

Some reflections on freedom of establishment of non-profit entities in the EU

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This article deals with the exclusion of non-profit-making entities from the right of freedom of establishment of Articles 49 and 54 TFEU. The article analyses the historical reasons for this exclusion. It is argued that the exclusion from freedom of establishment is no longer justified on the basis of two elements. Firstly, the development of the jurisprudence of the European Court of Justice in the fields of competition law, free movement of capital and tax law makes such exclusion systematically no longer tenable. Secondly, a law and economics treatment of non-profit firms as organisations that efficiently provide goods and services in alternative to for-profit firms weakens the reasons for the exclusion. The article proposes a uniform, European notion of non-profit entity based on a law and economics analysis of this type of firm for the purposes of Article 54 TFEU as opposed to possible different national notions. The article then analyses briefly the hypothesis of regulatory competition among jurisdictions for the provision of the law regulating the corporate governance of non-profit entities.

Keywords: non-profit firms, but lucratif, foundations, associations,

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Abstract

(a) simmetrie di Cartesio e la «nuova» libertà di stabilimento delle società nella prospettiva del Trattato di Lisbona, in *Le Società*, 29:1084-1097. For a survey on freedom of establishment in the context of harmonisation of company law, see ARMOUR JOHN, RINGE WOLF-GEORG, 2011, *European Company Law 1999-2010: Renaissance and Crisis*, in *Common Market Law Review*, 48:125-174. See already BASEDOW JÜRGEN, 2000, *The Communitarization of the Conflict of Laws under the Treaty of Amsterdam*, in *Common Market Law Review*, 37:687-708. With respect to the issue of mobility, I refer in particular to a possible XIV directive on mobility of companies. On the point see VOSSESTEIN GERT-JAN, 2008, *Transfer of registered office*. The European Commission's decision not to submit a proposal for a Directive, in *Utrecht Law Journal*, 4:53-65. On mobility of companies see also the second chapter of EUROPEAN COMMISSION, *Report of the Reflection Group On the Future of EU Company Law*, Brussels 5th April 2011.

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June 2012

This article deals with the exclusion of non-profit-making entities from the right of freedom of establishment of Articles 49 and 54 TFEU. The article analyses the historical reasons for this exclusion. It is argued that the exclusion from freedom of establishment is no longer justified on the basis of two elements. Firstly, the development of the jurisprudence of the European Court of Justice in the fields of competition law, free movement of capital and tax law makes such exclusion systematically no longer tenable. Secondly, a law and economics treatment of non-profit firms as organisations that efficiently provide goods and services in alternative to for-profit firms weakens the reasons for the exclusion. The article proposes a uniform, European notion of non-profit entity based on a law and economics analysis of this type of firm for the purposes of Article 54 TFEU as opposed to possible different national notions. The article then analyses briefly the hypothesis of regulatory competition among jurisdictions for the provision of the law regulating the corporate governance of non-profit entities.

Keywords: non-profit firms, *but lucratif*, foundations, associations, freedom of establishment, competition law, tax law, regulatory competition, USA, EU, corporate governance, agency problems, agency costs.

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1. Introduction

The topic of freedom of establishment of companies in the European Union according to Articles 49 and 54 TFEU (former Articles 43 and 48 TEC and former Articles 52 and 58 TEEC) has been extensively analysed by legal doctrine in recent years. The case law of the European Court of Justice (ECJ), began with the *Centros* case in 1999 and was later confirmed with the cases of *Überseering* in 2002, *Inspire Art* in 2003, *Sevic* in 2005 and *Cartesio* in 2008.¹ After the Treaty of Lisbon, this liberal jurisprudence influenced the TFUE, which has formally repealed Article 293 TEC. Freedom of establishment (meaning also mobility of companies among Member States) belongs now entirely to the context of Articles 49 and 54 TFEU.² Possible solutions for granting mobility to companies for the purpose of the change of applicable law can also be implemented according to Article 82.2(c) TFUE in terms of private international law.³ Harmonization of Member States' company laws can of course still be pursued on the basis of Article 50.2(g) TFUE.⁴

This article focuses on the exclusion of non-profit-making legal entities from freedom of establishment in the single market. Indeed, Article 54.2 TFUE excludes from freedom of establishment non-profit-making entities. Nevertheless, in more recent times non-profit entities, meaning here in *primis*

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¹ Respectively, Case C-212/97, *Centros Ltd and Erhvervs-og Selskabsstyrelsen*, 9 March 1999; Case C-208/00, *Überseering BV and Nordic Construction Company Baumanagement GmbH (NCC)*, 5 November 2002; Case-167/01, *Kamer van Koophandel en Fabriken voor Amsterdam and Inspire Art Ltd*, 30 September 2003; Case C-411/03, *SEVIC Systems AG*, 13 December 2005; Case C-210/06, *Cartesio Oktató és Szolgáltató bt*, 16 December 2008.

² On the new freedom of establishment, see LOMBARDO STEFANO, 2010, *Le (a)simmetrie di Cartesio e la «nuova» libertà di stabilimento delle società nella prospettiva del Trattato di Lisbona*, in *Le Società*, 29:1084-1097. For a survey on freedom of establishment in the context of harmonisation of company law, see ARMOUR JOHN, RINGE WOLF-GEORG, 2011, *European Company Law 1999-2010: Renaissance and Crisis*, in *Common Market Law Review*, 48:125-174.

³ See already BASEDOW JÜRGEN, 2000, *The Communitarization of the Conflict of Laws under the Treaty of Amsterdam*, in *Common Market Law Review*, 37:687-708.

⁴ With respect to the issue of mobility, I refer in particular to a possible XIV directive on mobility of companies. On the point see VOSSESTEIN GERT-JAN, 2008, *Transfer of registered office. The European Commission's decision not to submit a proposal for a Directive*, in *Utrecht Law Journal*, 4:53-65. On mobility of companies see also the second chapter of EUROPEAN COMMISSION, *Report of the Reflection Group On the Future of EU Company Law*, Brussels 5th April 2011.

associations and foundations, have been stressing their importance in the realisation of the single market and pushing for European legislation to grant recognition of their role in the modern market economies of the Member States and consequently also of the single market.⁵

It is worth remembering that in the case of (for-profit) companies the issue of freedom of establishment was strictly linked with the harmonisation of the company laws of the Member States according to Article 54 TEEC, for the protection of the members and other(s).⁶ On the contrary, in the case of non-profit entities there was no such harmonization. Since they were indeed excluded from freedom of establishment, there was no need to harmonise their legal provisions, particularly with respect to the protections of creditors.

The recent proposal of the European Commission for the introduction of a regulation on the European Foundation Statute highlights some of the issues dealt with in this article.⁷ Indeed, the foundation (together with the association) is the legal body that is usually considered to be a non-profit entity established to run an activity which is supposed to be other than economic *stricto sensu*: it is considered to be for public benefit. *Considerandum* 12 of the Regulation proposal refers to the necessity to grant to the EU Foundation freedom of establishment according to Article 49 notwithstanding the explicit wording excluding this possibility. This makes clear that the issue of freedom of establishment for non-profit entities is an important one.

The analysis of the distinction between for-profit entities and non-profit entities for the purposes of freedom of establishment is interesting from several perspectives and opens up the possibility of studying the topic in connection to other issues related to the single market.

⁵ As an introduction, see BREEN OONAGH B., 2008, *EU Regulation of Charitable Organizations: the Politics of Legally Enabling Civil Society*, in *International Journal of Not-for-Profit Law*, 10:50-78.

The importance of non-profit legal entities (which belong to the so called “third sector”) is apparently increasing in the Member States and consequently in the single market. On the importance of non-profit organizations in the economies of single Member States, see already EUROPEAN COMMISSION, 1997, *Communication from the Commission on Promoting the Role of Voluntary Organizations and Foundations in Europe*, COM(97) 241 final. For a comparative description of non-profit entities, see also *Report on Non-Profit Making associations in the European Community*, December 1986, s.c. Fonatine Report.

As last available document, see also EUROPEAN COMMISSION, *Commission Staff Working Paper Impact Assessment Accompanying the Document Proposal for a Council Regulation on the Statute for a European Foundation (FE)*, Brussels, 8.2.2012, SWD(2012) 1 final, where the introduction refers to several documents related to the “non-profit sector, i.e. foundations, charities, trusts, associations involved in social economy or philanthropy, and their networks and umbrella organisations” p. 6.

Also the topic of corporate governance, which is common for for-profit entities, has started to gain attention for non-profit entities, see HOPT KLAUS J., VON HIPPEL THOMAS, (edited), 2010, *Comparative Corporate Governance of Non-Profit Organizations*, Cambridge University Press, Cambridge.

⁶ On the correlation between freedom of establishment and harmonisation of company law, see LUTTER MARCUS, 1966, *Die Angleichung des Gesellschaftsrechts nach dem EWG-Vertrag*, in *Neue Juristische Wochenschrift*, 19:273-278.

⁷ See EUROPEAN COMMISSION, *Proposal for a Council Regulation on the Statute for a European Foundation (FE)*, Brussels, 8.2.2012, COM(2012) 35 final.

Firstly, the ECJ has already decided several cases related to non-profit entities.⁸ Certainly, such cases did not directly involve (at least as a consequence of the decisions) the freedom of establishment of non-profit entities *per se*. Nor did the ECJ provide for a definition of the concept of non-profit-making entity. The question arises as to whether Article 54 TFUE requires a European, uniform definition of “non-profit-making” entity.

Additionally, I note that in competition law, which is a very important pillar (of the construction) of the single market, the ECJ has already developed a jurisprudence that confirms the application of the relevant Treaty provisions also to non-profit entities. It follows that non-profit entities are subject to competition law. At the same time they are excluded from freedom of establishment, which is the second circulation freedom of the single market, by the literal wording of Article 54 TFUE.

As a third element, we can argue that this asymmetry in the treatment of non-profit entities (inclusion in the rules of competition law but exclusion from freedom of establishment) can be judged positively or negatively according to an evaluation of their role in the development of the single market. This perspective is interesting because it shows that the market economy can be properly “occupied” not only by for-profit entities but also by non-profit entities. The open market economy based on competition among productive factors characterises the single market which is based on the four freedoms of movement and is regulated in terms of competition law.

The law and economics of non-profit entities is relatively new and explains the presence of such entities as an economic answer to particular market failures. What is more important, it brings the legal theory of non-profit entities back to the theory of the market economy. It explains their natural compatibility with market economy theory, in terms of their economic dimension in pursuing an economic activity on the basis of the non-profit element.

The law and economics of non-profit entities explains the law of non-profit entities as organisations established in order to reach their (economic) purposes.⁹ Clearly, law and economics has devoted more attention to company law, *i.e.* the law of for-profit entities.¹⁰ According to a functional analysis, company law is considered to be a “product” and can be evaluated in

⁸ See the analysis in Section 4.

⁹ The law and economics of non-profit legal entities has been systematised and developed in two seminal papers by H. Hansmann. See HANSMANN HENRY B., 1980, *The Role of Nonprofit Enterprise*, in *Yale Law Journal*, 89:835-901; HANSMANN HENRY B., 1981, *Reforming Nonprofit Corporation Law*, in *University of Pennsylvania Law Review*, 129:497-623; see also HANSMANN HENRY, 1996, *The Ownership of Enterprise*, Harvard University Press, Cambridge MA. For a useful introduction to the legal theory of non-profit legal entities in the US single market, see OLECK HOWARD L., 1956, *Non-Profit Corporations and Associations. Organization, Management and Dissolution*, Prentice-Hall, Englewood Cliffs NJ.

¹⁰ See EASTERBROOK FRANK H., FISCHER DANIEL, 1991, *The Economic Structure of Corporate Law*, Harvard University Press, Cambridge MA; KRAAKMAN REINIER *et al.*, 2009, *The Anatomy of Corporate Law. A Comparative and Functional Approach*, Oxford University Press, Oxford.

terms of its relative efficiency to deal with agency problems.¹¹ Company law can furthermore be supplied by jurisdictions in competition.¹²

The European single market can be fruitfully compared also in the field of freedom of establishment of non-profit entities to the US, as has been done for freedom of establishment of for-profit companies.¹³ I believe that the law and economics dimension of non-profit entities and their legal regulation can become the basis for an analysis of the (efficiency of the) prohibition of Article 54 TFEU.

I underline at this point that this article does not focus on issues related to the tax law of non-profit entities. In many jurisdictions tax law grants to non-profit entities special privileges in terms of tax relief for donors and tax exemptions for non-profit entities. As the analysis will show, the European Court of Justice has decided some cases on tax issues related to non-profit entities. This is indeed a very important matter because the different treatment of non-profit entities according to their nationality can create discriminatory effects which are against the basic principles of European law. Nevertheless, this article concentrates on the relationship between the private law nature of a non-profit entity, explaining it in law and economics terms, and the European law dimension of freedom of establishment. In other words, as has been done for companies, the issues of tax law on one side and company law, international private law and European law on the other can be separated.

In order to study the topic of the relation between non-profit entities and freedom of establishment in the European single market, I first examine the analysis of this issue as pursued by earlier legal doctrine (Section 2). This is useful in order to understand how this legal doctrine interpreted the wording of Article 58 TEEC. Historically, this wording reflects a precise distinction between non-profit and for-profit entities and includes *in primis* associations and foundations as opposed to companies. Section 3 concentrates on the notion of non-profit entities, analysing in particular whether it is more useful to have a common European definition or a national one for the purposes of activating Article 54 TFUE. In Section 4, I describe the law and economics of non-profit entities. In Section 5, I focus on the case law of the ECJ which indirectly relates to non-profit entities. I analyse the case law in competition law, trying to understand whether the concept of non-profit entity has some elements in common with the notion of undertakings for competition law purposes (Section 5.1). In Section 5.2, I focus on the jurisprudence related to tax law and to free movement of capital. In Section 5.3, I analyse a decision

¹¹ ROMANO ROBERTA, *Law as a Product: Some Pieces of the Incorporation Puzzle*, in *Journal of Law, Economics, & Organization*, 1:225-283.

