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# The Czech Societas Europaea Puzzle

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## Abstract

The European Company (Societas Europaea, SE) has become a popular company law form for businesses, and it is most popular in the Czech Republic, which is puzzling. We study the motives of Czech SE founders on the basis of data from the Czech national Commercial Register on all Czech SEs registered in 2010 and 88 interviews with Czech SE users. SE incorporations in the Czech Republic are mainly driven by the desire to economize on board size and the positive European image of the SE (brand management). The large number of Czech shelf SEs probably results either from service providers overestimating these advantages and, as a consequence, demand for new SEs or, conversely, from users underestimating the beneficial effects of (re-) incorporating as an SE. Time will tell which conjecture comes closer to the truth.

Keywords: European Company, Societas Europaea, Czech Republic, Legal Arbitrage

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# The Czech *Societas Europaea* Puzzle

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Abstract

The European Company (*Societas Europaea*, SE) has become a popular company law form for businesses, and it is most popular in the Czech Republic, which is puzzling. We study the motives of Czech SE founders on the basis of data from the Czech national Commercial Register on all Czech SEs registered in 2010 and 88 interviews with Czech SE users. SE incorporations in the Czech Republic are mainly driven by the desire to economize on board size and the positive European image of the SE (brand management). The large number of Czech shelf SEs probably results either from service providers overestimating these advantages and, as a consequence, demand for new SEs or, conversely, from users underestimating the beneficial effects of (re-) incorporating as an SE. Time will tell which conjecture comes closer to the truth.

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## I. Introduction

After a slow start, the *Societas Europaea* (SE) has become a popular legal form for European businesses. As of 3 October 2011, 937 SEs were incorporated.[1] The clear market leader for SE incorporations is the Czech Republic: 529 SEs, i.e. approximately 56% of all existing SEs, were established in the Czech Republic, followed by 180 in Germany. Of the 529 SEs incorporated in the Czech Republic, only a tiny minority conduct (significant) business activities: according to a study of the European Trade Union Institute, 115 are shelf companies and 375 are UFO companies. The latter are described by the Institute as follows: "A UFO SE is probably operating. Although some information is available from the commercial register and/or the Supplement to the Official Journal, no information on the number of employees is available."[2]

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[1] The data is taken from research by the European Trade Union Institute, *see* http://ecdb.worker-participation.eu/show_overview.php?letter=A&orderField=se_name&status_id=3&title=Established%20SEs (last visited on 3 October 2011).

[2] *See* http://ecdb.worker-participation.eu/lexicon.php (last visited on 3 October 2011).

The enormous popularity of the SE in the Czech Republic in general and the fact that the overwhelming majority of Czech SEs are either shelf or UFO companies poses a puzzle. In 2010, GDP in the Czech Republic was EUR 145,049 million[3], which puts the country in 16th place amongst the 27 Member States of the EU and is roughly 17 times smaller than that of Germany, Europe's largest economy (EUR 2,498,800 million). Why has a company law form that was designed to be used mainly by large public corporations with significant cross-border activities become so popular in a country with such a relatively small economy? And why are most of the Czech SEs either shelf companies or companies that have UFO status in the sense described?

Prior empirical studies have shed some light on these questions but failed to resolve them conclusively. Based on a unique, hand-collected dataset on SE incorporations, Eidenmüller et al. investigated the motives of SE users in Germany via a telephone survey and a simple country-level regression model.[4] They found strong evidence that firms use the SE to mitigate the effect of mandatory employee participation at the board level. Establishing a one-tier board structure (in jurisdictions that impose a two-tier structure on their national public companies) and taking advantage of the SE's mobility for tax purposes also seem to be driving SE formations. However, Eidenmüller et al. did neither interview Czech SE users, nor did they specifically address the issue of shelf companies.

