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Eric Engle

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The EU Means Business: A Survey of Legal Challenges and Opportunities in the New Europe*

*Eric Engle***

I. INTRODUCTION

A single market from Brest to the Bering straights; An entire continent working in peaceful harmony toward the greater prosperity of all. This vision of Europe, at once practical in means and sweeping in scope, has driven the economies of Western Europe forward since 30 years. Now it is poised to drive the economies of Eastern Europe forward as well. One can look on this engine of growth and prosperity with hope or fear. But one cannot ignore it.

The single market in Europe has grown gradually and pragmatically over time. The thesis this article presents is just as practical. As others have also argued,¹ a number of EC Directives, regulations and cases together create a common European business law. This article surveys and outlines that law. All of the various efforts at harmonization this law embodies work toward creating a single integrated European market in order to garner the benefits of improved competition and synergies. Economic synergy is no idealist pipe dream. In materialist terms, economies of scale,² specialization³ at each stage of production, standardization of parts and services⁴ and trade itself,⁵ all result in a whole

* "New Europe" does not mean only Eastern Europe, though the greatest potential for growth in the EU is in Eastern Europe. Rather, it is Europe of 25 doing business under one common framework established by the Union.

** Professor of law at the University of Tartu, Estonia.

1. See Andrea J. Gildea, *Uberseering: A European Company Passport*, 30 BROOK. J. INT'L L. 25, 292 (2004). "Presently, a hybrid system of recognition exists in Europe. It consists of national rules, EC rules, and a somewhat substantial zone of ambiguity between the two regimes." *Id.*

2. *Economies of Scale*, at <http://www.investopedia.com/terms/e/economiesofscale.asp> (last visited Mar. 30, 2006). "The increase in efficiency of production as the number of goods being produced increases. Typically, a company that achieves economies of scale lowers the average cost per unit through increased production since fixed costs are shared over an increased number of goods." *Id.*

3. 1 ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS CH. 1, PARA. 3 (University of Chicago Press 1976) (1776) (noting an example of increased production in a pin factory due to specialization).

4. See, e.g., "Eli Whitney" at <http://www.answers.com/topic/eli-whitney> (last visited Mar. 30, 2006).

that is in real terms far wealthier than the sum of its parts. Synergies resulting from European integration are estimated to bring at least an additional five billion euros of wealth to the European economy.⁶

These economic facts have political implications. This article uses them to partially test a much larger hypothesis: The EU does not represent a misguided effort at neo-mercantilism. ASEAN, MERCOSUR, NAFTA and the EU are not competing continental empires doomed like the empires of 1914 and 1940 to mutual destruction because they are part of a global liberal trading regime under the aegis of the WTO.⁷ Rather, the economic policies of the European Community (Community), like those of the other mentioned interstate organizations, are founded on the presumptions of classical economic liberalism: That individuals should be able to make their own choices,⁸ that open markets are economically optimal,⁹ that the state has a limited role as market regulator¹⁰ and that trade encourages peace and prosperity¹¹ because it is a positive sum game¹² – even in cases where trading parties are asymmetric and one has an absolute advantage in production of all goods.¹³ These assumptions propelled America from wilderness to world power and have preserved peace since 1945. Rather than recreate the failed imperialist models of the past, the very object of the EU, the WTO, and the Bretton Woods institutions¹⁴ is to sever the link between territorial control and mar-

5. See 4 ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* CH. 2, PARA. 15 (University of Chicago Press 1976) (1776) (discussing restraints upon importation from foreign countries of goods that can be produced at home).

6. See Gildea, *supra* note 1 at 258.

7. See Eric Engle, *The Transformation of the International Legal System: The Post-Westphalian Legal Order*, 23 QLR 23, 26 (2004).

8. Eduardo M. Peñalver, *Property As Entrance*, 91 VA. L. REV. 1889, 1900-1901 n. 32(2005).

9. See generally SMITH, *supra* note 3; DAVID RICARDO, *ON THE PRINCIPLES OF POLITICAL ECONOMY AND TAXATION* 7.13-7.16 (John Murray 1817), available at <http://www.econlib.org/library/Ricardo/ricP2a.html#Ch.7,%20On%20Foreign%20Trade> (last visited Mar. 30, 2006).

10. See generally, SMITH, *supra* note 3.

11. See Eugene Kontorovich, *The Arab League Boycott And WTO Accession: Can Foreign Policy Excuse Discriminatory Sanctions?* 4 CHI. J. INT'L L. 283, 286 (2003). “[T]he free trade system was designed to promote not just prosperity but peaceful and amicable relations between Member States . . .” *Id.*

12. SMITH, *supra* note 3 at Ch. 1, para. 3 (noting an example of increased production in a pin factory due to specialization).

13. RICARDO, *supra* note 9, at 7.13-7.16.

14. See Debra Steger, *Peace And Prosperity Through Trade*, 20 AM. U. INT'L L. REV. 1133, 1133 (2005).

“‘Peace and prosperity through trade’ was the basic objective on which the General Agreement on Tariffs and Trade (“GATT”) was founded almost sixty years ago and it remains the fundamental *raison d’etre* of the World Trade Organization (“WTO”) today.” *Id.*

ket share which caused two world wars.¹⁵ Although the EU seeks to create autarchy in food production,¹⁶ it is constantly imbricated into the liberal world trade regime of the WTO and the security regime of NATO. Autarchy is unprofitable and the only security is collective security.

Not only is the EU no threat to U.S. interests it is in fact an opportunity for American business. As the late President Kennedy said “[W]e don’t regard a strong, united Europe as a rival, but as a partner.”¹⁷ Europe is good for business. Even if the increased productivity of the EU costs the U.S. relative market share in certain sectors so what? To put the point extremely: Who cares if you lose half your market share if at the same time you triple your income? That very roughly is what has happened to the U.S. since 1945. A massive increase in absolute wealth coupled with relative decline is the result of trading synergies. In short, the illusion of failure (relative decline in economic power) is built in to the reality of success (absolute increase in real wealth resulting from the above described synergies). In fact, the U.S. has been in relative economic decline since 1945. It has seen its share of world production decline from nearly 50% of a planet devastated by global war to just under 20% in a world of abundance.¹⁸ Does anyone seriously think that the U.S. was not in real terms much better in 2005 than it was in 1945?¹⁹ A cursory examination of life expectancy proves the point. Prosperity makes war irrelevant.

National security arguments against complacency in the face of relative decline ignore the obvious fact that nuclear weapons make war, already irrelevant²⁰ because it destroys productive capacity, unthinkable:²¹ “Conventional” war is also irrelevant. Just look at Iraq for the

15. See Eric Allen Engle, *The Transformation of the International Legal System: The Post-Westphalian Legal Order*, 23 QUINNIPIAC L. REV. 23, 26 (2004).

16. See generally Alastair J. Walling, *Early To Bed, Early To Rise, Work Like Hell And Globalize*, 13 KAN. J.L. & PUB. POL’Y 161, 174 (2003/2004) (discussing whether globalization is a good thing). See also Michael J. Trebilcock, *Critiquing the Critics of Economic Globalization*, 1 J. INT’L L. & INT’L REL. 213, 233-234 (2005) (noting that if each EU state “aspired to be self-sufficient in food, this would contradict the entire European economic integration process”).

17. TIMOTHY GARTON ASH, *FREE WORLD: WHY A CRISIS OF THE WEST REVEALS THE OPPORTUNITY OF OUR TIME*, 102, 221-22. (Allen Lane ed. Random House 2004).

18. PAUL KENNEDY, *THE RISE AND FALL OF THE GREAT POWERS: ECONOMIC CHANGE AND MILITARY CONFLICT FROM 1500 TO 2000* 352-59 (Vintage Books 1989).

19. See generally Kennedy, *supra* note 18.

20. Paul W. Kahn, *American Hegemony And International Law Speaking Law To Power: Popular Sovereignty, Human Rights, And The New International Order*, 1 CHI. J. INT’L L. 1, 6 (2000). “A strand of military analysis asserts that nuclear weapons are quite useless devices.” *Id.*

21. See Christopher B. Stone, *Signaling Behavior, Congressional-Executive Agreements, And The Salt I Interim Agreement*, 34 GEO. WASH. INT’L L. REV. 305, 305 (2002). In quoting former President R. M. Nixon’s memoirs:

most recent example of the failure of war to advance economic policy. Moreover, threats to the U.S. and the world today are either from non-state actors such as insurgents²² or from cross border environmental issues.²³ Conventional armies are ill adapted to meet either of these threats.²⁴ From all this follows that the state-centric *realpolitik* neoconservative²⁵ view of the national security state is dangerous and unrealistic because of the destructive power of nuclear weapons and irrelevant because military power does not create economic wealth.²⁶ An interdependent global marketplace has made the realist neoconservative view of the state pointless.²⁷ There is a much richer, more interesting and brighter world of commerce to be won.

To understand the construction of Europe as one pole in a world order based on liberalism we need to assess the methods of its construction, ontology, goals, and teleology.

A. *The Ontology of the Union—Functionalism*²⁸

The ontology of the EU is pragmatic. The Union was built up gradually on the basis of functionalist theory.²⁹ Functionalism is the idea that economic integration is best achieved not at one fell swoop with

It was clear to me by 1969 that there could never be absolute parity between the U.S. and the U.S.S.R. in the area of nuclear and conventional armaments. . . . [A]bsolute parity in every area of armaments would have been meaningless, because there is a point in arms development at which each nation has the capacity to destroy the other. Beyond that point the most important consideration is not continued escalation of the number of arms but maintenance of the strategic equilibrium while making it clear to the adversary that a nuclear attack, even if successful, would be suicidal.

Id. at 339.

22. Engle, *supra* note 15, at 34.

23. Col. Michael Wansink, *Whither Sovereignty?*, National Defense University Executive Research Project S19, at 22,35, available at <http://www.ndu.edu/library/ic6/95-S19.pdf> (last visited Mar. 30, 2006).

24. See Engle, *supra* note 15, at 29-30.

25. See, e.g., *Project for a New American Century: Rebuilding America's Defenses*, Report of the Project of the New American Century (2000) at <http://www.newamericancentury.org/RebuildingAmericasDefenses.pdf> (last visited Mar. 30, 2006).

26. See Susan George, *The International Geo-Economic System in HUMAN RIGHTS IN PERSPECTIVE* 275 (Asbjorn Eide, Bernt Hagtvet, ed., Blackwell 1992) (making an incisive argument that military power is outmoded but has been replaced by financial power which is more subtle and effective than direct control).

27. See Engle, *supra* note 15, for an extended discussion of this thesis.

28. As a theory of sociology, functionalism is essentially organicist, analogizing society to an organism, with each member having particular functions, like organs of a body. See, e.g., Kent McClelland, *Theoretical Perspectives in Sociology, Functionalism*, (2000), at <http://web.grinnell.edu/courses/soc/s00/soc111-01/IntroTheories/Functionalism.html> (last visited Mar. 30, 2006).

29. See José E. Alvarez, Steve Charnovitz, *Triangulating The World Trade Organization*, 96 AM. J. INT'L L. 28, 48 (2002). "The core idea of functionalism is that international governance should be organized according to 'tasks' and 'functional lines.'" *Id.*

grandiose and impossible ideas.³⁰ Rather, functionalism takes a pragmatic approach: it seeks to attain the possible, here and now, rather than the perfect, maybe someday.³¹ Functionalist methods obtain political legitimacy after the fact because of the success of the institution at achieving practical goals.³² No one complains about success.

Functionalist theory has successfully³³ drawn Europe from a Community of six nations jointly developing coal and steel resources into a 25 nation Union constituting the world's largest free trading area.³⁴ Functionalism has not however created a Federal Europe.³⁵ This is because its legitimacy is always *ex post*. Functionalism may build an economic union, but political union requires direct democratic input in concert with a clear political will. This is one more reason even the most defensive minded Americans should not fear Europe.

B. *The Teleology of the Union—Liberalism*

The teleology of the Union is a single market destined to create the conditions of prosperity necessary to enable people to live what Aris-

30. Hans J. Morgenthau, *Positivism, Functionalism, and International Law*, 34 AM. J. INT'L L. 260, 283 (1940). Noting that grandiose legalistic schemes purporting to solve the ills of the world have replaced the painstaking search for the actual laws and the facts underlying them). *Id.*

31. See Antony Anghie, *Time Present and Time Past: Globalization, International Financial Institutions, and the Third World*, 32 N.Y.U. J. INT'L L. & POL. 243, 264 n. 57 (2000) (quoting BARTRAM S. BROWN, *THE UNITED STATES AND THE POLITICIZATION OF THE WORLD BANK* 14-15 (Keegan Paul 1992)).

Functionalism is a theory of international organization which holds that a world community can best be achieved not by attempts at the immediate political union of states, but by the creation of non-political international agencies dealing with specific economic, social, technical, or humanitarian functions. Functionalists assume that economic, social and technical problems can be separated from political problems and insulated from political pressures.

Id. "Brown's important work has a special relevance to the current operations of the IFIs." *Id.*

32. "The neo-functionalist theory that has driven much of European integration, for example, posits that supranational institutions formed for fairly narrow purposes will attract political support over time and will thereby be able to expand their functions." Ernest A. Young, *The Trouble With Global Constitutionalism*, 38 TEX. INT'L L.J. 527, 540 n.86 (2003).

33. "... [F]unctionalism . . . has enabled the incremental, progressive development of the European Union."

Sabino Cassese, *European Administrative Proceedings*, 68 LAW & CONTEMP. PROB. 21, 23 (2004).

34. Laura Dale, *The Economic Impact Of Replacing The Federal Income Tax With A Federal Consumption Tax: Leveling The International Playing Field*, 9 INT'L TRADE L.J. 47, 47 (2000). See, e.g. Myrtle D. Bishop, Samuel J. Chandle, *Opportunities And Challenges: The Caribbean Involvement In The Free Trade Area Of The Americas*, 27 FORDHAM INT'L L.J. 909, 913 (2004) (noting that the FTAA is the world's largest free trade zone). However, the FTAA is still under construction and only comprises free trade in goods, not in labor.

