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Analysing the problematic allocation of competences between the EU and the Member States and suggesting a way forward

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Abstract

We analyse the tension surrounding the EU trade policy, with a particular focus on Free Trade Agreements (FTAs) that have recently gained considerable attention. The paper highlights different key trade policy objectives, including economic interests and moral values, and the expansive nature of the EU regarding the allocation of competences vis-à-vis Member States. Based on an a corporate versus FTA-law study regarding the right to establishment, our argument is that Member States may feel pressured by their competitors to change their national laws to implement the signed FTAs. This holds true, even if these changes are not strictly required according to the text of the FTA. The state of affairs can be explained through application of Hill's capability-expectation gap theory. This framework suggests that the current limited EU competences can scarcely serve the EU's international behaviour, thus causing a lack of coherence between the internal (protecting Member States' interests) and external action (promoting trade). In this sense, FTAs have bitten off more than they can chew. Such a situation could negatively affect the EU's reputation with Member States and citizens as well as its bargaining power with third countries. However, Hill's framework also indicates how the capability-expectation gap could be reduced. In the short term, this requires a sincere dialogue with EU citizens, clearly signalling what the EU can, and what it cannot do. In the long term, European decision-makers ought to be particularly careful in drawing a clear line between the specific competences of the EU and those of the Member States. One viable option would be to grant the EU additional powers for concluding FTAs, as to prevent competition between Member States to arise.

Keywords: EU FTAs; corporate law; capability-expectation gap; multilevel governance

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1. Introduction

Trade relationships have gained abundant political momentum and media coverage in the last decade. This holds true particularly for the European Union (hereinafter 'EU'), which occupies a prominent role in terms of volume of inflowing and outflowing goods and cross-border services.[1] In maintaining and increasing its position of strength, the EU has recently been executing on a rather active strategy, especially when it comes to third countries.[2] However, the complicated multi-level governance structure of the EU and the resulting allocation of competences between EU institutions and Member States (hereinafter 'MSs') makes the conclusion of these trade agreements increasingly difficult. Indeed, in negotiating such agreements, the EU seeks to foster a common strategy while respecting the division of competences as established by the Treaties. Unsurprisingly, some mutual tensions have arisen, endangering the EU position vis-à-vis not only MSs and citizens, but also third parties. Indeed, because of EU multilevel governance, the FTA counterparty might fear a certain degree of uncertainty in the implementation and the enforcement of negotiated terms.[3]

In this contribution, we revise the EU trade strategy with a particular focus on Free Trade Agreements, highlighting the expansive nature of the EU with regard to the allocation of competences between EU itself and the MSs in the area of corporate law[4]. Our argument is supported by the recent EU-Singapore agreement[5], of which the implementation would require MSs implementing corporate law reforms transcending the EU competences.

In explaining the reasons of such a situation we employ the so-called "capability-expectation gap" theoretical framework, developed by Christopher Hill and applied to the EU foreign policy.[6] Following Hill, we highlight a gap between the expectations and the actual capabilities of the EU trade policy. As our analysis will show, such a gap is mainly rooted in two factor: on the one hand, the difficulty to agree between MSs; on the other hand, the limited instruments at the disposal of the EU.

The paper is structured as follows. Section 2 reviews EU trade policy in general, setting the stage for the subsequent analysis by drawing a picture of the policy-making playing field, the actors and the interests involved. This section also discusses how this study can contribute to a better understanding of EU trade policy. Section 3 conducts an in-depth analysis on the right of establishment under European and Dutch

[1] Arguably, the prominence of the EU has increased further as a result of the reserved attitude of the US in concluding trade agreements in recent years. See n 8.

[2] See n 13.

[3] Although we acknowledge that implementation and enforceability are not exclusively EU-issues.

[4] This tendency is not peculiar to trade policy, as the on literature covert integration encompasses a wider range of policies, see Adrienne Héritier, 'Covert integration in the European Union' (2015) in Jeremy Richardson and Sonia Mazey (eds), *European Union: Power and policy-making* (4th edn, Routledge 2015). Specifically on trade, see Sophie Meunier and Kalypso Nicolaïdis. 'The European Union as a conflicted trade power' (2006) 13(6) JEurPublicPolicy 906.

[5] Free Trade Agreement between The European Union And The Republic Of Singapore, April 2018. Hereinafter "EU-Singapore FTA".

[6] Christopher Hill, 'The Capability-Expectations Gap, or Conceptualizing Europe's International Role' (1993) 31(3) JCMS 305; Christopher Hill 'Closing the Capability-Expectations Gap?' in John Peterson and Helene Sjursen (eds), *A Common Foreign Policy for Europe? Competing Visions of the CFSP* (Routledge 2005).

corporate law and studies (in)consistencies of some of the provisions with the recent EU-Singapore FTA. Corporate law is particularly relevant in this respect, as it reflects, to a considerable degree, national socio-economic preferences[7]. In fact, Section 3 aims to show that MSs may feel pressured to make legal changes so to implement the signed FTAs, even without being strictly required to do so according to EU-MSs division of competences. Section 4 employs the seminal capability-expectation gap theory as the lenses through which analyse the state of affairs. This framework suggests that the current limited EU competences can scarcely serve the EU's international behaviour, thus leading to a lack of coherence between the internal and external action. Thus, FTAs go further than their literal text suggests, and in this sense, FTAs have bitten of more than they can chew. Additionally, Hill's framework indicates what steps could be useful for reducing the capability-expectation gap. These measures may also serve as a reference for the improvement of the EU free trade policy in the eyes of EU citizens and third parties. An option for the long run would be to grant the EU additional powers for concluding FTAs, as to prevent competition between Member States Finally, Section 5 concludes.

