
CHAPTER 1

GENERAL PRINCIPLES ON RESIDENCE OF COMPANIES

A COMPARATIVE ANALYSIS OF CONNECTING FACTORS USED FOR THE DETERMINATION OF THE PROPER LAW OF COMPANIES

by Peter Behrens¹

1.1. The function of connecting factors

Legal relationships and institutions such as companies are, in principle, subject to the national laws of a specific nation state. Only exceptionally are they governed by international² or supranational³ legal rules. Whenever a company engages in international transactions (i.e. whenever there may arise a problem of “private international law”, “conflict of laws” or “choice of law” – terms hereinafter used synonymously), it becomes indispensable that it is somehow localized in a specific State in order to determine the “proper” national company laws which govern the company. It is this State then which can be said to have jurisdiction over the company, i.e. jurisdiction to prescribe legal rules as well as jurisdiction to adjudicate legal conflicts and to fulfil other procedural functions.

As far as companies are concerned, *prescriptive jurisdiction* is relevant with regard to

- substantive company laws (concerning, in particular, the formation, existence and legal characteristics of a company, the liability regime, the organizational structure, the status of members, and the dissolution and liquidation), or
- tax laws (concerning, in particular, corporate income tax);

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2. There are a limited number of companies that are legally based on an international treaty, such as e.g. the Scandinavian Airlines System (SAS).

3. The most relevant supranational form of company is the European Company (Societas Europea – SE), which is based on an EC regulation. The legal nature of regulations enacted by the European Community is supranational because they are directly applicable in all Member States (Art. 249 EC Treaty).

whereas *jurisdiction to adjudicate* is relevant with regard to procedural rules concerning

- national courts' jurisdiction to adjudicate disputes involving company law issues,⁴ or
- the opening of insolvency proceedings.

The localization of legal relationships or institutions is effected by means of “connecting factors”. They establish a link between the legal relationship or institution and the territory or the legal system of a specific nation state. Connecting factors vary in accordance with the characteristics of the relevant legal relationship or institution as well as in accordance with the legal context in which they are used. Consequently, different connecting factors are used, e.g. in the laws of contracts, torts, companies or taxation, and even when it comes to companies, different connecting factors are used for the determination of the proper company law, tax law or insolvency law.

The subject of this chapter is strictly limited to entities that qualify as “companies”. However, national legal systems differ already as to the notion “company”. Australian law, for example, regards as a “company” not only any body corporate (whether incorporated in Australia or elsewhere) but also any unincorporated body that under the law of its place of origin may sue or be sued, or may hold property (i.e. has a recognized legal personality).⁵ German law, on the other hand, limits the concept of “company” to bodies corporate, which are recognized as legal persons, whereas partnerships are not recognized as legal persons even though they may sue or be sued and acquire rights and obligations (so they in fact do have limited capacity). It is safe to say therefore that all national legal systems distinguish between bodies corporate and unincorporated bodies irrespective of whether the latter are regarded as legal persons or not. The notion “company” does not, however, everywhere include unincorporated entities. This chapter will therefore limit the concept “company” to bodies corporate only.

Furthermore, this chapter will mainly analyse the various approaches to the determination of prescriptive jurisdiction as far as substantive company laws are concerned. In other words, it will analyse, on a comparative basis, the connecting factors used in private international law (conflict of laws) of companies. Connecting factors used for the purposes of determining

4. Not surprisingly, the report on US law in this volume deals extensively with jurisdiction to adjudicate company law as well as non-company law issues.

5. Corporations Act 2001 (Cth), Sec. 57A.

the jurisdiction to adjudicate or to open insolvency proceedings or in the context of international corporate tax laws will be mentioned merely in order to illustrate the differences.

1.2. Categories of connecting factors

The various connecting factors used in different conflict of laws systems in order to determine the “proper law” of a company (*lex societatis*) may be categorized in a number of ways. A first distinction can be made between “indeterminate” and “determinate” connecting factors according to their ability or inability to directly determine the “proper law” of companies. Connecting factors are “indeterminate” if they are not self-sufficient because their localizing function depends on the use of other more specific (“determinate”) connecting factors. “Determinate” factors are connecting factors that are in fact able to directly localize a company within a specific jurisdiction without requiring the use of other more specific criteria.

1.2.1. Indeterminate connecting factors

Indeterminate connecting factors are widely used in many jurisdictions and in various contexts. These are the following:

- nationality;
- domicile; and
- residence.

The *nationality* of companies is a concept that is mainly used in Spain, Italy and France. Article 9(11) of the Spanish Civil Code expressly provides that “the personal law for legal persons is determined by their nationality”. In Italy it is just the other way round: The nationality of a company is said to be determined by the applicable company law. Even though in Italy “nationality” appears to be no more than a *façon de parler* for the designation of the applicable law, it indicates the significance that Italian jurists attribute to the concept of nationality.⁶ Also in France the concept of “nationality” has always been taken very seriously. In spite of early scepticism about the usefulness of the concept,⁷ it is still discussed at quite some

6. See Capotorti, *La nazionalità delle società* (1953), p. 113 et seq.

7. See Niboyet, “Existe-t-il vraiment une nationalité des sociétés?”, *Revue critique de droit international privé* (1927), p. 401 et seq.

