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Law Applicable to Persons Pursuant to Draft Private International Law Act

The draft Private International Law Act planned to enter into force together with the drafts of the new Law of Obligations Act and the General Part of the Civil Code Act is currently at its second reading in the *Riigikogu* (Estonian parliament). Unfortunately, the volume of this article is too limited to introduce the draft as a whole. Therefore, I would like to focus on a topic that was a subject of many discussions during the preparation of the draft and that is internationally the least harmonised issue of all: what kind of law should be applied to subjects of law, *i.e.* to natural and legal persons.

Whilst in the international law of property the principle *lex rei sitae* is applied and accepted in the whole world and the principle *lex loci delictii* is almost everywhere the basis for the determination of law applied to the infliction of damage, in the case of persons two fundamentally different traditional theories have developed, and at least now there is no sign of one theory completely surrendering to the other. Thus, the law applied to a natural person (*i.e.* the personal statute) is determined either by the domicile or nationality of the person, depending on the country; the determination of the passive and active legal capacity of legal persons is generally based on the theory of location or incorporation. These fundamental choices had to be made also during the preparation of the new draft Private International Law Act of Estonia; therefore, I will now try to give an overview of the reasons for the preference of one or another solution and the consequences that the choices will have. I would like to pay special attention to the issues of law applicable to legal persons as so far this not-at-all irrelevant subject has been neglected in Estonian legal literature, and several theories and standpoints that have long been accepted elsewhere may at first glance seem somewhat unaccustomed.

1. Law applicable to natural persons

1.1. Principles of domicile and nationality. Habitual domicile

As mentioned above, two fundamentally different options exist for the application of the legal order of a certain country to natural persons: the basis can be either the principle of domicile or the principle of nationality. Disputes about the advantages and disadvantages of these two theories are the most heated discussions ever held on the theory of private international law. The principle of domicile (*lex domicilii*) is taken as the basis mainly on the Anglo-American legal territory, but also in Switzerland

and in some Scandinavian countries; the principle of nationality (*lex nationalis*) dominates in the rest of Europe.

One of the main advantages of the principle of domicile is considered to be the fact that a person is bound to a legal order that surrounds the person and that is known to him or her. Another positive aspect is the simplification of the work of courts where the national law can then be applied more frequently (to be discussed in detail below). The supporters of the principle of nationality, in turn, consider a person's nationality to be an easily determined connecting factor that rarely changes throughout the person's life and that excludes possible manipulations with regard to the change of domicile and the concurrent change of personal statute.

Despite the dominance of the principle of nationality, the triumph of which at the end of the previous century was largely induced by the development of nation states and the resulting national view of the world, the importance of the principle is gradually diminishing. This can be traced in the development of German and Swiss law of the conflict of laws which served as a basis for the preparation of the new draft Private International Law Act of Estonia, but most of all in the unification of private international law in the conventions of the Hague Conference on Private International Law where the practice of taking the connecting factor of nationality as a point of departure has been limited considerably since 1951.

The concept of habitual domicile^{*1} used in the conventions established by the Hague Conference on Private International Law can be considered the modern trend that increasingly gains importance. Such a connecting factor is employed, for example, in the Convention on Law Applicable to Maintenance Obligations^{*2} of 1973, in the Hague Convention on the Form of Wills^{*3} of 1961 as well as in the later Hague conventions such as the Convention on the International Protection of Adults adopted in 2000. In addition thereto, the Rome Convention on the Law Applicable to Contractual Obligations of 1980 that is in force between the EU Member States also uses the habitual domicile as the connecting factor.^{*4} Since the above-mentioned Hague conventions are the *loi uniforme* type of conventions — *i.e.* they replace fully the national conflict of laws rules of the Member States — it is obvious that the importance of the notion of habitual domicile is growing in the whole world, including the countries that have traditionally followed the principle of nationality. This has also now been acknowledged in the German legal writing where the principle of nationality has been so far observed with extreme conservatism.^{*5}

But what exactly is meant by the habitual domicile of a person? Both domicile and nationality are concepts long known to everyone, their meaning is at least theoretically relatively easy to guess. Habitual domicile, however, seems to be rather strange at first glance. Why is it so that different conventions have abandoned the concept of domicile and have started to use a new connecting factor, unknown until that time?