35. This may be because functionalism and democratic deficit are capable of coexisting. Secondly, as the Union expands, political integration becomes more difficult, despite the insistence that new states accept the *acquis communautaire*, the attained goals of the Union, such as the single currency.

totle called “the good life”,³⁶ a life of well being, culture and fullest development and expression of the human spirt. A certain degree of wealth is a necessary condition to enjoying the good life, but wealth itself is not the end of the good life.³⁷

In practical terms, this teleology expresses itself most recently through efforts toward privatization and deregulation.³⁸ In the 1980s and 1990s a consensus emerged in the west that private ownership of the means of production was more efficient than public ownership. Thus, state owned enterprises such as rails, telecommunications and post offices throughout Europe have been privatized and listed on stock exchanges. An immediate practical reason for this may be due to budget deficits.³⁹

The goal of economic integration is attained through harmonization Directives, regulations and case law of the EU. EU securities regulation harmonization efforts aim to remove technical barriers that create transaction costs or prevent entry into markets to create a single market that clears as efficiently as possible.⁴⁰ This is done in order to create an integrated securities market. The creation of a single European capital market is a major goal of the European project.⁴¹ The

36. See 1 ARISTOTLE, POLITICS Part 2 (Benjamin Jowett trans., Adelaide 2004), available at <http://etext.library.adelaide.edu.au/a/aristotle/a8po/book1.html> (last visited Mar. 30, 2006). “When several villages are united in a single complete community, large enough to be nearly or quite self-sufficing, the state comes into existence, originating in the bare needs of life, and continuing in existence for the sake of a good life.” *Id.*

37. 1 ARISTOTLE, NICOMACHEAN ETHICS Ch. 5 (W.D.Ross trans., MIT 1994) available at <http://classics.mit.edu/Aristotle/nicomachaen.mb.txt> (last visited Mar. 30, 2006). “The life of money-making is one undertaken under compulsion, and wealth is evidently not the good we are seeking; for it is merely useful and for the sake of something else.” *Id.*

38. Manning Gilbert Warren, *Global Harmonization of Securities Laws: The Achievements Of The European Communities*, 31 HARV. INT’L L.J. 185, 194 (1990).

39. See Roberta S. Karmel, *The Case for a European Securities Commission*, 38 COLUM. J. TRANSNAT’L L. 9, 12 (1999).

All over Europe, governments are attempting to foster an equity culture for both ideological and practical reasons. Government planning and ownership of industry has fallen out of favor coincident with the collapse of Communism. In any event, ever increasing budget deficits are no longer sustainable by governments. One result of this political shift to a free market ideology coupled with a practical need to reduce government spending has been massive privatizations of government owned assets

Id.

40. *Id.* at 13-14.

41. Treaty Establishing the European Community, art. 2, Oct. 2, 1997, 37 I.L.M 56 (1998).

The Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing common policies or activities referred to in Articles 3 and 4, to promote throughout the Community a harmonious, balanced and sustainable development of economic activities, a high level of employment and of social protection, equality between men and women, sustainable and non-inflationary growth, a high degree of competitiveness and convergence of economic performance, a high level of protection and improvement of the quality of the environment, the raising

single capital market is intended to enhance international economic well being and to avoid economic crises.⁴² Europe is an agent of stable growth and thus is an opportunity for prosperity even for Europe's trading partners.

With this understanding of the means and ends of the European Union this article will now turn to the legal instruments used to attain the single market in labor, capital, goods and services. The article's focus will accordingly shift from grand political issues at the macro level to the practical legal mechanisms people build on the basis of those beliefs. Specifically, it surveys EU securities law, tax law and company law as these are at once economically interesting and useful vectors to examine the process of European integration.

II. EUROPEAN SECURITIES LAW

Comparisons of EC securities law and U.S. Securities law are inevitable and desirable. The two systems are very similar, though the EC System appears at once less centralized and to define its basic terms more completely. Parallels can also be seen in the federal structure. Each federated state in the U.S. is a sovereign,⁴³ as is true of the Member States of the EU.⁴⁴ The U.S. federal government⁴⁵ and the EU both exercise supreme⁴⁶ yet limited powers.⁴⁷ At the same time, each has a certain flexibility.⁴⁸

of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States.

Id.

42. Todd A. Sulger, *Harmonization Of Securities Market Regulations In The European Union: Is The Price Tag Too High?* 29 CAL. W. INT'L L.J. 221, 240 (1998).

43. U.S. CONST. amend. X.

44. See Treaty Establishing the European Community, *supra* note 41, at art. 5.

The Community shall act within the limits of the powers conferred upon it by this Treaty and of the objectives assigned to it therein.

In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and insofar as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community.

Any action by the Community shall not go beyond what is necessary to achieve the objectives of this Treaty.

Id.

45. U.S. CONST. Art. VI cl. 2.

46. Case 26/62, *NV Algemene Transporten Expeditie Onderneming van Gend en Loos v. Nederlandse Administratie der Belastingen*, 1963 ECR 1.

47. See Treaty Establishing the European Community, *supra* note 41, at art. 5 (subsidiarity).

48. See Treaty Establishing the European Community, *supra* note 41, at art. 308; .S. CONST. art I, § 8 cl.18.

Because of these facts of federalism, the implementation and enforcement of securities law in the European Union is found in the national law of the Member States. At the same time, the goals and direction of EU Securities law are found in the Directives, regulations and decisions of the Union. Member States retain the powers of regulating their stock markets subject however to their obligations under the EC and EU treaties. Thus, for example, procedure and practice to determine whether an instrument is a security subject to regulation are essentially found in national law⁴⁹ though the substantive definitions of securities are now included in the community Directives themselves. Directives are implemented and enforced by the national law of the the Member States which to some extent determine their content, particularly where the Member States exercise their option to offer greater protections than the minimum standards determined by the EC.⁵⁰

The policy goals of EC securities law are to protect investors, to assure the proper functioning of the securities market (capital formation and allocation) and to attain uniform minimal standards throughout the communities.⁵¹ This implies the necessity of investor confidence in the stability and security of the market. These goals run throughout European business law and can be seen just about anywhere in EC law one chooses to look. U.S. securities lawyers would immediately recognize them:⁵² Investor confidence in the integrity of the market is protected in order to assure adequate capital formation; and Market manipulations are prohibited in order to assure proper capital allocation. The ends of EU securities law look similar to those seen in U.S. securities law, however, the means used to attain those ends are at times different. To attain the goals of a stable and secure single capital market, the EU uses Directives, principally, and conventions and regulations secondarily. These instruments are in turn applied, interpreted or woven into the judgements of the European Court of Justice (ECJ).

Directives are proposed by the European Commission and enacted or rejected by the Council and if accepted become part of Community

49. Alexander B. St. John, *The Regulation of Cross-Border Public Offerings of Securities In The European Union: Present And Future*, 29 DENV. J. INT'L L. & POL'Y 239, 244-245 (2001).

50. See, e.g., Commission Directive 2004/72, art.6(2),7, 2004 O.J.(L 162) 70, 73-74 (Market Abuse Directive).

51. Warren, *supra* note 38, at 215.

52. For a (critical) examination of the "ends" of U.S. securities laws, see, e.g., Stanislav Dolgopolo, *Insider Trading And The Bid-Ask Spread: A Critical Evaluation Of Adverse Selection In Market Making*, 33 CAP. U. L. REV. 83, 86 (2004).

law.⁵³ Directives address the Member States and present binding guidelines for legislation to be implemented by the Member States.⁵⁴ If a Member State does not introduce legislation to transpose the Directive into national law then the Commission can force it to do so using Article 226 (ex article 169).⁵⁵ Likewise, other Member States can force the non-compliant Member State to act using Article 227 (ex article 170).⁵⁶ Further, individuals may also be able to enforce the Directive. As a general rule, however, Directives do not create rights enforceable by individuals⁵⁷ because the addressee of Directives are the Member States. For a provision of a Directive, regulation, or a Treaty article to be directly effective to create directly enforceable rights and duties inhering in individuals the provision of law must be clear, precise and unconditional.⁵⁸ However, non-implementation of a Directive may also lead to a the Directive having direct effect, conferring rights and duties on individuals.⁵⁹

The various Directives build bridges between the Member States on the basis of their national laws. As can be seen from the above description, there is no real equivalent to Directives in U.S. legislation. It would be as if congress ordered states to enact a law, but left the means to do so up to the states. The closest analogy to Directives in U.S. law are the enabling acts of administrative law which delegate authority from congress to an agency to implement policies. But the Directives are much more specific than enabling acts. The directives do not address the creation of an agency with delegated powers. Rather the directives address the Member States who must implement their provisions by enacting laws. So the analogy is at best partial, but at least gives some sense of how Directives work to a U.S. jurist.

Regulations are the other tool used by the EU to unify European law. Regulations are binding rules issued by the Commission.⁶⁰ They

53. See Treaty Establishing the European Community, *supra* note 41, at art. 37(2).

54. Richard Cole, *Authentic Democracy: Endowing Citizens With A Human Right In Their Genetic Information*, 33 *HOFSTRA L. REV.* 1241, 1285 n. 186 (2005).

55. Treaty of Amsterdam Amending the Treaty on European Union, the Treaties Establishing the European Communities and Related Acts, art. 226, Nov. 10, 1997, 37 *I.L.M.* 56 (1998), also available at <http://europa.eu.int/eur-lex/lex/en/treaties/dat/11997D/hfm/11997D.html> (last visited Mar. 30, 1996) (ex Art. 169, Treaty of Rome).

56. See Treaty of Amsterdam, *supra* note 55, at art. 227 (ex Art. 170, Treaty of Rome).

57. See, e.g., Case C-91/92, *Faccini Dori v. Recreb, SRL*, 1994 *E.C.R. I-3325*.

58. Case 26/62, *NV Algemene Transporten Expeditie Onderneming van Gend en Loos v. Nederlandse Administratie der Belastingen*, 1963 *ECR* 1. See http://europa.eu.int/comm/employment_social/fundamental_rights/legis/lgenforce_en.htm (discussing enforcement of directives in employment and racial discrimination cases).

59. Derek Devgun, *Multilateral Capital Transfer Tax Treaty Relief Within The European Community*, *E.L. REV.* 1995, 20(5), 451-470 (1995).

60. See Treaty of Amsterdam, *supra* note 55, at art. 110(2).

are self executing and have direct effect in the national legal systems of the Member States. They are legislation, but legislation made, in essence, by appointed representatives. For this reason Regulations are very indirectly democratic. They are made by political appointees who were appointed by elected representatives. It's democracy - but not as we know it.

In some ways the EU legislative process is more centralized than in the U.S. Congress does not order the states to enact legislation, but that is just what a European Directive does to Member States. But in most ways the EU is less centralized than the U.S. For example, Directives generally leave open how Member States are to implement them. Still, the EU constitutes a confederation of the Member States as there is a customs union, a common commercial and agricultural policy and a common currency and border control system, at least as to the core Member States and finally because the EC and by Extension the EU have international legal personality.

A. *Company Law Directives*

The exact legal basis of EU base securities law is a threshold question. The very purpose of the Union is to create a single market in labor capital goods and services. Yet, these goals are subject to the constraints of subsidiarity:⁶¹ The Union should only act when the end cannot be attained by the Member States working individually. However, because of the doctrine of supremacy, wherever the Union has competence it essentially has exclusive competence.⁶² Though securities law is currently an area of shared competence, the doctrine of supremacy could be used by the EU to justify replacing the business laws of the Member States with EU law.⁶³ An argument against Community jurisdiction on the basis of subsidiarity⁶⁴ would likely fail, all the more so because of Art. 308 of the Amsterdam Treaty.⁶⁵

61. See Treaty Establishing the European Community, *supra* note 41, at art. 5.

62. Case 26/62, NV Algemene Transporten Expeditie Onderneming van Gend en Loos v. Nederlandse Administratie der Belastingen, 1963 ECR 1.

63. Warren, *supra* note 38, at 212.

64. See Treaty Establishing the European Community, *supra* note 41, at art. 5.

65. See Treaty Establishing the European Community, *supra* note 41, at art. 308. EC Treaty provides:

If action by the Community should prove necessary to attain, in the course of the operation of the common market, one of the objectives of the Community and this Treaty has not provided the necessary powers, the Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, take the appropriate measures.

Id.

The EU's business law Directives seek to create uniform minimum standards throughout the community. Harmonization of company law started with modest but generally applicable Directives issued pursuant to under Article 94 (ex article 100) of the EC Treaty⁶⁶ for the harmonization of laws of the Member States directly affecting the common market. The fields covered by Directives have, consistent with functionalist method, grown constantly over time. Though harmonization does not create a truly uniform law it does lay the groundwork for eventual unification of EU securities law. What do the existing laws look like?

1. Company Law Directives

The First Company law Directive⁶⁷ obliges limited liability companies and limited partnerships to register their constitutive documents and requires them to provide an annual financial report.⁶⁸ The Second Company law Directive⁶⁹ imposes minimum capitalization requirements and minimal disclosure requirements for public limited companies (corporations) as well as limiting corporate restructuring and protects minority shareholders from abuse; Derogations from the rules are possible where such will encourage employee ownership of the company.⁷⁰ The Third Company Law Directive⁷¹ harmonizes laws regarding interstate mergers of publicly traded companies and includes rules for disclosure and to protect employees and creditors.

The Fourth Company Law Directive⁷² sets out minimum financial statement and auditing requirements; Smaller companies can provide summary financial statements.⁷³ Acquisitions of companies involving a sale of assets for shares are covered in the Sixth Company Law Directive⁷⁴ which requires publication of the fusion plan, shareholder approval for the sale, and sets out the required information to be published.⁷⁵ Information which must be published in company financial statements is also addressed in the Seventh Company Law Directive.⁷⁶ The Eighth Company Law Directive requires financial statements to

66. See Treaty of Amsterdam, *supra* note 55, at art. 94.

67. *Id.* at art. 2 (e).

68. Directive 68/151/EEC, Art. 2 (e).

69. Council Directive 77/91, preamble., 1977 O.J. (L 26) 1 (EEC).

70. *Id.*

71. Council Directive 78/855, 1978 O.J. (L 295) 36 (EEC).

72. Council Directive 78/660, 1978 O.J. (L 222) 11 (EEC).

73. *Id.*

74. Council Directive 82/891, art. 307, 1982 O.J. (L 378) 47-54 (EEC) (discussing divisions of public limited liability companies).