In a report for the European Commission, Ernst & Young also conducted an empirical investigation into the operation and the impact of the Statute for a European Company (SE).[5] In general, they concluded that there is rarely a single motive for setting up an SE. Rather, forming an SE results from a "business case" that is established by a set of reasons that are interrelated.[6] However, specifically with respect to the Czech Republic, the report identifies corporate governance reasons as the main driver for SE formations: board size can be reduced to a minimum of one member on the management and on the supervisory board, and a one-tier structure can be chosen – both options are not available for Czech public corporations.[7] The European image of the

[3] *See* http://en.wikipedia.org/wiki/Economy_of_the_European_Union (last visited on 3 October 2011).

[4] *See* H. Eidenmüller, A. Engert, L. Hornuf, "Incorporating Under European Law: The Societas Europaea as a Vehicle for Legal Arbitrage" (2009) EBOR pp. 1-33.

[5] *See* Ernst & Young, "Study on the operation and the impact of the Statute for a European Company" (2009), 2008/S 144 / 183482, 9 December 2009.

[6] *See* Ernst & Young, no. 5 above, p. 208; EC Commission, Report from the Commission to the European Parliament and the Council: The application of Council Regulation 2157/201 of 8 October 2011 on the Statute for a European Company (SE) COM (2010) 676 final, Brussels 17 November 2010, p. 3.

[7] Under Czech law, corporations must have a two-tier structure and at least three members of the board of directors and three members of the supervisory board. However, Czech law sets forth an exception for corporations with sole shareholders which are treated differently and, in terms of the number of board members, such corporations may have only one member of the board of directors. *See* section 194 (3) of Act No. 513/1991 Coll., Commercial Code, as amended (the "**Czech Commercial Code**"). Nevertheless, the requirement of three members on the supervisory board remains.

SE and tax considerations also seem to play a role.[8] However, the empirical basis for these conclusions is somewhat shaky. The authors sent an online-questionnaire to existing SEs and conducted 60 interviews all over Europe,[9] but only a tiny fraction (apparently less than a handful) of these interviews were conducted with interviewees in the Czech Republic, and it is unclear how many (Czech) companies responded to the questionnaire. Further, the authors of the report were not able to obtain information from shelf companies.[10] Hence, the Czech *Societas Europaea* puzzle must still be considered unresolved.

The authors of the present study therefore embarked on a new attempt to better understand what drives the decision to form an SE in the Czech Republic. Based on information available from the Czech national Commercial Register on all 220 existing SEs on 1 June 2010, we conducted 88 (telephone) interviews with SE users from September through November 2010. This figure represents 40% of all SEs that had been incorporated under Czech law prior to the survey and approximately 49% of the Czech SEs, leaving aside inactive (shelf) companies.[11] Hence, to the best of our knowledge, we were able to work with the most comprehensive dataset on the motives of Czech SE users that exists up to now. The central findings of our survey indicate that incorporations of Czech SEs have been mainly driven by the simplified internal governance structure offered, which does not necessarily relate to the availability of the one-tier board system, but rather to the option to reduce the number of board members. Other driving factors have been the image of the SE (brand management) and corporate mobility (the possibility of transferring the registered office of the company to another Member State). Shelf company providers obviously have a different motive, namely to incorporate and sell for profit, but they apparently grossly overestimate current market demand for SEs. All in all, then, our study empirically confirms that the SE is popular in the Czech Republic amongst operating firms primarily because of the enhanced governance flexibility that it offers. Mitigating mandatory employee participation appears not to play a significant role.

[8] *See* Ernst & Young, no. 5 above, pp. 82, 87, 129-131, 210-211, 228, 236-238.

[9] *See* Ernst & Young, no. 5 above, p. 209.

[10] *See* Ernst & Young, no. 5 above, p. 22.

[11] Out of 220 SEs existing on 1 June 2010, 41 of them were, to the best of our knowledge, shelf companies. For the purposes of this text, we understand a shelf company to be an SE which has neither operational activities nor employees. *Cf.* EC Commission, *Commission Staff Working Document: Accompanying Document to the Report from the Commission to the European Parliament and the Council on the Application of Council Regulation 2157/2001 of 8 October 2001 on the Statute for a European Company (SE)*, SEC (2010) 1391 final, Brussels 17 November 2010, p. 2, defining shelf SEs as "SEs with no activities or employees that are usually set up by professional company providers with the purpose of selling them afterwards to interested buyers." A clear indication that a Czech SE is a (inactive) shelf SE is that the sole shareholder of such company is a "parent" company of a professional provider who offers SEs for sale.

