Delaware regime - comprehensive statutes and case law, experienced judiciary, wealth of precedents and the interest of a state that depends more heavily than its competitors on incorporation revenues (receipts from franchise taxes and fees and the income of local service providers, including lawyers) in maintaining the stability and serviceability of its regime.[67] Bebchuk has characterised this as "the race for predictability and stability",[68] but says that it still does not address the question of whether state competition is desirable. His learned analysis, "largely endorses federal intervention with respect to the corporate law areas currently governed by federal law, including insider trading, corporate disclosure, certain aspects of takeover bids and proxy contests and creditor protection in bankruptcy." [69] He suggests that, "the federal role should be expanded significantly to cover important areas currently governed by state law. In particular, federal rules, or at least, federal minimum standards, are warranted with respect to self-dealing transactions, taking of corporate opportunities, freezeout mergers, all aspects of takeover bids and proxy contests, and limitations on dividends."[70]

B. A European Perspective

There is a growing body of literature examining the implications for Europe of the "race for the bottom" approach to corporate regulation.[71] There is also some evidence that there have in the past been some attempts within Europe to take advantage of the Delaware syndrome to the extent of business proprietors seeking a benign jurisdiction in which to incorporate their enterprise. In the latter half of the last century French based businesses were wont to incorporate in England using a 'post-box' office which merely redirected letters to the real centre of the business in Paris.[72] In this century, in recent years French enterprises wishing to avoid some of the constraints of the law on *sociétés anonymes* (S.A.) have sought to take advantage of the flexibility offered by the form of the Dutch *naamlose vennotschap (N.V.)*.[73] Earlier in this article the propensity of Dutch businesses to incorporate in England to avoid

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[65] Frank Easterbrook, "Managers' Discretion and Investors' Welfare: Theories and Evidence", 9 Del. J. Corp. L. 540; Frank Easterbrook & Daniel Fischel, "Voting in Corporate Law", (1983) 26 J.L. & Econ. 395; Daniel Fischel, "The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's corporation Law", (1982) 76 Nw. U. L. Rev. 913; Ralph Winter, "State Law, Shareholder Protection, and the Theory of the Corporation", (1977) 6 J. Legal Stud. 251; Peter Dodd & Richard Leftwich, "The Market for Corporate Charters: "Unhealthy Competition" Versus Federal Regulation", (1980) 53 J. Bus. 259.

[66] See for example John Coffee, "The Future of Corporate Federalism: State Competition and the New Trend Toward De Facto Federal Minimum Standards", (1987) 8 Cardozo L.Rev. 759.

[67] See Roberta Romano, "The Political Economy of Takeover States", (1987) 73 Va. L.Rev. 111; "The State Competition Debate in Corporate Law" (1987) 8 Cardozo L.Rev. 709; "Law as a Product: Some Pieces of the Incorporation Puzzle" (1985) 1 J.L.Econ. & Org. 225.

[68] Bebchuk *op. cit.,* at pp. 1446-7.

[69] *Ibid.,* at p. 1510.

[70] *Ibid.*

[71] See for example the excellent Chapter 9 in Brian Cheffins, *Company Law: Theory Structure and Operation*, (Oxford 1997), pp. 421-451; David Charny *op. cit.;* Werner Ebke, "The Limited Partnership and Transnational Combinations of Business Forms: "Delaware Syndrome" Versus European Community Law", (1988) 22 Int. Lawyer 191.

[72] Batiffol and Lagarde *op. cit.,* at p. 232.

[73] Michel Germain, "La société par actions simplifiée", (1994) La Semaine Juridique (JCP) Éd. G, n°. 12 p.153.

some of the more unwelcome features of the law of the place where their business would actually be carried on was noted. Is there a real threat of a Delaware syndrome developing in Europe?

We have had in the heart of Europe an accommodating company and enterprise law regime in the shape of that of the Principality of Liechtenstein. This jurisdiction offers a very wide variety of legal forms of enterprise, including that of the domiciliary enterprise which merely has to have its registered office or seat in Liechtenstein - with or without an actual office - and does not exercise any business or commercial activity within the country[74]. Such an entity can enjoy several advantages not widely offered in other European jurisdictions, for example in relation to publicity on formation[75], and inspection of the public register which does not, for example, provide information on the shareholders or accounts of the company[76]. Gibraltar too has an accommodating regime. Such jurisdictions could form the base for a European version of the Delaware syndrome, if other states in the region were inclined to give something like 'full faith and credit' to companies stemming from such a source.