¹² ROMANO ROBERTA, 1993, *The Genius of American Corporate Law*, AEI Press, Washington DC. For a short survey of the literature, concentrating then on an empirical analysis of closely held corporations, see DAMMANN JENS, SCHÜNDELN MATTHIAS, 2011, *The Incorporation Choices of Privately Held Corporations*, in *Journal of Law, Economics, & Organization*, 27:79-112.

¹³ See one of the latest contributions in this now immense literature, MUCCIARELLI FEDERICO M., 2011, *Freedom of Reincorporation and the Scope of Corporate Law in the U.S. and the E.U.*, New York University Law and Economics Working Papers, 257/2011, available at bepress.com.

where the Court touched indirectly the issue of freedom of establishment for non-profit entities. The analysis of these cases shows that the Court has included non-profit entities in the sphere of application of European law. This means that non-profit entities are already subject to European law. Section 6 concentrates on the notion of non-profit entities in the single market from a law and economics perspective. I argue that a European, uniform notion of non-profit entity should be used by the ECJ based on the law and economics notion of non-profit firm (Section 6.1). For this reason, I suggest that the exclusion of non-profit entities from freedom of establishment is no longer justified, neither systematically nor by an analysis of the economic role of non-profit entities. I argue that the ECJ should grant freedom of establishment also to non-profit entities based on the notion of the economic activity they carry out (Section 6.2). Finally, I briefly analyse the law and economics issue of a possible regulatory competition system for non-profit legal entities. The question is whether in the paradigm of agency problems and law as a tool to minimise agency costs, also the law of non-profit legal entities could be offered by jurisdictions in competition (Section 6.3). The article closes with some conclusions (Section 7).

2. (Non)-profit-making entities and freedom of establishment in earlier legal doctrine

In this section, I analyse the relationship between freedom of establishment and (non-)profit legal entities as interpreted by the first legal doctrine that addressed the issue about 50 years ago. In particular, I analyse the issue of what kind of legal entities this old doctrine included in the notion of non-profit bodies.

Freedom of establishment for legal entities was (and still is) established by the Treaty with a connection between Article 58 TEEC and Article 52 TEEC, where it was provided for individuals (nationals of a Member State). Indeed, Article 58.1 TEEC put legal entities on a par with individuals as regards the enjoyment of freedom of establishment as defined in Article 52 TEEC. Freedom of establishment for individuals was supposed to be granted in order for them to pursue an activity in terms of self-employment and of an undertaking activity.¹⁴ The notion of freedom of establishment was intended to be independent from the notions and the rules related to freedom of movement for workers (Articles 48-51 TEEC) and for services (Articles 59-66 TEEC).¹⁵ With respect to the nature of the activity to be pursued under the scope of

¹⁴ As a useful systematic introduction to the topic, also based on references to the legal doctrines of the founding Member States, see RUGGIERO ANTONIO, DE DOMINICIS MARIO, 1965, Art. 52, in QUADRI ROLANDO, MONACO RICCARDO, TRABUCCHI ALBERTO, *Trattato istitutivo della Comunità economica europea. Commentario*, Giuffrè, Milano, Vol. I, 398-418 and CAPOTORTI FRANCESCO, 1965, Art. 58, in QUADRI, MONACO, TRABUCCHI, *ibidem*, 447-468.

¹⁵ See RUGGIERO, DE DOMINICIS, *supra* 14, 403. In particular, the difference with workers refers to the fact that they are employed in a subordinated relationship while the difference with the provision of services refers to their residual nature.

freedom of establishment, legal doctrine intended it as “economic activity”, meaning an activity that includes industrial, commercial, handmade (*handwerkliche, artigianali*) and agricultural activities but also the liberal professions.¹⁶ These activities were considered to be *economic* activities, in terms of entrepreneurial or professional activities, which are typical (i.e. dominant in) of a market economy and are undertaken for the purpose of obtaining a (potential) gain, (*but lucratif, scopo lucrativo, Erwerbszweck*).¹⁷ It follows that the purpose of obtaining a (potential) gain (lucrative purpose) could be directly found in Article 52 TEEC as a qualification of the activity (economic activity) which freedom of establishment for individuals was meant to serve. Indeed, it was in the nature of the Treaty to establish an *economic* area for *economic* purposes, where the four *economic* freedoms, and the freedom of establishment among them, were functional to this *economic* aim.¹⁸

Article 58 TEEC extended the freedom of establishment granted to individuals to a wide variety of legal entities. These legal entities were given the generic term of “companies”. These include (i) companies or firms constituted under civil or commercial law,¹⁹ as well as (ii) other legal persons governed by public or private law. Furthermore, the tradition of the Member States includes also cooperative societies. They belong to the realm of private law and are explicitly included in the freedom of establishment by Article 58 TEEC.

Given the large number of entities included in group (i) and in group (ii) as well as the explicit inclusion of cooperative societies, the only exclusion from freedom of establishment (actually related to both groups)²⁰ which the Treaty sets is the one for companies that do not pursue a lucrative purpose. Indeed, in the Treaty versions in French, in Italian and in German reference is not in truth made with respect to the notion of companies “for-profit-making” or “not-profit-making”, but respectively to the notion of “*sociétés, qui ne poursuivent pas de but lucratif*”, “*società che non si prefiggono scopi di lucro*” and “*derjenigen, die keinen Erwerbszweck verfolgen*”.²¹

¹⁶ See RUGGIERO, DE DOMINICIS, *supra* 14, 408.

¹⁷ See RUGGIERO, DE DOMINICIS, *supra* 14.

¹⁸ Stressing the economic dimension of the Treaty and of the four freedoms of the productive factors as *ratio legis* for shaping an economic area where those factors are allocated efficiently according to the Ricardo theorem, see TROBERG PETER, *Vorbemerkung zu den Artikel 52 bis 58*, in VON DER GROEBEN HANS, THIESING JOCHEN, EHLMANN CLAUS-DIETER, (Hrsg.), 1997, *Kommentar zum EU-/EG-Vertrag*, Nomos, Baden-Baden, 1276.

¹⁹ In the Italian, French and German versions of the Treaty reference is made only to “companies” and not to “companies” and “firms”. In English the dyad “companies” and “partnerships” is maybe preferable. With respect to this first group, indeed, in the tradition of the original Member States there was a separation between companies regulated under the civil code and companies regulated under the commercial code. On this point, see LUSSAN CLAUDE, *Les sociétés dans le marché commun*, in *Rivista delle Società*, 5:979-995, 986.

²⁰ I share the opinion of CAPOTORTI, *supra* 14, 451, that the exemption of the non-lucrative purpose refers to companies in group (i) and group (ii).

²¹ I do not intentionally discuss here two points that are relevant to this topic. Indeed, I treat them as solved *ex ante*. The first one refers to the identification of the entity without lucrative purposes that is a legal subject, formally distinct from its members/founders. This issue is the same as for-profit entities and is decided by the Member State that creates

The use of the notion of *but lucratif* (“lucrative purpose”)²² in the Treaty versions of the founding Member States helps in identifying the notion for the purpose of freedom of establishment. Indeed, the common tradition of the original Member States was such that it was possible to divide legal entities in three major categories: associations, companies and foundations. The reconstruction of these categories was based in terms of the type of activity and the type of purpose permitted to them.²³ In analysing the notion, earlier scholarship appears to treat the topic from a national perspective, trying to identify it with national categories and taxonomies.²⁴ Nevertheless, these contributions seem to reach the conclusion that since the activity is an economic one, as already defined for the purposes of Article 52 TEEC, *but lucratif* excludes such entities that are not created for pursuing an economic activity, *i.e.* such entities, primarily but not exclusively associations, that are created for running an activity which is other than economic, with an ideal or altruistic purpose which is different from *but lucratif*.²⁵

The idea behind this conclusion was based on the traditional classification that proposes associations and foundations as legal entities typically constituted in order to carry on a non-economic activity (*i.e.* a social, political, cultural, charitable activity possibly differently defined in the single Member States) with an ideal purpose (again, possibly differently defined), unlike companies, which are typically constituted in order to carry out economic activity for a lucrative purpose (*but lucratif*).²⁶ Certainly, given this very broad and simple taxonomy, how the different legal orders of the founding Member States qualified and treated (and continue to qualify and treat) the single categories and the possible different sub-types inside the single

the legal entity: if there is no legal entity, single individuals enjoy freedom of establishment (ex Art. 49 TFUE) while if there is a legal entity this enjoys freedom of establishment (ex Art. 54 TFUE). The second topic I do not cover here which is also similar to entities with a lucrative purpose (in terms of the usual distinction between *Personengesellschaften* and *Kapitalgesellschaften*) is the question of their legal treatment. In other words, the extent to which the single Member State treats the legal subjectivity of associations and foundations or companies without lucrative purposes with respect to their registration, recognition and legal personality. Also in this case, the problem can be resolved only by the Member State of creation and in doubtful cases (*i.e.* in cases covering more than one Member State) by the international private laws of the Member States involved in the issue.

²² From now on, I use the French term *but lucratif* to express *scopo lucrativo*, *Erwerbszweck*.

²³ For this tripartition of the legal entities I refer to the results of the analysis carried out by VERRUCOLI PIERO, 1985, *Non-Profit Organizations. (A Comparative Approach)*, Giuffrè, Milano. This comparative (Italy, France, West Germany, Belgium, United Kingdom and United States) and historical introduction provides a taxonomy from the perspective of non-profit legal entities.

²⁴ This is particularly the case of CAPOTORTI, *supra* 14, 450.

²⁵ See CAPOTORTI, *supra* 14, 451 “che sono eccettuati dal beneficio del diritto di stabilimento gli enti, i quali si prefiggono scopi non suscettibili di dare lucro; diciamo pure, scopi diversi dallo svolgimento di una attività economica”; LUSSAN, *supra* 19, 987 “*associations de personnes à tendance, culturelle, amicale ou sportive*”.

²⁶ LUSSAN, *supra* 19, 987.

categories, was and is an exercise which leads to different results and is out of scope of this article.^{27,28}

²⁷ Extensively and comparatively on this point see VERRUCOLI, *supra* 23.

²⁸ Of particular interest is the extent to which the different legal entities can be used for an activity or for a purpose which is not the “proper” one. I refer to the question whether an association or a foundation can be used to carry on an economic activity with a lucrative purpose, either in exclusive form or in a form that is instrumental to the “proper” activity or to the “proper” purpose of the legal entity. This point is interesting because also in the proposal for a Regulation of the European Foundation, public activity (as defined for the public benefit purpose in Art. 5) and economic activity are considered to be different and the latter is permitted only to a limited extent (Art. 11). On the other hand, on the basis of the (simple) notion of company as legal entity constituted to carry out an economic activity for a lucrative purpose, I refer also to the extent to which the single Member States permit an exemption to this (typical) notion. An analysis of this kind (in its historical development and considering all the original and current Member States) is, of course, outside of the scope of this article. I simply note that, given the simple taxonomy between companies, associations and foundations (and omitting other possible forms like charities or trusts), the legal orders of the original Member States (and possibly also of the other Member States) show a picture with some level of complexity. See again the comparative analysis of VERRUCOLI, *supra* 23, 4 and *passim*. Furthermore, with respect to Belgium, see BAUGNIET JEAN, 1968, *Société et association, société et entreprise en droit belge*, in VERRUCOLI PIERO, 1968, *Evolution et Perspectives du Droit des Sociétés*, Tome I, Giuffrè, Milano, 31-44; for Spain, see DUQUE JUSTINO F., 1968, *Société, association et entreprise en droit espagnol*, *ibidem*, 69-92; for France, see HOUIN ROGER, *Société, association et entreprise en droit français*, *ibidem*, 93-120; for Germany, see SANDROCK OTTO, *Société et association, société et entreprise en droit allemand*, *ibidem*, 167-206; for English law, see PARKER CLIFFORD F., *Companies and Associations in English Law: Historical Development*, *ibidem*, 121-138.

For more recent contributions, considering also foundations, see VON HIPPEL THOMAS, *Nonprofit Organizations in Germany*, in HOPT, VON HIPPEL, *supra* 5, 197-227, 222; VAN DER PLOEG TYMEN J., *Nonprofit Organizations in the Netherlands*, in HOPT, VON HIPPEL, *supra* 5, 228-264, 259; DECKERT KATRIN, *Nonprofit organizations in France*, in HOPT, VON HIPPEL, *supra* 5, 265-324, 319; CSEHI ZOLTÁN, *Nonprofit Organizations in Hungary*, in HOPT, VON HIPPEL, *supra* 5, 325-378, 374; RONOVSÁ KATEŘINA, *Nonprofit organizations in the Czech Republic*, in HOPT, VON HIPPEL, *supra* 5, 379-427, 417; HEMSTRÖM CARL, *Nonprofit organizations and economic activities/enterprises*, in HOPT, VON HIPPEL, *supra* 5, 740-769; HANSEN SØREN FRIIS, *Nonprofit organizations and enterprises: the Danish foundation law as an example*, in HOPT, VON HIPPEL, *supra* 5, 770-788.

For the Italian legal system, the one I am more used to, I simply refer to the long discussion the legal doctrine has had regarding the extent to which the company is the only category to carry out an economic activity (meaning an undertaking activity, *attività d'impresa*) with or without a *scopo lucrativo*. For the foundation on the basis of the German case (on which see GOERDELER REINHARD, 1950, *Die Stiftung als Rechtsform für Unternehmungen*, in *Zeitschrift für das Gesamte Handelsrecht und Konkursrecht*, 113:145-165, but apparently *contra* see REUTER DIETER, 2007, *Stiftungsform, Stiftungsstruktur und Stiftungszweck*, in *Archiv für die civilistische Praxis*, 207:1-27, 23), see RESCIGNO PIETRO, 1967, *Fondazione e impresa*, in *Rivista delle Società*, 12:812-847; on associations, FARENGA LUIGI, 1982, *Associazione, società e impresa*, in *Rivista del Diritto Commerciale*, 80:21-49; CAMPOBASSO GIAN FRANCO, 1994, *Associazioni e attività d'impresa*, in *Rivista di Diritto Civile*, 40:581-595; as a synthesis of the problems and the perspectives of the regulation of associations and foundations in Italy, precisely in relation to their *ratio legis* in terms of activity and purpose permitted, see ZOPPINI ANDREA, 2005, *Problemi e prospettive per una riforma delle associazioni e delle fondazioni di diritto privato*, in *Rivista di Diritto Civile*, 51:365-367.