## II. Methodology

In this section, we briefly outline the methodology we used to ascertain what the driving forces behind the surprisingly high number of SEs incorporated in the Czech Republic might be. We took the following two steps: first, we collected the relevant information from the Czech national Commercial Register where every Czech SE needs to be registered in order to exist. As of 1 June 2010, 220 SEs were registered in the Czech Republic. We were able to collect data from the Commercial Register such as the board structure of Czech SEs (one-tier or two-tier), the number of board members, subscribed capital, and the route of formation. As noted later, particularly the option between the one-tier and two-tier board structure is of great interest to us as many of the companies told us that simplifying the internal corporate structure had been one of the leading motives behind seeking incorporation as an SE.

Second, we conducted a structured telephone survey among Czech SE users to ascertain the leading motives that led them to choose this corporate form instead of, for example, a Czech corporation or limited liability company. We then matched the responses with the data we obtained from the Commercial Register. Even though a telephone survey is a more time-consuming method than sending out a written questionnaire, it allowed us to increase the participation rate. However, as we were either not able to find telephone contacts for all Czech SEs or to reach them by phone during our study, we contacted these companies also by e-mail and/or by regular mail. The dataset, therefore, consists of answers that we were able to obtain by both telephone survey and e-mail/regular mail.

For the remaining companies, either no contacts were available, the contacted persons indicated they did not wish to participate, or the companies were shelf companies being offered on multilingual websites by various professional service providers. A significant number of the 41 shelf companies were sold in the course of our study.[12] Even though we contacted the professional sellers of Czech shelf SEs and asked for their cooperation, we did not explore their motives. These are obvious: to incorporate and sell for profit. Although the sellers provided us with some useful information on the incentives of their clients, we rather directly asked the clients about their motives concerning the purchase of the SE corporate form.

For the purpose of obtaining consistent responses, a structured questionnaire was designed and completed during each interview. All interviewees were in high ranking positions in their companies. In many cases, we interviewed the chief executives of the companies or persons directly involved in the SE formation process. In each interview, we asked the interviewee about the

[12] To the best of our knowledge, 40 out of the 41 shelf companies were sold in the course of our research.

motives for choosing to form an SE, whether it be by incorporation or by a purchase of the corporate form from some of the professional service providers. We asked the users of Czech SEs whether the following six issues played any role: (i) transfer of registered office, (ii) the specific image of the SE in the market place (brand management), (iii) the option to realize a cross-border merger, (iv) simplification of the internal company structure, (v) employee participation, (vi) regulatory reasons. Besides this set of issues, we asked the interviewees whether any other motives played a role in their choice to do business under the SE corporate form.

We assumed that in most cases, to some degree, more than one single motive played a certain role in the process of choosing the SE corporate form. In addition, some of the motives probably were more important in the context of a given case than others. Accordingly, we asked the interviewees to assign each answer a value from 0 (not important) to 5 (most important) as we believed that such a valuation would provide a better picture of the driving forces behind SE incorporations in the Czech Republic. Take, for example, a hypothetical situation in which one of the driving forces, e.g. regulatory reasons, is present in each case but all SEs assigned regulatory reasons the value of 1. In such a scenario, even though regulatory reasons may have entered the picture in the context of SE incorporations, it is most likely not the most important variable that actually persuaded the founders (users) of Czech SEs to choose this corporate form. Therefore, we not only measured the number of instances a particular driving force occurred, but also the importance of a particular variable vis-à-vis other driving forces.

All interviews were conducted during a narrow time frame of three months from September through November 2010 as we tried to minimize the possible influence of periodic changes on the results. All in all, we conducted 88 (telephone) interviews. This figure represents 40% of all SEs that had been incorporated under Czech law at the time of the survey and approximately 49% of the Czech SEs, leaving aside inactive (shelf) companies. Hence, we were able to obtain comprehensive first-hand information from Czech SE users where no systemized dataset had been available before. In this respect we are, of course, aware of the fact that surveys may easily suffer from misrepresentations by interviewees despite our assurance of anonymity. Admitting the possibility of such misrepresentation, which may be present in any survey of this kind, the resulting dataset of the reasons why the users of Czech SEs choose this corporate form and not any other is, to the best of our knowledge, the most complete of its kind.