75. *Id.*

76. Council Directive 83/349, art. 7, 1983 O.J. (L 193) 31 (EEC).

be audited by qualified auditors, and sets out minimum educational and professional requirements of auditors.⁷⁷

2. The New Prospectus Directive⁷⁸

In 2003 the EC issued a new Directive “On the Prospectus to be Published when Securities are Offered to the Public or Admitted to Trading” which amended Directive 2001/34/EC.⁷⁹ The new prospectus Directive was also accompanied by a regulation implementing it which specifies exactly the information to be listed in the prospectus.⁸⁰ The 2003 Directive grouped together⁸¹ the Listing Particulars Directive,⁸² and the Public Offer Prospectus Directive⁸³ and refers to both to define its contours. At the same time, it amended Directive 2001/34. Directive 2001/34 for its part grouped the Listing Admission Directive,⁸⁴ the Interim Reports Directive,⁸⁵ the Major Shareholdings Directive⁸⁶ into one Directive and referred to those prior Directives to define its scope.⁸⁷ Thus to understand Directives 2003/71 and 2001/34, we must be aware of the prior Directives. Specifically, 1) references to the provisions of the repealed Directives are included in the new Directive.⁸⁸ The new Directives essentially regroup and refine the earlier Directives. 2) The original Directives were transposed into national law and thus may be relevant to understanding national law. 3) The interpretation of Directive 2003/71 or of 2001/34 may turn on how the prior Directives were interpreted. The prior Directives may be persuasive

77. Council Directive 84/253, art. 3-6, 1984 O.J. (L 126) 20-26 (EEC).

78. Council Directive 2003/71, 2003 O.J. (L 345) 64-89 (EC).

79. *Id.*

80. Commission Regulation 809/2004, 2004 O.J. (L 149) 1 (EC).

81. Council Directive 2003/71, preamble, 2003 O.J. (L 345) 64 (EC).

82. Council Directive 80/390, 1980 O.J. (L 100) 1-26 (EEC).

83. Council Directive 89/298, 1989 O.J. (L 124) 8-15 (EEC).

84. Council Directive 79/279, 1979 O.J. (L 66) 21 (EEC), amended by Council Directive 82/148, 1982 O.J. (L 62) 22 (EEC).

85. Council Directive 82/121, 1982 O.J. (L 48) 26-29 (EEC).

86. Council Directive 88/627, 1988 O.J. (L 348) 62-65 (1988) (EEC).

87. Council Directive 2001/34, para. 1, 2001 O.J. (L 184) 36 (EC) states: “Directives 79/279/EEC, 80/390/EEC, 82/121/EEC and 88/627/EEC, as amended by the acts listed in Annex II Part A, are hereby repealed . . . 2. References to the repealed Directives shall be construed as references to this Directive”. *Id.*

88. Council Directive 2003/71, para. 3, 2003 O.J. (L 345) 64 (EC). “For reasons of consistency, however, it is appropriate to regroup the provisions of Directive 2001/34/EC which stem from Directive 80/390/EEC together with Directive 89/298/EEC and to amend Directive 2001/34/EC accordingly.” *Id.*

evidence of the meaning of current Directives, especially where the later Directive refers explicitly to its predecessor.⁸⁹

3. Public Offerings of Exchange-Listed Securities

a. The Listing Admission Directive

The Listing Admissions Directive determined conditions for listing securities issued by one Member State on the stock exchanges of other Member States. The goal of the Listing Admissions Directive, like the new prospectus Directive (2003/71)⁹⁰, was to protect investors by assuring adequate capitalization of companies⁹¹ and to build the single capital market by integrating securities law.⁹² In essence, admission to the stock market of one Member State permits the admitted security to be traded on the stock market of another Member State as well.⁹³ To protect investors the Listing Admissions Directive⁹⁴ required companies to report material information which may affect the price of the security⁹⁵ as does Directive 2003/71.⁹⁶ The earlier Directive also required companies to be adequately capitalized as does Directive 2001/34.⁹⁷ Offered securities must be freely and fully negotiable⁹⁸ and a market for the securities must in fact exist.⁹⁹

Financial information such as balance statements (annual reports) must be published and disseminated by widely distributed newspapers both in the earlier Directive¹⁰⁰ and in Directives 2003/71¹⁰¹ and 2001/34.¹⁰²

89. See Case C-350/02, *Commission of the European Communities v. Kingdom of the Netherlands*, 2004 E.C.R.I-6213. Case C-324/98, *Telaustria Verlags GmbH and Telefonadress GmbH v Post & Telekom Austria AG*, 2000 E.C.R. I-10745.

90. Council Directive 2003/71, preamble, 2003 O.J. (L 345) 64, 65 (EC) (discussing single market and investor protection).

91. Todd A. Sulger, *Harmonization Of Securities Market Regulations In The European Union: Is The Price Tag Too High?* 29 CAL. W. INT'L L.J. 221, 225 (1998).

92. See St. John, *supra* note 49, at 245.

93. Council Directive 2003/71, art. 17, 2003 O.J. (L 345) 78 (EC).

94. Council Directive 79/279, 1979 O.J. (L 66) 21 (EEC), amended by Council Directive 82/148, 1982 O.J. (L 62) 22 (EEC).

95. Sulger, *supra* note 91, at 224-225.

96. Council Directive 2003/71, art. 7, 2003 O.J. (L 345) 73 (EC).

97. Directive 2001/34, art. 43, 2001 O.J. (L 184) 22-23 (EC).

98. *Id.* at 23.

99. *Id.* at 22.

100. Warren, *supra* note 38, at 210.

101. Council Directive 2003/71, art. 14, 2003 O.J. (L 345) 76 (EC).

102. Directive 2001/34, art. 98, 2001 O.J. (L 184) 33 (EC).

b. The Listing Particulars Directive

The Listing Particulars Directive covered securities which are “the subject of an application for admission to official listing on a stock exchange situated or operating within a Member State.”¹⁰³ The Directive required issuers of a security to issue their securities on the stock market of their home state (their state of registration) if they will issue securities in any other state.¹⁰⁴ It also required disclosure of information “necessary to enable investors . . . to make an informed assessment of the assets and liabilities, financial position, profits and losses, and prospects of the issuer and of the rights attaching to such securities.”¹⁰⁵ including information about the issuer, the security, capitalization, activities of the company, and its management team as well as recent events and current prospects.¹⁰⁶ Exactly this language is retained in Directive 2003/71.¹⁰⁷ These mandatory disclosures are minima. Member States could require greater disclosure.¹⁰⁸ The earlier Directive¹⁰⁹ and its successor 2003/71 do not define what sanction Member States are to impose, leaving the determination of the exact contours of sanctions to Member States.¹¹⁰

Listing particulars serve two functions: They provide initial information to secondary markets¹¹¹ and are the basis of the prospectus for the public offering.¹¹² The requirements of the prospectus were set out in the Listing Particulars Directive.¹¹³ The listing particulars requirements have been taken up in Directive 2001/34.

Though there are practical limits to how effective harmonization can be in creating a unified legal system, the Listing Particulars Directive extended the EC’s “philosophy of disclosure”.¹¹⁴ The EC correctly recognized that “it could not immediately replace the entire field of securities regulation despite the primacy of EC law over national law in areas covered by the Treaty of Rome.”¹¹⁵ Rather than trying to achieve an impossible ideal, the EC instead opted for what is

103. See Council Directive 80/390, 1980 O.J. (L 100) 1-26(EEC).

104. See St. John, *supra* note 49, at 248. *Id.* at art. 8.

105. *Id.* at art. 4.

106. See St. John, *supra* note 49, at 248. Council Directive 80/390, art. 8, 1980 O.J. (L 100) 1-26 (EEC).

107. Council Directive 2003/71, art. 5, 2003 O.J. (L 345) 72073 (EC).

108. See St. John, *supra* note 49, at 249.

109. Warren, *supra* note 3,8 at 212.

110. Council Directive 2003/71, art. 25, 2003 O.J. (L 345) 81 (EC).

111. Directive 2001/34, preamble, 2001 O.J. (L 184) 9 (EC).

112. Warren, *supra* note 38, at 216

113. *Id.* at 216.

114. *Id.* at 212.

115. *Id.* at 212-213.

possible but imperfect: Gradual but irreversible progress towards the goal of a single market. The functionalist foundations of the process of economic integration are once again shown in practice.

c. The Interim Reports Directive

The Interim Reports Directive obligated companies which issue equities on Member State stock exchanges to also provide semi-annual balance sheets¹¹⁶ in order to allow investors to make informed decisions about whether to purchase the security.¹¹⁷ 2001/34 in contrast appears to require only annual reporting.¹¹⁸ The Interim Reports Directive requires the company to publish the information so that the public can obtain it and transmit the information to the competent authorities in each Member State where the security is sold.¹¹⁹ Again, the goal of the Directive is an integrated single capital market¹²⁰ as is the case of the successor Directives. There is still no common accounting standard such as GAAP or IAS valid throughout the EU.¹²¹ And that fact, along with language barriers, is one of the greater limits on EU business integration.¹²² In sum however, the various securities Directives are all aimed at transparency and market integration and are rational instruments developed to further desirable goals.

d. The Major Shareholdings Directive (“Anti-raiders” Directive)

The Major Shareholdings Directive requires a person who acquires or disposes of a certain percentage of shares in a company (10%, 20%, 33 1/3%, 50% and 66 2/3%) to give notice to the company and the public authorities responsible for stock market regulation.¹²³ It was incorporated into Directive 2001/34 as articles 85-97 and also in articles 102-110 of that Directive.¹²⁴ This transparency is intended to increase shareholder protection and assure investor confidence resulting in more efficient markets.¹²⁵ The Major Shareholdings Directive is similar to SEC disclosure rules.¹²⁶ SEC Rule 13d-1¹²⁷ is triggered

116. St. John, *supra* note 49, at 246.

117. *Id.*

118. 2001/34, art. 25(3), 2001 O.J. (L 184) 18 (EC).

119. Warren, *supra* note 38, at 214.

120. *Id.* at 214. 2001/34, 2001 O.J. (L 184) 7 (EC).

121. *Id.* at 214.

122. Sulger, *supra* note 91, at 230.

123. 2001/34, Annex III, 2001 O.J. (L 184) 71 (EC).

124. 2001/34, art. 89(1), 2001 O.J. (L 184) 31 (EC).

125. Warren, *supra* note 38, at 202.

126. For example, traders who would be otherwise liable for inside trading can immunize themselves by disclosing inside information. See *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968) (en banc).

when a shareholder, or group of shareholders, acquires more than 5 percent of a company's stock.¹²⁸ 13d imposes a filing obligation on the shareholders.¹²⁹ However the primary objective of most other SEC disclosure rules¹³⁰ is to protect ordinary investors by signaling them of purchases and sales by large shareholders¹³¹ as an indirect check on insider trading whereas the Major Shareholdings Directive focusses on maintaining a stable market. It is a question whether trades made by large investors are observed because of inside information or whether they are observed because of hostile takeovers. Since disclosure is a low cost remedy, in fact both reasons justify requiring large shareholders to signal their purchases and sales.

e. Prospectus Directive

The New Prospectus Directive essentially governs the conditions under which the securities issued by a company incorporated in one Member State will be admitted to the stock market and to the stock markets of other Member States. The ultimate objective of the Directive is to create a system of mutual recognition to reduce transaction costs associated with listing shares on other stock markets in the EU in order to attain an integrated capital market.¹³² To obtain that objective, investors have to know that the market is fair. Thus, a second objective of the Directive is protection of investors¹³³ via disclosure rules. Full disclosure should thus help improve capital formation and allocation.¹³⁴ Protection of investors and the creation of an integrated capital market are complementary goals the Directive seeks to attain so that European securities can compete on the global market.¹³⁵

127. Rule 13d-1, pursuant to beneficial ownership reporting requirements in § 13(d) of the Securities Exchange Act of 1934.

128. Broc Romanek, Mark S. Britton, *Online Shareholder Activism: How to Guard Against its Fallout* 20 No. 5 ACCA Docket 32, 37 (2002).

129. *Id.* at 36.

130. 15 U.S.C.A. § 78n (d)1 (2002).

131. Shaun Mulreed, *Private Securities Litigation Reform Failure: How Scierter has Prevented the Private Securities Litigation Reform Act of 1995 From Achieving Its Goals*, 42 SAN DIEGO L. REV. 779, 784 n. 14 (2005).

132. "In accordance with the principle of proportionality, it is necessary and appropriate for the achievement of the basic objective of ensuring the completion of a single securities market to lay down rules on a single passport for issuers." Council Directive 2003/71, preamble, 2003 O.J. (L 345) 68 (EC).

133. "One of the objectives of this Directive is to protect investors." *Id.* at 65.

134. Warren, *supra* note 38, at 209-210.

135. "The aim of this Directive and its implementing measures is to ensure investor protection and market efficiency, in accordance with high regulatory standards adopted in the relevant international fora." Council Directive 2003/71, preamble, 2003 O.J. (L 345) 65 (EC).

Accordingly, the New Prospectus Directive imposes on Member States a duty to require companies seeking to make public offerings of their securities to present a prospectus detailing financial and management information about the company and its shares for any security offered to the public within the territory of a Member State.¹³⁶ The Directive creates minimum uniform disclosure standards throughout the community for public offerings of securities, irrespective of whether those securities are listed or unlisted.¹³⁷ Listing particulars can be used throughout the EC interchangeably¹³⁸ which should help to build the integrated capital market. The earlier Prospectus Directive was “a first step towards a Community prospectus”¹³⁹ which the new directive fulfills.