In order to differentiate between for-profit and non-for profit entities in the legal discussion between types of activity and types of *but* (purpose) to be pursued by the entity as reason for its existence, an element is of interest. Indeed, it seems that a legal line of reasoning that can be advanced to explain, at least from a functional perspective, the different categories of entities is not really related to the type of activity carried out (i.e. the extent to which the activity is economic or non-economic, depending also on the notion of the adjective *economic*), but on the specification of the notion of *but lucratif*. I refer to the distinction between entities that have an income (*lucre*, however defined) but do not distribute it to their members (or founders), permitting its accumulation inside the organisation, and entities that have an income (*lucre*, however defined) and distribute it to their members. In other words, I refer to the notion of “distribution constraint” as a functional element to qualify an entity as a non-profit or as a for-profit. This functional element appears to characterise already from a legal perspective several jurisdictions.²⁹ The question of whether the legal system does or does not permit the entity to have a profit differs from the question whether the entity is allowed to distribute (on an ongoing basis or at the moment of liquidation) the profit to its members.³⁰ Although with some exceptions and different degrees of complexity, the nondistribution constraint seems to be the common legal factor (at least implicitly) that also more recent literature extracts from the analysis of the different jurisdictions. Indeed, jurisdictions appear to permit associations and foundations to have a profit that cannot be distributed among those who are in control of the entity.³¹

Co-operatives, explicitly included among the entities enjoying freedom of establishment by Article 58 TEEC, are a kind of entity whose nature in terms of category, activity and purpose could be considered hybrid.³²

²⁹ I have termed the non-distribution factor as “nondistribution constraint”, taking the concept from HANSMANN, *The Role*, *supra* 9, 838, on which see more in detail Section 3. Nevertheless, the same legal doctrine has advanced this as a differentiating element. This is true both for the US case, see OLECK, *supra* 9, 2, and for European jurisdictions, see VERRUCOLI, *supra* 23, 9; Fontaine Report, *supra* 5, point 3.

It should be noted that in the US system a corporate law definition of non-profit (in terms of non-distribution constraint) and a non-profit definition for tax purposes (repeating the non-distribution constraint and adding the public benefit purpose) exists according to Section 501(c)(3) of the Internal Revenue Code. On this point, see von HIPPEL THOMAS, 2005, *Begriffsbildung und Problemkreise der Nonprofit-Organisationen aus juristischer Sicht*, in HOPT KLAUS J., VON HIPPEL THOMAS, WALZ RAINER W., (Hrsg.), *Nonprofit-Organisationen in Recht, Wirtschaft und Gesellschaft*, Mohr Siebeck, Tübingen, 35-46, 37.

³⁰ Following the Italian wording, a difference is commonly made between a *lucre oggettivo* (the entity can make profits) and *lucre soggettivo* (the entity can distribute profits to its members). I assume that what the entity can or cannot do is decided by the law rather than autonomously by the entities themselves.

³¹ For Italy, see ZOPPINI, *supra* 28, 367; for Germany, see VON HIPPEL, *supra* 28, 200; for the Netherlands, see VAN DER PLOEG, *supra* 28, 230; for France, see DECKERT, *supra* 28, 268; for Hungary, see CSEHI, *supra* 28, 328; for voluntary organizations, see also EUROPEAN COMMISSION, *supra* 5, 1b.

³² Again, I omit a treatment of the topic and refer to the short reference to cooperatives by VERRUCOLI, *supra* 23, 7 and to the comparative analysis of the legislation of

The original exclusion from freedom of establishment for entities without *but lucratif* in the European single market can be compared to the US single market.³³ Indeed, apart from the legal (constitutional) regulation of the two markets, from a functional perspective they have the same goal of providing an integrated economic, single market among the (Member) States.³⁴ It seems that in the United States the “freedom of establishment” for “foreign” non-profit legal entities has mirrored the legal situation of for-profit legal entities. Non-profit entities have been granted the possibility to carry on their activity in the hosting state by way of a registration like their for-profit twins: in other words the “incorporation theory” applies also to non-profit entities.³⁵

3. *But lucratif*: A European or national notion?

The discussion has shown that past literature had reached the conclusion that Article 58 TEEC was intended to exclude from freedom of

the Member States provided by DABORMIDA RENATO, 1989, *Le legislazioni cooperative nei paesi della Comunità europea*, in *Rivista del Diritto Commerciale*, 87:451-496. For Italy, see ZOPPINI ANDREA, 2004, *Il nuovo diritto delle società cooperative: un'analisi economica*, in *Rivista di diritto civile*, 50:439-450. From a European perspective I note, that considerandum 7, 8 and 9 of Council Regulation (EC) No 1435/2003 of 22 July 2003 on the Statute for a European Cooperative Society, OJ L 207/1, 18.8.2003, provide some key elements to identify the common characteristics of a cooperative legal body: democratic control (one head one vote) and distribution of profits to the members on an equitable basis. On the other side, considerandum 10 describes the main characteristics of the European cooperative society. In case of winding up, net assets should be distributed not to the members but to another cooperative body. According to HOLGER FLEISCHER, 2010, *Supranational Corporate Forms in the European Union: Prologomena to a Theory on Supranational Forms of Association*, in *Common Market Law Review*, 47:1671-1717, 1677, the statute of the SCE is flexible and can be used also as a non-profit cooperative. On cooperatives in the single market, see also EUROPEAN COMMISSION, 2004, *Communication from the Commission to the Council and the European Parliament, The European Economic and Social Committee and the Committee of Regions on the promotion of co-operative societies in Europe*, COM(2004)18, Brussels, 23.02.2004.

For the description in terms of law and economics of cooperative firms, i.e. customer-owned firms and worker-owned firms, see HANSMANN, *The Ownership*, *supra* 9. In Hansmann's analysis, cooperatives are owned firms because their members enjoy the right to receive the profit (periodically and at liquidation) and the right to control the entity. It seems to me that the European Cooperative Society Statute limits the distribution of assets at liquidation so that the European Cooperative Society, at least as far as the distribution of the residual gain is concerned, seems more like a non-profit entity. The Proposal for a European Regulation on the European Foundation makes the entity a non-profit entity precisely because it limits the profit to be distributed periodically (art. 11, point 2) and at liquidation (art. 44).

³³ For the US, see OLECK, *supra* 9. For a more recent description of the US situation also with respect to tax law, see FISHMAN JAMES J., *Nonprofit organizations in the United States*, in HOPT, VON HIPPEL, *supra* 9, 129-169.

³⁴ Not suprisingly, for legal entities with *but lucratif* (i.e. companies) the term of comparison has always been the US single market.

³⁵ See OLECK, *supra* 9, 34 for foreign associations and 364 for foreign corporations and foundations. I assume that the same is true for foundations where they are organized as a trust or as a corporation.

establishment those entities that do not carry out economic activity for *but lucrative*. This basically means those legal entities that pursue activities other than economic ones, for ideal purposes which were not in the system of the Treaty that established an *economic* Community. In the system of entities of the original Member States there is a presumption that mainly associations and foundations were excluded from freedom of establishment, because they did not (*rectius*, were not supposed to) carry out an economic activity for *but lucratif*. The question is now whether for the purposes of application of Article 54 TFUE the notion of *but lucratif* is (should be) a national one or is (should be) a European one.

It is a well-established principle that the European Court of Justice has developed common European notions in the interpretation of European law. One only has to think of the notion of undertaking for activating European competition law. The similar question becomes whether for the application of Article 54 TFUE in terms of a prohibition of freedom of establishment it is more appropriate to rely on a European notion of *but lucratif* or on a national one. In other words, whether, if confronted with a case, the Court of Justice would rely on a national qualification of the entity for the purposes of Article 54 TFUE or would prefer a European one. As I will explain later on, neither in the case law indirectly related to freedom of establishment for non-profit entities nor in cases of competition law for non-profit, does the Court ask (i) what a non-profit entity is or (ii) whether a possible answer to the question lies in terms of a national or uniform, European notion.

In order to illustrate the possible practical implications of the issue, I will provide some examples. We can imagine a foundation (or an association) that is not permitted to carry out economic activity (however defined) with *but lucratif* (however defined) in the Member State 'A' of formation. Should the same foundation be allowed to carry out economic activity (however defined) with *but lucratif* (however defined) in Member State 'B' (in the form of primary or secondary establishment), with the argument that the hosting Member State allows foundations (or associations) to do so?

A second example brings the issue to an extreme hypothetical case, by considering that Article 49 TFUE and 54 TFUE have the potential for being the legal basis for the complete mobility of legal entities in the single market. The example refers to the possibility of transforming e.g. an association of Member State 'A' which is not permitted to carry out economic activity with *but lucratif* into a company with *but lucratif* in the same Member State 'A'.³⁶ What about a transformation of this association of Member State 'A' into a company for *but lucratif* in Member State 'B' on the basis of freedom of establishment (in this case freedom of movement)?³⁷ One could also think of the opposite case: a company with *but lucratif* is permitted to transform itself in an association

³⁶ E.g. the so-called *trasformazione eterogenea* (from a category without *scopo lucrativo* to a category with *scopo lucrativo* and vice versa) is now permitted in the Italian context.

³⁷ In *Cartesio*, *supra* 1, the Court mentions the possibility of a conversion without qualifying the notion (see para 111-113).

without *but lucratif* in Member State 'A'. Should it be permitted to realise the transformation in association without *but lucratif* in Member State 'B'?

These problems include two dimensions. The first one refers to the European aspect. This deals with the terms of permitting the transformation on the basis of a national or European notion of *but lucratif* (i.e. does the Court activate Article 54 TFUE on the basis of a European or national notion of *but lucratif*?). The second one refers to the legal systems of the two Member States and in particular whether their systems grant this possibility to internal legal entities and should this be (or not) overruled by European law if one of the two discriminates against legal entities of the other Member State.

Even though the principle of uniform European notions for the application of European law is well established, the development of the system of the freedom of establishment in the last decade reveals a national qualification of the notion of *but lucratif* (for-profit/non-for-profit). Indeed, in the case law on freedom of establishment the Court has clearly explained that at the moment companies (legal entities) are creatures of their Member State of formation and respond to their law with respect to their conditions of existence.³⁸ From this perspective, the issue whether an entity is allowed or not to carry out (economic) activity with a *but lucratif* in the Member State of formation or in the Member State(s) of primary or secondary establishment (ex Articles 49 and 54 TFUE) should remain the competence of the Member State of formation. Member States still maintain their more or less consistent system of taxonomies of categories of legal entities, and of different types within these categories. Member States are the actors that, according to the principle of subsidiarity, are best equipped to guarantee consistency in their (complex) legal systems.³⁹

The central argument against the national qualification of the legal entity with respect to the nature of the activity and the nature of the *but*, is that (possibly different) national solutions would jeopardise the consistent application of freedom of establishment in the single market. In this case a European specification of the notion would be preferable.

³⁸ The Court in *Cartesio*, *supra* 1, neglected any significance to the condition of keeping the administrative office in the Member State of formation (registration) stating the neutrality of the Treaty regarding the connecting factors and the symmetry between incorporation theory and real seat theory.

³⁹ On the other hand, I note that the same question whether an entity (e.g. association) can carry out an economic activity is indeed already a problematic issue. If Member State 'A' does not allow an association to carry out economic activity, the association doing it, may be re-qualified in a company. The question arises whether, in a possible European case, the association formed in Member States 'A' is permitted under the freedom of establishment to carry out economic activity in Member State 'B'. Is the definition of economic activity in this case a European one or a national one? Is there space for the principle of non-discrimination to be applied? For the Italian internal case, see CETRA ANTONIO, 1999, *L'associazione non riconosciuta che esercita un'impresa commerciale non è una società di fatto tra gli associati*, in *Giurisprudenza Commerciale*, 26:II/442-448.

4. Economic analysis of law and non-profit entities

The systematic study of non-profit entities in law and economics terms was made in a seminal paper by Henry Hansmann in 1980.⁴⁰ The study, even if primarily based on non-profit corporations, can be extended to other entities (associations and foundations) mainly because its approach is functional, i.e. economic.⁴¹ Indeed, it examines the economic reasons for the existence of non-profit firms in the market, as opposed to the economic reasons that justify the existence of for-profit firms in the same market.⁴² Both kinds of firm respond to particular economic problems and are an efficient answer in terms of their economic characteristics (as regards their nature and structure) to the suppression of the market mechanism. Indeed, as the seminal paper of Ronald Coase has evidenced there is a dyad between the market and the firm given the existence of transaction costs. The market is the realm of the contract as a mechanism for organising transactions, while the firm is an alternative mechanism for organising other types of more complex transactions.⁴³ Also the division between for-profit and non-profit firms arises mainly because of the existence of transaction costs.⁴⁴

⁴⁰ See HANSMANN, *The Role*, *supra* 9, 837. For a survey of the (few) theories of the non-profit firms before the one developed by Hansmann, see HANSMANN HENRY, 1987, *Economic Theories of Nonprofit Organization*, reprinted in STEINBERG RICHARD (edited), 2004, *The Economics of Nonprofit Enterprises*, Elgar, Cheltenham, UK, 3-18. Being unaware of an alternative systematic law and economics theory of non-profit legal entities which also includes the law and economics theory of for-profit entities (as systematized in HANSMANN, *The Ownership*, *supra* 9), I take the theory of Henry Hansmann as “the theory” of non-profit entities. This also because it has been chosen more recently as “the theory” and briefly reproduced in HANSMANN HENRY, *The economics of nonprofit organizations*, in HOPT, VON HIPPEL, *supra* 5.