## III. Empirical findings

This part presents our findings and is structured as follows: we present a chart providing the number of instances (out of 88) in which a particular variable played a role regardless of the degree of its importance in the given case. However, as this chart does not reflect the importance (relevance) of the key variables, the next charts also take into account the importance which our respondents assigned to each motive.

**Table**: Survey results 1 – Motives for setting up an SE.

| **Motive** | **Positive response (N=88)** |
|---|---|
| Image of the SE | 82 |
| Simplification of the company structure | 76 |
| Corporate mobility | 70 |
| Regulatory reason | 57 |
| Cross-border merger | 52 |
| Employee participation | 25 |

Out of the stated motives behind the relative popularity of the SE corporate form in the Czech Republic, two of them stand out – the image of the SE (brand management) and the simplification of the internal company structure. Our respondents named the image of the SE corporate form as a factor for 82 out of 88 companies and simplification of the internal company structure as a motive in 76 out of 88 instances. Prior empirical research on the popularity of the SE yielded the somewhat perplexing result that the legal certainty associated with the SE should make it popular especially in Eastern European countries – compared to domestic legal forms –, but that this does not hold true for the Czech Republic.[13] It appears that this assessment is clearly false. The European image of the SE is one of the main drivers for SE formations in the Czech Republic.

The SE Regulation offers European companies a choice between the one-tier and the two-tier board structure (Art. 38(b) SE Regulation). By contrast, Czech legislation does not give corporations this choice[14], although a proposal for a new company code contains it.[15] In addition, the SE corporate form may also be attractive because the Czech Commercial Code requires the

[13] *See* Ernst & Young, no. 5 above, pp. 130, 210-211.

[14] *See* Section 194 *et seq.* of the Czech Commercial Code.

[15] *See* Section 463 *et seq*. of the Governmental proposal no. 363/0, Companies Act (Zákon o obchodních korporacích a družstvech).

management body of a corporation to consist of at least three members unless the company has a sole shareholder.[16] The supervisory board must always consist of three members.[17] By contrast, the SE Regulation, absent issues of employee participation, does not stipulate similar size requirements (Art. 39 No. 4, Art. 40 No. 3, Art. 43 No. 2 SE Regulation). Hence, start-up companies and closely held companies may save on board compensation when choosing an SE instead of a domestic corporate legal form.

Respondents representing 70 companies (out of 88) brought up corporate mobility as another reason to opt for the European company.[18] The EU legislation designed the legal framework for the SE to foster cross-border activity in the internal market. Community law enables an SE to transfer its registered office to another Member State (Art. 8 SE Regulation). Given the Cartesio decision of the ECJ, however, national companies may also transfer their registered office into another Member State provided that the new home state permits such a move.[19] Czech legislation reacted to this decision by amending Act No. 127/2008 Coll., the Transformation Act, as amended (the "**Transformation Act**"), facilitating national companies in transferring their registered office abroad. This amendment is expected to enter into force on 1 January 2012.[20] Until then, an SE seems to have distinct advantages in terms of corporate mobility compared to Czech company law forms.[21] However, Czech companies can achieve a similar result by merging into a special purpose company of the target state (on this see the following paragraph). Also, as one can find out in the Commercial Register, there have been only a few cases in which Czech SEs transferred their registered office to another Member State.[22] For example, Crius Capital SE transferred its registered

[16] *See* Section 194 (3) of the Czech Commercial Code.

[17] *See* Section 200 (1) of the Czech Commercial Code.

[18] *See* also Z. Csehi, "Die Attraktivität der supranationalen Gesellschaftsformen in den mittel- und osteuropäischen Staaten", in: P. Jung (ed.), *Supranationale Gesellschaftsformen im Typenwettbewerb* (Tübingen: Mohr Siebeck, 2011), pp. 17, 21 (speculating that corporate mobility is the main driver for Czech SE incorporations).