Like the SEC registration requirements for publicly traded securities, the prospectus Directive does not apply to certain limited offerings. These include offerings to a “restricted circle of persons,” or to “persons in the context of their trades, professions or occupations”. Small offerings are also exempt¹⁴⁰ as are offerings arising out of mergers and acquisitions¹⁴¹ and intercompany compensation of employees or management.¹⁴² Similar exemptions for small offerings to experienced investors¹⁴³ and a qualified investor exemption appears in the New Prospectus Directive as well.¹⁴⁴ These are similar to the exceptions to the prospectus requirements of the U.S. Securities and Exchange Commission, which exempts small offerings to qualified investors from filing with the SEC.¹⁴⁵

Member States must in principle grant reciprocal recognition to those issuers who have a registered office in that Member State¹⁴⁶ The Member State which must recognize the registration may not generally require more information than the other Member State requires¹⁴⁷ with the exception of relevant local information, in particular regarding the Member State’s tax system.¹⁴⁸ The Directive permits Member States to limit the reciprocity requirement to issuers having

136. *Id.* at 71. Council Directive 89/298, art. 4, 9, 16, 1989 O.J. (L 124) 8-15 (EEC) (repealed).

137. Warren, *supra* note 38 at 215.

138. *Id.*

139. *Id.* at 216.

140. Council Directive 2003/71, art. 3(1), 2003 O.J. (L 345) 71 (EC).

141. *Id.* at 71-72.

142. *Id.*

143. Council Directive 2001/34, art. 17, 2001 O.J. (L 184) 18-19 (EC).

144. Council Directive 2003/71, preamble, 2003 O.J. (L 345) 8 (EC).

145. Securities Act of 1933, §§ 3-4, 15 U.S.C. §§ 77(c), 78(d) (2004).

146. Council Directive 2001/34, art. 37, 2001 O.J. (L 184) 21 (EC).

147. *Id.*

148. *Id.*

their registered offices in a Member State¹⁴⁹ as does the successor 2001/34¹⁵⁰

In conclusion, the securities Directives “demonstrate the principles of minimum standards, mutual recognition and home country control that are basic tenets of the single market in securities.”¹⁵¹ There are however some practical limits on the effectiveness of the Directives. Understandably, stock exchanges insist on a translation of listing particulars and often place further requirements on foreign issuers wishing to list on their exchange.¹⁵² Nevertheless, the Directives do move Europe toward the goal of a single integrated market.

4. The Insider Trading Directive

Insider trading law shows the influence of the EC on the Member States law most clearly. Prior to the Insider Trading Directive, insider trading was treated differently in each Member State, being a criminal offense in some states, yet perfectly legal in others.¹⁵³ Here, the EC has acted to create a Community standard and today insider trading is regarded as wrongful throughout the EU.

The first community prohibition of insider trading was the 1989 Directive.¹⁵⁴ This Directive has since been replaced by a more comprehensive Directive¹⁵⁵ which covers shares and a variety of option contracts as well as prohibiting market manipulation. Market manipulation is defined as trading or disseminating information in order to give false or misleading signals as to price movements.¹⁵⁶ Again, the directive is more specific about defining market manipulation than Securities Exchange Act (SEA) Section 10b, which prohibits “any manipulative or deceptive device or contrivance”.¹⁵⁷ This might be because the SEA was enacted in the wake of the greatest stock market crash in history, whereas the directives were not. The 2003 Directive covers shares, unit trusts, money markets instruments, futures, swaps, options, derivatives and any other instrument trading on a reg-

149. *Id.* at 14.

150. *Id.* at 21.

151. Karmel, *supra* note 39, at 20.

152. *Id.*

153. Insider trading was legal in Germany until 1994. See, e.g., Anupama J. Naidu, *Was its Bite Worse than its Bark? The Costs Sarbanes-Oxley Imposes on German Issuers may Translate into Costs to the United States*, 18 EMORY INT'L L. REV. 271, 299 (2004).

154. Council Directive Coordinating Regulations on Insider Trading, 1989 O.J. (C 277) 13 [1 Common Mkt. Rep. (CCH)] ¶ 95,028.

155. Council Directive 2003/6, 2003 O.J. (L 96) 16-26 (EC).

156. *Id.* at 20.

157. Securities Exchange Act of 1934, § 10, 15 U.S.C. § 78j (1994) (discussing manipulative and deceptive devices).

ulated market or for which a request to trade has been made.¹⁵⁸ Once again the terms are more specific than the 1933 and 1934 acts which defines security very broadly¹⁵⁹ – so broadly in fact that even investments in a common ponzi scheme have been held to be a security.¹⁶⁰ The basic premises of the 1989 Directive are retained within the 2003 Directive and the 1989 Directive may be persuasive evidence of the meaning of the 2003 Directive.

a. Rationale of the Insider Trading Directive

The EC takes the position that insider trading undermines investor confidence,¹⁶¹ which leads to sub-optimal clearing of securities markets.¹⁶² These rationales of the 1989 Directive are also found in the 2003 Directive.¹⁶³ They are essentially the same rationales for the pro-

158. Council Directive 2003/6, art. 1(3), 2003 O.J. (L 96) 21 (EC).

159. The Securities Act of 1933 defines “security” as:

[A]ny note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a ‘security’, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

15 U.S.C. § 77b(1).

The Securities Exchange Act of 1934 defines “security” as:

[A]ny note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a ‘security’ or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to any purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker’s acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

15 U.S.C. § 78c(a)(10).

160. *Sec. & Exch. Comm’n. v. Glenn W. Turner Enter., Inc.*, 474 F.2d 476; (9th Cir. 1973).

161. *See, e.g., Case C-384/02, Criminal Proceedings against Knud Grøngaard and Allan Bang*, 2005 (C 384) par. 22 (ECR). “Directive 89/592 prohibits insider dealing with the aim of protecting investor confidence in the secondary market for transferable securities and, consequently, of ensuring the proper functioning of that market.” *Id.*

162. *Adoption of Insider Trading Rules Creates Wide Ban on Use of Information*, 2 Int’l Sec. Reg. Rep. (BNA) No. 14, at 1 (June 21, 1989). *See also Case C-384/02, Criminal Proceedings against Knud Grøngaard and Allan Bang*, 2005 (C 384) par. 22 (ECR). “Directive 89/592 prohibits insider dealing with the aim of protecting investor confidence in the secondary market for transferable securities and, consequently, of ensuring the proper functioning of that market.” *Id.*

163. Council Directive 2003/6, preamble, 2003 O.J. (L 96) 16,17 (EC).

hibition of insider trading that one sees in U.S. law.¹⁶⁴ But, unlike the U.S., at the time of the adoption of the Insider Trading Directive, insider trading was by no means a criminal offence in all or even a majority of Member States.¹⁶⁵ The Directive seeks to improve protection against abuse throughout the community.

The Directive essentially shifted the focus on insider trading from “pure company law” which juxtaposed the company’s interest against the insiders based on a rationale that insider trading is a breach of fiduciary duty to a multilateral approach. Under the modern multilateral approach, stockholders, employees, managers, and the general public are seen as having competing interests to be balanced and the rationale for the prohibition of insider trading is to maintain market efficiency.¹⁶⁶ The basis of the Directive is not in Art. 54 of the Treaty of Rome but in Art. 100a of the Single European Act.¹⁶⁷

b. Insider Defined

The 1989 predecessor Directive clearly defined the term “insider”, unlike U.S. law, where the term is not statutorily defined. An insider is one who, due to his relationship to the company as manager, director, employee or major shareholder, possesses inside information (material non-public facts) and knowingly uses such inside information to acquire or dispose of securities to which the information relates for his own account or another.¹⁶⁸ The 2003 Directive not only directs the prohibition to persons who acquired inside information due to their position as a director, manager, employee or majority shareholder but includes those who acquired the information illegally.¹⁶⁹

164. The Securities and Exchange Act of 1933 defines itself as “[A]n [Act] [t]o provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes.” Securities Act of 1933, Pub. L. No. 22, 48 Stat. 74 (1933). The Securities Exchange Act of 1934 states that its purposes are “. . . to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets in such transactions.” Securities Exchange Act of 1934, §15 U.S.C.A. §78(b) (2006).

165. *E.g.*, *supra* note 153.

166. Stephen J. Leacock, *In Search Of A Giant Leap: Curtailing Insider Trading In International Securities Markets By The Reform Of Insider Trading Laws Under European Union Council Directive 89/592*, 3 *Tulsa J. Comp. & Int'l L.* 51, 58 (1995).

167. *Id.*

168. Council Directive 89/592, art. 2, 1989 O.J. (L 334) 30-32 (EEC).

169. Council Directive 2003/6, art. 2(1)(a-d), 2003 O.J. (L 96) 16, 21 (EC) (defining insiders as members of boards of Directives, key management, large shareholders and even employees of the company).

The 1989 Directive prohibited insiders from “tipping” others about inside information except in the course of ordinary business.¹⁷⁰ The prohibition of “tipping”,¹⁷¹ as well as the exception for trades in the ordinary course of business are also found in the Directive 2003/6.¹⁷² “Tipping”, a source of controversy and uncertainty in U.S. securities law, is more clearly defined in E.U. law than in U.S. law¹⁷³ as are the instances where “tipping” is permitted. The “safe harbor” provisions allowing disclosure of inside information in the ordinary course of employment (“tipping”) are, as an exception to a general rule, to be interpreted strictly.¹⁷⁴ Thus, disclosure of inside information in the course of employment is also prohibited unless “there is a close link between the disclosure and the exercise of his employment, profession or duties, and that disclosure is strictly necessary for the exercise of that employment, profession or duties.”¹⁷⁵ That is, disclosure of inside information in the course of employment will be seen as rightful “only if it is strictly necessary for the exercise of an employment, profession or duties and complies with the principle of proportionality.”¹⁷⁶ The court will examine the quality of the disclosed information to determine whether the disclosure was, given the actual facts of the case, necessary.¹⁷⁷ One could thus predict a correlation between the impact of information on prices inversely to the probability that the information rightfully disclosed. In all events, the judicial interpretations of the meaning of the earlier Directive very likely apply to the successor Directive.

170. *Id.* Case C-384/02, Criminal Proceedings against Knud Grøngaard and Allan Bang, 2005 (C 384) par. 26 (ECR) (stating that under Article 3(a) of Directive 89/592, the prohibition of disclosing inside information does not apply to its disclosure by a person in the normal course of the exercise of his employment, profession or duties).

171. Council Directive 2003/6, art. 3(a), 2003 O.J. (L 96) 16, 21 (EC).

172. *Id.*

173. Tippees are defined as those to whom fiduciary duty can be imputed based on their relationship to an insider and/or the character of the information they received. *See* U.S. v. Chiarella 588 F.2d 1358, 1365-67; (2d. Cir. 1978) *rev'd*, U.S. v. Chiarella, 445 U.S. 222 (1980). That definition is ambiguous.

174. *Grøngaard*, 2005 E.C.R. II-0000. “Even if that rule, having regard to the terms used, is capable of covering very different situations, it must, as an exception to a general prohibition and in the light of the objective pursued by Directive 89/592, be interpreted strictly.” *Id.*

175. *Id.*

176. *Id.*

177. *See id.* (stating that “[i]n order to determine whether a disclosure is justified in a particular case, it is appropriate to take account also of the sensitivity of the inside information in question. Particular care is required when the disclosure is of inside information manifestly capable of affecting significantly the price of the transferable securities in question. In that context, it is appropriate to observe that inside information relating to a merger between two companies quoted on the stock exchange is in general particularly sensitive.”).

c. Inside Information Defined

The 1989 Directive and its 2003 successor clearly define “inside information”.¹⁷⁸ This is not the case in U.S. law: Just as “insider” is not clearly defined in U.S. law¹⁷⁹ so also is “inside information” undefined in the relevant SEC legislation and regulations.¹⁸⁰ In U.S. law the concepts, presumptions and rationales for the prohibition of insider trading are amorphous at best, conflicting at worst. The theoretical situation is better in Europe because the basic terms of the law are clearer.

What is inside information? The 1989 Directive defined inside information as “information which is unknown to the public of a specific nature and relating to one or more issuers of transferable securities, or to one or more transferable securities, which, if it were published, would be likely to have a material effect on the price of the transferable security or transferable securities in question.”¹⁸¹ The 2003 Directive similarly provides that: “‘Inside information’ shall mean information of a precise nature which has not been made public, relating, directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments.”¹⁸²

The European Directive’s definition of insider trading is clearer than the U.S. definition. However, the same elements arise in both legal systems: Materiality and Publicity (“material non-public information”).¹⁸³ However, “[U]nlike the U.S. insider trading laws, determination of illegal trading is based not on breach of a fiduciary duty, but rather, on possession of non-public information.”¹⁸⁴ That is, both the rationale and definition of prohibited conduct are clearer in the EU than in the U.S.

178. Council Directive 2003/6, art. 1(1), 2003 O.J. (L 96) 16, 20 (EC).

179. “The term ‘insider’ is not defined by statute in the context of the U.S. prohibitions against insider trading.” Michael D. Mann & Lise A. Lustgarten, *Internationalization of Insider Trading Enforcement: A Guide to Regulation and Cooperation*, PLI/Corp 7, 14 (1993).

180. “In fact, section 10(b) and Rule 10b-5 (or any of the federal statutes, rules, or regulations) do not define ‘insider trading’ or ‘inside information’ (or ‘misappropriation,’ for that matter).” Micah A. Acoba, *Insider Trading Jurisprudence after United States v. O’Hagan: A Restatement (Second) of Torts § 551(2) Perspective*, 84 CORNELL L. REV. 1356, 1362 (1999).