2. The EU international trade relations negotiating position

2.1 The merchant and the vicar

The EU represents one of the most important players on the current international trade scene, accounting for over 2000 billion € in both imports and exports.[8] In maintaining and fostering such leadership, it is no coincidence that the EU has started playing a prominent role in large-scale negotiations at the WTO, as well as in inter-regional negotiations such as the Mercosur Free Trade Agreement.[9]

Trade in goods and commercial services 2013, € billions

Country or region	Imports	Exports
EU	2188	2415
United States	2079	1688
China	1716	1817
Japan	750	648
South Korea	468	506

Source: Eurostats, WTO

Figure 1

Bilateral negotiations, in particular, have recently become the core of EU trade policy. This shift has been linked to several factors, both structural and conjunctural. For instance, the inherent complexities of

[7] More background on this specific matter id discussed in Section 3.1.
[8] Data retrieved at European Commission, 'EU position in world trade' <http://ec.europa.eu/trade/policy/eu-position-in-world-trade/> accessed 15 May 2018.
[9] Michael Smith, 'The European Union's commercial policy: between coherence and fragmentation' (2001) 8(5) JEurPublicPolicy 787, 788.

multilateral negotiations make it easier to conclude Preferential Trade Agreements (PTAs) with single jurisdictions.[10] In parallel, the termination of the 'Lamy doctrine' – a *de facto* moratorium on new PTAs in favour of a multilateral strategy – has led to new momentum in negotiating PTAs.[11] In so doing, in recent years, the EU has started actively pursuing a somewhat newer kind of PTAs – which are the focal point of the present contribution, the so-called Free Trade Agreements (FTAs). Since the announcement of the 'Global Europe' Strategy in 2006[12], EU FTAs have been negotiated with Canada (CETA), South Korea, Singapore and Vietnam, while others are still being drafted[13]. The increasing number of FTAs shows the necessity felt by the EU not to limit itself to multilateral trading systems. Subsequently pursuing bilateral and regional agreements would allow – from an economic perspective – for the promotion of openness and integration in a smaller, more closely connected area.[14]

However, merely highlighting the economic aspects of FTAs would account only for a partial narrative of the overall strategy of the EU. Indeed, the economic significance of FTAs goes hand in hand with a further element of the EU political agenda that broadens their scope. The newly concluded EU FTAs seek in fact to combine, unlike US FTAs, economic benefits with diverse interests not directly linked with trade.[15] In this vein, the EU approach consists of using trade agreements as leverage to promote European fundamental values around the world.[16] Apparently, the EU has a vested interest in harmonizing external trade relationships while promoting "the respect of human rights, labour standards, the environment, and good governance, including in tax matters".[17] Such an approach impacts the EU's external and internal dimension. With regard to the former, the EU seeks to enhance non-EU citizens' rights,[18] whereas to the latter, the EU intends to export standards to protect European producers and citizens.[19]

2.2 A complex web of competences

An additional element of trade policy concerns the EU competence versus the competences of the MSs to negotiate and conclude FTAs. Since its inception, the EU has acted with a single external voice in

[10] Stephen Woolcock, 'EU Policy on Preferential Trade Agreements in the 2000s: A Reorientation towards Commercial Aims' (2014) 20(6) ELJ 718, 721.
[11] Sieglinde Gstöhl and Dominik Hanf, 'The EU's Post-Lisbon Free Trade Agreements: Commercial Interests in a Changing Constitutional Context' (2014) 20(6) ELJ 733, 744.
[12] Commission, 'Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions. Global Europe: competing in the world. A contribution to the EU's Growth and Jobs Strategy' COM (2006) 567 final.
[13] An overview of the pending EU-FTA negotiations is available at <http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc_118238.pdf> accessed 25 June 2018.
[14] See Katharina Holzinger and Frank Schimmelfennig, 'Differentiated Integration in the European Union: Many Concepts, Sparse Theory, Few Data' (2012) 19(2) JEurPublicPolicy 292.
[15] Henrik Horn, Petros C. Mavroidis and André Sapir, 'Beyond the WTO? An Anatomy of EU and US Preferential Trade Agreements' (2010) 33(11) The World Economy 1565.
[16] European Commission, 'Trade for all. Towards a more responsible trade and investment policy' (2015) <https://trade.ec.europa.eu/doclib/docs/2015/october/tradoc_153846.pdf> accessed 15 May 2018.
[17] Commission, 'Communication from the Commission to the Council, the European Parliament, the European Social and Economic Committee and the Committee of the Regions, Trade, Growth and World Affairs: Trade Policy as a Core Component of the EU's 2020 Strategy' COM (2010) 612 final, 15.
[18] Gstöhl and Hanf (n 11) 735.
[19] Maria Garcia, 'From Idealism to Realism? EU Preferential Trade Agreements Policy' (2013) 9(4) JCER 521, 530.

international trade negotiations.[20] This was certainly due to the limited scope of the subjects covered at that time and the inherent features of a Common Market, namely its supranational character and the unity of external representation. However, current commercial policy-making hinges on a wide array of subjects, each provoking tensions concerning competence and accountability.[21] It is no coincidence that the Lisbon Treaty – and particularly Article 21 – has subordinated trade policy to a vast array of EU objectives, thus making various amendments as to the competences for the conclusion and implementation of FTAs.

Additionally, new FTAs might be too ambitious in terms of economic integration compared to the current legislative framework of individual MSs. These MSs have to support the EU trade policy through structural and political reforms, but may fear to partially lose their grip on national law and sovereignty.[22] Because of this, in recent years, MSs have not always welcomed this transfer of sovereignty. The institutional setup has then resulted in a precarious equilibrium between the EU institutions and the MSs.