⁴¹ Another reason is the possible dilution of the categories among legal entities that has characterized the US system (in relation to the law of the legal form but also from tax law, or other kinds of laws) and has led to the widespread use of the corporation as legal entity to pursue “non-profit goals”. On the different forms of non-profit organizations, see OLECK, *supra* 9, 3. Stressing the necessity to approach the issue from a functional perspective for legal comparative purposes (“*rechtswissenschaftliche Frage nach der funktionalen Vergleichbarkeit*”), see VON HIPPEL, *supra* 29, 40.

⁴² Referring to HANSMANN HENRY, *Ownership of the Firm*, in *Journal of Law, Economics, and Organization*, 4:267-304, I prefer to use the term *firm*, which is also the usual one in microeconomics and in the literature of the theory of the firm.

⁴³ See COASE RONALD, 1937, *The Nature of the Firm*, in *Economica*, 16:386-405.

⁴⁴ Later scholarship has pointed out that the same firm is a nexus of contracts, i.e. a focal point, “a galaxy in the universe which is the market”, for organizing more or less complex subsets of contracts (solar systems) in the market. See MICHAEL JENSEN, MACKLING WILLIAM, 1976, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, in *Journal of Financial Economics*, 3:305-360. This article is notably the basis of the economic analysis of the company and of company law, i.e. of the for-profit legal entity and of its legal regulation. See e.g. EASTERBROOK, FISCHER, *supra* 10, and KRAAKMAN *et al.*, *supra* 10, 6.

Another point to be made that is relevant for the development of the discussion is that the economic reasons that justify from an economic perspective the existence of for-profit firms and non-profit firms are essentially economic regardless of tax law reasons.⁴⁵ In other words, from an ideal economic perspective, the organisation of a (series of) transaction(s) with a non-profit firm is already efficient in comparison to the organisation of the same (series of) transaction(s) by way of a for-profit firm, independently of possible tax law measures (subsidies) for the non-profit firm. This means that the justification of the non-profit firm as an efficient competitor of the for-profit firm is ensured without any reference to tax privileges. As a result, these tax exemptions do not explain the core, economic reason for the existence of the non-profit firm.⁴⁶ Nevertheless, jurisdictions do generally provide non-profit firms with some kind of tax exemption as well as tax relief for those who donate resources to non-profit entities.⁴⁷

The proposed definition of a non-profit firm is the one already advanced by traditional legal scholarship. The notion relates to the impossibility for the non-profit firm to distribute net earnings (income that remains after the goods and services to run the firm are paid) to the persons who are in *control* of it (non-distribution constraint).⁴⁸

The categorisation of non-profit firms is based on two major elements.⁴⁹ The first element is the financing (income) for the organisation. Patrons are those who provide the income (i.e. financing) of the non-profit firm. Non-profit firms that derive their income from donations are *donative* non-profit while non-profit firms that derive their financing from the selling of their products/services are *commercial* non-profit.⁵⁰ The second element is the control of the

⁴⁵ On this point see HANSMANN HENRY, 1981, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, in *Yale Law Journal*, 91:54-100. The author limits his analysis, which is accompanied by a formal mathematical model, to income (federal) taxation of incorporated non-profits. In the United States nonprofit organisations benefit from several tax exemptions at state but most importantly at federal level. On this point, see FISHMAN, *supra* 33, 139.

⁴⁶ This point is essential in the discussion on the relative efficiency of the two kinds of firms and has to be stressed. See HANSMANN, *supra* 45, 74.

⁴⁷ Traditional reasons to grant tax exemptions to non-profit entities are summarised by HANSMANN, *supra*, 45, 58. Hansmann provides an alternative explanation to the tax relief on income federal tax based on the difficulty for non-profit entities in the accumulation of capital.

A useful review of the several theories for tax exemptions in case of non-profit legal entities on the basis of the case law of the ECJ is provided by THEODORE GEORGOPOULOS, 2010, *Can Tax Authorities Scrutinize the Ideas of Foreign Charities? The ECJ's Persche Judgment and Lessons from US Tax Law*, in *European Law Journal*, 16:458-476, 460.

⁴⁸ See HANSMANN, *The Role*, *supra* 9, 838. Note that while for-profit firms are characterised by ownership (i.e. the contemporaneous possibility to get profits and control), non-profit firms are by definition not owned because profits are not shared. On this point see HANSMANN, *The Ownership*, *supra* 9, 228.

⁴⁹ See HANSMANN, *The Role*, *supra* 9, 840. I summarize the major results of Hansmann's analysis by strictly adhering to his description.

⁵⁰ See HANSMANN, *The Role*, *supra* 9, 840.

organisation. We can distinguish between mutual non-profit firms that are controlled by their patrons and entrepreneurial non-profit firms that are not.⁵¹

With these two elements and the relative specifications in place, four categories of non-profit firms are possible: (a) donative mutual: where those who finance the firm also control it; (b) donative entrepreneurial: where those who finance the firm do not control it; (c) commercial mutual: where those who finance the firm control it; (d) commercial entrepreneurial: where those who finance the firm do not control it.⁵² These are ideal categories because in the real world mixed types exist.⁵³

The existence of non-profit firms in the market is explained in economic terms as a response to particular market failures which are a specification of transaction costs. As already mentioned, following Coase, transaction costs explain the existence of the for-profit firm as an alternative to the market.

The market failure identified as the one explaining the presence of non-profit firms is the (magnitude of the) “contract failure” in controlling the producers of the services provided.⁵⁴ In other words, given the particular type of services delivered or the particular type of conditions (in terms of public goods, price discrimination, imperfect loan market), the “contract failure” results in the impossibility of monitoring the quality of the services provided.⁵⁵ The non-profit firm becomes a better “fiduciary subject” (as termed by Hansmann) in performing the contractual relationship than the for-profit firm. When contract failures problems are present, the non-profit firm is a probable or possible alternative to the for-profit firm for delivering services.⁵⁶ In the case of donative non-profit firms the magnitude of the contract failure is very high. This is in particular the case with philanthropic or charitable non-profit firms where the donor (the patron who finances the non-profit firm and is the purchaser of the service) buys the service of providing material or financial help to a person or group of persons (the recipient of the service) she possibly does not even know.⁵⁷

The magnitude of contract failure can vary among the four categories of non-profit firms and in the different economic sectors, so that the non-distribution constraint could not be necessarily efficient in comparison to a

⁵¹ See HANSMANN, *The Role*, *supra* 9, 841.

⁵² See HANSMANN, *The Role*, *supra* 9, 842.

⁵³ See HANSMANN, *The Role*, *supra* 9, 841.

⁵⁴ See HANSMANN, *The Role*, *supra* 9, 843, “In sum, I am suggesting that nonprofit enterprise is a reasonable response to a particular kind of “market failure,” specifically the inability to police producers by ordinary contractual devices, which I shall call “contract failure””, 845.

⁵⁵ See HANSMANN, *The Role*, *supra* 9, respectively 845 and 846.

⁵⁶ For the analysis of the single contract failures, see HANSMANN, *The Role*, *supra* 9, from 845.

⁵⁷ See HANSMANN, *The Role*, *supra* 9, 846. For non-profit firms in the case of public goods where the donor is also one of the recipients of the service, see 849, and of price discrimination and imperfection in the loan market where also the donor is one of the recipients, see respectively 854 and 859. Stressing the fact that donative charitable non-profit firms in any case are commercial in the sense that they sell a service, see Hansmann, *The Role*, *supra* 9, 873.

distribution possibility. This is the reason why in some markets the contemporaneous presence of for-profit-firms and non-profit firms is observed. This is among others the case of commercial non-profit-firms active in nursing care or hospital care. In this case the patrons, who finance the non-profit firm buying the complex service, are at the same time also the recipients of the service.⁵⁸ The taxonomy provided and the different contexts in which non-profit-firms may operate illustrates an important point on the nature of the activity that non-profit firms perform. In the perspective of law and economics this activity can be qualified as an economic activity. In other words, this paradigm rejects the supposed distinction between a public benefit purpose of non-profit firms and a private benefit purpose of for-profit firms which finds an echo also in the proposal for a Regulation on a European Foundation (Article 5 on the public benefit activity and Article 11 on limits to the “proper” economic activity).⁵⁹ Indeed, the only difference with usual business activity, organised in the form of for-profit-firms, is that it is carried out by firms with a non-distribution constraint.⁶⁰ This result is important because it does not specify the scope of the entity in terms of type of activity (economic, charitable, philanthropic) or *but* (*lucratif* or ideal) but only on the possibility of the distribution of possible incomes deriving from the activity. This is not surprising because in a law and economics paradigm all elements of the analysis are brought back to their economic dimension, so that the activity becomes (by definition) an economic one.⁶¹ Provided the different utility functions of the different subjects, there is a market where contracts are formed. Where the market fails because transaction costs are too high there are firms: for-profit-firms and non-profit-firms. In such a paradigm there is no space for elements (type of activity and type of *but*) different from economic ones, such as charitable, philanthropic or ideal.⁶²

⁵⁸ See HANSMANN, *The Role*, *supra* 9, from 862, nursing care for elderly people, day care for children, educational institution, hospitals.

⁵⁹ Of course the distinction between public benefit and private benefit is relevant for tax purposes but it does not really qualify in economic terms the nature of the entity and more importantly the reasons for its development in the market as an alternative mechanism to for profit firms for the provisions of economic activity where contract failures are present.

⁶⁰ On the point see HANSMANN, *The Role*, *supra* 9, 880 and HANSMANN, *Reforming*, *supra* 9, 504. Indeed, the central point is that non-profit organizations, like for-profit-firms, have in any case to cover their operating costs (possibly to be borne by their founders) to be able to stay in the market.

⁶¹ In this context it is interesting to note that for the Italian legal system, where the original taxonomy of the categories (associations, foundations and companies) seems to be lost with respect to the type of activity they can carry out, from a legal perspective the only systematic element of certainty for a useful legal distinction is the non-distribution constraint for associations and foundations derived from the definition of company in Article 2247 of the Italian civil code. On the point ZOPPINI, *supra* 28, 367.

⁶² The reconstruction of non-profit firms in economic terms can be of course subject to criticisms because of its extremism. One could argue that an element of ideology or psychological motivation other than the economic one makes non-profit firms possible. For a review of the literature, see ROSE-ACKERMAN SUSAN, 1996, *Altruism, Nonprofits, and Economic Theory*, in *Journal of Economic Literature*, 34:701-728. For a contribution stressing the motivation factor of workers as key factor of the non-profit incentive structure, see

Finally, the law and economics of the regulation of non-profit entities, and in particular of non-profit corporations, has pointed out the necessity to regulate non-profit corporations in a functional way. This means by clearly stating the non-distribution constraint and by enforcing it.⁶³

5. The case law of the ECJ

In this section, I analyse the case law of the ECJ on non-profit entities with respect to competition law (Section 5.1) and tax law (Section 5.2). In Section 5.3, I focus on freedom of establishment of non-profit entities considering the few cases which have indirectly dealt with it.

In this section my intention is to argue and to show that non-profit entities are subject to several areas of European law different from freedom of establishment and at the same time that the Court did not really provide an answer to the question of what a non-profit entity is, or an answer to whether the qualification should be a European one or a national one.

5.1. Non-profit entities and competition law

In some cases the ECJ has argued that non-profit entities can be subject to European competition law (meaning also state aid law).⁶⁴ I just concentrate on a recent decision focusing on the notion of undertaking and on the notion of economic activity.⁶⁵ This is the *MOTOE* case.⁶⁶ In this judgment the Court decided that a Greek non-profit association (ELPA) carrying out an economic activity which consists in organising and marketing motorcycling

FRANCOIS PATRICK, 2003, *Not-For-Profit Provision of Public Services*, in *Economic Journal*, 113:53-61.

⁶³ See HANSMANN, *Reforming*, *supra*, 9, and on the non-distribution constraint 553.

⁶⁴ See e.g. Case C-222/04, *Ministero dell'Economia e delle Finanze v Cassa di Risparmio di Firenze Spa, Fondazione Cassa di Risparmio di San Miniato, Cassa di Risparmio di San Miniato Spa*, 10 January 2006. For a (comparative with the US) analysis of non-profit and competition law, see CICORIA CRISTIANA, 2006, *European Competition Law and Nonprofit Organizations: A Law and Economics Analysis*, in *Global Jurist Topics*, 6:1-54. For the US case presenting some models, see also PHILIPSON TOMAS J., POSNER RICHARD A., 2009, *Antitrust in the Not-for-Profit Sector*, in *Journal of Law and Economics*, 52:1-18; PRÜFER JENS, 2010, *Competition and Mergers Among Nonprofits*, in *Journal of Competition Law & Economics*, 7:69-92.

⁶⁵ I will not cover here the entire complexity of the notion of undertaking and of economic activity being this outside of the limited scope of this analysis. On the two points, actually doubting the consistency of the development of the two notions with respect to the notion of public activity and activity under solidarity constraint, see most recently NIAMH DUNNE, 2010, *Knowing when to see it: state activities, economic activities, and the concept of undertaking*, in *Columbia Journal of European Law*, 16:427-463. On the notion of undertaking, see also KORAH VALENTINE, 2006, *Advocate General Jacobs' Contribution to Competition Law*, in *Fordham International Law Journal*, 29:716-746.

⁶⁶ Case C-49/07, *Motosykletistiki Omospondia Ellados NPID (MOTOE) v Elliniko Dimosio*, 1 July 2008.

sports events is an undertaking and for this reason is subject to European competition law.⁶⁷ The Court specifies that the form of the entity and the way it is financed is irrelevant for the purpose of European competition law: once economic activity is pursued the entity becomes an undertaking.⁶⁸ The notion of economic activity concerns the offering of goods or services on a given market.⁶⁹ Two points are worth considering.