The main reason for this is the extremely varied definition of the concept of domicile in different countries. Some countries allow a person to have only one domicile, while some allow several domiciles. Some countries require that a person should have lived at the place of domicile for a particular period of time. Yet other countries require that a person should be nationally registered to belong to a certain territorial unit in order to create a domicile. As a result, a concept not present in traditional legal regulations has been searched for a long time, and in the last decades the concept of habitual domicile has proved to be the one. This apart, despite the increasingly frequent use, the concept has never been defined in international conventions. Nevertheless, in 1972 the Council of Europe did issue a recommendation for the uniform interpretation of the concept of habitual domicile^{*6} in which it has been provided, among other things, that a person's length of stay at the place of domicile as well as other personal and financial circumstances that indicate a constant connection between the person and his or her domicile are to be taken into account when determining the habitual domicile, emphasising that the existence of a habitual domicile does not depend on the existence of a domicile permit.

¹ In German: *gewöhnliche Aufenthalt*, in Estonian: *harilik viibimiskoht*.

² Estonia became a party to the Convention in 1999. – Riigi Teataja (The State Gazette) II 1999, 24, 140 (in Estonian).

³ Estonia became a party to the Convention in 1998. – Riigi Teataja (The State Gazette) II 1998, 38, 1087 (in Estonian).

⁴ See article 4 (2) of the Convention.

⁵ J. Kropholler. *Internationales Privatrecht*. Tübingen: Mohr, 1997, S. 267.

⁶ Council of Ministers Resolution of 18 January 1972.

1.2. The choices of Estonia

Looking back at history, it can be said that the principle of domicile has almost always been favoured in Estonia. The principle of *lex domicilii* rather than the principle of nationality was taken as a basis already in the Baltic Private Law Code that entered into force in 1865 and that can be considered the first code in force on the territory of Estonia that contained the conflict of laws rules.⁷ The principle survived in the draft Civil Code of 1940 that was largely based on the Baltic Private Law Code, and today it is contained in sections 130 and 131 of the General Part of the Civil Code Act. The only period of time in which — clearly for political reasons — the principle of nationality has been at least partially in force in Estonia was the Soviet period.

Knowing the historical background, the transfer from the principle of domicile to the principle of nationality would have meant an extremely fundamental change in the foundations of the Estonian private international law as a whole. Yet there was no actual need for this. On the contrary, the enforcement of the principle of nationality in a country where the citizens of foreign countries form a large percentage of the population would render the work of courts much more complicated. It is namely the principle of domicile that generally leads to the application of *lex fori* or the law of the court's state of location because a person's domicile is more likely to coincide with jurisdiction than his or her nationality. This means, for example, that in the case of Finnish citizens residing in Estonia, the court will not have to determine and apply the law of the person's state of nationality, in this case Finland, but it may proceed from the familiar national legislation.⁸ Consequently, the abundance of the citizens of foreign countries residing in Estonia, which was the reason for keeping the principle of *lex domicilii* already in the draft Civil Code of 1940⁹, was also the main argument in the preparation of the draft Private International Law Act, and it can be claimed firmly that the law of a person's state of domicile is and will be the basis for the determination of a natural person's "statute" in Estonia.

1.3. What country's law determines the existence of a domicile or nationality?

What country's law should the court hearing the matter take as the basis for the determination of the existence of a domicile in one or another country? Should it be done pursuant to the national law, *lex fori*, or based on the law of the person's presumable state of domicile? In other words, if an Estonian court had to decide whether a person has a domicile in Sweden, would it be done according to the definition of domicile provided in Estonian or in Swedish law? As indicated above, the concept of domicile may have extremely varied meanings in different states, which is why the opinions concerning the existence of a domicile may differ *toto caelo*.

