Introduction

A. Creditor protection – a focal point of current developments

1. The Centros case: from Denmark to Delaware

In any future account of the history of European company law the Centros case¹ will take a pride of place as one of those cases that deserve the epithet ‘seminal’. The case concerned a Danish couple who wanted to set up a business in Denmark, but did not want to use a Danish corporate vehicle. Instead they bought a shelf-company registered in England. When the Danish authorities refused to register their (single) place of business as the Danish branch office of the English company, the couple appealed successfully to the European Court of Justice. The Court accepted the argument that a company formed under the laws of one Member State with a view to carrying on its business exclusively in another Member State had a right to do so under the principle of freedom of establishment enshrined in Articles 43 and 48 of the EC Treaty.

The Centros decision came as a surprise to many lawyers in Germany, and for a short time it engendered an intense debate whether or not it would force them to abandon a doctrine of German domestic law known as the ‘theory of the real seat’.² Its conformity with Community law had previously been widely assumed on the basis of an earlier decision by the European Court of Justice in The Queen v HM Treasury, ex parte Daily Mail and General Trust plc.³ Against the seemingly unassailable authority of that case, even scholars who had previously

thought that the theory of the real seat was incompatible with Community law felt reluctantly that the European Court had decided otherwise. Arguably, however, the near-universal German understanding of *Daily Mail* as confirming the theory of the real seat was coloured by a slightly misleading German translation of that judgment, and by the fact that German lawyers were all too willing to read the case through their specific doctrinal lens, which had been shaped by the previous debate in Germany. Before *Centros*, German courts had been confronted with similar cases involving companies incorporated under English law, but carrying on business in Germany, and they had used these cases as opportunities to reinforce their doctrine of the real seat, while refusing to refer the issue to the European Court of Justice. After *Centros*, a reference from a German court would only be a matter of time. It duly came with *Überseering BV v Nordic Construction Company Baumanagement GmbH*. Although this decision did not outlaw the theory of the real seat as such, arguably allowing Member States to prevent the cross-border movement of companies formed under their own law, the European Court of Justice put an end to all reasonable doubt that Member States cannot normally invoke the theory to stave off companies registered elsewhere within the European Union. Moreover, attempts to interpret *Überseering* restrictively as requiring only the recognition of the existence, status and capacity of the foreign company, but leaving the host Member State free to impose its own law on the


8 Cf. *Überseering* (fn. 7), para. 66–70 and 81, citing *Daily Mail* [1988] ECR 5483, para. 19–20 and 23. Reading the judgment to this effect was promoted by some German commentators, e.g. Stefan Leible / Jochen Hoffmann, ‘“Überseering” und das (vermeintliche) Ende der Sitztheorie’, RIW 2002, 925 at 930 ff.; yet doubted by others, e.g. Daniel Zimmer, ‘Wie es Euch gefällt? Offene Fragen nach dem Überseering-Urteil des EuGH’, BB 2003, 1. The compatibility of such restrictions with the freedom of establishment is called into question in a case currently before the ECJ: C-210/06 (*Cartesio*).
internal and external relations of the company via its choice of law rules,\(^9\) were hard to maintain after the subsequent decision of the European Court of Justice in *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd*,\(^10\) where the Court held that a Dutch statute applying the domestic rules on minimum capital and directors’ liability to a company registered in the United Kingdom, while recognising the legal personality granted by the law of incorporation, was nevertheless incompatible with the freedom of establishment guaranteed by Articles 43 and 48 of the EC Treaty.

What was it that German lawyers had found so appealing about the theory of the real seat? In essence, the theory is a rule of private international law that a company will be treated according to the law of its central place of management (the ‘real seat’), notwithstanding that it may have been incorporated in a different jurisdiction. If the company has not complied with the formal requirements of registration in the jurisdiction of its real seat, it will normally lack the quality of a legal person there. The aim of the theory is to preserve national company law as a policy instrument in areas like creditor protection, by imposing a blanket ban on ‘pseudo-foreign companies’, i.e. companies doing business mainly or exclusively in one jurisdiction, but evading local regulation there by incorporating abroad. Hence, as long as Germany was allowed to shield behind the theory, German entrepreneurs wishing to set up a business in Germany had to accept whatever strings were attached to forming a company under German law.