To address this issue, the European Court of Justice (ECJ) has been requested to deliver a preliminary ruling, formally in relation to the EU-Singapore FTA, that might impact pending and future FTA negotiation as well. On December 21, 2016, Attorney-General Sharpston concluded that the EU-Singapore FTA was a "mixed agreement", which could only be concluded by the EU and the MSs acting jointly.[23] According to Attorney-General Sharpston, the hybrid character of the FTA related to matters of non-Foreign Direct Investment (non-FDI) and dispute resolution. The latter includes the Investor-State Dispute Settlement (ISDS) mechanism, entailing ad-hoc arbitrage, or a more permanent Investment Court System (ICS) mechanism.[24] The ECJ later confirmed the view of the Attorney-General.[25] Somewhat more cynically, one might observe that these mechanisms could circumvent the jurisdiction of the ECJ in preliminarily interpreting FTAs norms in light of the EU law. Although some scholars suggest that, given current EU and WTO law, the room for far-reaching legal effect of the FTAs is anyway limited,[26] our contribution claim that indirect effects may yield relevant consequences and, consequently, have to be take into consideration.

Under these circumstances, one may acknowledge that EU external trade policy is a rather complicated area in terms of the institutions involved in the decision-making process, FTAs not being an exception.[27] As a result, EU international economic relations should be considered a complex and dynamic web of competences, in line with the well-known institutional model of multi-level governance.[28] These political

[20] Sophie Meunier and Kalypso Nicholaidis, 'EU Trade Policy: The Exclusive versus Shared Competence Debate' in Maria Green Cowles and Michael Smith (eds), *The State of the European Union: Risks, Reform, Resistance, and Revival* (OUP 2000) 326.
[21] Smith (n 9) 789.
[22] See Section 3.
[23] Opinion 2/15 *Singapore FTA* [2016] ECLI:EU:C:2016:992, Opinion of AG Sharpston.
[24] See e.g. Chapter 14 of the EU-Singapore FTA (n 5)
[25] Opinion 2/15 *Singapore FTA* [2017] ECLI:EU:C:2017:376.
[26] Aliki Semertzi, 'The Preclusion of Direct Effect in the recently concluded EU Free Trade Agreements' (2014) 51(4) CMLR 1125.
[27] M Shawn Reichert and Bernadette ME Jungblut, 'European Union external trade policy: Multilevel principal-agent relationships' (2007) 35(3) The Policy Studies Journal 395, 396.
[28] Gary Marks, Liesbet Hooghe and Kermit Blank, 'European integration from the 1980s: State-centric v. Multi-level Governance' (1996) 34(3) JCMS 341.

dynamics can only be understood by taking into account complex vertical and horizontal inter-institutional relations. In fact, a complicated relation between EU institutions themselves complements the multi-layer dynamic.[29]

2.3 The focus of interest

In parallel, the current EU approach of integrating moral interests with the mere economic ones has placed FTAs at the centre of public attention.[30] The conclusion of new trade agreements has indeed become an area of contentious politics where anti-globalisation claims and a push towards more transparency are put forward.[31] Besides, the altered competences, resulting from the adoption of the Lisbon Treaty, may have caused confusion and consequently, problems of inconsistency. In other words, broadening the scope of trade agreements has made the process of negotiation and approving FTAs more cumbersome and more susceptible to inconsistencies.[32] Against this background, we are witnessing a scenario where the capability of the EU vis-à-vis the competences of MSs cannot well serve the ambitions of the EU's international trade strategy.

Apart from some exceptions focusing more at a general and broader level,[33] the lack of coherence between the external and internal EU sphere (vis-à-vis third parties and amongst MS, respectively) seems at least partially overlooked by the current literature. On the one hand, the bulk of (economic) research has mainly focused on the economic impacts of FTAs.[34] For instance, Jean et al. evaluate the impact on the Chilean economy of the EU-Chile Free Trade Agreement.[35] Similarly, Magrini et al. assess the causal impact of the EU trade preferences in the southern Mediterranean countries.[36] On the other hand, a (legally-based) strand of the scholarship has aimed at assessing the impact of FTAs on the legal system of developing countries.[37]

This paper, instead, seeks to investigate the new FTAs from an internal perspective, namely that of a MS. More precisely, it intends to demonstrate that some aspects of FTAs concluded by the EU are, on closer review, too ambitious in terms of economic integration compared to the current legislative framework. In fact, the implementation of FTAs norms in MSs might imply a level of legal harmonization

[29] Beatriz Perez de las Heras, 'European Union – Asia-Pacific Trade Relations: Tentative Bilateralism amidst Competing Plurilateral Initiatives' (2016) 16(4) Romanian Journal of European Affairs 32, 35.
[30] Jan Beyers and Bart Kerremans, 'The press coverage of trade issues: a comparative analysis of public agenda-setting and trade politics' (2007) 14(2) JEurPublicPolicy 269.
[31] Reichert and Jungblut (n 27).
[32] Gstöhl and Hanf (n 11) 745.
[33] Smith (n 9).
[34] Jean-Jacques Hallaert, 'Proliferation of preferential trade agreements: Quantifying its welfare impact and preference erosion' (2008) 42(5) JWT 813.
[35] Sébastien Jean, Nanno Mulder and María Priscila Ramos, 'A general equilibrium, ex-post evaluation of the EU-Chile Free Trade Agreement' (2014) 41 Economic Modelling 33.
[36] Emiliano Magrini, Pierluigi Montalbano and Silvia Nenci, 'Are EU trade preferences really effective? An impact evaluation assessment of the Southern Mediterranean Countries' case' (2017) 31(1) International Review of Applied Economics 126.
[37] Kenneth Baltzer, 'Institutional and policy adjustments to implement Free Trade Agreements with the European Union A developing country perspective' (2015) No. 2015/127 WIDER Working Paper.

which falls beyond the level mandated by the Treaties. To prove this point, in the next section, we critically analyse the norms addressing the right of establishment in relation to cross-border M&A under the EU-Singapore FTA vis-à-vis the relative competences of EU and Dutch law. In so doing, it will be possible to provide a clearer understanding of what can (and shall) actually be the role of the EU in international economic law.