We have now reached the issue that is called qualification in the theory of private international law. To put it otherwise, which country's law is taken as a basis for defining various legal concepts and institutions (e.g. what is meant by active legal capacity, immovables, limitation period). In respect of qualification, we can also speak about two different approaches: the approach based on the principle of *lex fori* (the law of the court's state of location) and on the principle of *lex causae* (the law presumably applicable to the legal relationship). Judging by the approach generally accepted in literature, the qualification of the concept of domicile is mainly based on the principle of *lex fori*, which, in other words, means that in qualification the court proceeds from the national law.¹⁰ According to the position expressed in the contemporary Estonian legal literature, too, the meanings of domicile and location are based on the definitions given in sections 21 and 40 of the General Part of the Civil Code Act where, among other things, a rule has been set out, providing that if several places in different states may be deemed the domicile of a person, the domicile of the person is in

⁷ Article XXVIII; J. Kitsing. Uue Tsiviilseadustiku ruumiline kehtivus. (Territorial Applicability of the New Civil Code). – Õigus 1936, nr. 5, lk. 227 (in Estonian).

⁸ Against this background, it is somewhat astonishing that the Estonian-Russian and other legal assistance agreements concluded in the initial years of our newly regained independence stem from the principle of nationality instead of the principle of domicile.

⁹ A. Piip. Konfliktnormide ühtlustamine Balti riikides (Harmonisation of Conflict of Laws Rules in the Baltic States). – Õigus, 1937, nr. 8, lk. 344–346 (in Estonian).

¹⁰ The principle of *lex fori* also applies to the qualification of the majority of other institutions. Münchener Kommentar zum Bürgerlichen Gesetzbuch. Bd. 10. München: C. H. Beck'sche Verlagsbuchhandlung, 1998, Rdn. 460.

the state of the person's nationality.*¹¹ This principle has been clearly expressed in section 7 of the draft Private International Law Act, according to which the basis for the determination of a natural person's domicile is the definition of domicile provided in Estonian law and not in the law of the presumable state of domicile.*¹²

A different approach is adopted when determining a person's nationality, in which case the definition of the concept of nationality under *lex causae* or the law of the presumable state of nationality is decisive. This, too, is a widely acknowledged principle*¹³ arising from the need to respect the other country's exclusive right to decide on the country's nationality. Since on some occasions, the connecting factor in the draft Private International Law Act is also the nationality of a natural person (e.g. in sections 26, 49 (2), 60 (2)), the principle of *lex causae* is expressly established in section 8 of the draft. Pursuant to this provision, the nationality of a natural person is determined according to the law of the state whose nationality is being decided; in the case of persons with several nationalities, the decisive nationality is that of the state to which the person has the closest connection.

2. Law applicable to legal persons

2.1. Theory of location and theory of incorporation

Similarly to the fundamental difference between the principle of domicile and the principle of nationality applicable to natural persons, different theories exist about the statute of a legal person, which should determine the conditions on which "a legal person comes into existence, lives and dies".*¹⁴ In the legal transactions of different countries, mainly the following two theories are used for the determination of law applicable to legal persons:

- (1) the theory of location, which today is the point of departure for Estonia and the majority of the states in Western Europe;
- (2) the theory of incorporation, which is taken as the basis by the states of the Anglo-American legal system, but also by the Netherlands and Switzerland (although with significant limitations).

According to the **theory of location**, the personal statute of a legal person is the law of the state in which the directing body of the legal person is located. This law determines the creation and termination, the passive and active legal capacity, the bodies, and the internal relations of the legal person as well as the liability and legal representation of the legal person. Proceeding from the theory of location, the legal persons having its seat in one country but founded under the laws of another country (e.g. offshore companies) have no passive civil legal capacity.*¹⁵

The main advantage of the theory of location is undoubtedly the hindrance of the penetration of exceedingly liberal foreign company law and the resulting protection of national legal transactions, creditors and minority shareholders. It would be inefficient to impose on companies strict capital requirements and a thorough regulation for the guarantee of the maintenance of fixed capital, *etc.*, in order to protect the creditors if the requirements could be ignored by founding a one-hundred-dollar "mailbox company" and thereby participating in economic activities. The theory of location enables the state to exercise control over the companies operating on the state's territory and require that the economic activities on the territory should be conducted in compliance with the requirements of the local law.*¹⁶

The theory of location raises doubts about the transfer of the seat of a legal person from one country to another without dissolving the company and re-founding it in the course of the process. Thus, for

¹¹ H. Pisuke. *Rahvusvahelise eraõiguse sätted*. (Provisions of Private International Law). – *Juridica*, 1994, nr. 8, lk. 201–204 (in Estonian).