181. Warren, *supra* note 38, at 220.

182. Council Directive 2003/6, art. 1(1), 2003 O.J. (L 96) 16, 20 (EC).

183. See *U.S. v. Svoboda*, 347 F.3d 471, 475 n. 3 (2d Cir. 2003).

184. Karmel, *supra* note 39, at 23.

d. Prohibition of Insider Trading

The text of the 1989 Directive and the 2003 Directive are similar so we can expect that interpretations of the 1989 text would be likely to apply to the 2003 text. The 1989 Directive orders Member States to forbid:

... any person who . . . has access to such information by virtue of the exercise of his employment, profession or duties, possesses inside information from taking advantage of that information . . . by acquiring or disposing of for his own account or for the account of a third party, either directly or indirectly, transferable securities of the issue or issuers to which that information relates.¹⁸⁵

And its successor version in 2003 says:

Member States shall prohibit any person referred to in the second subparagraph who possesses inside information from using that information by acquiring or disposing of, or by trying to acquire or dispose of, for his own account or for the account of a third party, either directly or indirectly, financial instruments to which that information relates.¹⁸⁶

Thus, rather than seeing the 2003 Directive as displacing case law and legislation developed under the 1989 Directive we should expect to see the courts interpreting the 2003 Directive in light of the 1989 Directive and its attendant case law.

e. Prohibition of Market Manipulation

Unlike the 1989 Directive, the 2003 Directive prohibits market manipulation. Market manipulation is clearly defined as transactions which give false or misleading signals to the market as to supply and demand or which fix the price of a given issue at an abnormal or artificial level.¹⁸⁷ Art. 2(b) of the Market Abuse Directive uses language quite similar to SEA Section 10, including in market manipulation: “transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance;”¹⁸⁸ Subsection 2(c) goes on to list some possible manipulative devices, such as internet rumor mongering. That list is of course not exhaustive.

f. Sanctions for market abuse

Both the 1989 and 2003 inside trading Directives require Member States to enact sanctions for insider trading but do not define what

185. Council Directive 89/592, 1989 O.J. (L 334) 30, (EEC).

186. Council Directive 2003/6, art. 2(1), 2003 O.J. (L 96) 16, 26 (EC).

187. *Id.*

188. *Id.*

they may be.¹⁸⁹ Thus a Member State could punish insider trading as a crime or a tort or both. This shows that Directives permit a flexible and nuanced response to the problems posed by the construction of the single market, all the more so when we remember that Directives generally establish minimum standards which Member States can exceed.¹⁹⁰

5. The Financial Instruments Directive

The Investment Services Directive (ISD) was adopted in order to foster the formation of a single continental capital market pursuant to art. 57 of the Treaty of Rome.¹⁹¹ It has since been modified by the Directive on financial instruments.¹⁹² References to the ISD are now construed to refer to the Financial Instruments Directive.¹⁹³ The Financial Instruments Directive¹⁹⁴ establishes minimum standards throughout the community and to provide mutual recognition of Member State business entities.¹⁹⁵ Mutual recognition enables a company registered in one Member State to do business anywhere in the community without reregistering.¹⁹⁶ The obverse of a single market is prevention of protectionism: As seen in *Commission v. Italy*,¹⁹⁷ the single market for financial services implies an opposition to any form of intra-community protectionism, whether in goods, services, or movement of capital and labor.

The Financial Instruments Directive applies to investment firms and regulated markets generally.¹⁹⁸ Insurance companies, "in house" asset managers and certain pension funds are not covered.¹⁹⁹ The Directive sets out minimum capital requirements for financial services companies²⁰⁰ as well as requires the maintenance of an office in the country where it will do business to assure the expertise and reputability as a financial services provider.²⁰¹ Disclosure and transparency require-

189. Warren, *supra* note 38, at 220.

190. See, e.g., Council Directive 2003/6, art. 6(2), 2003 O.J. (L 96) 16, 21 (EC).

191. See generally Treaty Establishing the European Community, 1992 O.J. (C 224) 1; Council Directive 93/22, 1993 O.J. (L 141) 27 (EEC).

192. Council Directive 2004/39, 2004 O.J. (L 145) 1 (EC).

193. *Id.* at 39.

194. *Id.* at 1.

195. *Id.* at 3.

196. Karen M. Smith, *The Need for Centralized Securities Regulation in the European Union*, 24 B.C. INT'L & COMP. L. REV. 205, 210 (2000).

197. Case C-101/94, E.C. Commission v. Italy, 1996 E.C.R. I-2691, [1996] 3 C.M.L.R. 754 (1996).

198. Council Directive 2004/39, art. 1, 2004 O.J. (L 145) 1, 8 (EC).

199. Council Directive 2004/39, art. 2, 2004 O.J. (L 145) 1, 8 (EC).

200. Council Directive 93/22, art. 3, 1993 O.J. (L 141) 27, 37 (EEC).

201. See Council Directive 2004/39, art. 5, 2004 O.J. (L 145) 1, 12 (EC).

ments are also a part of the Directive.²⁰² Service providers are obligated to execute trades on terms most favorable to their clients.²⁰³

6. Life Insurance Directives

The Third Life Directives²⁰⁴ permits cross border life insurance business “but has accomplished little with regard to liberalizing cross border securities investment.”²⁰⁵ However it too demonstrates the will to create an integrated financial services market.

7. Mutual Funds Directive (UCIT)²⁰⁶

Undertakings for the Collective Investment in Transferable Securities (UCITS), better known in American English as mutual funds,²⁰⁷ or in Britain as PEPs, are investment companies that makes money buy purchasing and selling shares in other companies. According to the UCITS Directive such funds “may be constituted according to the law of contract (as common funds managed by management companies) or trust law (as unit trusts) or under statute (as investment companies).”²⁰⁸ The UCITS must be authorized in the Member State where they do business²⁰⁹ but once authorized may do business anywhere in the Union.²¹⁰ UCITS may only invest in securities listed in a Member State or approved regulated foreign markets. UCITS may not borrow funds and must be able to redeem units of shareholders when asked to do so.²¹¹ UCITS are regulated by the state of incorporation though the marketing of UCITS units are subject to the marketing laws of the host state.²¹²

202. *Id.* at 18.

203. *Id.* at 17.

204. Council Directive 92/49, 1992 O.J. (L 228) 1 (EEC), *amended by* Council Directive 95/26, 1995 O.J. (L 168) 7 (EC); Council Directive 92/96, 1992 O.J. (L 360) 1 (EEC), *amended by* Council Directive 95/26, O.J. (L 168) 7 (EC).

205. Karmel, *supra* note 39, at 27.

206. Council Directive 85/611, 1985 O.J. (L 375) 3 (EEC).

207. Allan S. Mostoff & Olivia P. Adler, *Collective Investment Vehicles*, C700 A.L.I.-A.B.A. 499, 534 (1991).

208. HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, *INTERNATIONAL CAPITAL MARKETS AND SECURITIES REGULATION* § 50:29 (2005) (quoting Council Directive 85/611/EEC, art. 1, 1985 O.J. (L 375) 3 (EEC)).

209. Council Directive 85/611, art. 4, 1985 O.J. (L 375) 3 (EEC).

210. Council Directive 85/611, art 1, 1985 O.J. (L 375) 3 (EEC).

211. Samuel Wolff, *Securities Regulation in the European Community*, 20 *DENV. J. INT'L L. & POL'Y* 99, 141 (1991).

212. Warren, *supra* note 38, at 218-19.

9. Banking Directive²¹³

The Second Banking Directive establishes a single license applicable throughout the EU for the provision of banking and other financial services. Banks operating under the Second Banking Directive may provide a wide variety of financial services, including investment services, authorized by the home Member State, without obtaining an additional license.²¹⁴

10. Limits of Directives

There are practical limits on the use of Directives to achieve legal harmonization. As mentioned earlier, Directives are not generally directly applicable. A Directive may however have direct effect if “(i) the obligations are clear and unambiguous, (ii) they are unconditional and (iii) their operation is not dependent on further action by the community”.²¹⁵

Because the Directive must be implemented separately in each Member State there is a risk of conflicting interpretations and more seriously of duplicated effort. Further, Directives are the result of compromises and thus may be conflicted, yet at the same time are a bit inflexible and are difficult to amend.²¹⁶ However Directives are effective at encouraging creation of community wide minimum standards. Though imperfect, Directives do work generally speaking. Moreover, Directives build the consensus necessary for legitimate market integration. Other mechanisms for harmonization of law do exist, namely conventions and regulations, which we now examine.

B. *Conventions: The Insider Trading Convention*

Article 293 (ex art. 220) ECT obliges the Member States to negotiate among themselves to abolish double taxation in the Community. Unlike Directives, conventions are not a part of Community law.²¹⁷ Community institutions are not necessarily at all involved in the conclusion of an international convention, even one made pursuant to Art. 293 ECT.

Directives are generally not directly applicable and do not create rights enforceable by individuals. Likewise, though an international

213. Council Directive 89/646, 1989 O.J. (L 386) 1 (EEC).

214. Samuel Wolff, *Recent Developments In European Union Securities Law*, 30 DENV. J. INT'L L. & POL'Y 292, 296 (2002).

215. Devgun, *supra* note 59, at 464.

216. Gilles Thieffry, *Towards a European Securities Commission*, J. INT'L FIN. MKTS. 1999, 1(7), 300, 300 (1999).

217. *See, e.g.*, Case T-67/01, JCB Service v Commission, 2004 E.C.R. II-49.

convention might be directly applicable, the better view is that international conventions are presumed not to create directly enforceable individual rights and duties unless they explicitly otherwise affirm.

There is at least one tax convention made pursuant to Art. 293 ECT: The Transfer Pricing Arbitration Convention.²¹⁸ The Transfer Pricing Arbitration Convention provides a mechanism for Member States to arbitrate their disputes regarding double taxation of a business which transfers profits from operations in one Member State to another. There is also a convention addressing insider trading. The insider trading convention²¹⁹ seeks to create mutual assistance mechanisms for the exchange of information. The insider trading convention defines an insider as a director, officer, board member or their agent. Inside information is defined as non-public information obtained from the insider's employment and which if disclosed would be likely to have a significant influence on the stock market.²²⁰ State parties are obligated to exchange information about suspected inside trading.²²¹

C. *Regulations: The Council Regulation for a European Economic Interest Grouping*

Another tool for harmonization of community law is the regulation. Unlike Directives, regulations are immediately effective:²²² They do not require any national legislation to be implemented. Because regulations are binding law throughout the entire community it is more difficult to enact regulations than Directives and this limits their use.

The EEIG Regulation creates the European Economic Interest Group²²³ (EEIG). The EEIG is essentially an institutional form for joint venture partnerships between two or more companies, whether public or private. The contract concluded does not create a legal person independent of the partners to the EEIG, though the EEIG can enter into contracts in its own name.²²⁴ Though the EEIG must register in the Member State where it is domiciled, it is governed by EU

218. Convention 90/436, 1990 O.J. (L 225) 10 (EEC).

219. Convention on Insider Trading, European Treaty Series No. 130, Strasbourg, 20.IV (open to both non-member and Member States). The convention essentially provides for mutual assistance and cooperation by the authorities regarding investigation of financial frauds. *Id.*

220. *Id.* art. 1.

221. *Id.* art. 2.

222. See Case C-499/03, *Nahrungsmittel GmbH v. Commission of the European Communities*, 2005 E.C.R. I-1751; Case C-253/00, *Antonio Muñoz y Cia SA, Superior Fruticola SA v Frumar Ltd., Redbridge Produce Mktg. Ltd.*, 2002 E.C.R. I-7289.

223. Council Regulation 2137/85, 1985 O.J.(L 199) 1 (EEC).

224. Hans-Jürgen Zahorka, *EEIG European Economic Interest Grouping*, 5 (2001) available at www.eito.org/download/EEIG.pdf.

law.²²⁵ Like any joint venture partnership, the parties to an EEIG do not enjoy limited liability, though this drawback as far as tort liability may also be an advantage as far as lenders are concerned since either partner would be responsible for the debts of the partnership. Article 308 ECT (ex art. 235) is the basis of the EEIG.²²⁶

D. Comparison

1. Comparison of EU and U.S. Securities Law

There are some similarities but also differences between the regime mandated by the Directive and U.S. securities law. SEA Section 10²²⁷ and Regulation 10b(5)²²⁸ prohibit trading on material non-public information,²²⁹ like the Directive. However it is unclear whether Section 10b is based on a theory of breach of fiduciary duty, fraud on the market, misappropriation of information, or any or all of these theories. It is just as unclear to whom duties are owed. In contrast the Directive is clear that it is based not on breach of fiduciary duty but on possession of material non-public information. Courts interpreting SEA Section 10b and Regulation 10b(5)²³⁰ find an implied private right of action.²³¹ The Directive does not provide for any private right of action. Once again, there is much less chaos in the European legislation. Unlike the Directive, which clearly defines both what inside information is and who is an insider Section 10b does not define or even use those terms, though courts do.

225. Warren, *supra* note 38, at 201.

226. Thieffry, *supra* note 216, at 301.

227. 15 U.S.C. § 78j (2000) (prohibiting "any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered. . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.").

228. 17 C.F.R. § 240.10b-5 (2004) (stating "[i]t shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.").

229. *U.S. v. Svoboda* 347 F.3d 471, 475 n. 3 (2d Cir. 2003).

230. SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (2004).

231. *See, e.g., Kardon v. National Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946) (recognizing implied action under Section 10(b) of the 1934 Act).

As seen, there are both important similarities and divergences between the Directive and the SEA. U.S. securities law is essentially federal, though vestigial state anti-fraud provisions in tort such as the tort of deceit²³² do still exist and supplement the federal provisions. This is just about the opposite of Europe, where the securities laws of the Member States are still the starting point. Though, as time passes, the European law will displace the national laws.

One key feature of U.S. securities law is that it usually permits both a criminal action by the state and a private enforcement by individuals. This “privatization” of the public’s authority to punish crime is much more often available in the U.S. than in Europe. Directives do not provide for private enforcement because they are meant to establish goals and guidelines, requiring the Member States to take action, but leaving to the Member States how to implement them. Further, Directives only provide for minimum standards – Member States are generally free to go beyond the minima of the Directives and to propose greater protections.²³³ Ironically this flexibility also explains why a truly uniform European law cannot not be attained using Directives. Yet, Directives can create the groundwork necessary if one day creation of a European Code to displace national laws were desired. In all events, while in fact unlikely, a Member State could create a private right of action in its own national law and this would quite likely be found to be consistent with the Directives’ goals and permissible range of action. The EU can attain a clearer and more coherent law of insider trading than the U.S. Whether it can do so throughout Europe is the greater challenge.

2. A European Securities and Exchange Commission?

Some authors recommend that the EU establish its own Securities and Exchange Commission. For example, Manning argues that:

[T]he EU should . . . reestablish the European Securities Committee as an independent administrative agency that would, in addition to its rule-making authority, help develop and monitor the proposed centralized clearance and settlement system, maintain the proposed centralized filing system, collect and disseminate compliance and enforcement data, coordinate Member State enforcement of EU securities laws and regulations, monitor the administration of alterna-

232. *Bradford Third Equitable Benefit Building Society v Borders*, [1941] 2 All ER 205 (House of Lords 1941) (explaining the tort of deceit).