Besides, the internal division of competences between the EU and its MSs is not negligible in the external sphere. Third states as well as outside parties – say EU citizens – may be rather interested in clearly identifying the responsibilities of those involved at the EU and national level. Third states could determine what concessions might be obtained when it comes to negotiating FTAs, whereas EU citizens could know whom to hold accountable for the specific decisions adopted. In so doing, although the EU may speak with one single voice, it would also be possible to identify the institutional ownership of specific policy issues.

3. FTAs in practice: the right of establishment for corporations

3.1 Introduction

The expanding nature of FTAs is not only external, e.g. targeted at enhancing *latu sensu* human rights implementation in the legal framework of trade partners. FTA law can have expanding effects even at intra-EU level, pushing MSs to harmonize their legislation beyond the level required by the Treaties. A paradigmatic example of this argument is offered by juxtaposing the right of establishment, as granted by FTAs, with a corporate law perspective.[38] Corporate law is particularly relevant concerning global developments such as FTAs, as it reflects to a considerable degree – apart from provisions inspired by EU law – national socio-economic preferences. Indeed, even though the "anatomical elements" of corporate form are to a large extent uniform, a considerable degree of heterogeneity (and even divergence) has been highlighted by recent scholarship.[39] In other words, the path of convergence forecasted at the beginning of the new millennium[40] have not come to a conclusion, primarily because of social preferences of specific jurisdiction[41]. To illustrate the FTA effects, we analyse the right of establishment, as under FTA law and subsequently focus on two specific issues: (a) cross-border mergers and conversions and (b) schemes protecting the national systems of corporate law of the MSs. These two aspects, if examined together,

[38] In this chapter, we take the standpoint of Dutch corporate law. For the sake of a more in-depth analysis, it would be nonetheless easy to broaden the argument to different corporate law regimes or other fields of socio-economic law affected by FTA requirements.

[39] Reinier Kraakman and John Armour, *The anatomy of corporate law: A comparative and functional approach* (OUP 2017).

[40] Henry Hansmann and Reinier Kraakman, 'The end of history for corporate law' (2001) 89(2) GeoLJ 439.

[41] This can e.g. be said of national schemes on employee co-determination, insofar these influence the composition of the company board. For example, German co-determination law mandates that for (sufficiently) large corporations (see § 7 Mitbestimmungsgesetz), half of the members of the supervisory board should consist of worker representatives, whereas concerning e.g. England and Italy, such schemes are entirely absent. For an analysis of the development of these differences, see e.g. Ewan McGaughey, 'The Codetermination Bargains: The History of German Corporate and Labour Law' (2016) 23 ColumJEurL 135.

show the extent to which national authorities shall become more proactive and adapt domestic legislation to the newly concluded FTAs.

3.2 Right of establishment under FTA law

Chapter 8 of EU-Singapore FTA deals with the right of establishment of legal entities. Although the right of establishment usually concerns only juridical persons, the newly concluded FTAs also consider natural persons. However, visas may still be required for nationals from one country while not for those of others, so that FTAs do not always provide for a *full* right of establishment.[42]

Juridical persons, as defined in Article 8.2 (b) and (c), encompass a wide range of entities, including corporations, trusts, partnerships, joint ventures and sole proprietorships.[43] For such entities to be able to invoke an FTA (i.e. the right of establishment), several conditions must be met. First, it is necessary to be validly incorporated under the national laws of either of the Party States, including the EU MSs. Secondly, they are required to have their registered office, central administration or principal place of business in one of the Party States.[44] When the juridical person merely maintains a registered office or central administration in one of the Party States, it shall not be considered a qualified juridical person, unless it engages in substantive business operations.[45] This is the (optional) third requirement under the Singapore FTA. A particularly relevant aspect is that the actual nationality of the owner(s) of an entity meeting these requirements (which is thus 'covered' by the FTA) is irrelevant. Conversely, according to Article 8.2 (c)(iii), FTAs may also be applied in relation to entities not incorporated under the laws of one of the Party States, if Party State nationals are owning more than 50% of their share capital, or if these are allowed to nominate more than half of the directors.[46] It has been argued that such mechanisms may prove rather useful for fiscal purposes, as it allows for the use of corporations domiciled in countries with low effective tax rates.[47]

Entities that are, according to the requirements outlined above, 'covered' by the FTA, are granted the right to establish themselves in the Party States, through (i) the constitution, acquisition or maintenance of a juridical person or (ii) the creation or maintenance of a branch or representative office[48]. Party States, as provided by Article 8(10), are obliged to treat foreign and national juridical persons equally when these

[42] This situation does not nullify or impair the benefits resulting from a specific FTA-commitment. *See* e.g. footnote 1 concerning art. 8.1 of the EU-Singapore FTA (n 6); see also footnote 4 concerning art. 7.1 (6) EU-South Korea FTA; art. 10.2 (3) EU-Canada FTA.

[43] See similarly art. 7.2 (e) EU-South Korea FTA. The Canada and Vietnam FTAs (also) apply the concept of "enterprise", which includes corporations, trusts, partnerships, joint ventures and sole proprietorships.

[44] See e.g. art. 8.2 (c) EU-Singapore FTA; art. 7.2 (f) EU-South Korea FTA.