¹² Jurists of the time reproached the Baltic Private Law Code and the draft of 1940 for the lack of such clear principle. U. Lender. *Rahvusvahelise eraõiguse normidest tsiviilseadustiku eelnõus* (Provisions of Private International Law in the Draft Civil Code). – *Õigus*, 1936, nr. 3, lk. 139 (in Estonian).

¹³ G. Kegel. *Internationales Privatrecht*. 6. Aufl. München: C. H. Beck'sche Verlagsbuchhandlung, 1987, S. 296; *Münchener Kommentar* (Note 10), paragraph No. 488.

¹⁴ C. v. Bar. *Internationales Privatrecht*. Bd. II. Besonderer Teil. München: C. H. Beck'sche Verlagsbuchhandlung, 1991, S. 459.

¹⁵ *Kommentar zum Bundesgesetz über das Internationale Privatrecht*. Zürich: Schulthess Polygraphischer Verlag, 1993, S. 1341.

¹⁶ To be more precise, it should be noted that here the exceedingly liberal company law does not denote low taxes but only the non-existence or extreme lenience of company law requirements for minimum capital, *etc.*

instance, a company founded and entered in the commercial register in Germany cannot move its seat to Austria without damage to the existence of the company. The reason therefor is simple: at the moment the seat is transferred to Austria, the personal statute of the company changes — from that moment onwards, it is Austrian law. But Austrian law, which also proceeds from the theory of location^{*17}, demands adherence to the requirements of law in force in the legal person's state of location (*i.e.* Austria) and an entry in the Austrian register as prerequisites for the creation of the legal person.^{*18}

According to the **theory of incorporation**, the personal statute of a legal person is the law of the state under the legislation of which the legal person has been founded and where it is located pursuant to the articles of association. This law also determines the passive legal capacity of the legal person. Thus, the existence of a legal person depends only on adherence to the requirements prescribed by the law of its state of foundation, whereas the legal person need not have an actual seat in the same state.

The main positive aspects of the theory of incorporation are the simplicity and clarity of determination of the applicable law as well as legal certainty regarding the fact that the passive legal capacity of a company that has once been validly founded will not be doubted later (which could damage the interests of creditors). Besides this, the theory of incorporation allows to transfer the location of a legal person from one country to another without dissolving the legal person and re-founding it in the course of the process, which undoubtedly serves as a favourable factor with regard to international economic activities.

As a rule, the Continental European countries have avoided a transfer from the theory of location to the theory of incorporation. This is due to the desire of the countries with highly-developed company law to protect their legal transactions and ensure the adherence to the strict requirements established by the national company law.

The efforts to unify these fundamentally different approaches have not succeeded to date. The Hague Convention of 1956 concerning the recognition of the legal personality of foreign companies did not enter into force because of the small number of ratifications. The same initiative of the European Union in 1968 was a failure.

2.2. The choices of Estonia: the theory of location or the theory of incorporation?

Perhaps the most fascinating part of the draft Private International Law Act is the regulation of law applicable to legal persons in part 3 of the draft. It can be considered intriguing mainly because the draft allows, under certain conditions, to claim that the offshore companies operating in Estonia have no passive legal capacity at all. Although the new draft Private International Law Act has, in fact, opted for the theory of incorporation on the grounds of the established practice of law in force, the simplicity of determination of the applicable law and legal certainty (pursuant to subsection 12 (1) of the draft, a legal person is subject to the law of the state in which it has been founded and entered in the register), Estonian law is applied to a foreign legal person if the legal person is managed from Estonia (subsection 12 (2) of the draft).

Thus, the draft has combined the theory of incorporation with the theory of location if it can be proved that the legal person is managed from Estonia.^{*19} If the legal person is managed from Estonia, it means that the passive legal capacity of the legal person is also determined by Estonian law (in keeping with clause 3 of section 13 of the draft). However, pursuant to Estonian law, the passive legal capacity of a legal person in private law commences as of its entry in the commercial register or in the non-profit associations and foundations register, which is why a company founded, for example, in the Virgin Islands cannot be considered to be created at all according to the Estonian law and consequently it cannot be a subject of law, either.