The first point is that the Court does not scrutinise the nature of the Greek non-profit-making entity. It simply takes the issue as solved by Greek law. Both MOTOE and ELPA are non-profit Greek associations.⁷⁰ The nature of what is meant to be a non-profit-making legal body according to Greek law is not really specified.⁷¹ Referring just to Greek private law (i.e. omitting complications from Greek tax law) it should be asked whether (i) the entity can carry out economic activity (as defined according to Greek law for the purposes of the definition of the entity in the national taxonomy of legal entities), (ii) make a profit and (iii) distribute it to the members.⁷²

The second point refers to the notion of economic activity. Possibly, there may be a different notion of economic activity in Greek law and in European competition law. The Greek internal notion could be instrumental for the definition of the several types of legal entities and for deciding what kind of activities and for what *but* they are allowed to operate in Greece (point (ii)). This point refers to the problem of what an entity can do or cannot do inside its legal order of formation for the purpose of the consistency of the taxonomy of legal entities.⁷³

Leaving aside this national issue, it is worth specifying the notion of economic activity for the purposes of European competition law. The notion of economic activity carried out by an undertaking (non-profit firm or for-profit firm) is defined as the offering of goods or services on a given market.⁷⁴ This concept has been developed and specified in several decisions without being

⁶⁷ To be sure, the importance of the case is relevant also due to the fact that ELPA is a (private) legal body that exercise public powers and at the same time exercises economic activity as undertaking, being for this reason subject to European competition law. On this aspect, see DUNNE, *supra* 65, 450.

⁶⁸ Para 21. See also *Cassa di Risparmio di Firenze*, *supra* 64, para 107 and 108.

⁶⁹ Para 22.

⁷⁰ See para 4 and 6 of the decision and para 11 and 13 of the opinion of the AG. In para 37 and 41 the AG states that ELPA “operates without seeking to make a profit”. It is not clear whether the legal body is permitted (by its legal system of formation) to make a profit or does not intentionally pursue to make a profit or to distribute a possible profit.

⁷¹ Again, the AG refers to ELPA as a non-profit-making association that “operates without seeking to make a profit”, see para 37 and 41.

⁷² Being unable to answer these questions, I simply refer to the document of the EUROPEAN COMMISSION, *supra* 5, 44, which in fact actually only partially answers them.

⁷³ In this specific case, apparently the referring Greek court specified that ELPA did enter into sponsorship, advertising and insurance contracts, carrying out an economic activity also for the purposes of Greek law. See para 16.

⁷⁴ Para 22 of the Court decision.

actually clearly defined.⁷⁵ With respect to non-profit firms, the test that has been used for defining the economic nature of the activity refers to the possibility that the activity could be carried out also by for-profit entities.⁷⁶ This comparability test ends up in a competition test between non-profit and for-profit entities for the definition of the notion of economic activity. It has actually been extended in MOTOE. Indeed, the AG refers to the possibility that non-profit entities may be in competition with for-profit entities but also that they could be in competition among themselves (para 41). This argument was accepted by the Court (para 28).⁷⁷

From a law and economics perspective (and also from a competition law perspective) a justification of the presence of ELPA as a non-profit entity (non-distribution constraint) in efficiency terms in this particular market can be argued in terms of market failures (contract failures) that justify the relative efficiency of the non-profit firm in comparison to the for-profit firm. Two points can be made. A first point is that it is unlikely that the kind of activity justifies its monopolistic supply. In other words, with the presence of the contract failure there could be space for other non-profit firms operating on the market. The second point is that apparently ELPA is selling services in a market where the market failures that justify the efficiency of the non-profit firm are not so intensive, so that possibly there is space for the same (economic) activity to be carried out by for-profit entities. It is the same market that has to discover the final equilibrium in this kind of industry. In other words, it is hardly possible to specify *ex ante* the more efficient kind of firm or the number and type of suppliers.

⁷⁵ For an elaboration of the concept of economic activity, see DUNNE, *supra* 65, 434.

⁷⁶ On this point see DUNNE, *supra* 65, 436, referring to the opinion of the AG in *Albany* (Case C-67/96, *Albany International BV and Stichting Bedrijfspensioenfonds Textielindustrie*, 21 September 1999) (para 311) and to the opinion of the AG in *Federacion Espanola de Empresas de Tecnología Sanitaria* (Case C-205/03, *Federación Española de Empresas de Tecnología Sanitaria (FENIN) v Commission of the European Communities*, 11 July 2006) (para 28). In *MOTOE*, *supra* 66, see para 27.

⁷⁷ It is worth trying to describe the decision according to the law and economics of non-profit entities. I specify that my classification has an indicative character. The working hypothesis is that the two entities can produce a profit but are non-profit entities because of the non-distribution constraint. Given the taxonomy of non-profit entities based on the financing by some patrons (customers and donors) and possible control by the patrons, it seems that ELPA for its way of financing is a commercial non-profit. I presume that ESPA receives also donations and is ultimately controlled by its members. Indeed, several customers (patrons) buy its services. ELPA is the Greek automobile and touring club, a non-profit making association (para 11 AG opinion). It sells various kinds of things to different customers: it sells services that are bought by those who participate in the events or by their clubs, it sells services to sponsors as well as tickets and televisions broadcasting rights (para 34 AG opinion). For the way it is controlled, it is not completely clear whether ELPA is a mutual commercial non-profit or, as apparently seems more probable, an entrepreneurial non-profit so that as an overall result ELPA can be qualified as a commercial entrepreneurial non-profit. It is not clear whether the customers of ELPA control the legal entity (mutual commercial non-profit: the patrons who finance it also control it, is the case of the American Automobile Association according to HANSMANN, *The Role*, *supra* 9, 842).

5.2. Non-profit entities and tax law

In the field of tax law the jurisprudence of the ECJ related to non-profit entities is substantial. I just concentrate on some decisions with respect to the non-profit entity as tax payer in the case of VAT and with respect to the non-profit entity as a recipient as well as the position of the donor.

The case *Kennemer Golf & Country Club*⁷⁸ illustrates the notion of non-profit entity for the purposes of the application of the Sixth Directive on VAT.⁷⁹ Kennemer Golf used to provide services to its members on the basis of different kinds of fees as well as to external customers. Among other issues, the case concerned the question of whether the tax exemption covered only the profits deriving from the services provided to members (covered by the provisions) or also to non members. The Court provided some interesting points for a definition of the notion of non-profit entity for the purposes of the Sixth Directive. The Court pointed out the importance of considering the aim (purpose) of the entity, i.e the fact that the entity does not have the aim of achieving profits for its members.⁸⁰ While commercial undertakings have the aim of pursuing profits for their members, non-profit-making do not. The analysis is also based on a linguistic comparison among the different versions of the provision (para 26).⁸¹ The Court then specified that it is the task of the competent national authorities to verify whether the entity is a non-profit one according to the circumstances of the single case (para 27). At the same time the Court provided a binding (European) element national authorities have to consider. The non-profit making entity is such as long as profits are not distributed to its members as profits but are instead used to provide services (para 28 and 33, profits as financial advantages for the organisation members).

This decision is important because even if the notion of non-profit entity which is provided is limited to the application of the relevant provisions of the Sixth Directive, at the same time it reflects the law and economics notion of non-profit entity. In this framework national authorities are free to decide according to the nature, the object, the aim (purpose, *but*) and the elements of the single case whether the legal entity is a non-profit-making one. At the same time, the European uniform framework requires that the entity does not distribute profits (which can be occasional, habitual or even systematic). The

⁷⁸ Case C-174/00, *Kennemer Golf & Country Club and Staatssecretaris van Financiën*, 21 March 2002.

⁷⁹ Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment, OJ L 145/1, 13.6.1977.

⁸⁰ Para 25 is interesting because it shows that opinions on the issues were based on the aim of the entity. While according to some the issue was “whether the organization ... aims to make a profit and not the fact that it actually makes a profit, even if it does so habitually” according to others, exemption was impossible “when profits are made systematically” but only “where surpluses are achieved occasionally or merely incidentally”.

⁸¹ In this respect, I note that while Article 54 speaks of *but lucrativ, scopo lucrativo, Erwerbszweck* and non-profit-making, the directive at Article 13(1)(m) speaks of *sans but lucrativ, senza scopo di lucro, ohne Gewinnstreben* and non-profit-making.

non-distribution constraint requires profits not to be distributed to members in whatever kind (financial advantages and benefices, para 33) but instead to be invested in the provisions of the services. Functionally, and by way of analogy the non distribution constraint can be extensively interpreted as also including the liquidation and dissolution of the entity. I will argue later on, that this definition of non-profit entity can be used also for the purposes of Article 54 TFUE.⁸²

The *Stauffer* judgment has become the point of reference as a case concerning the tax privileges of non-profit entities.⁸³ German tax authorities refused to grant a tax exemption on income deriving from a contract of letting to an Italian foundation which owned a building in Munich. The Court did not solve the case in terms of freedom of establishment. This point is interesting because the German referring Court argued that the tax privileges were not doubtful had *Stauffer* established itself in Germany (para 57). This argument is in apparent contrast to Article 54 TFUE where it is literally excluded that non-profit entities enjoy under EU law the freedom of establishment both in terms of primary establishment and secondary establishment.⁸⁴ Nor did the Court solve the case in terms of freedom to provide services. The case was solved in terms of freedom of movement of capital with some implications in the area of tax law privileges. This, on the premise that Member States tax law competence cannot be exercised as to limit the scope and effect of Community law.

What is relevant for this article is that, as in *MOTOE*, the Court did not really question the nature of the non-profit legal entity. The Court considers the issue as solved by the Italian legal system. From an Italian perspective, the foundation can be considered a non-profit entity because (like associations) foundations in Italy can pursue economic activity (*attività imprenditoriale* ex art. 2082 *codice civile*) and can also have profits: the core of being non-profit is that they are subject to the non-distribution constraint (both in terms of periodical distributions and final distribution by liquidation and dissolution).⁸⁵ Certainly, since this case concerned tax privileges for legal entities that pursue

⁸² The recent decision of 8 September 2011 on Cases C-78/08 to C-80/08 (*Ministero dell'Economia e delle Finanze, Agenzia delle Entrate v Paint Graphs Soc. Coop. arl; Adige Carni Soc. Coop. arl v Agenzia delle Entrate, Ministero dell'Economia e delle Finanze; Ministero delle Finanze v Michele Franchetto*) refers to state aids granted to Italian cooperatives in form of tax privileges. The case is interesting because the Court describes the main characteristics of cooperatives companies as opposed to normal companies (points 55 to 62) and delegates the national court to verify whether the entities can enjoy state aids by way of tax privileges as opposed to for-profit companies.

⁸³ Case C-386/04, *Centro di Musicologia Walter Stauffer v Finanzamt München für Körperschaften*, 14 September 2006.

⁸⁴ See also para 6 of the opinion of the AG where it is specified that the foundation does not have a registered branch in Germany nor operates through a German subsidiary. As far as the prohibition of Article 54 TFUE, as European law is concerned the statement could refer to a bilateral agreement between Germany and Italy for the purpose of recognition and freedom of establishment of foundations.

⁸⁵ As I have mentioned *supra* 28, legal doctrine has debated the possibility for foundations and associations to carry on an economic activity (*attività d'impresa* ex art. 2082 *codice civile*) and to destine possible profits. See ZOPPINI, *supra*, 28.

some specified objects, the Court considered the issue of the comparability of the charity character of this entity with a similar German entity (para 39 and 40).⁸⁶ The Court delegated this task to the national authorities. Once similarity in the charity purpose is established, the fact that the Italian foundation was granting financial assistance (only) to Swiss people for residing in Italy, was not considered to be a reason for denying tax privileges.⁸⁷ The third case, *Persche*, relates to the position of the donor of a non-profit entity.⁸⁸ In this case a German citizen donated some movable goods to a Portuguese non-profit entity and asked for tax deduction in Germany. The Court treated the case in terms of freedom of movement of capital and decided that the refusal of German tax authorities to grant the tax deduction was contrary to European Law. Leaving apart the tax issues of the case, from a national and European perspective,⁸⁹ what is interesting for the purposes of this article, is again the fact that the Court did not really scrutinise the nature of the recipient Portuguese non-profit entity in terms of the (private) law governing the entity.⁹⁰ In other words, it did not ask what is meant to be a non-profit entity according to Portuguese (private) law. In terms of tax policy the issue is the verification of

⁸⁶ According to the taxonomy of legal entities proposed in Section 3, the Stauffer foundation should be a donative entrepreneurial non-profit (provided the nondistribution constraint deriving from Italian law). The resources of the foundation are originally provided by a donor (the patron who finance the legal entity) with the aim of providing financial assistance for musical education to Swiss people in Italy.

⁸⁷ For a more complete analysis of *Stauffer* from a tax law perspective, see BECKER FLORIAN, 2007, Case C-386/04, *Centro di Musicologia Walter Stauffer v. Finanzamt München für Körperschaften*, *Judgment of the Court (Third Chamber) of 14 September 2006*, in *Common Market Law Review*, 44:803-816. See also HELIOS MARCUS, 2007, *Taxation of non-profit organizations and EC law*, in *EC Tax Review*, 65-73; EICKER KLAUS, 2005, *Do the basic freedoms of the EC Treaty also require an amendments to the national tax laws on charities and non-profit organizations?*, in *EC Tax Law*, 140-144.