C. The Real Seat Response

However, as has been said, it is this very threat that has motivated the conflicts systems of most civil law systems in Europe to adopt the real seat recognition test referred to above. A whole series of French decisions spanning the years between 1889 to 1957 has firmly maintained, in reponse to the 'post-box' companies referred to above, that a company cannot have a fictive seat, and that only one which corresponds to the actual location of the headquarters of the enterprise will be acceptable.[77] The mere possibility of a corporation coming into their country from a more lax jurisdiction, and thereby enjoying legal advantages over domestic corporations, has proved anathema to these jurisdictions. As Inne Cath has stated, [78]

> "The system of '*siège réel*' .... is generally defended on the ground that abuse of foreign and more lenient company law should be prevented or that certain mandatory requirements of (domestic) substantive law are of primordial importance (`*règles d'application immédiate*') for public policy considerations, or simply as a protectionist means to regulate entry of foreign companies."

This view is very strongly held in a majority of European Union countries, with only the Netherlands, the United Kingdom, Ireland and Denmark taking the more liberal place of incorporation line.

We need to look at the interests of the various countries when the question of recognition and acceptance of a foreign corporation is in issue. The real seat countries are very wary of a corporation coming from abroad which has no real connection with its state of incorporation, being recognised as a legal entity in their country and possibly enjoying advantages of a lax or liberal regime, thus putting itself at a competitive advantage compared to home produced corporations. However, this hypothesis requires further analysis. While real seat states require a genuine connection between a corporation and the state from whose laws it derives validity, when it comes to the capacity or status of that corporation, and the rights that such a corporation is to enjoy, they generally take the line that such a foreign corporation cannot enjoy rights greater than those of domestic equivalent corporations. Hence the spectre of unfair competition is not a real

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[74] Dr. P. Meinhardt *Company Law in Europe* 3rd ed. (Aldershot 1981) at entry FL.-Intr(ii).

[75] *ibid.,* at FL(AG) - 2(iii) where publicity for the formation of a domiciliary enterprise is not published in the official journals as ordinary public companies (AG) are, but is instead posted as a notice on the announcement board of the court (*Personen- und Gesellschaftsrecht* art. 955).

[76] L.S. Sealy, P.G. Xuereb, R.R. Drury, C.R. Emmanuel, S.J. Gray, C. Murphy and D. Smith eds *International Corporate Procedures,* (Jordans, loose-leaf), entry for Leichtenstein IV A 1.

[77] For further details of these cases see Batiffol and Lagarde *op. cit., at p. 232.*

[78] Inne G.F. Cath, "Freedom of Establishment of Companies: a New Step Towards Completion of the Internal Market" (1986) 6 YEL 247, 250.

one in this respect. However, when it comes to liberal reporting and accounting arrangements or the rights of shareholders, the foreign corporation may be able to enjoy benefits not available to the domestic corporation. Hence there is a considerable and genuine fear of the Delaware syndrome in Europe, [79] and this continues to underpin and reinforce a stringent adherence to the real seat doctrine as a first line of defence.

D. The Place of Incorporation Response

The Delaware syndrome also poses problems for place of incorporation countries, whose apparently liberal recognition policies potentially leave them wide open to abuse. However these jurisdictions have shown that they are not powerless to defend themselves, and they have used a variety of techniques to protect vulnerable interest groups. In the US, as we have seen earlier in this work, in the case of *Western Airlines Inc. v. Sobieski*, some state jurisdictions apply special conflicts rules when dealing with "tramp" or "pseudo-foreign" corporations. Other techniques involve the use of statutory rules or protection devices. In an influential article[80], Elvin Latty poses the question whether the law can be, "so simple and so blind", as to allow the citizens of one US state to avoid uncongenial features of local corporation law by incorporating in another state which does not have those features. He argues that decisions which seem superficially to support the conclusion that pseudo-foreign corporations are beyond the reach of local law because of the place of incorporation rule, are in fact reconcilable with an approach that distinguishes between pseudo-foreign corporations and the genuine variety. Latty reviews the line of cases that have applied the classic place of incorporation rule selection doctrine to pseudo-foreign corporations, a line pre-eminently represented by *Demarest v. Flack*[81], and argues that these decisions were in fact sound because no local policy was prejudiced by the recognition of such corporations as valid. He finds that this whole line of cases which have applied the law of the place of incorporation does not conclusively establish a determining rule because, in his words, "the courts looked first to the state of incorporation and, finding no particular local policies substantial enough to overbalance the convenience of applying the foreign law, applied it."[82]