Naturally, the regulation is no wonder-remedy for offshore companies or tax evasions through such companies as in practice it is still relatively difficult to prove that a legal person is managed from

¹⁷ See article 10 of the Private International Law Act of Austria.

¹⁸ Considering the Centros judgement of the European Court of Justice, the validity of the approach in the case of the EU Member States has become questionable.

¹⁹ The same solution has been favoured in article 25 of the new Private International Law Act of Italy.

Estonia. This is also demonstrated by the fact that despite analogous regulations in the applicable law (section 134 of the General Part of the Civil Code Act), the author has no information about any cases in which the question has been raised in court practice. On the contrary, the theory of incorporation seems to be dominant in court practice and disputes about the passive legal capacity of a foreign legal person have only been held with regard to whether a company allegedly founded in Bermuda really exists in the local register and if it has been founded in compliance with the local regulations.^{*20} But nevertheless, the draft creates a theoretical possibility and legal regulation for contesting whether such a pseudo foreign company is a subject of particular law or not.

Virtually the same result is achieved in Germany, where the theory of location has been applied. Namely, it is presumed in German court practice that the actual location of a legal person coincides with its location under the articles of association. This means that the party who, in a dispute about the passive legal capacity of a foreign legal person, claims that the legal person's actual location is elsewhere must prove it.^{*21}

When the application of the theory of location leads to the conclusion that a legal person founded in a foreign country but having an internal location does not actually have any passive legal capacity at all, there is reason to inquire about the fate of transactions concluded by the legal person. In this event, it is possible to proceed from subsection 125 (4) of the draft General Part of the Civil Code Act which provides for the liability of a person without the right of representation also if the transaction was concluded on behalf of a non-existent person. Consequently, there is the option of the personal liability of the person who concluded the transaction on behalf of a legal person and in some cases there is the option to treat the company without passive legal capacity as a civil law partnership.

It should be remarked that the position of the law in force, according to which only foreign **legal persons** are recognised in Estonia, is not justified. While in Estonia it seems that there is a cult of legal persons, *i.e.* legal persons are founded even if it is not expedient at all, in other countries also the associations that do not have the status of a legal person may have passive legal capacity (*e.g.* general partnership in Germany), and there is no reason to exclude them from the regulation. Pursuant to the new draft Private International Law Act, the provisions concerning legal persons are also applied to other organised associations of persons or property units (subsection 17 (1) of the draft). Law applicable to contracts is applied to contractual associations that have no organisational structure and passive legal capacity (subsection 17 (2) of the draft) and it is the task of the court to draw a distinction between a company with passive legal capacity and a contractual association in each specific case.

The provisions of section 135 of the applicable General Part of the Civil Code Act which says that foreign legal persons are recognised in Estonia and they have passive legal capacity and active legal capacity equal to that of Estonian legal persons has been abandoned in the draft. Such a provision has caused confusion at least among the authors of the draft as to whether and to what extent applicable Estonian law actually stems from the theory of location. Naturally, the exclusion of the provision does not mean that foreign legal persons will be unable to conclude transactions, open bank accounts, *etc.* in the future. If a legal person has been founded in accordance with the law applicable to the legal person and it has the passive and active legal capacity, it is sufficient for the legal person to participate in Estonian legal transactions. Consequently, it is important to determine a person's passive and active legal capacity: after its existence has been determined, the foreign legal person in question is recognised as a subject of law with all possibilities arising therefrom.

2.3. The consistency of the theory of location with European Union law

The consistency of the theory of location with the freedom of establishment (articles 43–48 of the EC Treaty) has long been discussed in the European Union law. Despite the continuous harmonisation of substantive company law within the European Union, there are still wide discrepancies between the Member States in this area. The agreement between the Member States on the mutual recognition of companies completed in 1968 has not entered into force to date, and the future prospects for its entry into force are close to none.

²⁰ See, *e.g.* judgement No. II-2-197/99 of the Tartu Circuit Court.

²¹ J. Kropholler (Note 5), p. 488.