[45] ibid.

[46] The English versions of the FTA apply the term "director", which may cover both executive and non-executive directors. We understand that, concerning two-tier board systems, where the executive board and the supervisory board are constituted as separate organs, both should be taken into account for FTA purposes. See also art. 7.2 (f) (ii) EU-South Korea FTA.

[47] See Karsten Engsig Sørensen, 'Free Movement of Companies under the New EU Free Trade Agreements' (2016) 13(2) European Company Law 46.

[48] See Chapter 8 – Section C of EU-Singapore FTA.

exercise their right of establishment.[49] Importantly, it is not uncommon for FTAs to state expressly that the right of establishment should be applied substantively (not: formally). These wordings can be found in Article 8(11) of the EU-Singapore FTA and, again, in the EU South-Korea FTA, where it is clearly stated that, no matter the formality of the establishment, the treatment of established companies ought to be substantially identical to national ones.[50]

However, FTAs generally lack direct effect.[51] Thus, investors cannot set aside conflicting provisions of national law, merely by claiming applicability of the FTA. Usually, this absence of direct effect follows from the wording of the FTA itself.[52] Despite the lack of direct effect, FTAs granting a right of establishment have some rather interesting consequences from a corporate law point of view. It seems that Party-States (and MSs in particular, as these are familiar with the concept of equal treatment) are implicitly encouraged, if not to say competitively pressured, to go further than what is strictly required by grammatical interpretation of the FTA. In fact, corporate law is an area of the law that has been harmonized only through Directives, with considerable room left to national legislators. Therefore, for achieving the requirement of substantial equal treatment provided by Article 8(11) and attracting foreign companies, national legislator might need to adapt their corporate law provisions, *de facto* harmonizing them, even without the EU being in the legal position to dictate MSs such changes.

In a nutshell, promising corporation of third-party States substantial equal treatment even in areas where MSs maintains considerable discretion, such as corporate law, is the main legal channel through which the EU pressures MSs to achieve a deeper level of harmonization than the one established by the EU Treaties.

3.3 Cross-border M&A

Following the line of reasoning set down in Section 3.1, guaranteeing a substantial identical right of establishment might clash with a national provision concerning cross-border mergers and acquisition. Cross-border M&A, indeed, has been a long lasting delicate issue in the process of harmonisation corporate law within EU. The EU Company Law Directives have been highly important for harmonizing modifications to the structure of corporations. The Third[53] and Sixth[54] Company Law Directives of 1978

[49] Here, it should be noted that some economic sectors fall outside the scope of FTAs. This can e.g. be said of the nuclear and the weapons industry. See also art. 7.10 EU-South Korea FTA; art. 8.2 EU-Canada FTA.

[50] Art. 7.12 (1), (2) and (3) EU-South-Korea FTA. See also (albeit slightly differently) art. 8.6 EU-Canada FTA.

[51] See e.g. art. 17.15 EU-Singapore FTA; art. 30.6 EU-Canada FTA; on the legal consequences of this situation, see Semertzi (n 26).

[52] The EU-South Korea FTA is an exception in this regard, as it does not specifically exclude direct effect. However, Article 5 of the Council Decision 2016/839 explicitly provides that "The Agreement shall not be construed as conferring rights or imposing obligations which can be directly invoked before Union or Member State courts and tribunals". See Council Decision 2016/839 of 23 May 2016 on the conclusion, on behalf of the European Union, of the Association Agreement between the European Union and the European Atomic Energy Community and their Member States, of the one part, and the Republic of Moldova, of the other part [2016] OJ L 141/28. Semertzi (n 26) notes that strictly speaking, such a unilateral declaration should carry little weight, but also argues that the ECJ will not easily deliver a ruling to the contrary.

[53] Third Council Directive 78/855/EEC of 9 October 1978 based on Article 54 (3) (g) of the Treaty concerning mergers of public limited liability companies [1978] OJ 295/36. Note that whereas the Company Law Directives referred to in this paper have been

and 1982 governed mergers between and divisions of Public Limited Companies within a single MS. Intra- and extraterritorial structural changes have proven to be a different thing, however. Here, it should be noted that 10th Company Law Directive[55] on cross-border mergers was only agreed upon in 2005, effectively ending a 40-year process of negotiations. Because of this directive, a German AG could e.g. merge with (into) an Italian SpA, after which the former may cease to exist. These lengthy negotiations resulted notably from the large differences between MSs concerning employee co-determination rights.[56] Additionally, MSs have effectively succeeded in blocking a directive on cross-border conversions for an even longer period. Cross-border conversions allow for the more direct transition of a German AG into an Italian SpA. Despite years of efforts, the (informally) proposed 14th Company Law Directive on the cross-border transfer of a company's registered office never entered into effect.[57] In fact, cross-border conversions in the EU only became possible in 2012, because of enabling case law of the European Court of Justice (ECJ, cases Cartesio[58] and Vale[59]). There, it was essentially ruled that, barring the public interest providing otherwise, a MS should allow such outbound conversions without the loss of legal personality (which would entail a liquidation and the sale of assets). In case the corporation could convert into a corporate form recognized under the national laws of the receiving MS; for inbound purposes, provisions concerning national conversions should be applied analogously as much as possible. Only after the Polbud-ruling of the ECJ,[60] which effectively finalized the discussion on cross-border conversions, the EC presented a proposal for a Directive.[61]

The protracted character of the European policy-making process for cross-border initiatives also relates to the fact that, in relation to the law governing corporations, two approaches strive for dominance amongst MSs. These are the incorporation doctrine and the real seat doctrine. According to the former, a corporation is governed by the MS law of incorporation (i.e. where it has its registered office). Based on the latter, the applicable legal regime is determined by the place where the corporation has its headquarters or which is its principal place of business. The co-existence of these approaches gives rise to political sensitivities regarding sovereignty, as to solve the issue, one side must ultimately give in to the

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superseded by Directive 2017/1132, this concerns primarily a codification, so that historical references are maintained for the sake of completeness.