233. *See, e.g., Case C-28/99, Criminal Proceeding Against Verdonck*, 2001 E.C.R. I-3399 (stating that “Article 6 of Directive 89/592 does not preclude the application of legislative provisions of a Member State which, as regards the prohibition of use of inside information, are more stringent than those laid down by the directive”).

tive dispute resolution proceedings, and provide consumer education to retail investors to further develop and protect its unified retail securities market.²³⁴

His is not the only voice and is essentially correct. The EU should develop a securities and exchange authority because a central authority can act more rapidly and decisively, and also because a central authority will inevitably develop a unitary law reducing legal uncertainty and transaction costs.²³⁵ Twenty five or more national authorities are inevitably going to be less efficient and inevitably divided in their approach than one central authority. Moreover, a central authority can and should look not just at sectors, which is the current approach,²³⁶ but rather at the entire financial services business.²³⁷ “Just as the euro required the establishment of a European Central Bank, a pan-European equity market will require a European SEC.”²³⁸

Opponents of an EU SEC center their arguments around the idea that private market incentives will best protect investors.²³⁹ However, private remedies would do so suboptimally, since there would be twenty five different national views with attendant uncertainty and higher transaction costs.

a. Disclosure

Inside traders in U.S. law are under an obligation to disclose the inside information or abstain from trading. One author recommends increased disclosure as a part of EU securities law, noting that: “Investors need consistency and comparability in financial statement presentations and timely disclosure of material corporate events.”²⁴⁰ For example, there is no equivalent to the shareholder’s right to inspection guaranteed by the EU in any of the Directives. Similarly, the EU needs to either complete the establishment of international accounting standards (IAS) or accept the reality that the U.S. standard Generally Accepted Accounting Principles (GAAP) are the world

234. Warren, *supra* note 38, at 220.

235. Smith, *supra* note 196, at 216.

236. See, e.g., Michael Gruson, *Supervision of Financial Holding Companies in Europe: The EU Directive on Supplementary Supervision of Financial Conglomerates*, 36 INT’L LAW. 1229, 1235-1236 (2002) (stating “[t]he existing EU legal framework for the supervision of financial institutions is incomplete because it only covers the so-called sectoral supervision, that is, supervision over institutions within a particular sector of the financial industry. Cross-sectoral supervision of financial groups, combining institutions from different financial sectors, exists only to a limited extent.”).

237. Smith, *supra* note 196, at 217.

238. Karmel, *supra* note 39, at 33.

239. *Id.*

240. *Id.* at 35.

standard.²⁴¹ Uniform standards for accounting and languages would result in lower transaction costs and greater market efficiency.

b. The Legal Basis of the EU SEC: Art. 308 and/or Art. 2

If a European Securities Authority were created it would most likely be based on Article 308 ECT (ex art. 235).²⁴² Art. 308 provides that:

If action by the Community should prove necessary to attain, in the course of the operation of the Common Market, one of the objectives of the Community and this Treaty has not provided the necessary powers, the Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, take the appropriate measures.

This clause might be compared to the combined effect of the elastic clause²⁴³ and the commerce clause²⁴⁴ in the U.S. constitution in that it theoretically empowers the Community to do much more than is explicitly stated in other provisions of the treaty. However, at least to now, Art. 308 is not as liberally construed as the commerce clause of the U.S. constitution. The action taken under Art. 308 must be “necessary to attain” an “objective of the Community”, as no other provision addresses a securities and exchange authority. The objective to be obtained, a single market in securities, is clearly a central task of the Community as set out in Article 2 of the Treaty:

[T]he Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing common policies or activities referred to in Articles 3 and 4, to promote throughout the Community a harmonious, balanced and sustainable development of economic activities and economic and social cohesion and solidarity among Member States.

Further in Article 3.1(c) and 3.1(g) state that:

1. For the purposes set out in Article 2, the activities of the Community shall include, as provided in this Treaty and in accordance with the timetable set out therein:

(c) an internal market characterised by the abolition, as between Member States, of obstacles to the free movement of goods, persons, services and capital;

(g) a system ensuring that competition in the internal market is not distorted;

Thus, if the goals of a single capital market cannot be achieved with twenty five national authorities – that is, if the subsidiarity argument

241. *Id.*

242. See Thieffry, *supra* note 216, at 301.

243. U.S. CONST., art. I, § 8, cl. 18.

244. *Id.* art. I, § 8, cl. 3.

can be overcome, which I think is the case – then these provisions of the Treaty would be the basis of a European Securities Authority. As there is a European Prospectus Regulation it is likely that Europe will at some point establish a central securities authority. Like the single currency, the reduced transaction costs and economies resulting make such a development desirable.

II. EUROPEAN TAX LAW

Just as Europe seeks to harmonize securities law it also seeks to create a uniform tax law, albeit less successfully. It uses the same instruments: Directives, regulations, conventions and case law.

A. Tax Teleology

Adam Smith long ago set out four principles of taxation: Taxes should be simple. Taxes should be levied according to ability to pay. Taxes should be easy to administer. Taxes should be certain and economically neutral.²⁴⁵ This idea that taxation should be economically neutral to avoid economic distortion is a part of the European tax system, however imperfectly implemented²⁴⁶ and this idea is at the root of several community decisions.²⁴⁷ This can be seen for example in the fiscal aspects of state aids. State subsidization of industry normally would be seen by economists as a distortion of the free market. For this reason, direct and indirect state aids are problematic under the EC Treaty.

245. 5 ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* CH. 2 (University of Chicago Press 1976) (1776).

246. Sandra Eden, *Corporate Tax Harmonisation in the European Community*, 6 *BRIT. TAX REV.* 624, 624 (2000).

At an economic level the issue is simple—in order for the single market to operate smoothly, the aggregate effects of 15 tax systems should ensure that there are neither disincentives nor incentives for business to be conducted in one place rather than another. This is actually rather easily achieved at a technical level. If all Member States operate the same tax system, using the same tax base and rates, and exempt all foreign income, there will be perfect neutrality as to location. The overlay of the real world with its political and social issues makes matters more difficult. This makes it necessary to unpack the notion of neutrality in order to understand more clearly the ways in which the inter-relationship of national tax systems causes problems of distortion, and what can be done about them.

Id.

247. See, e.g., Peter Dreher, *European Community Taxation*, 4(8) *INT'L CO. & COM. L. REV.* 295 (1993).

B. *State Aids and Taxation*

EU Member States cannot grant aid which threatens to distort the single market. Article 87(1) (ex Article 92(1)) provides:

Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.

State aid is not defined by the EC Treaty,²⁴⁸ however, favorable tax treatment such as a tax credit can constitute a state aid. Though, de minimis state aids are permissible,²⁴⁹ Art. 87 is to be construed narrowly.²⁵⁰ Taxes used to finance state aids which were found permissible under Art. 87, have been held nevertheless invalid as interfering with the single market under Art. 90 (ex art. 95)²⁵¹ for if the court were to consider a state aid separately from the financing mechanism used to fund it and attain it would be impossible to attain the objectives of the EC Treaty.²⁵² For example:

It may be that aid properly so-called, although not in conformity with Community law, does not substantially affect trade between states and may thus be acknowledged as permissible but that the disturbance which it creates is increased by a method of financing it which would render the scheme as a whole incompatible with a single market and the common interest.²⁵³

248. Edén, *supra* note 246, at 633.

249. Case C-156/98, F.R.G. v. Commission, 2000 E.C.R. I-6857.

According to Commission notice 96/C 68/06 on the de minimis rule for State aid (OJ 1996 C 68, p. 9, the de minimis notice), which amends the Community guidelines of 20 May 1992 on State aid for small and medium-sized enterprises as indicated in Commission notice 92/C 213/02 (OJ 1992 C 213, p. 2), Article 92(1) of the Treaty is to be considered as not applying to aid the amount of which is below the ceiling of ECU 100 000 over a three-year period beginning when the first de minimis aid is granted.

Id.

250. *Id.*

251. Edén, *supra* note 246, at 633.

252. Case 73/79, Commission v. Italy, 1980 E.C.R. 1533 (stating “the method of financing an aid cannot be isolated from consideration of the aid properly so-called.”).

253. Case 47/69, France v. Commission, 1970 E.C.R. 487.

Unlike Art. 87, which is conditional,²⁵⁴ Art. 90 is unconditional.²⁵⁵ Article 87, alone, does not have direct effect.²⁵⁶ Article 90 can have direct effect.²⁵⁷ When a national tax only partly violates article 90 - where for example the basis taxed is valid, but the tax rate discriminates between domestic and foreign entities taxed - whether the tax will be partly enforced is for the national legislator to determine.²⁵⁸ Partial enforcement of the tax would not be a contravention of Community law.

The objectives of principled economic liberalism were also upheld in *Pabst & Richarz KG v. Hauptzollamt Oldenburg*.²⁵⁹ There, a tax scheme was held in violation of the treaty where the tax was essentially to further an anticompetitive monopoly. As a general rule, whenever a tax impedes the formation of the single market we should expect it will not be permitted.

C. Conventions to Avoid Double Taxation

The principle of avoiding double taxation is another liberal economic view that finds its expression in the practice of EU law. Double taxation, whether of income or of income sources, is bad economics because double taxation just about always distorts market transactions. Taxing a good increases its price reducing demand for that good, and double taxing a good makes the good even less likely to be bought.

Tax conventions, whether bilateral or multilateral, are the usual method to avoid the double taxation that occurs when two different governments claim to be able to tax the same source of income or the same taxpayer.²⁶⁰ The OECD proposes model conventions which have been taken up and enacted by numerous states.²⁶¹

254. Case 78/76, *Steinike & Weinlig v. Germany*, 1977 E.C.R. 595 (stating "the prohibition in Article 92 (1) is neither absolute nor unconditional since Article 92 (3) and Article 93 (2) give the Commission a wide discretion and the Council extensive power to admit aids in derogation from the general prohibition in Article 92 (1).").

255. See Case 27/67, *Firma Fink-Frucht GmbH v Hauptzollamt München Landsbergerstrasse*, 1968 E.C.R. 327.

256. Case C-114/91, *Criminal Proceedings Against Gérard Jérôme Claeys*, 1992 E.C.R. I-6559 (stating "[i]ndividuals cannot therefore simply, on the basis of Article 92 alone, challenge the compatibility of an aid with Community law before the national courts or ask them to decide as the main or a subsidiary issue on any incompatibility . . .").

257. *Id.*

258. Case 34/67, *Firma Gebruder Luck v. Hauptzollamt Koln-Rheinau*, 1968 E.C.R. 359.

259. Case 17/81, 1982 E.C.R. 1331.

260. Devgun, *supra* note 59, at 451-470.

261. *Id.*

Discriminatory taxation is sometimes challenged as a violation of the right to establishment. Art. 43 (ex art. 52) of the EC Treaty (right of establishment) is one of the basic freedoms of the EC Treaty and as such has direct effect, creating rights and duties in and enforceable by individuals.²⁶²

Where a Member State takes steps to prevent double taxation of dividends the exoneration from double taxation the Member State must also provide such exoneration for the branches of companies from other Member States that are doing business in the Member State in question.²⁶³ Moreover, tax advantages provided to a company of a Member State by that Member State as part of a double taxation treaty with a non-Member State must also be provided to permanent establishments in that Member State of companies of other Member States.²⁶⁴

However, the obligations that the ECT imposes on Member States do not normally affect the obligations of Member States to non-Member States under treaties to avoid double taxation.²⁶⁵ Two Member

262. Case C-307/97, *Compagnie de Saint-Gobain v. Finanzamt Aachen-Innenstadt*, 1999 E.C.R. I-6161.

263. Case 270/83, *Commission v. France*, 1986 E.C.R. 273 (stating that “by not granting to the branches and agencies in France of insurance companies whose registered office is in another Member State on the same terms as apply to insurance companies whose registered office is in France the benefit of shareholders’ tax credits in respect of dividends paid to such branches or agencies by french companies, the French Republic has failed to fulfil its obligations under Article 52.”).

264. *Compagnie de Saint-Gobain*, 1999 E.C.R. I-6161.

Article 52 of the EC Treaty (now, after amendment, Article 43 EC) and Article 58 of the EC Treaty (now Article 48 EC) preclude the exclusion of a permanent establishment in Germany of a company limited by shares having its seat in another Member State from enjoyment, on the same conditions as those applicable to companies limited by shares having their seat in Germany, of tax concessions taking the form of:

- an exemption from corporation tax for dividends received from companies established in non-member countries (corporation tax relief for international groups), provided for by a treaty for the avoidance of double taxation concluded with a non-member country,
- the crediting, against German corporation tax, of the corporation tax levied in a State other than the Federal Republic of Germany on the profits of a subsidiary established there, provided for by German legislation, and
- an exemption from capital tax for shareholdings in companies established in non-member countries (capital tax relief for international groups), also provided for by German legislation.

Id.

265. *Id.*

[T]he obligations which Community law imposes on the Federal Republic of Germany do not affect in any way those resulting from its agreements with the United States of America and the Swiss Confederation. The balance and the reciprocity of the treaties concluded by the Federal Republic of Germany with those two countries would not be called into question by a unilateral extension, on the part of the Federal Republic of

States can thus have differing policies as to third states. For example, a German and French company could be taxed differently on their overseas operations in a non-Member State by the non Member State with no conflict arising under EC law.

D. Directives

Our analysis of tax law Directives looks first at non-binding and then at binding norms.

1. "Soft" Law

a. Code of Good Conduct

Non-binding codes of conduct are one more instrument that the EU has which it uses to encourage harmonization of laws. For example, the EU has proposed a non-binding Code of Conduct which was signed by Finance Ministers at the ECOFIN Council meeting in 1997. The objective of the Code of Conduct is to prevent a "race to the bottom"²⁶⁶ where each Member State lowers its taxation to attract businesses with an attendant reduction in social services and decline in the quality of life. "[B]y signing the resolution, Member States commit themselves not to introduce new harmful tax measures and to amend existing harmful tax measures as soon as possible."²⁶⁷ The Code is "a political commitment and does not affect the Member States' rights and obligations or the respective spheres of competence of the Member States and the Community arising from the Treaty".²⁶⁸ That is, the Code is a non-binding resolution. However "if Member States do not take action to remove the provisions identified as harmful, the Commission may be prepared to use Article 96 of the Treaty to propose a Directive to the Council, who may then act on a qualified majority."²⁶⁹

Germany, of the category of recipients in Germany of the tax advantage provided for by those treaties, in this case corporation tax relief for international groups, since such an extension would not in any way affect the rights of the non-member countries which are parties to the treaties and would not impose any new obligation on them.