Pursuant to article 48 of the EC Treaty, companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall be subject to the freedom of establishment. Consequently, the EC Treaty prescribes that all companies founded in a Member State and having an office or principal place of business in a Member State — but not necessarily in the same Member State — should be recognised.^{*22}

2.3.1. *Daily Mail* judgement

Until 1999, such interpretation was disregarded due to the *Daily Mail Case* of 27 September 1988.^{*23} Adjudicating the case, the European Court of Justice said in its head note:

“The Treaty regards the differences in national legislation concerning the connecting factor required of companies incorporated thereunder and the question whether — and if so how — the registered office or real head office of a company incorporated under national law may be transferred from one Member State to another as problems which are not resolved by the rules concerning the right of establishment but must be dealt with by future legislation or conventions, which have not yet been adopted or concluded. Therefore, in the present state of Community law, articles 52 and 58 of the Treaty, properly construed, confer no right on a company incorporated under the legislation of a Member State and having its registered office there to transfer its central management and control to another Member State.”

The court case in question was provoked by reasons related to tax law: namely, the British Inland Revenue refused to give the necessary permit to a company incorporated in England who wanted to transfer its actual location to the Netherlands due to tax incentives. The European Court of Justice did not consider the act of the English Inland Revenue to be contrary to European Union law. In German legal literature the dominant opinion is that in this judgement the European Court of Justice recognised the admissibility of the theory of location also within the European Union^{*24} by declaring the provision of English law that renders the change of a company’s location contingent on a permission granted for this to be in accordance with freedom of establishment.^{*25} This generated enthusiasm among the supporters of the theory of location who claimed that despite the principle of freedom of establishment, the European Union also allowed the Member States to protect themselves by means of the theory of location. Nevertheless, 11 years later the European Court of Justice made a judgement in which a contrary tendency — abandonment of the theory of location and the triumph of the theory of incorporation — was spotted.

2.3.2. *Centros* judgement

Throughout Europe, heated discussions were provoked by the *Centros* judgement of the European Court of Justice made on 9 March 1999.^{*26} In the abundance of articles and comments that followed, the prevailing opinion was that it was a revolutionary judgement for international company law by which the European Court of Justice made a fundamental decision in favour of the theory of incorporation and extended the principles of the *Cassis de Dijon* judgement to freedom of establishment of companies.^{*27}

In this judgement, the Court of Justice declared the refusal of the Danish court register to make an entry concerning the branch of an English “mailbox company” to be contrary to European Union law. In this case, a Danish couple wanted to register the branch of a private limited company founded under English law in Denmark with the aim to engage in economic activities in Denmark. In the course of the proceedings, the married couple did not conceal that the reason for the use of an English form of company was that the capital requirements therefor were considerably lower: 100 pounds for the English private limited company, but 200,000 Danish kroner for the Danish private limited company. The plaintiffs also admitted that the English company they founded had never been engaged

²² *Ibid.*, p. 494.

²³ Judgement C-81/87 of the European Court of Justice.

²⁴ G. H. Roth. Gründungstheorie: Ist der Damm gebrochen? – Zeitschrift für Wirtschaftsrecht, 21/99, S. 861; C. v. Bar (Note 14), p. 459.

²⁵ A. Flessner. Schiffbruch der Interpreten und Statuten. – ZEuP 2000, S. 2. It should be mentioned that the author of the article is convinced that the judgements referred to have no connection with the preference of the theory of location or the theory of incorporation and she considers it to be simply the misinterpretation of most authors.

²⁶ Judgement in C-212/97 *Centros v. Erhvervs-og Selskabsstyrelsen* of the European Court of Justice.

²⁷ E. Verlauff. Ausländische Gesellschaft für inländische Aktivität. – Zeitschrift für Wirtschaftsrecht, 21/99, S. 867.

in economic activities in England and they planned to do business only through the Danish branch. The plaintiffs claimed that the Danish commercial register violated freedom of establishment guaranteed by the EC Treaty, and indeed — the European Court of Justice in this case ruled as follows: “It is contrary to articles 52 and 58 of the EC Treaty for a Member State to refuse to register a branch of a company formed in accordance with the law of another Member State in which it has its registered office but in which it conducts no business where the branch is intended to enable the company in question to carry on its entire business in the State in which that branch is to be created, while avoiding the need to form a company there.”