Latty also examines a formidable number of cases which have applied local law to pseudo-foreign corporations. Some comparatively early cases have challenged the *'situs'* of a localised pseudo-foreign corporation, for example by allowing local garnishment of shares held by a defendant in such a corporation. Another line of cases has disregarded the law of the place of incorporation on the grounds that it is contrary to local public policy, even though the policies have been somewhat outmoded by today's standards. Examples have included restrictions on the ability to incorporate, seeking after limited liability unavailable locally and avoiding local safeguards for protecting creditors such as minimum capitalisation provisions. In a case which is relevant in a current European context, a Missouri court, mindful of a local statute requiring authorised capital to be fully subscribed and paid up to fifty per cent., found a group of Missouri residents, who had formed an undercapitalised Colorado corporation to run a Missouri business, subject to unlimited personal liability.[83] More modern protective legislation which has been litigated concerns the right to inspect corporate books without having to prove a 'proper' motive as required by the law of the place of incorporation. Latty suggests that states should stick to known and certain conflict rules, "until - but only until -

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[79] See for example Werner Ebke, "The Limited Partnership and Transnational Combinations of Business Forms: "Delaware Syndrome" versus European Community Law" 22 The International Lawyer 191 (1988).

[80] Elvin R. Latty, "Pseudo - Foreign Corporations" 65 Yale L.J. 137 (1955).

[81] 128 N.Y. 205, 28 N.E. 645 (1891).

[82] Latty, *op. cit.,* at p.150.

[83] *Cleaton v. Emery* 49 Mo. App. 345 (K.C. Ct. App. 1892)

there are strong policy reasons for doing otherwise"[84]. When this occurs, the local law could be applied on a selective basis favouring, "those protective features of local law that indicate a fairly strong policy of safeguarding the particular local interests in question (creditors, stockholders)."[85]

The desire to safeguard local interest groups has led individual states in the US to bring in a statutory protection device. It must be remembered that recognition under the place of incorporation rules does not mean that the corporation will automatically be allowed to do business in the recognising state. Most states have a qualification statute which requires a foreign corporation to "qualify" before doing business in that state. Usually this qualification will involve a registration process and a formal appointment of an agent to receive service of process or writs. There are limits though, because it should also be remembered that the commerce clause of the US constitution prevents states from imposing undue burdens on interstate commerce and hence upon corporations engaged in it. William Carney has described the process in the following way[86],

> Beginning in 1852, the states gradually adopted laws that resemble modern statutes dealing with the qualification of foreign corporations to do business locally. Typically these laws required a foreign corporation to obtain a certificate of authority to transact business locally, which would issue on condition that the corporation make fundamental disclosures comparable to those of domestic corporations, appoint a local agent for service of process, and pay franchise fees. These statutes were not adopted grudgingly, but as a means of assuring that local citizens could obtain jurisdiction over such corporations, should disputes arise.

In a significant group of US states the penalty for non-compliance with such laws requiring authorisation is that the corporation cannot enforce a contract in the state courts.[87] In a smaller group of US states the non-complying corporation loses not only its rights to sue in the state courts, but also its rights under the contract.[88]

Latty's analysis has shown that there are statutes in more that half of the US states which have the effect of approximating locally active foreign corporations to local ones.[89] These statutes may provide that foreign corporations which are admitted to do business locally are not to get better treatment than domestic corporations, or they may subject foreign corporations doing local business to all of the law, or just the corporation law, of the state. In a few states in the US certain local regulations are expressly applied to pseudo-foreign corporations. Following the Californian decision in *Western Airlines Inc. v. Sobieski* a statute was adopted applying certain sections of the Californian Corporation Code regulating fundamental corporate changes to pseudo-foreign corporations. New York also takes a similar line with all foreign corporations not just pseudo-foreign ones. Latty notes that, "some of the local statutes that are expressly made applicable to foreign corporations in matters of what may be called internal affairs seem to be invoked in full force only against predominantly localized enterprises."[90]

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84 Latty o*p. cit.,* at p. 140.

85 *Ibid.,* at p. 141.