Id.

266. For a good description of the development of the idea of a race to the bottom due to regulatory competition in the U.S. as a basis for a comparative analysis of EU law, see Catherine Holst, Note, *European Company Law After Centros: Is the EU on the Road to Delaware?* 8 COLUM. J. EUR. L. 323, 332 (2002).

267. Eden, *supra* note 246, at 633.

268. Resolution of the Council and the Representatives of the Governments of the Member States On a Code of Conduct for Business Taxation, 1998 O.J. (C 002) 2, available at <http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=CELEX:41998X0106:EN:NOT>.

269. Eden, *supra* note 246, at 633.

b. Mutual Assistance Directive

Like the Code of Conduct, the Mutual Assistance Directive²⁷⁰ provides a cadre in which Member States taxing authorities can exchange information in order to combat tax fraud.²⁷¹ These soft law provisions provide an important context in which law can be interpreted and applied.

2. “Hard” Law

a. Merger Directive²⁷²

Mergers and acquisitions of companies almost always raise tax issues because the sale of stock involved technically is a realization event. The merger Directive defers taxation of capital gains of property transferred pursuant to “mergers, divisions, transfers of assets and exchanges of shares” where the assets are still taxable by that jurisdiction. Professor Sandra Eden provides an exemplary illustration of the type of problem the Merger Directive addresses:

company A, a manufacturing company in the United Kingdom, decides to transfer all its operations in Newcastle to company B in Germany in exchange for shares in B. There will be no charge to tax on the disposal of the assets to B, because the assets will be attached to a permanent establishment of B’s in the United Kingdom, and so will remain within the United Kingdom tax charge. The deferred gain will be caught when B disposes of the assets.²⁷³

Essentially, the taxation of the realized gain or loss in the transaction is deferred because the taxable basis was not transferred outside the tax jurisdiction of the Member State and because such corporate restructurings would be disfavored were the gain or loss immediately recognized. The basis of the capital good is transferred to its new owner and will serve as the starting point to determine tax when the good is finally alienated. This deferral of taxation in order to permit flexible restructuring is one more example of the principle of economic neutrality of taxation guiding community tax law.

270. Council Directive 77/799, 1977 O.J. (L 336) 15 (EEC).

271. Eden, *supra* note 246, at 628.

272. Council Directive 90/434, 1990 O.J. (L 225) 1 (EEC), amended by Council Directive 2005/19/EC, 2005 O.J. (L 058) 19.

273. Eden, *supra* note 246, at 630.

b. Parent Subsidiary Directive

The Parent Subsidiary Directive²⁷⁴ is very similar to the merger Directive. The goal of both Directives is to allow enterprises to flexibly reorganize their operations without being influenced by tax considerations. The objective of the Parent Subsidiary Directive is “to exempt dividends and other profit distributions paid by subsidiary companies to their parent companies from withholding taxes and to eliminate double taxation of such income at the level of the parent company”.²⁷⁵ The Directives exempt cross-border dividend payments from withholding taxes where such dividends are paid within a corporate group: Member states can either exempt the dividend or provide an equivalent tax credit. There must be at least 25% control of the company in question by the parent and both the company paying and the company receiving the dividend must be fiscal residents of Member States.²⁷⁶

D. Cases: *Futura*, *Marks and Spencer*, and the Principle of Territoriality

Internationally, it is generally admitted that residents are taxable for their income regardless of its source, but non-residents are taxable only on income sourced to the taxing jurisdiction. Thus, in principle residents and non-residents can be taxed differently under the EC Treaty.²⁷⁷ However this theoretical starting point does not really decide the issue. The goal of building a single market, the right to free movement of persons, and the attendant duty to avoid discriminatory treatment, whether in terms of taxation or services leads the court to analyze tax liabilities in terms of the practical facts on a case by case basis.²⁷⁸ One example of this is the *Futura Participations SA v. Administration des Contributions*²⁷⁹ decision.

1. *Futura*

The question presented in *Futura* was whether a Member State can limit the right of a permanent establishment (corporate headquarters)

274. Council Directive 90/435, 1990 O.J. (L 225) 6 (EEC), amended by Council Directive 2003/123, 2004 O.J. (L 7) 41 (EC).

275. Council Directive 2003/123, 2004 O.J. (L 7) 41, 41 (EC).

276. Eden, *supra* note 246, at 628.

277. See Case 270/83, *Commission v. Fr.*, 1986 E.C.R. 273; Case C-279/93, *Finanzamt Koln-Altstadt v. Schumacker*, 1995 E.C.R. I-225; Case C-80/94, *Wielockx v. Inspecteur der Directe Belastingen*, 1995 E.C.R. I-2493; Case C-311/97, *Royal Bank of Scot. v. Elliniko Dimosio*, 1999 E.C.R. I-2651

278. See generally Eden, *supra* note 246.

279. Case C-250/95, 1997 E.C.R. I-2471.

to offset gains with losses only for losses which were realized in that Member State.²⁸⁰ Of course, while “direct taxation falls within the competence of the Member States, the latter must none the less exercise that competence consistently with Community law and therefore avoid any overt or covert discrimination on grounds of nationality”²⁸¹ That is, the court looks beyond discriminatory intent and considers also discriminatory effect as a basis for breach of treaty obligations.²⁸² Even though “direct taxation does not as such fall within the purview of the Community . . . , the powers retained by the Member States must nevertheless be exercised consistently with Community law”.²⁸³ Thus, a law which has the effect of discrimination on the basis of nationality is in principle contrary to the EC Treaty. This is obviously consistent with the goal of the EU (a single market for labor, capital, and goods) and its teleology (economic liberalism in the service of peace and prosperity).

Yet, in *Futura* the court pointed out the power of the Member States to tax: “effectiveness of fiscal supervision constitutes an overriding requirement of general interest capable of justifying a restriction on the exercise of fundamental freedoms guaranteed by the Treaty”²⁸⁴ The court did not need to affirm the power of the Member State to derogate from its treaty obligations to reach the economically neutral liberal result, yet did so. Moreover, though the court already

280. *Id.* The operant portion of the case states very precisely the issue of offsetting gains and losses:

Article 52 of the Treaty does not preclude a Member State from making the carrying forward of previous losses, requested by a taxpayer which has a branch in its territory but is not resident there, subject to the condition that the losses must be economically related to the income earned by the taxpayer in that State, provided that resident taxpayers do not receive more favourable treatment. On the other hand, that article does preclude the carrying forward of losses from being made subject to the condition that, in the year in which the losses were incurred, the taxpayer must have kept and held in that State accounts relating to his activities carried on there which comply with the relevant national rules. The Member State concerned may, however, require the non-resident taxpayer to demonstrate clearly and precisely that the amount of the losses which he claims to have incurred corresponds, under its domestic rules governing the calculation of income and losses which were applicable in the financial year concerned, to the amount of the losses actually incurred in that State by the taxpayer.

Id.

281. *Id.* (citing *Schumacker*, 1995 E.C.R. I-225 and *Wielockx*, 1995 E.C.R. I-2493).

282. Case C-1/93, *Halliburton Servs. BV v. Staatssecretaris van Financiën*, 1994 E.C.R. I-1137. “[T]he rules regarding equality of treatment forbid not only overt discrimination by reason of nationality or, in the case of a company, its seat, but all covert forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result.” *Id.* (citing Case C-330/91, *The Queen v. Inland Revenue Commissioners, ex parte Commerzbank*, 1993 E.C.R. I-4017).

283. C-55/98, *Skatteministeriet v. Bent Vestergaard*, 1999 E.C.R. I-7641.

284. *Futura Participations SA*, 1997 E.C.R. I-2471.

had enough reasons to decide the issue in favor of the single market/economic liberalism, it went on, unnecessarily, to justify its decision on the basis of the principle of fiscal territoriality.²⁸⁵ This is the interesting part of the decision. First, it was just as much surplusage as the statements on the ability of Member States to derogate from their treaty obligations in the interest of orderly taxation. Moreover, the principle of territoriality presents a counterbalance to the power of the Member State to derogate from the treaty. Member State taxation may only derogate from the treaty if such derogation is consistent with the principle of fiscal territoriality.

The principle of territoriality is a general principle of international law and of community law,²⁸⁶ if only because the EC and EU treaties are treaties under international law and subject thereto. The principle of territoriality states that a taxing jurisdiction may tax income sourced from that jurisdiction, and that the taxing jurisdiction has an absolute right to tax its nationals.²⁸⁷ By establishing these concurring norms – the right of Member States to derogate from the treaty, but subject to the principle of territoriality – the court allows itself in future decisions to justify any outcome it wants to.

2. *Steinike*

The court in *Steinike* was confronted by a state aid offered by Germany to aid German food processing companies to open new domestic and foreign markets.²⁸⁸ The Commission had been informed of the aid and had not objected.²⁸⁹ The German food processors received the aid regardless of the origin of the food to be processed.²⁹⁰ The court noted prohibition in ex Art. 92 are not absolute but are conditional²⁹¹

285. *Id.* “Such a system, which is in conformity with the fiscal principle of territoriality, cannot be regarded as entailing any discrimination, overt or covert, prohibited by the Treaty.” *Id.*

286. Case C-446/03, *Marks & Spencer PLC v. Halsey* (Her Majesty’s Inspector of Taxes), 2005 E.C.R. 00.

287. *Id.*

In accordance with the principle of territoriality applicable both in international law and in Community law, the Member State in which the parent company is established has no tax jurisdiction over non-resident subsidiaries. As regards the latter, tax competence belongs in principle, in accordance with the usual allocation of competence in such matters, to the States on whose territory they are established and carry out commercial activities.

Id.

288. Case 78/76, *Steinike & Weinlig v. F.R.G.*, 1977 E.C.R. 595.

289. *Id.*

290. *Id.*

291. *Id.*

and then went on to do a multifactor balancing test.²⁹² Interestingly, the court did make clear that a state aid cannot at once be a tax under article 90 (ex article 95) and a charge having equivalent effect to a customs duty under former articles 9,12 and 13.²⁹³

3. *Marks and Spencer*²⁹⁴

A British company, with several subsidiaries also incorporated in Britain and other Member States, divested itself of its foreign establishments.²⁹⁵ Britain allowed tax transparency between British companies, whether doing business in Britain or overseas, but did not allow tax transparency between subsidiaries owned by British companies but incorporated in other Member States.²⁹⁶ Essentially, dividend payments from the foreign subsidiary to the British parent company were not taxed if the subsidiary was incorporated in Britain but would be taxed if the company were set up under the laws of another Member State.²⁹⁷ Losses would also be allowed to offset gains within the corporate group, but only as to companies incorporated under British law.²⁹⁸ This presented a case of differential taxation. The question was whether the tax preference was a violation of the right of establishment under former articles 43 and 48 (now articles 37 and 39).²⁹⁹ The court decided that while in theory such differential tax treatment might under certain circumstances be permissible, namely (at least) where there is the opportunity for the foreign subsidiary to offset the double taxation in the tax system of the other Member State.³⁰⁰ Where the foreign subsidiary has however exhausted all opportunities to avoid the double taxation, such differential taxation would be a violation of the EC Treaty.³⁰¹ The court did make clear that not only the tax credit to avoid double taxation of dividend income but also loss deductions (including carry forwards) would enter its considerations as to whether the theoretically permissible differential taxation would

292. *Id.* "In judging in these cases whether state aid is compatible with the common market complex economic factors subject to rapid change must be taken into account and assessed. Article 93 of the Treaty therefore provides for a special procedure whereby the Commission shall keep aid under constant review." *Id.*

293. *Steinike*, 1977 E.C.R. 595.

294. Case C-446/03, *Marks & Spencer PLC v. Halsey* (Her Majesty's Inspector of Taxes), 2005 E.C.R. 00.

295. *Id.*

296. *Id.*

297. *Id.*

298. *Id.*

299. *Marks & Spencer*, 2005 E.C.R. 00.

300. *Id.*

301. *Id.*

be also allowed in the specific case at bar. Though the court does not expressly invoke the doctrine of fiscal realism in practice it does so in this case.

4. Synthesis

In *Futura, Marks and Spencer*, and *Steinike*,³⁰² the court clearly takes a realist approach: It is not interested in legal formalities or whether the black letter law was observed. Rather it looks to a number of factors³⁰³ to reach a balanced decision on a case by case basis.³⁰⁴ In all these cases the court is leaving itself openings, both in noting the power of Member States to tax more or less as they see fit, and in describing the principle of territoriality so that it can justify whatever result it feels necessary to achieve the single market. The court gives in to the Member States whenever absolutely necessary, yet advancing the process of legal integration whenever possible.

III. EUROPEAN CORPORATE LAW: THE RIGHT OF ESTABLISHMENT AND THE SOCIETAS EUROPA

A. *National Law: Real Seat Theory of Corporate Nationality v. Place of Incorporation Theory of Corporate Nationality*

The citizenship and residence of companies are treated very differently in common law as opposed to the civil law. This fact marks EU business law and must be explained if we are to understand EU law.

Most common law jurisdictions adhere to the “incorporation theory” – a corporation is deemed to be the creature of the state where it is incorporated, regardless of where it does business. The internal affairs of the corporation are governed by the laws of the place of incorporation, even when it does business outside of that state. The advantages of the place of incorporation theory is that it allows the company to move without being obliged to dissolve itself and reincorporate. The place of incorporation theory also allows management to forum shop. It is also a rule of easy and certain application, a type of bright line test.

302. “[W]hether state aid is compatible with the common market complex economic factors subject to rapid change must be taken into account and assessed.” Case 78/76, *Steinike & Weinlig v. F.R.G.*, 1977 E.C.R. 595.