[19] *See* Cartesio Oktató és Szolgáltató bt, Judgment of 21 February 2009, Case C 210/06, ECR I-09641.

[20] *See* section 384f *et seq*. of the Act No. 355/2011 Coll., amending Act No. 127/2008 Coll., the Transformation Act, as amended.

[21] Although Czech law has provided national companies (corporations and limited liability companies) with the theoretical possibility to transfer their respective seat abroad since 1991 under Section 26 (1) of the Czech Commercial Code, this provision has been a declaratory "statement on the books" only as, to the best of our knowledge, no such seat transfers have ever occurred based on this provision. One reason could be that the other relevant provisions of Czech law (e.g. regulation no. 250/2005 Coll., as amended, on forms for petitions to the Commercial Register) have not considered the possibility of a seat transfer based simply on this provision, which lacks any specific steps to be taken in order to carry out such a transfer. The same is true for another provision concerning corporate mobility which, in connection with the entry of the Czech Republic into the European Union, states in Section 26 (4) of the Czech Commercial Code that transferring a legal entity's registered office from the Czech Republic abroad is also permissible in cases and on conditions stipulated by law of the European Communities or under a special Act. The special law concerning the transfer of seats mentioned in the text shall enter into force on 1 January 2012 by virtue of an amendment to the Transformation Act and, to the best of our knowledge, no seat transfers have ever occurred "in cases and on conditions stipulated by the laws of the European Communities" before.

[22] Based on the information from the Commercial Register, there have been three transfers of the registered office of Czech SEs to another Member State as of 1 November 2011. *Contradictory* Ernst & Young, no. 5 above, pp. 130 and

office to Slovakia, and Spirall Solutions SE transferred its registered office to Cyprus. Hence, even though corporate mobility is stated as a driving factor, we have not seen much of it yet.

In our survey sample of Czech SEs, the option to realize a cross-border merger under the SE Regulation seems to have played some role in 52 incorporations. However, after the adoption of Directive 2005/56/EC on cross-border mergers, Czech legislation implemented this Directive by the Transformation Act. Since 1 July 2008, cross-border mergers can be accomplished in ways other than by establishing an SE. Czech corporations or limited liability companies may also participate in a cross-border merger. Hence, it is to be expected that the merger motive is becoming less important over time.

Respondents representing 25 out of 88 companies named employee participation as a factor that influenced the decision to choose the corporate form of an SE. While this number may seem rather small, one may look at it in another way and say that more than one fourth of the companies named employee participation as a factor that played some role. This finding is particularly surprising given that, with respect to the 88 Czech SEs investigated by us, no negotiations on employee involvement in the SE took place during the formation process. Most Czech SEs are set up by professional providers and have only very few (if any) employees. At the same time, European law requires negotiations on employee involvement to take place unless neither the founding companies and concerned subsidiaries nor the proposed SE has any employees or at least not as many as needed to establish the Special Negotiating Body that negotiates on behalf of the employees.[23] Hence, even if, under Czech law, mandatory co-determination rules would not apply to a Czech corporation,[24] negotiations on employee involvement when setting up an SE must usually take place if the company established is not a shelf SE. It may well be that some market actors in the Czech Republic incorrectly perceive the legal position on this issue when setting up an SE.

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213 (no seat transfers so far (130), five seat transfers (213)), and EC Commission, no. 11 above, p. 17 (4 seat transfers). The European Commission lists DIAG Human SE and Imperio Regere SE among Czech SEs which transferred their seat abroad when, in fact, these companies engaged in creating an SE by virtue of a cross-border merger.