86 William Carney in *Current Issues of Cross Border Establishment of Companies in the European Union*, at p.256.

87 See E. Rabel *The Conflict of Laws: A Comparative Study* at pp. 203-4, where it is noted that the party dealing with the corporation is still bound to the contract, and the offending corporation may sue on the contract in the courts of other states and in the federal courts.

88 *Ibid.,* at p.205.

89 Latty *op. cit., at* pp. 156-8.

90 Latty *op. cit.,* at p. 154. He cites as an example the case of *State ex rel. Weede v. Iowa Southern Utilities Co. of Delaware* Iowa 784, 2 N.W. 2d 372 where a local Iowa statute that made certain provisions of Iowa corporations law applicable to foreign public utility corporations was applied to a Delaware corporation with utility properties solely in Iowa by a court which emphasised the essentially local character of the corporation.

However, despite the line taken in these states and in some isolated decisions like the ones referred to above, generally US states stick to a place of incorporation approach regarding the internal affairs of foreign corporations, and do not seek to protect the interests of their citizens by manipulating conflict of laws rules, preferring to rely on the 'qualification to do business' approach.

In the UK it has long been the case that, despite a very liberal attitude to recognition of foreign companies, certain safeguards have been put in place to protect those who do business with them. The UK has for many years protected its citizens by requiring all 'overseas companies' which establish a place of business in Great Britain to register in the Companies Registry in accordance with the provisions of the Companies Acts and to disclose their accounts.[91]. This regime has now largely been subsumed into the new structure inaugurated by the Eleventh Company Law Harmonisation Directive[92]. Under this EC wide regime the same information has to be provided, plus certain other particulars such as the extent of the authority of the directors to represent the company.[93] This can be seen as an attempt to protect the citizens of the host state by giving them access to information on companies doing business in their domain.

As has been mentioned above, Switzerland, by passing its Private International Law Statute, which became effective from 1 January 1989, moved from being a jurisdiction which was characterised by its preparedness to insist on determining validity by the *siège réel* of a company[94], to one which looks primarily to the place of incorporation, and failing that to the place where the company is in fact administered, as a back-up test.[95] However, although the place of incorporation theory predominates, Swiss law has a number of protective devices. For example, Art. 158 of the Private International Law Statute, in the Chapter dealing with foreign companies, provides that, "A company may not invoke those limitations of the power of representation of an officer or an agent that are unknown to the law of the country in which the other party has its business establishment or habitual residence unless the other party knew or should have known of the limitation."[96] The implications of this provision for the protection of Swiss citizens are obvious. There is another provision which could have even more far reaching effects. This is Art.159 which provides, "If the business of a company organised under foreign law is managed in Switzerland or from Switzerland, the liability of the persons acting on its behalf is governed by Swiss law."[97] The provision is not tightly drafted and much depends upon the way in which Swiss courts will construe it, but it is nevertheless a very rigorous way of protecting Swiss creditors against the misuse of a pseudo-foreign corporation.

In the Netherlands there have been problems with the total application of the place of incorporation theory where this is being used to evade certain matters of importance in the domestic jurisdiction. One manifestation of these problems led to the *Segers v. Bedrijfsvereniging* Case[98] in which the Dutch Social Security administration attempted to treat a company incorporated in England, which pursued its main activities in the Netherlands, in a

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[91] See for example the provisions of ss. 406-414 Companies Act 1948, and later those of Part XXIII Companies Act 1985. The registration process included the provision of copies of the constitution of the company, a list of directors and secretary and the names of one or more persons resident in Great Britain authorised to accept service of process and notices. Names used by overseas companies are regulated, and they are required to register copies of their balance sheet and profit and loss accounts.

[92] 87/666/EC implemented in the UK by the Oversea Companies and Credit and Financial Institutions (Branch Disclosure) Regulations 1992.

[93] The provisions governing the registration of accounts are now slightly less rigorous than formerly, because accounts which under the law of the place of incorporation are required to be prepared, audited and disclosed are now acceptable in the UK.

[94] See for example the decision of the *Bundesgericht*, 7 October 1982, *BGE*, 108, II, 318 *et seq.*

[95] Swiss Private International Law Statute Art. 154. See A.Samuel, "The New Swiss Private International Law Act", 1988 I.C.L.Q. 681.

[96] *Switzerland's Private International Law Statute* , trans. P.Karrer and K.Arnold, 1989 Deventer, at p.143.