length in French textbooks.⁸ It appears, however, that – contrary to Spain and Italy – in France the concept is, strictly speaking, not used for conflict of law purposes but mainly in the context of regulations dealing with the domestic legal status of foreign nationals where the exercise of specific types of business transactions or professional activities are reserved for nationals. Such regulations deliberately discriminate between domestic and foreign companies and therefore require the determination of a company’s nationality. What is striking, however, is the absence of a generally agreed definition of “nationality” or of a specific criterion according to which the nationality of a company is determined. Spanish and Italian law determine a company’s nationality by specifying the applicable company law which in turn depends upon a connecting factor (i.e. the “place of incorporation”) sufficiently determinate to be able to localize a company. (Interestingly, the same is true in the United States).⁹ French law, however, in order to characterize a company as non-national, relies, in principle, on the company’s seat and/or the nationality of the controlling shareholders (control test).¹⁰

The *domicile* is a concept deeply rooted in English law. It is primarily applied to natural persons with an intention to reside and it is said to be occasionally and infelicitously attributed also to corporations.¹¹ “The attribution is achieved by way of analogy with the domicile of origin which is ascribed to every natural person upon birth, and accordingly a corporation is domiciled in the country under whose law it was created.”¹² Thus a company formed under the English Companies Act has an English domicile if it is registered in England. Just like the “nationality” of a company, therefore, a company’s “domicile” can only be determined by way of using a specific connecting factor which refers more directly to the applicable company law. The same is true for US law where a corporation’s “domicile” is said to be in the State of incorporation.¹³

Pretty much the same applies to the concept of *residence*. Again, the concept depends on an intention to reside which, strictly speaking, can be said only of natural persons. Nevertheless, a residence is sometimes

8. See Menjuq, *Droit international et européen des sociétés* (2001), p. 15 et seq., nos. 10–43.

9. See Scoles/Hay/Borchers/Symeonides, *Conflict of Laws* (2004), § 23.2, p. 1222, note 8.

10. Menjuq, *supra* note 7, p. 19 et seq.

11. Farnsworth, *The Residence and Domicile of Corporations* (1939), p. 201 et seq.

12. Dicey and Morris, *The Conflict of Laws*, Collins, 2002, Vol. 2, 13th ed., Rule 152(1) and Comment 30-002.

13. Scoles/Hay/Borchers/Symeonides, *supra* note 8, § 23.2, p. 1222.

attributed to corporations as well. This is true, in particular, in the context of taxation. “Residence” is not, however, used as a connecting factor in the context of private international law of companies. It would not be an appropriate concept anyway because it is not sufficiently determinate for it to be able to localize a company and thereby determine the applicable law. In order to fulfil this function, the concept of residence, to the extent it is applied in the law of taxation, has also to make use of more specific connecting factors such as the “place of central management and control”.¹⁴

It can therefore be concluded that the “nationality”, “domicile” or “residence” of a company is not in itself an indication of the law governing the company. It is rather the other way round: The “nationality”, “domicile” or residence” of a company depends on the proper law of the company as determined by the relevant determinate connecting factors used in conflict of laws (choice of law) rules.

1.2.2. Determinate connecting factors

When it comes to determinate connecting factors which are capable of directly localizing a company in a specific nation state, a comparative analysis of national private international law systems leads to the identification of three different sub-categories of connecting factors. In order to localize a company, a first category of connecting factors relies on the creation of the company as a legal person (a); a second category relies on the internal governance structure and decision making within the company (b); a third category relies on the business activities of the company (c). First, an overview of the three categories shall be given, before their use in various national legal systems will be analysed.

1.2.2.1. Factors relying on the creation of the company as a legal person

The comparative analysis of national laws shows that connecting factors relying on the creation of the company as a legal person come in a number of variations, such as:

- the place of incorporation;
- the place of registration;

14. Farnsworth, *supra* note 9, p. 74 et seq.; Dicey and Morris, *supra* note 11, Rule 152 (2).

- the registered office; and
- the legal (statutory) seat as defined in the articles.

The underlying principle is evident: Since companies as legal persons are creatures of State laws, their existence is necessarily linked to the national company law under which the company was incorporated. It follows that a company may be localized at the place of incorporation. The other connecting factors listed are variations of this theme, because they are all interconnected. It is true everywhere that incorporation of a company requires its entry in a public register. In principle, there can be no attribution of legal personality without registration. Consequently, a company is incorporated at the place of registration. The public register's jurisdiction is in turn determined by the company's registered office or its legal seat as defined in the company's instrument of constitution (memorandum, articles, statutes). In sum, therefore, the connecting factors grouped together in this category are practically identical. They all refer to the company law under which the company was created and they are all based on the legal definition of the company's seat or registered office. Since that definition in the company's instrument of constitution is within the discretion of the founding shareholders, this conflict of laws approach allows for the founding shareholders' free choice of the place of incorporation.

1.2.2.2. Factors relying on the internal governance structure and decision-making

Another group of connecting factors that transpires from a comparative analysis of national laws is based more on factual rather than on purely legal considerations. Where a connecting factor is based on specific factual circumstances, the founding shareholders' discretion is much more limited. In order to subject their company to a specific national company law system, it is not sufficient for them to merely define the legal seat or the registered office in the memorandum, articles or statutes; rather, they have to locate the relevant factual factors within the jurisdiction of their choice. The reason for such an approach lies in the protection of third party interests. It is argued that an important part of company laws is for the protection of creditors. The great majority of the creditors are said to be located in the State with which the company is connected by certain important factual links and not merely by a clause in the company's instrument of constitution.

This is true for connecting factors that link the proper law of a company to the place where the centre of the company's decision-making is located.