Now, the freedom of establishment enshrined in the EC Treaty requires all Member States to accept as a rule of private international law what is known as the ‘theory of incorporation’, under which the law applicable to a company is the law of its (chosen) jurisdiction of incorporation. In many respects this new development within the European Union resembles a system which has long been in operation within the United States. It opens up the possibility of a ‘market for incorporations’, where entrepreneurs can shop around Europe to choose whatever legal regime they like best for setting up their company.\(^11\)

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11 See already Brian Cheffins, Company Law (1997), 421 ff. (describing the situation in the US) and 426 ff. (pondering portability to the EU).
Consequently, ‘regulatory competition’ (‘Wettbewerb der Rechtsordnungen’, as it is put in German) has become a much debated topic.\(^\text{12}\)

However, the choice element inherent in such a system has also made it the target of vocal criticism, which, as far as the American discourse is concerned, is indelibly associated with the name of William Cary. In a 1974 article,\(^\text{13}\) which was to become one of the most-cited articles in the history of the Yale Law Journal\(^\text{14}\) and said to have had ‘the impact of a firecracker in a hornets’ nest’,\(^\text{15}\) he coined the phrase ‘Delaware syndrome’ and called it a ‘race for the bottom’, arguing that state legislators were undercutting each other in a competition to please corporate decision-makers to the detriment of other interest groups. His article has sparked an ongoing debate in the United States about the virtue or vice of, respectively, uniform corporate law rules (advocated by Cary) and its opposite, federalism, where the states retain the power to legislate on matters of corporate law. Cary’s argument and most of the American debate ever since has centred on the conflict of interest between shareholders and managers in large publicly quoted companies, and issues of creditor protection hardly come to the fore.\(^\text{16}\) In the aftermath


\(^{14}\) Fred R. Shapiro, ‘The Most-Cited Articles from The Yale Law Journal’, 100 Yale Law Journal 1449 (1991), ranking the article as ninth in citations between January 1985 and August 1989 (at 1464), even though by then more than ten years had passed since its publication.

\(^{15}\) Commentary by John C. Coffee, Jr. (fn. 14, at 1498).

\(^{16}\) Some believe that there is no need at all for legislative protection of creditors, see Frank Easterbrook / Daniel Fischel, ‘The Corporate Contract’, 89 Columbia Law Review 1416 (1989): ‘For debt investors . . . everything (literally) is open to contract’ (at 1418). In contrast Lucian Bebchuk, ‘Federalism and the Corporation: The Desirable Limits on State
of *Centros*, however, the powerful image of the ‘race for the bottom’ has been taken up in Europe, as fears about an erosion of standards of creditor protection, in particular, have been voiced – especially in Germany.

An obvious difference between English company law on the one hand and German company law on the other is that the former has never known a minimum capital requirement for private companies.17 This appears to be attractive for some entrepreneurs, and in *Centros* the applicants left no doubt that their reason for choosing England as the jurisdiction of incorporation was to avoid Danish rules on minimum capital. In terms of policy, minimum capital rules may not be all that important as an instrument of creditor protection. It has been said that ‘the symbolic significance of this issue for the (supposed) modernisation of corporate law far exceeds its economic relevance’.18 Yet it seems that precisely this symbolic value of a ‘headline figure’, easy to grasp for lawyers, business people and politicians alike, has been the main driver behind the debate about competition among the Member States in the field of company law.

2. The European regulation on insolvency proceedings

In a curious twist of legal history, at around the same time as the European Court of Justice demolished the theory of the real seat, efforts were under way to adopt a new piece of EC legislation in a closely related field, viz. the Insolvency Regulation.19 Nothing indicates that the contemporaneous development in the case law had any direct impact on the drafting of the Regulation. On the contrary, the Regulation took over, more or less without any substantive changes, the text of the failed

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17 The minimum capital requirement of £50,000 in s. 763 CA 2006 only relates to public companies; it is a requirement under Article 6 of the Second Company Law Directive (77/91/EEC), OJ L 26 of 31.1.1977, p. 1. This directive has never been extended to private companies, not least due to resistance from the UK: Vanessa Edwards, EC Company Law (1999), 53–55.


European Insolvency Convention, which goes back to a time when it seems to have been unchallenged wisdom among European lawmakers that the theory of the real seat was here to stay. So entrenched was the defence of the theory in some Member States, and the belief in its compatibility with primary Community law, that even as late as April 1998 (less than a year before Centros), a senior official from the European Commission informed the audience at a conference in Bonn that the Commission had no plans to introduce legislation with a view to forcing Member States to relinquish it.