[54] Sixth Council Directive 82/891/EEC of 17 December 1982 based on Article 54 (3) (g) of the Treaty, concerning the division of public limited liability companies [1982] OJ 378/47.

[55] European Parliament and Council Directive 2005/56/EC of 26 October 2005 on cross-border mergers of limited liability companies (Text with EEA relevance) [2005] OJ L310/1.

[56] See Jan Wouters, 'European Company Law: *quo vadis?*' (2000) 37 Common Market L Rev 257.

[57] On this (informal) proposal, see Stephan Rammeloo, *Corporations in private international law* (OUP 2001) 297-300.

[58] Case C-210/06 *Cartesio* [2008] ECR I-09641. On this, see e.g. Marek Szydło, 'Case C–210/06, CARTESIO Oktató és Szolgáltató bt, Judgment of the Grand Chamber of the Court of Justice of 16 December 2008' (2009) 46 Common Market L Rev 703.

[59] Case C–378/10 *VALE Építési* [2012] ECLI:EU:C:2012:440. On this, see e.g. Thomas Biermeyer, 'Shaping the space of cross-border conversions in the EU. Between right and autonomy: VALE Építési kft' (2013) 50 Common Market L Rev 571. Recently, the *Polbud* judgement more or less finalized this discussion. See Case C-106/16 *Polbud – Wykonawstwo* [2017] ECLI:EU:C:2017:804.

[60] See *Polbud – Wykonawstwo* n (59).

[61] Commission, 'Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions' COM (2018) 241 final.

other.[62] In the Netherlands, it has therefore traditionally been considered that the ECJ has not voiced a preference for either approach, although the views on this matter might differ along scholars in various MSs.[63] The relative disorder in the EU may be contrasted with the straightforwardness of the situation in the US. There, in principle, the same issue could have arisen (i.e. states applying different theories concerning the law governing corporations). However, the internal affairs doctrine – comparable with incorporation doctrine – is predominant in the US entire, so that a homogeneous system is in place.[64]

Returning to FTAs, it may be argued that a cross-border conversion concerning a non-EU entity should be considered a constitution or acquisition, although this is not evident from a grammatical point of view.[65] In the absence of enabling regulation, it currently does not seem possible to conclude a cross-border merger or conversion from or to a third country (i.e. non-EU) Party State, solely based on an FTA. National laws that have confined themselves to merely implementing the EU Directive currently only allows such transactions intra-EU and FTAs lack direct effect.[66] The resulting situation is that, on the one hand, MSs are not legally mandated by EU Directives nor by the FTA to allow for non-EU cross-border M&A but, on the other hand, the requirement of substantial equal set down by the FTA cannot be guaranteed without enabling non-EU cross-border M&A.

However, this discouraging approach seems at odds with the overall goal of the FTAs of substantive equal treatment. Additionally, the situation of being able to execute cross-border conversion in relation to third countries differs between MSs. For instance, Luxembourg is a relevant case of a jurisdiction that has embraced a highly flexible approach with the aim of structuring a "competitive" corporate law and attract foreign companies. Other MSs have followed suit or are considering to do so. Therefore, FTAs could act as a catalyst for increased competition in this regard between MSs. Thus, it may be argued that the *status quo* in fact puts some pressure on governments to facilitate cross-border mergers and conversions in a broader sense, and to go further than strictly required by the FTA.

3.4 Protecting national systems of corporate law

As was already discussed, the harmonization of EU corporate law has constantly been a bumpy ride.[67] MSs, indeed, have been reluctant to give up their sovereignty, so that harmonization has mainly followed

[62] For an overview of the dominant approaches in respective EU MSs, see the European Added Value Assessment on the 14th Company Law Directive, available at <http://www.europarl.europa.eu/RegData/etudes/etudes/join/2013/494460/IPOL-JOIN_ET(2013)494460(ANN02)_EN.pdf> accessed 20 August 2018.

[63] See e.g. for the German position Alexander Schall, 'Kapitalaufbringung nach dem MoMiG', (2009) 38(1) Zeitschrift für Unternehmens- und Gesellschaftsrecht 129.

[64] See e.g. *Restatement (Second) of Conflict of Laws* § 296-312 (1971); see also Frederick Tung, 'Before Competition: Origins of the Internal Affairs Doctrine' (2006) 32 J Corp L 33. Here, it should be noted that both New York and California deviate partially from the internal affairs doctrine concerning out-of-state corporations not traded on a national securities exchange, in a way similar to the Dutch PFFCA (see § 3.3). The incorporation doctrine (and the internal affairs doctrine, for that matter) allow for (efficiency-based) competition between systems of corporate law. We abstain from discussing whether this causes a 'race to the bottom' or a 'race to the top'.

[65] See e.g. Sørensen (n 47).

[66] ibid.

[67] See Section 3.3.

a bottom-up, competitive pattern.[68] At times, the competition between EU MSs intensified. At the end of the 1990s and at the beginning of the 2000s, England acted as the 'Delaware of Europe', attracting many out-of-state incorporations.[69] In response, Germany modernized its corporate statute through the MoMiG Act of 2008, which created a mini-version (*Unternehmergesellschaft* (*haftungsbeschränkt*)) of the Private Limited Company (*Gesellschaft mit beschränkter Haftung*) featuring lower capital requirements.[70] In the Netherlands, the situation seems to have stabilized following the 2012 revision of the statute concerning Private Limited Company (*Besloten Vennootschap*).[71] Importantly, this encompassed the abolition of the minimum legal capital requirement of € 18,000. A similar path has been followed, for instance, by Italy, whose corporate law was deeply revised and modernized by a comprehensive reform in 2003, followed by numerous subsequent adjustments creating, among other, something close to Limited Corporation with no minimum capital[72].