[23] *See* H. Eidenmüller, L. Hornuf, M. Reps, "Contracting Employee Involvement: An Analysis of Bargaining over Employee Involvement Rules for a Societas Europaea" (2011) (mimeograph, on file with authors). This is typically the case with respect to SEs being formed as shelf companies, understood as companies that have neither business activities nor employees and are for sale. However, it is well established that negotiations must be conducted where the proposed SE does not have any employees, but the founding companies have. If even the founding companies lack employees, negotiations would be pointless. In such rare cases, the issue of employee involvement and, thus, the establishment of the Special Negotiating Body come again to the fore at the time the shelf company is "activated", i.e. starts carrying out business activities and hiring employees (*cf.* Recital 18 of the Preamble and Art. 11 SE Directive).

[24] Under Section 200(1) of the Czech Commercial Code, the supervisory board of a Czech corporation must have at least three members; the number of members must be divisible by three. Two thirds of the supervisory board members are elected by the general meeting and one third by the company's employees, provided the company has more than 50 employees in an employment relationship for working hours which exceed half of the weekly working hours stipulated by special legal regulation as of the first day of the accounting period in which the general meeting is held to elect the members of the supervisory board.

Finally, we asked the respondents to provide additional reasons (if any) that may have played some role in their decision to do business under the SE corporate form. They stated various reasons such as tax consequences, ease in doing business in other Member States, or better protection of investments. However, none of these reasons figured prominently.

Whereas the previous part discussed the frequency in which the chosen variables occurred in the context of incorporation under the form of an SE, the two following charts take into account the importance that our respondents assigned to each variable. The first reflects the importance of all the variables by computing their overall score with 440 as the maximum score (88 times 5).

**Table**: Survey results 2 – Adjusted relevance of different motives.

| **Motive** | **Overall Score** |
|---|---|
| Image of the SE | 306 |
| Simplification of the company structure | 302 |
| Corporate mobility | 226 |
| Regulatory reason | 160 |
| Cross-border merger | 157 |
| Employee participation | 47 |

In absolute numbers, brand management received 306 points whereas simplification of the internal structure received 302 points. This finding correlates with the frequency with which users (founders) of the Czech SE named brand management or simplification of the internal structure as motivating factors. However, this result may suffer from a certain bias, as some of the respondents might assign to one variable a higher value than other respondents, even though in fact the importance of the given motive was pretty much the same. Therefore, we decided to adjust this finding by focusing on our respondents individually. Hence, we examined in how many instances a particular variable was the most important factor in the process of incorporation under the form of an SE or for purchasing an SE. The following chart lists our findings:

**Table**: Survey results 3 – Most important motives for setting up an SE.

| **Motive** | **Positive Answers** |
|---|---|
| Simplification of the company structure | 51 |
| Image of the SE | 37 |
| Corporate mobility | 21 |
| Regulatory reason | 15 |
| Cross-border merger | 12 |
| Employee participation | 1 |
| Other | 1 |

These positive answers add up to more than 88 as some respondents assigned a value of 5 to more than one reason. Clearly, the results show that simplification of the internal structure was named as the most important motive in choosing the SE corporate form in 51 out of 88 cases followed by the image of the SE (37 out of 88 cases). Accordingly, even though the image of the SE seems to play a very important role in 42% of the cases, simplification of the internal corporate structure has been the most important motive in a majority of the cases (58%).

This point deserves further elaboration as one can view the motive to simplify the internal company structure in two different ways: (i) preference for the one-tier board structure over the two-tier board structure or (ii) a simplified internal structure within the two-tier board structure. Our respondents named simplification of the internal structure in 76 out of 88 instances, but out of the 76 companies only one of them adopted the one-tier board structure. In addition, only 4 companies out of 220 SEs existing at the time of our research chose the one-tier board structure. On the other hand, 75 out of 76 companies apparently chose the SE corporate form because of a simplified internal structure within the two-tier board system.

As already mentioned, Art. 39 No. 4 and Art. 40 No. 3 of the SE Regulation provide that, in the two-tier board structure, the number of board members of the management board and the supervisory board or the rules for determining them shall be laid down in the SE's statutes. A Member State may, however, set a minimum and/or a maximum number of board members. Czech legislation has set neither a minimum nor a maximum number of management board or supervisory board members. Accordingly, Czech legislation (in accordance with the SE Regulation) allows Czech SEs to have only one management board member and one member of the supervisory board. It is noteworthy that out of the 75 companies which stated simplification of the internal structure to

be an important motive in the process of incorporation under the SE corporate form, 59 of them adopted an internal structure under which the company has only one management board member and one member of the supervisory board.