⁸⁸ Case C-318/07, *Hein Persche v Finanzamt Lüdenscheid*, 27 January 2009. Also the case *Hebert Schwartz* (Case C-76/05, *Herbert Schwarz Marga Gootjes-Schwarz v Finanzamt Bergisch Gladbach*, 11 September 2007) regarding the issue of tax deduction is interesting. The case concerned a German couple who asked for income tax deduction in Germany for the fees paid to a Scottish school attended by two daughters. Even though it is not completely clear whether the Scottish school operates for-profit or not (see para 36 of the AG opinion) it is nevertheless interesting that the European Court of Justice decided that the impediment of tax deduction was against Community law on the basis of the freedom to choose educational services (freedom to provide services). Since education and schooling are typical sectors of activity for non-profit entities, it is clear that in a hypothetical case a non-profit entity could not be discriminated (like a non-profit one) in terms of attractiveness of the services provided because of an impossibility of tax deduction. Furthermore, in this case it seems, that the non-profit character would be a condition for the German educational entity to permit tax deduction (para 47 of the AG opinion, schools which do not operate commercially).

⁸⁹ On which see GEOGOPOULOS, *supra* 47. See also VON HIPPEL THOMAS, *Tax benefits for foreign-based charities: key challenges of the non-discrimination rule of the European Court of Justice*, in *ERA Forum Academy of European Law*, 10:281-294.

⁹⁰ Without entering the issue from a legal perspective, from para 17 one could understand that the entity is a charitable non-profit. It is not clear whether it can have profits and/or share them.

the charitable nature of the entity and its comparability with a German entity. This task is delegated to the German authorities (para 63).

5.3. Non-profit entities and freedom of establishment

Besides competition law and tax law,⁹¹ there have been several other cases related to non-profit entities active in the single market. These include decisions on public procurement law,⁹² and on employment law,⁹³ as well as other cases.⁹⁴ This is of course not a surprise as non-profit entities are indeed an important part of the economic landscape of the Member States. Furthermore, as a consequence of their activities, their relationships concern (potentially) the entire single market and the different fields of its regulation by European law. My impression is that the Court has always relied on the national, internal notion of non-profit entity. The Court has not specified in its case law whether a European notion of non-profit entity was required or has to be preferred. This has been done, as in the VAT case of the Sixth Directive, only to the extent that the European provision included a European definition of non-profit-making entity, to be uniformly interpreted for its correct application.

Non-profit entities are explicitly excluded from freedom of establishment by Article 54 TFUE. It is worth stressing that Article 49 TFUE provides for both primary and secondary freedom of establishment. For individuals the difference is in the magnitude of the establishment: exclusive, in the case of primary establishment while ancillary, in the case of secondary establishment.⁹⁵ For companies (for profit entities) the situation is not completely clear. It is possible to incorporate a company in for instance the United Kingdom as mail-box company and to exercise the entire business activity in, say, Italy. It is not clear whether this is primary or secondary establishment and whether a branch has to be registered in Italy according to the eleventh directive.⁹⁶

⁹¹ See also Case C-25/10, *Missionswerk Werner Heukelbach ev v État belge*, 10 February 2011; Case C-246/04, *Turn- und Sportunion Waldburg v Finanzlandesdirektion für Oberösterreich*, 12 January 2006.

⁹² Case C-305/08, *Consorzio Nazionale per le Scienze del Mare (CoNISMa) v Regione Marche*, 23 December 2009; Causa C-119/06, *Commissione delle Comunità europee contro Repubblica italiana*, 29 November 2007.

⁹³ Case C-32/02, *Commission of the European Communities v Italian Republic*, 16 October 2003; Case 196/87, *Udo Steymann and Staatsecretaris van Justice*, 5 October 1988;

⁹⁴ On trade mark law, see Case C-442/07, *Verein Radetzky-Orden v Bundesvereinigung Kameradschaft 'Feldmarschall Radetzky'*, 9 December 2008; on non-profit and gambling activity, see Joined Cases C-447/08 and C-448/08, *Otto Sjöberg (C-447/08) Anders Gerdin (C-448/08)*, 8 July 2010.

⁹⁵ See e.g. LOMBARDO STEFANO, 2005, *Libertà di stabilimento e mobilità delle società in Europa*, in *La nuova giurisprudenza civile commentata*, 21:353-379, 354.

⁹⁶ Indeed, sine the eleventh directive (Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in Member States by certain types of company governed by the law of another State, OJ L 395/36, 30.12.1989) explicitly refers the branch as a form of secondary establishment (Article

I was not able to find a case that directly touches the issue of the exclusion of non-profit entities from freedom of establishment. It is nevertheless interesting to analyse the only case which touches indirectly freedom of establishment. I refer to the *Sodemare* decision.⁹⁷

According to Italian national and local regulation, public reimbursements for special health care services associated to the assistance of elderly people were reserved to non-profit entities that host such people. Sodemare (a Luxemburg company) and its Italian affiliates (operating in Italy on the basis of secondary freedom of establishment as subsidiaries) entered the Italian nursing market but the Italian public authorities refused reimbursement, questioning the for-profit nature of the companies. Apart from the dimension of the organisation of the national welfare system, the case is interesting for two reasons.⁹⁸

The first reason is that the question of what is a non-profit entity is left to the national (Italian) legal system to decide. Apparently, the question of what is a non-profit legal entity in this specific case involved a national dimension (provided by the *codice civile* defining the entity) and a local dimension (the law of the *Regione Lombardia*).⁹⁹

49 TFEU); it is not clear whether a company (as in *Überseering*, *supra* 1,) could be forced to register a branch if it argues that it is exercising its right to primary establishment in Germany. Elsewhere, I have argued that the ECJ should analogously apply the obligation to register a branch also in the case of a mail-box company, see LOMBARDO, *supra* 95, 368 and 370.

⁹⁷ Case C-70/95, *Sodemare SA, Anni Azzurri Holding Spa, Anni Azzurri Rezzato Srl and Regione Lombardia*, 17 June 1997.

⁹⁸ A useful contribution is HANCHER LEIGH, SAUTER WOLF, 2010, *One Step Beyond?: from Sodemare to Docmorris: The EU's Freedom of Establishment Case Law Concerning Healthcare*, in *Common Market Law Review*, 47:117-146. For the case law on the health care system of the Member States and its correlation with free movement and competition law, see also VAN DE GRONDEN JOHAN W., 2006, *Cross-Border Health Care in the EU and the Organization of the National Health Care Systems of the Member States: The Dynamics Resulting from the European Court of Justice's Decisions on Free Movement and Competition Law*, in *Wisconsin International Law Journal*, 26:705-760.

⁹⁹ According to para 6 of the opinion of the AG, the law of *Regione Lombardia* of 1980 referred to private associations, foundations and institutions (possibly of religious character) that according to letter a) are non-profit as defined by the PSA (*Piano regionale socio-assistenziale*, in footnote 9) as “those which, according to their statutes, do not have objectives of an economic character or do not distribute their profits among their shareholders or members”. Provided that the legal entities (foundations, associations, committees and companies) are defined in the Italian *codice civile*, I note that there is a notion of the non-profit legal entity provided by the *codice civile* and a notion of non-profit provided by the PSA. Since according to the *codice civile* foundations and associations can carry on an economic activity and make a profit (*lucro oggettivo*), their characteristic as non-profit entities being only the non-distribution constraint (limitation of *lucro soggettivo*, see ZOPPINI, *supra* 28), the reference to institutions and shareholders may refer to companies which, contrary to the rule of art. 2247 *codice civile*, which defines the notion of company (including both *lucro soggettivo* and *oggettivo*), do not distribute profits (again limitation of the *lucro soggettivo*) and maybe also to cooperatives (whose nature was and is more debated, see ZOPPINI, *supra* 32). On the nature of being non-profit in this case, see para 38 of the opinion of the AG. See also para 31 of the Court decision, where the characteristic of being a non-profit entity is described (following the suggestion of the Italian government) as choices

The second reason why the case is interesting is based on what the Court would have decided in a hypothetical situation involving freedom of establishment not of a for-profit entity but of a non-profit one. We can imagine for example an English non-profit entity, establishing itself in Italy on the basis of primary establishment (a kind of mailbox company, like in *Centros*) or secondary establishment (principal activity in the United Kingdom and secondary activity also in Italy by way of a branch or of a subsidiary). From the perspective of the Italian legal system the coherence of the social dimension of the welfare system would have probably been respected by an English non-profit entity entering the Italian market. From the perspective of the European legal system, according to the principle of non discrimination, the English non-profit could not have been discriminated in favour of Italian non-profit entities. The problem is that non-profit entities do not enjoy freedom of establishment according to the literal wording of article 54 TFEU.¹⁰⁰ As a consequence freedom of establishment (primary and secondary) for non-profit entities is not a European “constitutional” right. In the specific case (i.e. involving Italy) there is apparently the possibility to form an Italian non-profit entity in Italy, but if the real seat or the main object of the (foreign) entity are in Italy, Italian legislation applies.¹⁰¹ This would of course not be the case in a *Centros* or *Inspire Art* mailbox company situation involving a for-profit entity.¹⁰² In this case, European principles on freedom of establishment would prevent Italian legislation applying to the “foreign” company.

“made in terms of organization and provision of assistance by non-profit-making private operators are not influenced by the need to derive profit from the provision of services so as to enable them to pursue social aims as a matter of priority”. This description seems to resemble the notion of *but lucratif* or *not lucratif* but is not clear enough in terms of *lucro oggettivo* (possibility to have a profit) and *lucro soggettivo* (possibility to share the profit).

In relation to the coherence of the welfare system issue, I simply note that the element provided by the PSA of not having an objective of an economic character, which is probably to be understood not as objective but as *scopo/but*, is interesting in this particular industry because the care of the elderly is a typical economic activity where competition between non-profit entities and for profit-entities is indeed present and where the relative efficiency of the two types has to be evaluated in relation to the question of the more efficient provider on the basis of the “contract failure” dimension.

¹⁰⁰ This is recognized also by AG in para 21, where he argues that the national treatment of non-profit entities (a category which is excluded from freedom of establishment) cannot limit the scope of the freedom of establishment of for-profit entities. See also para 25 of the Court decision.

¹⁰¹ See Article 25 of Legge 31 maggio 1995, n. 218 *Riforma del sistema italiano di diritto internazionale privato*. A short reference to the establishment of foreign non-profit is provided in footnote 57 of the opinion of the AG.

¹⁰² Given the diffusion of cooperatives in Italy and the possible inclusion in the eligible entities for reimbursement according to the law of *Regione Lombardia*, we could ask whether a cooperative (which enjoys, without actually being defined for the purposes of the application of the Article, freedom of establishment ex Article 54 TFEU) might have been excluded from the reimbursement. The answer is probably no.

6. Some law and economics considerations on freedom of establishment and non-profit legal entities in the single market

The discussion of the ECJ case law on non-profit entities in relation to several fields of European law has shown that non-profit entities are treated as “active and proud consumers” of European law. As for-profit entities they enjoy the different kinds of rights deriving from European primary and secondary legislation because they are an essential part of the *economic* landscape of the single market. Non-profit entities are subject to competition law and enjoy freedom of capital movement and tax exemptions. I stress again the point that the Court normally takes the notion of what is a non-profit entity from the national legal system. It does not really develop a European notion of non-profit entity (apart from the case of VAT law).¹⁰³

In Section 6.1, I argue that for the purposes of Article 54 TFUE a European notion of non-profit making entity can be developed and is to be preferred to domestic notions. I argue that the notion should be based on the law and economics analysis of the structure of the different types of firms. In section 6.2, taking a normative and policy oriented perspective, I argue that the literal wording of Article 54 TFUE limiting freedom of establishment only to for-profit entities should be overcome by a systematic analysis of the position reached by non-profit entities in the ECJ case law and the development of the single market. In Section 6.3, I try to establish a comparison between the regulatory competition debate in case of company law and a possible regulatory competition regime for the laws of non-profit entities.

6.1. A European notion of *but lucratif* based on law and economics

I asked in Section 2.1 whether for the purposes of Article 54 TFUE it is better to have a system based on national notions of non-profit entity or a uniform, European one. The advantage of having national notions is that this would ensure the coherence of the single national taxonomy of legal entities in relation to the type of activity and of *but*. This is true both for private law purposes defining the entity with respect to its legal character and for other sources of law, *in primis* tax law. Furthermore, this solution seems more coherent with the case law of the ECJ, which refers to companies as “creatures” of their Member States of formation. The disadvantage of having national definitions of non-profit entity for the application of Article 54 TFUE is that potentially there is space for different definitions, so that the uniform application of Article 54 TFUE would be jeopardized. On the other hand, it is an established principle of European law that national legislation cannot be in contrast with European law (primary and secondary).¹⁰⁴ This means that

¹⁰³ On the contrary, it seems that the Court described the main characteristics of a cooperative in European terms in points 55-62 of the cases C-78/08 to C80/08, *supra* 84, on the basis of the European Cooperative Society Statute.

¹⁰⁴ See e.g. with reference to tax law para 44 of the opinion of the AG in *Persche*, *supra* 88.

national notions of legal institutions have to be coherent with the proper functioning of the single market.

I suggest that for the purposes of the application of Article 54 TFUE the ECJ should rely on a notion of non-profit based on a law and economics analysis of non-profit v. for-profit firms and ultimately on a law and economics notion of non-profit entity. This notion should define the entity from a private law perspective (meaning legal nature) and not from a tax law perspective. A non-profit entity for the purposes of Article 54 is a legal entity where (possible) profits (possible net earnings) are not distributed to the members of the entity or to those who control it. The non-distribution constraint relates to periodical distribution and to the final distribution in case of winding up and dissolution of the entity. Indeed, all possible profits are accumulated and diverted to a similar entity or to the State in case of dissolution.¹⁰⁵

This European, uniform notion of legal entity is justified on several grounds. First, it is already a common notion from a legal perspective in several Member States. As in the case of the United States, where the non-distribution constraint stems from corporate law (meaning the private law that shapes the nature of the entity, corporation, association, trust), the non-distribution constraint is the characteristic that in (some) Member States qualifies non-profit as opposed to for-profit entities. Second, this notion is already present in European law via European tax law. Even though the notion of the Sixth Directive was elaborated for tax purposes for the scope of the directive, at the same time it encompass, similarly to the US case, a non-distribution constraint accompanied by the specification of the activity exempted (charitable, philanthropic, scientific, etc). Third, the European, uniform notion empowers the Court with a simple test to verify the nature according to the law and the bylaws regulating the entity. Finally, the Regulation for a European Foundation Statute incorporates the nondistribution constraint as factor that qualifies from a private law perspective the nature of the legal body.¹⁰⁶

6.2. Is the exclusion of non-profit entities from freedom of establishment still systematically tenable?

I maintained in Section 5 that non-profit-making entities are “proud subject(s)” and “obedient servant(s)” of several areas of European law. In Section 6.1, I argued for a uniform European notion of non-profit entity for the purpose of Article 54 TFUE.