One peculiar and somewhat exotic mechanism enacted with the intention of disrupting the competition among corporate laws and attract foreign companies is the Dutch Pro Forma Foreign Companies Act (PFFCA, *Wet op de formeel buitenlandse vennootschappen* or Wfbv). Its specific aim was to impose obligations on entities founded abroad while merely active domestically. To that end, it mandates that Pro Forma Foreign Companies are to identify themselves as such when registering at the Dutch Chamber of Commerce and on stationary. Subsequently, it contains penal sanctions in case of non-compliance.[73] The Centros[74] and (especially) Inspire Art[75] rulings by the ECJ found such provisions in principle discriminatory, insofar these could not be considered compatible with the 11th Company Law Directive.[76] Consequently, the PFFCA was amended. Currently, it no longer applies to entities incorporated

[68] On this trend, see globally Hansmann and Kraakman (n 40); for the EU perspective with a somehow sceptical view on EU Delaware, see Luca Enriques and Matteo Gatti, 'The Uneasy Case for Top-Down Corporate Law Harmonization in the European Union' (2006) 27 UPaJIntlEconL 939.

[69] This situation would bear some resemblance to that of the second half of the 19th century. See e.g. Matthew G Dore, 'Deja Vu All over Again - the Internal Affairs Rule and Entity Law Convergence Patterns in Europe and the United States' (2014) 8(2) Brooklyn Journal of Corporate, Financial & Commercial Law 3. The position of England as 'legal innovator' in the EU may suffer, at the longer term, following the 'Brexit', causing the (bottom-up) competitive effect to disappear. See Peter Böckli, Paul L. Davies, Eilis Ferran, Guido Ferrarini, José M. Garrido Garcia, Klaus J. Hopt, Adam Opalski et al., 'The Consequences of Brexit for Companies and Company Law' (2017).

[70] See e.g. Michael Beurskens and Ulrich Noack, 'The Reform of the German Private Limited Company: Is the GmbH Ready for the 21st Century?' (2008) 9 GLJ 1069; Maarten A. Verbrugh, 'De herziening van het GmbH-recht in een concurrerende omgeving. Het wetsvoorstel MoMiG' (2008) 10 Ondernemingsrecht 401.

[71] On this revision, see e.g. Barend Verkerk, 'Modernizing of Dutch Company Law: Reform of Law Applicable to the BV and a New Legal Framework for the One-Tier Board within NVs and BVs' (2010) 7 Eur Company L 113.

[72] On the Italian case, and more generally on EU MSs corporate law reforms, see Luca Enriques and Paolo Volpin, 'Corporate governance reforms in continental Europe' (2007) 21(2) Journal of Economic Perspectives 117.

[73] Art. 2, 3 and 7 Wet van 17 december 1997 op de formeel buitenlandse vennootschappen, respectively.

[74] Case C-212/97 *Centros Ltd v Erhvervs- og Selskabsstyrelsen* [1999] ECR I- 01459. On this, see e.g. Wulf-Henning Roth, 'Case C-212/97, Centros Ltd v. Erhvervs- og Selskabsstyrelsen, Judgment of 9 March 1999' (2000) 37 Common Market L Rev 147.

[75] Case C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd* [2003] ECR I-10155. On this, see e.g. Daniel Zimmer, 'Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd.', (2004) 41(4) Common Market L Rev 1127. This case is especially important as the relevant company directly concerned the PFFCA, as opposed to the *Centros*-ruling.

[76] Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State [1989] OJ L 395/36.

under the laws of other MSs.[77] However, the PFFCA is still relevant for entities incorporated under the laws of third countries, so also for FTA Party States.

Again, this distinction between MSs and FTA third countries seems at odds with the overall goal of promoting ever-stronger economic ties and, more specifically, the legal requirement of substantive equal treatment. Given the experience that has been gained previously on the effects of competition, we consider it quite likely that FTAs put pressure on governments (here, the Dutch, which may start considering repealing the PFFCA) to stimulate trade, thus however going further than what is strictly required by FTAs.

4. Mind the gap: EU expectations versus capabilities

The previous analysis shows that, in the realm of corporate law, competitive forces might push national authorities to become more proactive and adapt domestic legislation to the newly concluded FTAs, thus acting according to what they perceive as the underlying rationale of a FTA. In so doing, FTAs are not only more ambitious than the bilateral trade agreements (BITs) concluded before, but also more ambitious than their texts seem to suggest. Meanwhile, most of the discussion about the conclusion of FTAs by the EU in fact revolves around the distribution of competences as well as the degree of convergence of national and EU political agenda. In other words, a tug-of-war between a maintenance policy for domestic laws versus the promotion of European values occurs.