By contrast, if a Czech SE chooses the one-tier board structure, Czech law, in line with Art. 43 No. 2 SE Regulation, requires that the administrative body have at least three members.[25] Accordingly, the founders of a Czech SE may choose between the two-tier board structure with one management board member and one member of the supervisory board, and the one-tier board structure with at least three members of the administrative body. If the founders were to opt for a Czech corporation, as already explained, the management board would need to have at least three members (unless the corporation has a sole shareholder), as would the supervisory board. Clearly, setting up an SE with a two-tier structure with one member on both boards seems to be the most economic option provided that one wishes to cut back on management costs. This explanation correlates with the finding that out of the SE companies which chose the SE corporate form and reasoned their decision on the grounds of simplification of the internal corporate structure, the founders preferred the two-tier board structure over the one-tier system.

As a consequence, the users and founders of the SE may end up with an internal structure only slightly more complex than the one usually found in a Czech limited liability company that requires only one executive director. In this respect, one must note that, as a company form, the limited liability company is not considered as credible as a corporation in the Czech Republic due to country-specific circumstances in the 1990s.[26] Since that time, a corporation has been viewed to be a more "reputable" legal form. Hence, the SE seems to represent a corporate form that combines the credibility of a corporation with a simple internal structure consisting of one member of the management board and one member of the supervisory board.

In conclusion, the central findings of our survey indicate that incorporations of Czech SEs have been mainly driven by the simplification of the internal structure, which does not necessarily concern the availability of the one-tier board system, but rather the reduction of management board members and members of the supervisory board. Another very important factor has been the positive image of the SE. Corporate mobility comes third; however, so far there have been only

[25] *See* Section 26(1) of Act No. 627/2004, on a European Company, as amended.

[26] In the early 1990s, the protection of minority shareholders and namely creditors of Czech corporations and limited liability companies was, to a great extent, only at the beginning of its evolution. For instance, there were basically no rules for conflicted transactions up until 1996. The absence of effective tools led to significant tunneling of Czech companies which, of course, harmed minority shareholders and creditors. Even though this experience concerned both corporations and limited liability companies, the limited liability companies came out of the 1990s with a reputation of being not as trustworthy and credible a company form as that of a corporation (probably because of the lower capital required to set up a limited liability company compared to a corporation). *Cf.* J. Hurdík, *Právnické osoby a jejich typologie*, (C. H. Beck, Praha, 2003), p. 73.

very few cases in which Czech SEs actually embarked on moving their registered office into another Member State.

## IV. Shelf companies in particular

The foregoing account pretty much seems to solve the "Czech SE puzzle" at least with respect to operating companies that have some employees. However, questions remain with respect to the enormous number of shelf SEs that have been and continue to be set up in the Czech Republic. Why is it that so many SEs in the Czech Republic have no operations at all or have UFO status as described by the European Trade Union Institute?

One explanation might be related to employee involvement issues and an anticipated seat transfer. While there need not be negotiations on employee involvement if neither the founding companies nor the SE in formation have any employees, such negotiations must take place later on once the shelf company is "activated", i.e. once it starts carrying out business activities and hiring employees.[27] However, it is unclear under what circumstances exactly such activation can be assumed. Further, there have been cases in other Member States such as Germany in which registrars have been requiring undertakings by the founders of a shelf SE that the SE has no employees and will not have any in the foreseeable future.[28] These registrars are apparently concerned that the mandatory provisions of the SE Directive on employee involvement are circumvented.[29]

It might be the case that market participants, notably shelf company providers, perceive that Czech registrars take a more liberal attitude with respect to the initial registration of shelf SEs and the activation issue than, for example, German registrars. For instance, Czech registrars do not, to the best of our knowledge, require any undertakings by the founders of a shelf SE that the SE has no employees and will not have any in the foreseeable future.