[97] *Ibid*.

manner different from that in which it treated companies incorporated in the Netherlands. The European Court held that this type of discrimination was unjustified. The Netherlands, a confirmed place of incorporation jurisdiction, has developed its own style of protecting its populace from the depredations of such pseudo-foreign corporations in the form of Art.138 of Book Two of the Civil Code. This applies in the case of the involuntary winding up of a legal person incorporated under foreign law which is subject to corporation tax. It provides in Art. 138.1 that in such a winding up each of its managing directors shall be jointly and severally liable for liabilities remaining unpaid, if the management has manifestly performed its duties improperly and where this has contributed to the involuntary winding up.[99] In addition, as Rammeloo explains, "regulations relevant to both company and labour law provisions governing annual accounts and audit reports ..... imposing a duty to keep accounts on all persons who carry on a business, also apply to foreign "entities".[100]

However, because of increasing and justified fears of abuse, there are two Dutch proposals for legislation which go even further. The first is contained in the 1992 draft of an Outline of a Consolidated Conflict of Laws Act, Art. 76 of which contains a "set of mandatory rules imposing duties on the company, to be fulfilled by its managers and (para. 8) others who are in charge of the management activities conducted in the Netherlands."[101] There is also a further Advisory Draft of an Act governing abuse of foreign company forms which proposes to apply several provisions of Dutch law to pseudo-foreign companies, which are defined as being linked to a foreign legal system purely because of their incorporation.[102]

Altogether these examples from place of incorporation jurisdictions display what a formidable array of armaments can be deployed in order to combat the Delaware syndrome. In very many respects they achieve the same objectives as those which lie behind adherence to the siège réel approach to recognition, in that they ensure the protection of the citizens of the state where the foreign company is trading against attempts by businessmen to shelter behind more favourable provisions of a foreign legal system. However, retention of the place of incorporation basis for recognition does mean that these jurisdictions appear more welcoming to inward investment flows and other business generated by companies that genuinely stem from other jurisdictions.

V CONCLUSION

One gets the feeling that there must have been a certain amount of friction over the years between the proponents of the different views on a suitable connecting factor for corporations in a conflict of laws situation. International conferences and institutions have sought compromise solutions to bring about a situation facilitating recognition among the participating states. Many, if not most, of these have decided on a route which has adopted a base rule looking to the place of incorporation as the deciding factor, but provided derogations in favour of real seat factors where these were felt necessary to protect relevant interests. In reality both views have much to offer, but both proceed from deeply held convictions. The place of incorporation approach offers certainty and comparative simplicity, while the real seat

98 Case 79/85 *Segers v Bedrijfsvereging voor Bank-en Vezekeringswezen, Groothandel en Vrije Beroepen* [1986] ECR 2375.

99 S.Rammeloo in *Current Issues of Cross Border Establishment of Companies in the European Union* at p.. 56.

100 *Ibid*. at p. 59.

101 *Ibid*. at p. 56. These rules include registration, certification of compliance with Dutch minimum capital rules and submission of annual accounts and audit rules. These latter provisions though do not apply to companies governed by the law of an EU state.

102 *Ibid*. at pp. 60-1. These rules will relate in a similar fashion to registration, publicity, minimum capital and disclosure of accounts.

line offers greater protection from abuse and a conceptually more satisfying link between an artificial entity and its contemporaneous legal matrix. It may well be the case that many of the thoughtfully devised solutions referred to above have failed to gain acceptance because real seat states have felt that the protection offered by the compromise solutions (usually non-recognition of corporations whose main activities were not in their place of incorporation) did not go far enough. Local interests were not felt to be adequately protected.

This article has attempted to outline the approaches taken by place of incorporation and real seat jurisdictions to the questions of regulation and recognition of foreign corporations. It has then indicated some of the ways in which such jurisdictions have responded to the threat posed by a corporation incorporated in one jurisdiction, which carries out its business in another jurisdiction which perhaps has more stringent rules governing its domestic corporations. While real seat jurisdictions have relied essentially on that doctrine of recognition to protect themselves, place of incorporation jurisdictions have had to devise other rules to achieve the same ends. If these rules can be seen to fulfil the same function as that carried out by the real seat recognition doctrine, real seat states may be able to make their own evaluation of such rules, and find that they give a viable alternative approach to protection. Such a realisation could lead to a more positive reappraisal of proposals for a Convention on the Mutual Recognition of Companies with its corresponding benefits for world trade.