However, our analysis indicates that the current capabilities of the EU cannot well serve the ambitions of the EU's international behaviour. To put it differently, it seems that the instruments at the disposal of the EU are not sufficient to achieve its set objectives: the MSs have not provided the EU with enough legislative competences to act as it deems desirable to achieve its goals, which would here be to curb intra-MS competition. Indeed, MSs have different views as to what extent the EU shall be responsible for legislation. In this regard, Meunier and Nicolaïdis argue that the EU is a conflicted trade power whereby "Member States governments, influenced by a host of domestic actors, hold very different views on how to wield such power through trade".[78]

All this leads to a lack of coherence between the internal and external action, which in turn negatively impacts the EU's reputation as well as its functioning.[79] However, an appropriate functioning of EU trade policy is "crucial for the credibility and survival of the EU as a world actor".[80] In fact, trade policy has always been central in the EU policies being it one of the main tool to achieve a genuine and functioning internal

[77] Art. 1 (2) (n 73).
[78] Meunier and Nicolaïdis (n 4).
[79] Jessica Bain and Annick Masselot, 'Gender equality law and identity building for Europe' (2013) 18 Canterbury Law Review 97.
[80] Meunier and Nicholaidis (n 20) 326.

market.[81] It is no coincidence that trade policy has been a – if not the – subject where MSs were more likely to transfer their sovereignty[82].

Against this background, EU FTAs may be read through the lens of the "capability-expectations gap", a theoretical framework developed by Christopher Hill and already applied to EU foreign policy more than twenty-five years ago.[83] In his seminal articles, Hill in fact argues that there is an apparent gap between the capabilities and expectations of the European foreign policy due to three main features: (1) difficulty to agree between MSs, (2) the (un)availability of resources and (3) the instruments at the disposal of the EU.

Interestingly, these features seem also applicable to the current situation of the EU trade policy. Indeed, the conclusion of FTAs by the EU suffers the shortfalls (1) and (3) identified by Hill. As a result, and given the current state of the art, we may start asking ourselves what would exactly be the proper role in free trade for the EU. This question is not trivial and would help to delineate more precisely the role and competences of the involved institutions vis-à-vis the EU legal framework as designed by the current Treaties.

In line with our previous claim, the insights derived from this conceptualization would allow for a reflection on how the EU could improve the drafting process of FTAs. This would involve lowering the high expectations towards FTAs in the short term. European decision-makers shall craft a dialogue with the European citizens, clearly signalling what the EU cannot, and what it can do. Instead, in the long term, the European decision-makers ought to be particularly careful in drawing a clear line between the specific competences of the EU and the ones of the MSs, adopting a broad conception of the scope of FTAs. In other words, the first step that needs to be taken – if we wish to close the capability-expectations gap – is to identify the specific functions of the EU. Once having carried out this 'mapping exercise', it would be possible to check whether the involved institutions fully make use of their pre-existing powers to meet the set objectives, and whether perhaps additional powers should be granted.

It is fairly unsurprising, in fact, that the MSs and third parties are inclined to have great expectations on the EU. This type of behaviour partly stems from the fact that states have less 'moral duties' to fulfil, having transferred more expectations to a supra-national organisation. Yet, as we have noticed, a transfer of expectations from the MSs to the EU has not corresponded to an equal transfer of competences. Under these circumstances, it is of utmost importance that the EU would be capable of communicating what is its precise role. If not, the credibility of the political statements and aspirations of the EU may be in jeopardy. Notably, the lack of credibility of the EU vis-à-vis MSs citizens is not the only cause of concern. Indeed, a parallel argument can be drawn for those third states that have negotiated or are willing to negotiate FTAs with the EU. The fact that the contractual clauses negotiated at FTA level might not be (fully)

[81] Jan Orbie, Hendrik Vos and Liesbeth Taverniers, 'EU Trade Policy and a Social Clause: A Question of Competences?' (2005) 17(3) Politique europeenne 159, 174.
[82] Meunier and Nicholaidis (n 20) 326.
[83] See n 11.

implemented because of factors falling out of the domain of control of the contracting counterparty might lower their willingness to enter in FTA in the first place or, more fundamentally, lowering the EU contractual power.

In summary, in order to safeguard the room for manoeuvre necessary for concluding future FTAs – the need for which is evident from an economic point of view – it is advisable that the EU would act in a more prudent fashion. This would mean that the EU shall commit itself to clarify what are its precise functions and act accordingly. In so doing, the EU would protect more easily its reputation, taking well-defined decisions and holding to them.

5. Conclusion

In this paper, we analysed the tension surrounding the EU free trade agreements from an internal perspective. More precisely, a complex web of competences leading to an involvement of various European and national institutions in both the decision-making process and consequent implementation is apparent. We show that, from the perspective of intra-EU governance, FTAs may push MSs to harmonize their legislation beyond what the actual wording of the FTA suggests. We substantiated our argument by juxtaposing the right of establishment, as granted by FTAs, with a corporate law perspective. Corporate law provides a useful proxy for MSs preferences, as it reflects to a considerable degree national socio-economic habits. Specifically, we focused on two aspects: cross-border M&A and protection of national corporate law.

Currently, it does not seem possible to conclude a cross-border merger from or to a third country (i.e. non-EU) Party State, solely based on a FTA. However, this discouraging approach seems at odds with the overall goal of the FTAs of substantive equal treatment. Indeed, the situation of being able to execute cross-border conversion in relation to third countries differs between MSs. Therefore, FTAs could act as a catalyst for increased competition in this regard. With regards to the protection of national corporate law as well, the distinction between MSs and FTA third countries seems at odds with the overall goal of promoting ever-stronger economic ties and the requirement of substantive equal treatment. Given previous experience, we consider it quite likely that FTAs will contribute to the eventual repeal of the PFFCA.

Within this framework, our analysis tentatively suggests a way forward. In the short term, the applicable Treaties staying equals, European decision-makers shall craft a dialogue with the European citizens, clearly signalling what the EU can and cannot achieve. Instead, in the long term, the European decision-makers ought to draw a clear line between the specific competences of the EU and the ones of the MSs. In this line of reasoning, a potentially desirable option could be to grant additional competences to the EU in that respect so to clarify rights and duties of all the parties involved and minimize the uncertainty in FTAs implementation.