Under the Insolvency Regulation, insolvency proceedings are governed by the law of the insolvency forum (Article 4), and the insolvency forum is determined according to the ‘centre of a debtor’s main interests’ (Article 3). This ‘centre of a debtor’s main interests’ or COMI (as it is known colloquially) represents a kind of re-incarnation of the old idea of the ‘real seat’, albeit with a rebuttable presumption that the centre of a company’s main interests is situated at its registered office. Concerns have been voiced about the ambiguity of the COMI standard. Moreover, there appears to be some scope for forum shopping, notwithstanding that the Regulation aims at preventing it.

Still, taken together, the case law under Articles 43 and 48 of the EC Treaty and the Insolvency Regulation create an intriguing bifurcation as regards the private international law framework for creditor protection. On the one hand, freedom of establishment, as interpreted by the European Court of Justice, requires all Member States to accept the law of the Member State of incorporation in matters properly characterised as company law, including, arguably, capital maintenance and directors’ duties. On the other hand, in all matters properly characterised as

22 Recital 13 of the Regulation; Virgos/Schmidt-Report on the Insolvency Convention para. 75 (with reference to the company’s ‘head office’).
25 Cf. the ECJ’s reference to the ‘functioning’ of the company in Überseering [2002] ECR I-9919, para. 81. For the position of English law see Arab Bank Plc v Merchantile Holdings Ltd [1994] Ch. 71, holding that s. 151 CA on the prohibition of financial assistance by a
insolvency law (of which Article 4 of the Regulation contains a non-
exhaustive list), the Insolvency Regulation allows and indeed requires each
Member State to apply its domestic law to all companies which have their
‘centre of main interests’ within its territory, even though a company may
have been incorporated in another Member State. While, under EC rules,
the distinction between company law and insolvency law has been elevated
to a question of law, the substantive national rules on creditor protection
have typically evolved in response to domestic fact situations, and as long
as Member States could rely on the theory of the real seat, they did not
have to worry about whether protection would be effected through
mechanisms of company law or insolvency law. Thus, the newly estab-
lished European framework for the conflict of laws may upset delicate
balances between company law and insolvency law. Moreover, notwith-
standing the list of insolvency law matters in Article 4 of the Insolvency
Regulation, there remains a grey area with anything but general agreement
among the Member States on where to draw the line between company
law, insolvency law, and possibly other categories such as the law of delict:
English-style wrongful trading and its German counterpart, Insolvenz-
verschleppungshaftung (liability for delayed filing for insolvency), present
an excellent illustration, on which more will be said in chapter 5.

3. The interconnectedness of company law and insolvency law

Whereas the new European legal framework clearly creates some diffi-
culties with respect to delineating the realms of company law and
insolvency law, it is equally important to bear in mind that company law
and insolvency law go hand in hand and complement each other with a
view to protecting the creditors of limited liability companies.26 Com-
pany law and insolvency law do not operate as two islands with no
bridges between them. Yet if one takes a parallel look at the landscapes
mapped out by the respective legal discourses in England and Germany,
one cannot help but realise that the islands appear markedly different in
size. As a preliminary point to this, it is pertinent to enquire into the

26 On ‘unbundling’ and ‘packaging’ company and insolvency law in the context of choice
of forum see Horst Eidenmüller, ‘Free Choice in International Company Insolvency Law
respective usage of the notions of ‘creditor protection’ and ‘Glaubigerschutz’, and to reflect on whether the use of the English term ‘creditor protection’, as the literal translation of ‘Glaubigerschutz’, provides a sufficiently neutral ground.

‘Glaubigerschutz’ has long been a standard topic in the analysis of company law in the literature of German-speaking countries. A search in two databases reveals that within the present decade at least twenty-six monographs have been published in Germany which carry the word ‘Glaubigerschutz’ in their main title and discuss the topic in the context of company law. A German textbook refers to ‘Glaubigerschutz’ as a ‘classic task’ of company law.

27 At www.buchhandel.de (a search engine provided by German publishing companies) and at www.obvsg.at/kataloge/verbundkataloge (the electronic catalogue of the Austrian university libraries).