303. “In each specific situation, it is necessary to consider whether the fact that a tax advantage is available solely to resident taxpayers is based on relevant objective elements apt to justify the difference in treatment.”

Marks & Spencer, 2005 E.C.R. 00.

304. “[I]n tax law, the taxpayers’ residence may constitute a factor that might justify national rules involving different treatment for resident and non-resident taxpayers. However, residence is not always a proper factor for distinction.” *Marks & Spencer*, 2005 E.C.R. 00.

Though some civilian jurisdictions such as the Netherlands and Switzerland do take up the place of incorporation theory, France and Germany among others do not. Most continental civilian jurisdictions takes a different view from the “incorporation theory” and instead use the “real seat theory” (*Sitztheorie*) to determine residency. The “real seat theory” holds that the corporation is a citizen of the state where it has its headquarters, i.e. does business. The corporation is obliged to register or incorporate where it has its headquarters or it will be denied legal personality. This rule makes it easier for host states to control foreign corporations but makes it difficult for the corporation to move since dissolution and reincorporation would be required to do so. This theory prevents forum shopping.

Both rules exist in the EU today. A Directive could force Member States to adopt one or the other theory. However none exists or is proposed. In fact “the ‘place of incorporation’ doctrine coexists best with the goal of a single European market because it recognizes foreign companies and the laws that govern their internal affairs and it allows companies to move to a new state.³⁰⁵

Understanding the differences between these two regulatory systems is essential for understanding the conflicts arising out of the right of establishment.

B. *The Case Law of the Right of Establishment: Daily Mail, Centros, Überseering and Futura*

1. *Daily Mail*

It is well settled that any enterprise incorporated in the EU has in principle the right to do business anywhere in the Union. The right of establishment is central to the single market and one of the four basic rights guaranteed by the ECT. However, this nearly absolute right in principle is not without problems in practice.

An early leading case on the right of establishment is *Daily Mail*.³⁰⁶ A British company wished to transfer its head office from England to the Netherlands to take advantage of a more favorable Dutch taxation system.³⁰⁷ That move required prior approval of the tax authorities.³⁰⁸ The required approval was not forthcoming.³⁰⁹

305. Gildea, *supra* note 1, at 292.

306. Case 81/87, *The Queen v. H.M. Treasury and Comm’r of Inland Revenue*, ex parte *Daily Mail and General Trust plc*, 1988 E.C.R. 5483.

307. *Id.*

308. *Id.*

309. *Id.*

One might think that the ECJ could have rejected this move as an example of tax evasion resulting from manipulation of law – *abus de droit*. Or, one could imagine the court saying that such a move would be illegal by invoking a doctrine of fiscal realism. It is clearly a general principle of tax law that tax authorities, whether in France or the United States, look not to the form of a transaction but at its substance to determine its effects. And general principles of law are a source of law, both in international law³¹⁰ and in EU law.³¹¹ Yet, the court did not take these obvious doctrinal moves, neither in *Daily Mail*, nor in its progeny (*Centros*, *Überseering*, *Futura*)! Rather, the court limited itself to an examination of the EC Treaty. But, the court did not follow the obvious teleology of the treaty. It did not determine that the right of establishment should permit the British company to establish its head office in the Netherlands. Rationales for such a decision could be to encourage integration of the single market and even to encourage regulatory competition among the Member States. Instead, the court determined that the right of establishment did not permit the company incorporated in one Member State to move its head office to another Member State,³¹² at least not where such move was motivated by tax avoidance purposes (and we must remember, tax avoidance is not per se tax fraud). The reasoning of the court is that the EC Treaty does not adopt either the real seat theory or the place of incorporation theory. Thus, the issue was left for national law to determine, and Articles 43 and 48 of the Treaty of Rome do not give companies an absolute right to transfer their head office.³¹³

310. Statute of the International Court of Justice, June 26, 1945, art. 38(1), 59 Stat. 1031, T.S. No. 993. In fact however the foundation of general principles of law has a source of international law natural law. Aaron Judson Lodge, *Globalization: Panacea For The World or Conquistador Of International Law and Statehood?*, 7 OR. REV. INT'L L. 224, 292 (2005); Jon M. Van Dyke, *The Role of Customary International Law in Federal and State Court Litigation*, 26 U. HAW. L. REV. 361, 381 n. 123 (2004) (citing Grotius); Joel Brandon Moore, *The Natural Law Basis Of Legal Obligation: International Antitrust and OPEC in Context*, 36 VAND. J. TRANSNAT'L L. 243, 273-275 (2003). This is because: (1) the ICJ is a creature of treaty, not custom. As such, states may choose not to be bound by its decisions; (2) its decisions do not have value as precedent; and (3) general principles of law were a source of law long before the ICJ was constituted. Thus, general principles of law may be a source of law due to custom, for they are the customary interpretations of law done by states.

311. See, e.g., Case T-83/96, *van der Wal v. Commission*, 1998 E.C.R. II-545 (stating “[i]t is settled case-law that fundamental rights form an integral part of the general principles of law whose observance the Community judicature ensures . . .”).

312. Case C-208/00, *Überseering BV v. Nordic Construction Co. Baumanagement GmbH*, 2002 E.C.R. I-9919.

313. Holst, *supra* note 266, at 328.

2. *Centros*

After *Daily Mail* an observer might think that the ECJ would see through attempts to manipulate the tax system and not allow the EC Treaty to be invoked to further such schemes, applying a sort of “fiscal realism by other means”. In fact however that has not proven to be the case as seen first in *Centros Ltd v. Erhvervs og Selskabsstyrelsen*.³¹⁴

The facts of *Centros* are as follows: Residents of Denmark wished to incorporate a “shell” company in the UK and to then use that company to conduct business in Denmark. No business was to be transacted in the UK. Clearly then this was an example of abusing the legal system to obtain a pecuniary result. Namely, the avoidance of Danish rules requiring all companies to have a minimum of capital prior to incorporation. The risk claimed by Denmark was that such manipulation places creditors at risk. Yet, despite *Daily Mail*, the ECJ held that Denmark was required to recognize the formally “foreign” company and allow it to do business in Denmark. Like Netherlands and the UK, Denmark follows the incorporation theory of corporate residence.³¹⁵

The best justification of *Centros* would be a *reductio ad absurdum*. If Denmark were allowed not to recognize the formally British company what about other companies? Would a company owned by French nationals incorporated in Britain be able to do business in Denmark? A similar justification would be the idea that each Member State must essentially give full faith and credit to the legal acts of the other Member States. But why should those rationales be permitted to justify an abuse of the law through manipulation to disguise transactions?

The court does in fact recognize both the possibility of legal manipulation and the right of Member States to prevent abuse of community law at least by its own citizens.³¹⁶ However, measures which restrict the fundamental freedoms of the Treaty must be “applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not

314. Case C-212/97, 1999 E.C.R. I-1459.

315. Holst, *supra* note 266, at 323.

316. *Centros Ltd.*, 1999 E.C.R. I-1459 (stating “[i]t is true that according to the case-law of the Court a Member State is entitled to take measures designed to prevent certain of its nationals from attempting, undercover of the rights created by the Treaty, improperly to circumvent their national legislation or to prevent individuals from improperly or fraudulently taking advantage of provisions of Community law . . .”).

go beyond what is necessary in order to attain it".³¹⁷ In *Centros*, this was not the case, since the end, protection of creditors, would not have been met by the means as to British companies incorporated by Britons.³¹⁸ There were less restrictive means to the legitimate end sought by the Danish government.³¹⁹ To an American lawyer, this looks a lot like means-ends constitutional review.³²⁰

3. *Überseering*

After *Centros* and *Daily Mail* the community law seemed at odds with itself. The situation was clarified, somewhat, in the *Überseering* decision. The facts of *Überseering* are as follows: A company was incorporated in the Netherlands. It is owned by German nationals, but not registered as a German company. Can that company go before German courts? German law follows the real seat theory (*Sitztheorie*). Since the ostensibly Dutch company was not registered in Germany, which was the place of the center of its economic interests (the place where it has its administration or headquarters) Germany considered that the entity was subject to German law. As it was not properly registered it had no legal existence under German law. The problem is that this amounts to non-recognition of a foreign company, and thus might be a breach of the EC Treaty.

So the question is, whether *Überseering* is more like *Daily Mail*, or more like *Centros*? Or is it *sui generis*? In *Überseering* there was no attempt at manipulation of law or of tax avoidance. So there may in fact be no analogy between *Überseering* on the one hand and *Daily Mail* or *Centros* on the other. Nevertheless, the court and analysts seems to consider the cases as somehow related: They all concern the rights of foreign establishments, and legal fictions. But the legal fiction in *Überseering* is invoked by the state (denying the factual existence of the company) whereas the legal fiction invoked in *Centros* and *Daily Mail* is invoked by the individual. So *Überseering* on the one hand and *Centros* and *Daily Mail* on the other are not in fact analogous.

In any event, the ECJ in *Überseering* required legal fictions to resemble practical facts. Germany was forced to recognize the existence of the formally Dutch company under Articles 43 and 48 of the Treaty of Rome. The German law was not considered a reasonable means to

317. *Id.*

318. *Id.*

319. *Id.*

320. For an explanation of means-end constitutional review, see Gerard J. Clark, *An Introduction to Constitutional Interpretation*, 34 SUFFOLK U. L. REV. 485, 499-500 (2001).

the permissible end of protecting creditors.³²¹ The German measure was not proportional.³²² Moreover, the German ruling denied the company its fundamental right to establishment,³²³ the right to a fair hearing³²⁴ and possibly the right to own property.³²⁵ However, the ECJ did not appear to consider the disturbing fact that it attributed fundamental human rights to a non-human!

The court's decision would support an analogy of *Überseering* to *Centros* rather than to *Daily Mail* because *Centros*, like *Überseering*, addressed the relation of a host state and a corporation.³²⁶ The ECJ distinguished *Daily Mail* from *Überseering* because *Daily Mail* "concerned relations between a company and the Member State under whose laws it had been incorporated" while "the present case concerns the recognition by one Member State of a company incorporated under the law of another Member State."³²⁷ That is, *Überseering* involved not the right of a company to move outside of the state it incorporated in, but rather whether a company has a right to recognition in a host state.³²⁸ This implies perhaps that a company could compel recognition in a "real seat theory" Member State by incorporating in an "incorporation theory" Member State, but only possibly, since *Überseering* clearly involved no element of fraud or other abuse of the law. However the facts of *Überseering* are sufficiently different from *Centros* and *Daily Mail* such that one can question whether any analogy at all should be found.

Whatever we think about the fact that *Überseering* tries, unsuccessfully, to defuse the conflict between *Centros* and *Daily mail* by forcing an analogy that is really not there the fact is: *Überseering* sends a clear message that ambiguities will be resolved in favor of the Community and the single market."³²⁹

C. Regulation: The *Societas Europa*³³⁰

The *Societas Europa* (SE) is an attempt to overcome the problem that there are two differing theories of corporate residency. It is also

321. Case C-208/00, *Überseering BV v. Nordic Construction Co. Baumanagement GmbH*, 2002 E.C.R. I-9919.

322. *Id.*

323. *Id.*

324. *Id.*

325. *Id.*

326. Gildea, *supra* note 1, at 278.

327. *Überseering BV*, 2002 E.C.R. I-9919.

328. *Id.*

329. Gildea, *supra* note 1, at 292.

330. Council Regulation 2157/2001 on the Statute for a European Company (SE), 2001 O.J. (L 294) 1 (establishing the SE).

an attempt to create a European company form. How does one form an SE? What are its advantages?

1. Definition of the SE

The SE is business corporation with legal personality. The SE must be registered in one of the Member States, and its place of registration must also be the seat of its headquarters. SE's face a minimum capitalization requirement of 120,000 euros.³³¹ Liability of shareholders is limited to the value of their investment.³³² The SE is subject to the same formalities of registration, reporting, and internal governance that are found in similar national laws.

2. Formation of the Societas Europa

SE's are created by merger of national corporations (e.g., SA, GmbH, AG, PLC), whether as equals, holdings, or subsidiaries, where at least two of the merged companies are from different Member States;³³³ The SE cannot be created from scratch, rather only through merger of existing companies from two or more Member States.

3. Advantages and Limits of the SE

The advantage of the SE is that it is easier for an SE in a real seat theory state to transfer its registered office from one Member State to another.³³⁴ Transfer of the head office does not require dissolution and reincorporation.³³⁵ Thus the SE is adapted to solving the problem of real seat theory states.³³⁶ The SE is intended to reduce administrative and transaction costs to help build a single efficient market to benefit all Europeans. It should reduce administrative and transaction costs by an estimated 30 Billion euros.³³⁷

Some do question whether harmonization efforts lead to lower transaction costs.³³⁸ The better answer is a qualified yes. Of course, greater legal certainty, lower transaction costs, and more transparency are always possible. However the question is not whether the efforts at integration reach the very best result possible in theory. Rather the

331. *Id.* at 4.

332. Andreas Kellerhals & Dirk Trüten, *The Creation of the European Company*, 17 TUL. EUR. & CIV. L.F. 71, 76 (2002).

333. Council Regulation 2157/2001, art. 2(1), 2001 O.J. (L 294) 1, 4 (EC).

334. Charles de Navacelle, *Council Regulation EC 2157/2001 of October 8, 2001 Establishing The European Company Statute*, 9 COLUM. J. EUR. L. 199, 200 (2002).

335. Council Regulation 2157/2001, art. 8, 2001 O.J. (L 294) 1, 4 (EC).

336. Gildea, *supra* note 1, at 271.

337. de Navacelle, *supra* note 333, at 200.

338. Holst, *supra* note 266, at 338-39.

question is whether they achieve better results than an unharmonized system. And the answer to that question is clearly yes.

IV. CONCLUSION

Directives, regulations, case law and conventions together form a body of binding EU business law. Such laws are inevitable, and inevitably evolving, as the Community grows into a Union and federation. These laws foster peace by creating the conditions for liberal trade and attendant prosperity. These developments are hopeful as they will make the world more wealthy and thus make conflict less likely. Rather than viewing the EU with fear, U.S. policy makers should see that the challenge the EU represents is also an opportunity.