The next step is to ask whether the exclusion from freedom of establishment for non-profit entities (mainly associations and foundations from

¹⁰⁵ The European, uniform notion of non-profit-making entity for the purpose of Article 54 TFUE could also be used to specify its nature *vis à vis* the nature of the cooperative entity also mentioned by the same Article. As explained *supra* 32, the cooperative as a legal type from a law and economics perspective permits distribution of profits to its members on an ongoing basis as well as at dissolution. For a comparative perspective with the US systems see HANSMANN, *Reforming*, *supra* 9, 592.

¹⁰⁶ See Art. 11 and 44 of the proposal.

a civil law perspective of the original six Member States) as originally provided by Article 58 TEEC is nowadays still systematically justified. Article 62 TFEU extends the scope of application of Article 54 TFEU also to Chapter 3 related to services. It follows that non-profit entities are also excluded from the freedom of providing services.¹⁰⁷ These, as explained in Section 2, are considered to be of residual nature in the system of the four freedoms (and particularly *vis a vis* freedom of establishment which encompass permanent and stable presence in the hosting Member State).

Nevertheless, even given the literal wording of Article 54 TFEU, some scholars have already argued that non-profit-making entities should be granted freedom of establishment if they carry on economic activity. The Court could apply a functional approach as the one adopted in competition law.¹⁰⁸

The explicit exclusion of non-profit entities (mainly foundations and associations) from two significant freedoms of the European economic system, was decided in a time (almost 60 years ago) when such institutions operated on a local and national dimension. Their activity was considered to be of charitable, philanthropic, scientific, educational character. This means of a nature and a purpose which was considered to be different from the commercial, economic character that qualifies for-profit entities. This doctrinal approach still persists in the public benefit character of the Regulation for a European Foundation.¹⁰⁹

The law and economics dimension of the non-profit element and the consideration that non-profit firms are (more) efficient organisers of some *economic* transactions in comparison to for-profit firms, was not considered by legal doctrine and by the European legislator. The law and economics analysis of non-profit firms bring back their operations to the realm of economic activity.

From the perspective of the application of Articles 49 and 54 TFEU to non-profit entities, it is worth analysing an ECJ decision of 1999.¹¹⁰ This decision, in my opinion, is extremely interesting because it focuses on freedom of establishment in relation to two Belgian laws on associations that provided for limitations based on nationality to their membership and administration. The Court argued that the Belgian law in question was against Article 6 TEEC (Article 12 TEC and Article 18 TFEU). The Court speaks about fundamental freedoms (i.e. plural) without explicit reference to freedom of establishment (para 12). This means that individuals of all the Member States are free to

¹⁰⁷ Article 62 TFEU prohibits non-profit firms to provide services. For the parallelism between Article 62 TFEU and Article 54 TFEU, see MÜLLER-GRAFF PETER-CHRISTIAN, 2003, Art. 55 EGV, in STREINZ RUDOLF, OHLER CHRISTOPH, *Vertrag über die Europäische Union und Vertrag zur Gründung der Europäischen Gemeinschaft*, Beck, München, 747.

¹⁰⁸ See BECKER, *supra* 87, 810; apparently also HELIOS, *supra* 87, 67; and EICKER, *supra* 87, 143.

¹⁰⁹ Article 5 enumerates the public benefit purposes of the European Foundation. This is also relevant for tax purposes.

¹¹⁰ Case C-172/98, *Commission of the European Communities v Kingdom of Belgium*, 29 June 1999.

form and join a Belgian association which is (apparently) a non-profit entity.¹¹¹ The explicit reference to freedom of establishment is made by the AG (para 11 and 12). The opinion of the AG is interesting not only because it explicitly refers to freedom of establishment but also because it provides a national definition of being non-profit,¹¹² as well as a notion of non-profit relevant for the purpose of Article 54 TFUE (former Article 52 TEC).¹¹³

By trying to reconstruct the system between the Court decision and the opinion of the AG, it seems that individuals have the right to join and also to form a Belgian non-profit association on the basis of Article 18 TFUE and article 49 TFUE. However, Article 49 TFUE for individuals literally speaks of activities as self-employed persons and the setting up and managing of for-profit entities (in conjunction with Article 54 TFUE). My argument is that, apparently, it is already possible for individuals to enjoy freedom of establishment in forming non-profit entities. Since freedom of establishment for legal entities mirrors freedom of establishment for individuals, what is possible for individuals should also be possible for legal entities. A point made by the AG (see para 12) and developed by the Court in several decisions helps, in my opinion, to grant freedom of establishment also to non-profit firms (defined for the purpose of Article 54 TFUE in terms of the L&E nondistribution constraint). The point is that the activity is economic in nature and can be pursued both for-profit and not-for-profit (nondistribution constraint). When economic activity is pursued, freedom of establishment should be granted also for non-profit entities.

The notion of economic activity has to be understood very broadly to include all non-profit entities. While the intuition of the idea is simple for “proper” commercial non-profit entities, the idea covers indeed also pure charitable non-profit entities and entities included in the enumeration of Article 5 of the Regulation of the European Foundation. By taking an already made example,¹¹⁴ if I want to donate from Italy €1000 for helping (in whatever form) poor people in a third world country, I presumably choose a non-profit firm and not a for-profit firm for the economic reasons explained above (contract failure argument). I decide to choose a British charity (along the lines of the *Persche* case). From an economic perspective, I am “buying” a service whose benefits are not for me but for third persons.¹¹⁵ The nondistribution constraint helps to

¹¹¹ Intentionally, I omit the treatment of what a non-profit entity is in Belgian law (type of activity and possibility of profits) and refer the reader to VERRUCOLI, *supra* 23, 30.

¹¹² On the basis of the arguments of the Commission, the national non-profit character is described in terms of maximization of profit or distribution of profit (para 11 of the opinion of the AG).

¹¹³ On the basis of a not better specified *doctrine dominante* (in the French text, which is different from the Spanish version where the part “*en tant que cette notion relève exclusivement du droit communautaire*” is missing), the European notion of non-profit entities is that of bodies that do not have the “*but principal d’augmenter leurs profits*”. No reference is made to the non-distribution constraint (see para 12 of the AG opinion).

¹¹⁴ See HANSMANN, *The Role*, *supra* 9, 880.

¹¹⁵ Since I am buying a service I get an utility because my contract with the non-profit firm maximises my utility function which wants to help poor people of a third world country. Note that this example mirrors the typical example of transferring money to a third

mitigate the asymmetric information problem. Buying this service (intermediation in helping in whatever form in a cost minimising way) is an economic activity. It is interesting to note that this reconstruction has direct implications both as regards freedom to provide services (and in particular with Article 62 TFUE) and with competition law.

With respect to services, the fact that I buy a service offered by a non-profit entity which is established in the United Kingdom refers not only to freedom of capital movement (with the possible tax privileges for the donor and the recipient) but also to the freedom of providing services.¹¹⁶ In other words, the development of the ECJ's jurisprudence in tax law in terms of freedom of movement of capital makes Article 62 TFUE already systematically doubtful in its coherence with the entire framework of the Treaty: indeed, I buy a service provided by a UK non-profit firm which operates in competition with other English non-profit firms but also possibly in competition with Italian non-profit firms (for the competition among non-profit firms argument, see the opinion of the AG in *MOTOE*, para 41 as accepted by the Court para 28).¹¹⁷

person (who is usually known so eliminating the problem of asymmetric information) that is commonly pursued by several for-profit firms in competition. Firms charge a commission (which should be the normal competitive one) which covers the costs. A profit (which should be the normal competitive one) remains at the end to be distributed to the shareholders.

¹¹⁶ Article 57 TFUE specifies the characteristics of the notion of service, enumerating the categories included in the notion. Remuneration is granted because I am paying for a service even though I am not the direct beneficiary of the service. The commercial character of Article 57 TFUE is commonly understood as for-profit but it is precisely the non-profit firm that performs the task in a more efficient way given the asymmetric information problem and the relative contract failure. Once it is understood that what I am buying is indeed a service offered by a non-profit entity precisely because of its nature, it becomes also clear that this entity is pursuing an economic activity: the organisation of a series of transactions to provide help bought by donors. Since a non-profit firm has to be financed by somebody (patron) in order to stay on the market (covering at least costs with revenues) what it provides is always financed by somebody and is an economic activity. *De jure condendo* and following a law and economics approach to the theory of the (non-profit) firm, I challenge the idea that Article 57 TFUE cannot cover services offered by non-profit firms and financed by donors. This conclusion is the usual one and is followed also by the Commission, EUROPEAN COMMISSION, *Commission Staff*, *supra* 5, 12, "Being unremunerated, the awarding of grants (which is the main or exclusive type of activity of certain foundations) would not be considered an "economic activity" under the Treaty provisions relating to establishment and services or under Directive 2006/123/EC on services in the internal market ... (hereafter the Services Directive) - and would not therefore be covered. As far as funding in general is concerned, if this is defined as a payment of contributions for a non-profit purpose, it would not be considered an economic activity either; in contrast fund "raising" may well be an economic activity (i.e. renting out property, selling handicrafts or organising sports activities for which participants or spectators are charged entry fees)".

¹¹⁷ The non-profit firm helping the people in the third world country will have to cover the costs of organising its activity, just as a for-profit firm would have to do (again see HANSMANN, *The Role*, *supra* 9, 880). Certainly, I could directly donate food or assistance but I would have higher transaction costs of doing so by myself by way of simple market transactions. Others, like me, would incur the same costs. This is the reason why a firm (a non-profit firm as a nexus of contracts) is needed instead of (a sum of) simple market

With respect to competition law, continuing with the example of a donative non-profit firm,¹¹⁸ since I am the patron (the ultimate person who finances the non-profit entity) this reconstruction includes also a competition law notion of undertaking. The competition notion relies on an economic activity (selling of goods and services) independently from the way of financing. In this case the person who buys the service (the patron who finances the legal body) is not the same person who enjoys the benefits (in whatever form) of the service.¹¹⁹

The inclusion of non-profit entities that carry on economic activity within freedom of establishment could be interpreted by the Court in a way consistent with the actual definition of economic activity used for competition law purposes.¹²⁰ More in particular, the Court could ask whether the activity carried on by the non-profit entity in the hosting Member State(s) in the form of primary or secondary establishment is (potentially) subject to competition law as economic activity or excluded from competition law precisely because of its non-economic nature. The non-economic nature does not really refer to the public benefit nature¹²¹ but to the welfare state nature (*social* nature) of the activity.¹²² In the latter case neither for-profit entities nor non-profit entities

transactions. The type of firm which is more efficient is the non-profit firm. The asymmetric information problem makes the for-profit firm unsuitable for this kind of economic activity.

For a paper modelling the contract failure argument of HANSMANN, *The Role*, *supra* 9, demonstrating the relative efficiency of the non-profit firm relative to the for-profit firm, see GLAESER EDWARD L., SHLEIFER ANDREI, 2001, *Not-for-profit entrepreneurs*, in *Journal of Public Economics*, 81:99-115. For contributions modelling competition among non-profit firms, see BILODEAU MARC, SLIVINSKI AL, 1997, *Rival charities*, in *Journal of Public Economics*, 66:449-467; CASTANEDA MARCO A., GAREN JOHN, THORNTON JEREMY, *Competition, Contractibility, and the Market for Donors to Nonprofits*, in *Journal of Law, Economics, & Organization*, 24:215-246.

¹¹⁸ In section 4, I briefly mentioned the taxonomy of non-profit firms in relation to patrons who finance and control them. The taxonomy relies on: (a) donative mutual: where those who finance the firm also control it; (b) donative entrepreneurial: where those who finance the firm do not control it; (c) commercial mutual: where those who finance the firm control it; (d) commercial entrepreneurial: where those who finance the firm do not control it. The example of the text refers to a commercial entrepreneurial non-profit firm, letter (d).

¹¹⁹ The nature of the activity being economic with respect to the person that finances it can also be extended to letters (a), (b) and (c) of the taxonomy of non-profit firms.

¹²⁰ Going back to the discussion of Section 3, I assume that the non-profit entity can carry on economic activity according to its legal system (Member State) of formation. Indeed, leaving apart the conflict-of-law issue, apparently an Italian *associazione* could carry on economic activity while a German *Verein* could not or only in a limited way (see for Italy ZOPPINI, *supra* 28, 371 for Germany VON HIPPEL, *supra* 28, 222).

¹²¹ Which can help the legal body to qualify itself for tax law reasons as in the US or in the proposed regulation for a European Foundation, but not really for a qualification in terms of the private law nature of the legal body or for a law and economics qualification of the type of firm.