Hence, legal arbitrage would suggest setting up a shelf SE in the Czech Republic for later use in other Member States after sale and transfer of the registered office. However, as already noted, even though many Czech shelf SEs have been sold in the course of our study,[30] only a

[27] See note 23 above.

[28] *See* e.g. OLG Düsseldorf, Resolution of 30 March 2009, FGPrax 2009, p. 124 (absent negotiations on employee involvement, the SE could only be registered because an undertaking had been given that it did not have any employees and would not have employees in the future).

[29] *See also* EC Commission, no. 6 above, p. 8 (noting that some respondents and trade union representatives mentioned the lack of clear rules on employee involvement when a shelf SE is activated or structural change after the SE's creation, which in the trade unions' view poses a risk that the employee involvement rules can be circumvented) or EC Commission, no. 11 above, p. 11.

[30] *See* no. 12 above.

handful of Czech SEs have so far transferred their registered office to another Member State. Hence, the suggested explanation for the great number of Czech shelf SEs is probably false.

That leaves us with the conclusion that shelf company service providers in the Czech Republic are probably too optimistic with respect to the overall demand for Czech SEs. True, there are strong reasons for Czech businesses to opt for this company form, such as simplification of the internal governance structure and the positive European image of the SE, and many operating firms have, on this basis, actually chosen to (re-)incorporate as an SE. However, overall demand seems to be lower than the number of shelf incorporations would suggest, at least for the time being. We will see in due course whether demand for "real" Czech SEs picks up significantly or whether most Czech SEs will remain on the shelves.

## V. Conclusion

After a slow start, the SE has become a highly popular company legal form for European businesses. Surprisingly, the Czech Republic is the clear market leader for SE incorporations with a majority of Czech SEs being shelf companies. The enormous popularity of the SE corporate form in the Czech Republic in general and the large number of Czech shelf SEs is puzzling.

The present empirical study has attempted to solve the puzzle on the basis of data on all 220 Czech SEs registered as of 1 June 2010 and a unique dataset of 88 interviews conducted with users of 88 Czech SEs in the period from September through November 2011. To the best of our knowledge, we have obtained the most comprehensive empirical basis for ascertaining the motives of Czech SE founders. It appears that with respect to operating firms, two motives clearly stand out: the desire to simplify the internal governance structure and the positive European image of the SE. With respect to the first motive in particular, an SE allows economizing on board size as, under the relevant European and Czech rules, both the management board and the supervisory board need not have more than one member. By contrast, a Czech corporation would need to have three members on each board unless it has a sole shareholder. Nearly all Czech SEs have retained the two-tier system, albeit with fewer members on the respective boards.

Shelf SEs are another matter. A potential explanation for the huge number of Czech shelf SEs seems to be that Czech registrars might take a more liberal attitude towards employee involvement issues in the context of shelf SEs with no employees. Hence, there seems to be scope for legal arbitrage by firms that seek to exploit this liberal attitude. However, so far only very few Czech SEs have moved their registered office to another Member State, which we take as strong evidence to refute this explanation. It is likely that shelf company service providers are currently

overestimating the demand for SEs in the Czech Republic. Alternatively, the (existing) advantages of the SE corporate form with respect to the simplification of the internal governance structure have not yet been fully appreciated by its domestic users. Time will tell which explanation is more plausible.

The market for Czech SEs could also shed some light on another European company policy debate, namely that on a private European company law form. A proposal for a "Statute for a European private company" (*Societas Privata Europaea*, SPE) was made by the European Commission in 2008.[31] After three years of intensive academic and political debate, it appears that the proposal has been shelved – at least for the time being. Minimum capital requirements, governance issues and the perennial co-determination problem in particular pose insurmountable obstacles. Behind these issues probably lies another one: Member States such as Germany and Austria fear that an SPE might become too popular, threatening the territorial dominance of their domestic legal forms for closely held corporations. The interests of other Member States from Eastern Europe are different. The popularity of the SE, a public corporation, in the Czech Republic for start-ups suggests that jurisdictions without a popular domestic legal form for closely held corporations are in clear need of a *Societas Privata Europaea*.

[31] COM (2008) 396/3.

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