Only in the cases of fraud, the judgement allows a Member State to use additional collateral instruments for creditors.^{*28}

At first glance, such wording seems to say nothing about the legal status of the company. The judgement also carefully avoids mentioning the theory of location or the theory of incorporation.^{*29} But an in-depth analysis shows that **permitting the entry of the branch automatically means the affirmation of the passive legal capacity of the English company** since only a legal person with passive legal capacity can have a branch. In other words: the provision that allows a Member State to refuse to recognise that a company founded in another Member State is a subject of law for the reason that the actual location of the company in question is not in the same Member State is not in compliance with the European Union law. It can also be concluded from the above that it is impossible to establish a requirement in the national law by which only a branch of such a foreign legal person can be entered in a register that has a certain amount of minimum capital.

Thus, it can be said that in the *Centros* judgement the European Court of Justice decided in favour of the theory of incorporation within the European Union, making “jurisdiction shopping” permissible upon the foundation of legal persons within the Union.

It is extremely interesting that only a couple of months later, on 15 July 1999 the Austrian Supreme Court made a similar judgement in an analogous court case^{*30}. In that case, a company newly founded in England wished to establish a branch in Austria and enter it in the Austrian commercial register. Similarly to the *Centros* judgement, the register refused to enter such a branch. The court of the first instance and the court of appeal supported the approach based on article 10 of the Austrian Private International Law Act that stems from the theory of location. The Austrian Supreme Court, in turn, followed the *Centros* judgement of the European Court of Justice and, recognising the superiority of the European Union law, considered the Austrian conflict of laws rules to be contrary to the European Union freedom of establishment.^{*31} Here, the Austrian Supreme Court goes even further than the European Court of Justice, adopting expressly the position that the theory of location is inconsistent with the principles of the European Union concerning freedom of establishment.

On the one hand, the *Centros* judgement of the European Court of Justice will definitely result in the more frequent use of “pseudo foreign companies” and it may even lead to the transfer of the Delaware syndrome to Europe. On the other hand, the judgement of the European Court of Justice still leaves a possibility for states to protect themselves from the exceedingly liberal company law in some other manner. This can be done, for example, by demanding bank guarantees from companies with a small fixed capital or by accepting the additional liability of partners.^{*32} The restraints must only be transferred from the foundation phase to the operating phase of the company.

For Estonia, the principles deducible from the *Centros* judgement may become relevant upon accession to the European Union. While the determination of law applicable to legal persons could be considered to be in the competence of the Member States until the aforesaid judgement and every state could basically choose a legal regulation suitable to the state, then in the case of the persistence of principles contained in the *Centros* judgement, the permissibility of the theory of location within the European Union will become doubtful. Thus, unless the European Court of Justice decides

²⁸ That interpretation does not, however, prevent the authorities of the Member State concerned from adopting any appropriate measure for preventing or penalising fraud, either in relation to the company itself, if need be in co-operation with the Member State in which it was formed, or in relation to its members, where it has been established that they are in fact attempting, by means of the formation of a company, to evade their obligations towards private or public creditors established on the territory of the Member State concerned.

²⁹ Moreover, the judgement did not even refer to the earlier *Daily Mail* judgement. Nevertheless, it is assumed in literature that the European Court of Justice must have been aware of the consequences that its judgement entailed from the point of view of international company law. G. H. Roth (Note 24), p. 872.

³⁰ RS U OGH 1999/07/15 6 Ob 124/99z.

³¹ I. Rappaport. *Companies in General*. – *The Journal of Business Law*, November 2000, p. 631.

³² Namely the countries in which there are extremely low minimum capital requirements have developed the principles of the partners' additional liability for the company's obligations: for example, the English “lifting the veil” principle. E. Verlauff (Note 27), p. 875.

otherwise in the meantime, it may happen that Estonia will have to abandon the principle provided in subsection 12 (2) of the new draft Private International Law Act at least with regard to companies founded in the Member States of the European Union. It will naturally not prevent the persistence of the aforesaid possibility with regard to companies founded in other countries but operating in Estonia. Nevertheless, taking into consideration the hitherto liberal practice and the development of Europe it seems unlikely that the possibility to dispute the passive legal capacity of a company offered by the theory of location will be used very often after the entry into force of the draft as an act. But still, even a few court decisions of the kind could possibly contribute to some purification of Estonian business affairs — be ready to give it a try!