In contrast, the terms ‘creditor protection’ or ‘protection of creditors’ have been less prominent in England. A similar search in the on-line catalogue of the Squire Law Library at Cambridge University yielded not a single hit, and a search in the on-line catalogue of the Oxford Libraries Information System came up with a book published in the United States in 1912 and a recent Ph.D. thesis by a Greek scholar. Most textbooks do not feature a separate chapter on the topic and many do not even carry the term in their subject index. Company lawyers tend to discuss the matter under various separate headings such as ‘directors’ duties owed to creditors’, ‘maintenance of capital’, and ‘company charges’ (an issue which German lawyers never discuss as part of company law, but as part of property law, the law being the same for companies and for individuals). Thus, for ‘creditor protection’ to be the core notion in this book might be seen as already tilting the scales slightly towards the German side. Recent scholarly writing in English has, however, accentuated the idea of ‘creditor protection’ as a subject worthy of inquiry in its own right, although the term is still not used nearly as widely as in the German discourse. Nevertheless, the present study relies on this development to argue that creditor protection, which will be used from now on without giving the German word in brackets, can be seen as a sufficiently neutral term.

The prominent role that the topic of creditor protection has traditionally occupied in German company law scholarship goes hand in hand with a curious disregard for insolvency law. In retrospect, it is amazing how many volumes – quite literally – German company lawyers have managed to write on creditor protection without ever touching on the subject of insolvency law. Several observations are pertinent here.

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32 For an exception see Paul Davies, Gower’s Principles of Modern Company Law in its 6th edition, Part Six of which was entitled ‘Shareholder and Creditor Protection’; but this has disappeared since the 7th edition.
33 See, for instance, Gower & Davies’ Company Law (7th edn 2003), 372–374. With the arrival of the Companies Act 2006, this discussion has moved into a slightly different context, viz. the directors’ duty to promote the success of the company (s. 172); see now Gower & Davies’ Company Law (8th edn 2008), 519–523.
34 Ibid. 8th edn 2008, ch. 13. 35 Ibid., ch. 32.
In England, the connection between company law and corporate insolvency law has long been evident, not least in the legislative history. The ‘Insolvency Act 1986’, despite this being its official short title (s. 444 IA), does not only apply to insolvencies; it is an ‘Act to consolidate the enactments relating to company insolvency and winding up (including the winding up of companies that are not insolvent, and of unregistered companies)’. The combination of the ‘winding up’ (compare the German term ‘Abwicklung’) of both solvent and insolvent companies goes back to the earliest ‘Companies Winding Up Acts’ of the mid-nineteenth century, which were consolidated, for the first time, in the Companies Act 1862. The provisions on company insolvency remained part of subsequent Companies Acts, before the Insolvency Act 1986 took over all the provisions on company insolvency from the Companies Act 1985. At the same time, the insolvency of individuals, i.e. natural persons, was treated entirely separately. This explains why, in contrast to the terminology in the United States, the term ‘bankruptcy’ in English legal parlance is strictly limited to the insolvency of individuals. Unsurprisingly, the linkage of company law and insolvency law is reflected in the legal literature. Standard texts on company law invariably deal with wrongful trading (s. 214 IA), and many carry chapters outlining corporate insolvency. Numerous company lawyers have also written on insolvency law, whereas recent

37 The first such act was 7 & 8 Vict. c. 111, passed on the same day in 1844 as the famous act which introduced the incorporation of companies through registration.
38 Companies (Consolidation) Act 1908; Companies Act 1929; Companies Act 1948; Companies Act 1985.
39 Bankruptcy Act 1869; Bankruptcy Act 1883; Bankruptcy Act 1914. There were occasional cross-references from the company insolvency regime to the bankruptcy regime for individuals, notably s. 320 of the Companies Act 1948, whose effect it was to make the rules on fraudulent preferences laid down in s. 44 of the Bankruptcy Act 1914 applicable to company insolvencies as well.
42 Robert Pennington has produced textbooks on both subjects: ‘Pennington’s Company Law’ (8th edn 2001) and ‘Pennington’s Corporate Insolvency Law’ (2nd edn 1997); Len Sealy is the author of ‘Cases and Materials in Company Law’ (7th edn 2001; 8th edn 2007, together with Sarah Worthington) and, together with David Milman, of an ‘Annotated Guide to the Insolvency Legislation’ (10th edn 2007); the title and location of Dan Prentice’s article ‘The Effect of Insolvency on Pre-Liquidation Transactions’, in: Ben Pettet (ed.), Company Law in Change (1987) is in itself testimony to this cross-over thinking. Other writers with publications on both subjects include (without any claim to