¹²² I acknowledge that this taxonomy may be flawed by the fact that the qualification of the activity as economic or non-economic has been characterised by the Court in different ways. In fact, while in *MOTOE*, *supra* 66, for example, the Court stresses the fact that the activity which qualifies the entity as undertaking may be an economic activity even if the entity is a non-profit entity as defined by the national legal system (para 27 and 28), in *AOK* (Joined Cases C-264/01, C-306/01, C354/01 and C355/01, *Aok Bundesverband*

would enjoy freedom of establishment to provide the activity which is not economic for competition law purposes or for freedom of establishment purposes.¹²³

The uniformity of the notion of economic activity for the purposes of freedom of establishment and of competition law brings for-profit firms and non-profit firms back to the same, common economic dimension.¹²⁴ If the activity is economic (for competition law purposes) it can be carried on by way of freedom of establishment (Articles 49 and 54 TFUE) both by for profit firms and by non-for profit firms.¹²⁵ In this way, the literal wording of Article 54 TFUE would be escaped by pointing attention not to the nature of the *but per se* but rather to the nature of the activity.¹²⁶

and others, 16 March 2004) the Court states that the activity is a social one and not an economic one, also because it “is entirely non-profit making” (para 47). The problem is that in the AOK case, the funds have to cover expenses with revenues (being price-takers because of the impossibility to decide monopolistically on contributions, para 8) by minimising operating costs (para 56) with a system of compensation (solidarity mechanism) with social character (para 10). If expenses are not covered, a national solidarity mechanism enters into play. From *MOTOE* and *AOK* it follows that the activity is always economic if carried on by for-profit entities (leaving aside the issue of the possible socialisation of losses of for-profit firms by way of state aids) while it can be economic or non-economic if carried on by non-profit entities. For competition law purposes this line of reasoning can be considered either correct or misguided on the basis of economic reasons. So the issue becomes whether from an economic perspective the exclusion of some activities from the Treaty provisions on competition law (based on reasons of coherence of the welfare system) makes any economic sense. This topic, being a competition law and economics issue, can of course not be covered here. In the solution I suggest, as the AOK case implies, for-profit firms would not enjoy freedom of establishment for competing with German funds precisely because the activity is considered to be not an economic one (para 54).

¹²³ I did not analyse in depth the notion of economic activity for competition law purposes based on the argument of the coherence of the welfare state system (on which see HANCHER, SAUTER, *supra* 98). Intuitively, I tend to believe that the development of the European Court of Justice may be systematically weak considering the potential to introduce market elements in some sectors. I only propose a solution where the notion of economic activity that is valid for competition law can be valid also for the purposes of freedom of establishment.

¹²⁴ This line of reasoning was partially argued also by the European Commission in 1984 in relation to its analysis of the television market organised by national firms, see COMMISSION OF THE EUROPEAN COMMUNITIES, *Television without Frontiers. Green Paper on the establishment of the Common Market for Broadcasting, Especially by Satellite and Cable*, Brussel 14th June 1984, Com(84) 300 final, 213. The Commission opted for a European uniform notion of non-profit making entity as opposed to a national one, as an entity “where no financial gain to the owners is intended” (219) and where the attention is put on the nature of the activity.

¹²⁵ This rule has an exemption for donative non-profit firms where the non-distribution constraint is of such meaning that it is the only efficient way to ensure free contributions of donors. In fact, anecdotal evidence suggests that for-profit donative firms with charitable or philanthropic mission are not existent. Donative non-profit firms are the only efficient way to organise the economic activity they run. Freedom of establishment should be granted also to them.

¹²⁶ So for instance if in the case of *Sodemare* the Court had decided that the activity is not under the privilege of the welfare system argument, freedom of establishment could have been granted to non-profit firms coming from other Member States.

The proposed solution is based on three steps: (i) Article 54 TFUE clearly distinguishes between for-profit entities and non-profit entities; (ii) from a European perspective (*i.e.* deriving European, uniform notions of the two concepts) for-profit entities permit the distribution of the gains deriving from the activity while non-profit entities do not permit this distribution; (iii) to the extent that the activity is economic in terms of competition law, both for-profit and non-profit firms enjoy freedom of establishment. My solution pushes the focus not really on the type of *but* (*lucratif* or not *lucratif*) but on the type of activity: economic and non-economic activity on the basis of competition law considerations. It follows that the element of the *but* is overruled and no longer applicable to freedom of establishment as it is no longer applied to the freedom of providing services given the case law of the ECJ in the area of free movement of capital and tax provisions.

This reconstruction is made possible because our understanding of non-profit entities (mainly foundations and associations) has been recently enriched by economic analysis. Non-profit firms are efficient in providing particular (economic) services on the free market as an alternative to for-profit firms. This position, made possible by the development of the law and economics of the different types of firms (for-profit, non-profit and cooperatives), makes the traditional distinction between entities based on the *but* included in Article 54 TFUE no longer valuable and systematically untenable. The practical consequence is that the literal wording of Article 54 TFUE in a policy-oriented dimension can be overruled in order to achieve the complete realisation of the single market.

6.3. Regulatory competition for non-profit entities?

I have argued above that non-profit firms justify their economic existence in the market on the basis of economic reasons and more in particular on the basis of transaction costs deriving from contract failures. A distinction between public benefit of non-profit firms and private benefit of for profit firms albeit useful for tax law purposes is irrelevant for the proper qualification of the entity in economic terms. Non profit-firms are simply alternative types of firms for organising economic transactions among economic actors. I have also argued that the prohibition of Article 54 TFUE is today probably no longer systematically justified. This is also because the same application of Article 62 TFUE is no longer pursued given that non-profit firms enjoy freedom of movement of capital. Functionally speaking, this is similar to the provision of services, which means that they can provide services in the entire single market.

Since the EU, like the US, is made up by a plurality of jurisdictions that provide the law regulating legal bodies, it is interesting to analyse on a comparative basis the extent to which a regulatory competition regime could emerge among Member States for the production of regulation for non profit

entities.¹²⁷ I am not arguing in favour or contra a (possible) European market for non-profit charters like the one for company law of for-profit entities. I simply sketch some reflections on the possible development of a free choice of legal forms also in the market for non-profit legal entities which is a consequence of my argumentation in favour of a liberal interpretation of freedom of establishment also in this sector. Indeed, the proposal for a Regulation of a European Foundation already provides a European entity which increases the offer of legal entities provided by the Member States.

In the case of company law regulating the agency problems of the for-profit firm (the typical business corporation), the United States case shows a practical example for the following logical chain. The business corporation produces agency costs between shareholders and managers that decrease profits. Company law tries to minimise these agency costs in order to maximise profits. The value of the profits is reflected in the share value. Given the existence of several company laws in the US system, it should be possible to establish whether freedom of (re)incorporation is an efficient solution. So the question has become less a theoretical one and more an empirical one. If share value increases after a reincorporation or is larger for firms incorporated in a particular jurisdiction, this should be proof that the company law of this jurisdiction is better in minimising agency costs precisely because the share value (which measures and discounts the agency problem) is higher.¹²⁸

A for-profit firm (a business corporation) is a particular type of firm: it is owned. The owners are those who have two residual rights: the residual right of control and the residual right of earning (in terms of remuneration, i.e. profit, for the invested capital). However badly these owners exercise residual control (by way of a good or bad company law and securities regulation as well as less or more efficient capital markets able to fully discount the agency problem) they still exercise control. They are indeed the beneficiaries of the firm. Fiduciary duties are monopolistically reserved only for them precisely because they are the residual claimants.¹²⁹

Non-profit firms are by definition not owned because, independently of those who may control the firm or finance the firm, nobody has right to residual earning. What is missing in non-profit firms (by definition) is the coexistence of a residual right to control and a residual right to earning. In fact, there is the possibility to gain a profit but its sharing among those who control the firm is not permitted. Non-profit firms are formed in the different jurisdictions with several legal types: non-profit corporations, non-profit trusts, registered and non-registered associations and foundations, charities. As the legal taxonomy

¹²⁷ I share some of the reflections of this section with those of HANSMANN HENRY, 2006, *Two Systems of Law for Corporate Governance: Nonprofit versus For-profit*, working paper available at http://www.law.yale.edu/documents/pdf/two_systems_for_corporate_governance_v04.00.pdf.

¹²⁸ See DAMMANN, SCHÜNDELN, *supra* 11.

¹²⁹ For a discussion on the fiduciary duties of managers to shareholders, see MACEY JONATHAN R., 1991, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, in *Stetson Law Review*, 21:23-44. See also HANSMANN, *supra* 127, 2.

of entities can vary from jurisdiction to jurisdiction, the functional element of the non-distribution constraint makes it possible to establish a taxonomy based on the dyad between two factors: residual financing of the entity and residual control over the entity.

Even though ownership in non-profit entities is missing, agency problems are present. Those who control (i.e., run) the entity may divert the assets to pursue other aims than the proper ones financed by the patrons of the entity. Managers of non-profit entities own fiduciary duties to those (patrons) that finance the entity.¹³⁰

The extent to which different jurisdictions solve the agency problem between agents and principals of non-profit firms is something legal scholarship in the European context has only recently started to analyse.¹³¹ In the United States the discussion is well established.¹³²

The US system of non-profit corporations apparently did not develop a market for corporate charters, mirroring the market for corporate charters for business corporations.¹³³ The reason probably relates to both sides of the market. On the demand side, those who create the non-profit firm (incorporate the non-profit corporation) do not share the same incentive as those who (re)incorporate the for-profit firm in Delaware in terms of maximisation of share value. The signalling factor of (re)incorporating a for-profit firm in a jurisdiction which is supposed to provide better company law for dealing with the agency problems of for-profit firms is apparently not exportable to non-profit firms. Those who are the residual financiers of the entity (the principals) cannot appreciate a possible choice of a better law regulating the agency problem.¹³⁴ On the supply side, the states seem not to have implemented a fee regime similar to the one for business corporations and one able to create a credible commitment for efficient corporation law.

Given an “incorporation theory” system (as opposed to a “real seat theory” system) the question of whether a European market for the regulation of non-profit firms could arise refers mainly to foundations and to associations for civil law Member States and to non-profit entities of the common law Member States. The core issue in economic terms is the ability of the Member

¹³⁰ See HANSMANN, *supra* 9, 600. For an introduction to the agency theory in non-profit firms, see KOSS CLAUS, 2005, *Prinzipial-Agent-Konflikte in Nonprofit Organisationen*, in HOPT, VON HIPPEL, WALZ, *supra* 9, 197-241; STEINBERG RICHARD, 2010, *Principal-agent theory and nonprofit accountability*, in HOPT, VON HIPPEL, *supra* 5, 73-125.

¹³¹ See HOPT KLAUS J., 2005, *Corporate Governance in Nonprofit Organisationen*, in HOPT, VON HIPPEL, WALZ, *supra* 29, 243-258; HOPT KLAUS J., 2010, *The board of nonprofit organizations: some corporate governance thoughts from Europe*, in HOPT, VON HIPPEL, *supra* 5, 531-563.

¹³² See HANSMANN, *supra* 9, 600. The discussion has involved both the law on the books as well as the enforcement level, which is more important for non-profit firms than in for-profit firms because of the absence of “active” principles, see NOTE, 1992, *Developments in the Law. Nonprofit Corporations*, in *Harvard Law Review*, 105:1578-1699, particularly 1590; see also HANSMANN, *supra* 127.

¹³³ I am not aware of literature discussing this topic. Without any kind of evidence (even anecdotal) the question is whether Delaware is attractive not only for-profit corporations but also non-profit ones.

¹³⁴ See also HANSMANN, *supra* 127, 12.

State of foundation (on the basis of the incorporation theory that permits choice of law) to create a credible commitment that the law governing the legal entity is and will be also in future able to minimise agency costs in comparison to the law of other Member States. The credible commitment refers both to the law on the books and to enforcement and includes the ability of the Member State of incorporation to extend control over the entity also in the hosting Member State(s).

In the case of foundations, the founder (who is the donor of the original assets) may be able to choose a jurisdiction that in her opinion provides for a superior foundation law. In the case of non-profit legal entities like associations or non-profit corporations depending on the beneficiaries of the entity the issue would replicate the US situation. A multiplicity of beneficiaries (principals) would possibly be unable to properly respond to the signal sent by those in control of the entity in terms of better law to minimise the agency costs.¹³⁵

As to creditors, the hypothetical market for non-profit charters would not necessarily have to deal with the protection of creditors, meaning those parties that enter in contractual arrangements with the entity. Article 54.2(g) TEEC was intended to provide harmonisation of the company laws of the Member States for members and others and *in primis* creditors. Nevertheless, the development of the jurisprudence of the ECJ in relation to private limited companies not covered by European harmonised legislation on capital requirements, weakens the argument against freedom of incorporation and possible regulatory competition for non-profit entities.¹³⁶

7. Conclusions

In this article I have argued that the European Court of Justice should rely on a European, uniform notion of non-profit legal entities for the application of Article 54 TFUE. This notion refers to an entity where the non-distribution constraint prohibits ongoing and final (upon dissolution) distribution of profits to those who are in control of the entity. Furthermore, I have argued that the original exclusion from freedom of establishment of non-profit entities is today systematically no longer justified. Given the uniform, European notion of non-profit entity, the Court should grant also to this kind of firm freedom of establishment if the entity carries on an activity that is qualifiable as economic, such as the notion of economic activity for competition law purposes. As for the US case, a regulatory competition regime system for non-profit entities is

¹³⁵ See also HANSMANN, *supra* 127, 12.

¹³⁶ Possibly, given the enforcement of the non-distribution constraint in non-profit firms, the typical agency problem between shareholders and creditors, where the former exploit the latter, is weakened (but not completely eliminated) by the missing presence of shareholders (who receive profits) and their incentive to choose riskier projects and divert assets. Of course the discussion has centered on the extent to which creditors are unable to deal with the agency problem on a contractual basis without the need of minimal capital requirements. See for example KRAAKMAN *et al.*, *supra* 10, 115. On economic activity of non-profits and their creditors, see from a German perspective REUTER DIETER, *Die wirtschaftliche Beteiligung von Nonprofit Organisationen*, in HOPT, VON HIPPEL, WALZ, *supra* 29, 307-319.

unlikely to arise because of differing incentive structures, particularly in the case of associations. On the contrary, for the case of foundations the founder could find it attractive to shop among jurisdictions for the provision of the entity she considers superior for minimising the agency costs deriving from the corporate governance of this type of entity.

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