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Are the Japanese Regulations on Pseudo-Foreign Companies Compatible with the Treaty of Friendship, Commerce and Navigation?

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Introduction

Corporations, foundations or other business entities are established based on certain laws and they can become judicial persons only when the law grants them judicial personalities[1]. Thus, each judicial person has its own "applicable law."

In regard to the determination of applicable laws of judicial persons including companies, there are two contrasting conflict of law theories, i.e., "incorporation theory" and "real seat theory." According to incorporation theory, applicable company laws are determined by reference to the laws of the country in which a company was founded. Therefore, once a company is founded in a foreign country based on its laws, it is also recognized as a judicial person in another. However, this could result in that the laws of the country where the company mainly carries out its business can be evaded by it choosing a different place of foundation.

Applicable company laws according to real seat theory, on the other hand, are determined by reference to the laws of the country in which the company has its real seat such as a head office or center of administration. Hence, when the place of incorporation is different from the place of a real seat, the company cannot be recognized as a judicial person. Since a pseudo-foreign company has its real seat in a country that is different from the country of incorporation, it cannot be recognized as a judicial person according to real seat theory.

It has been said that Japan adopts incorporation theory as conflict of law rules, and substantive laws have regulations regarding pseudo-foreign companies. More precisely, Article 821, Paragraph 1 of Japanese company law defines a pseudo-foreign company as "a foreign company that has its head office in Japan or whose main purpose is to conduct business in Japan" and it forbids the company from continuously carrying out transactions in Japan.

In contrast, Germany has traditionally adopted real seat theory. According to

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1) Yuko Nishitani, *Houjin oyobi Gaijin-hou Kisei*, in CHUSHAKU KOKUSAI SHIHOU VOL. 1 143 (Y. Sakurada & M. Dogauchi eds., 2011).

real seat theory, a foreign company that has its real seat in Germany cannot be recognized as a judicial person. Therefore, a company that is defined as a pseudo-foreign company according to Japanese company law cannot be recognized as a judicial person in Germany.

Thus, Japan and Germany have adopted different approaches to determine applicable laws to companies. However, both countries have enacted a Treaty of Friendship, Commerce and Navigation (hereafter called the "FCN") with other countries, which stipulates articles regarding "Freedom of Business" or "Freedom of Establishment" providing national treatment to a company that has been founded in other contracting state. In the Treaty of Friendship, Commerce and Navigation between Japan and the United Stateds of America (hereafter called the "U.S.-Japan FCN"), Article 22, Paragraph 3 defines the term of "companies" in the treaty and Article 7 grants them "Freedom of Business", which ensures them national treatment to carry out any type of business in either country.

As was previously stated, Article 821 of Japanese company law forbids pseudo -foreign companies from carrying out continuous transactions in Japan. This means that companies founded in the United States are also forbidden from carrying out continuous transactions when they are deemed to be pseudo-foreign companies. However, this could be contrary to the national treatment provided by the U.S.-Japan FCN, since only U.S. companies are forbidden from carrying out business continuously in Japan while Japanese companies do not have such limitations.

Despite this, there have been no court cases that have been judged on the relationship between regulations on pseudo-foreign companies and "Freedom of Business." Furthermore, there have been few studies on this topic in Japan.

In contrast, Germany also enacted an FCN with the U.S., which is almost identical to the U.S.-Japan FCN, which stipulates "Freedom of Establishment." The Federal Court of Justice in Germany (Bundesgerichtshof: BGH) interpreted "Freedom of Establishment" as adopting the incorporation theory, which overrides real seat theory that Germany has traditionally been based on. Seen from the fact that real seat theory has a function of regulating pseudo-foreign companies by not recognizing their judicial personalities, and the theory is overridden by the "Freedom of Establishment" according to the judgement by the Federal Court of Justice in Germany, there could be some possibilities of obtaining suggestions from the judgement in regard to the interpretation of the relationship between Japanese regulations on pseudo-foreign companies and the "Freedom of Business."

The author of this article tries to demonstrate the possibility of whether the judgement by the Federal Court of Justice in Germany provides hints for an

interpretation of the relationship between Japanese regulations on pseudo-foreign companies and the "Freedom of Business by comparing the treatment of foreign companies both in Japan and Germany.

This article consists of three sections: 1. The treatment of foreign companies in Japan and Germany, 2. The treatment of foreign companies incorporated in a contracting state of the Treaty of Friendship, Commerce and Navigation in Japan and Germany, and 3. A comparison between "Freedom of Business" and "Freedom of Establishment".

1. Treatment of foreign companies in Japan and Germany

1.1 Treatment of foreign companies in Japan

Since there are no written conflict of law rules in Japan regarding the determination of applicable laws to judicial persons, this matter has still been left open to interpretation[2]. According to the prevailing major theory, Japanese conflict of law rules adopt incorporation theory[3]. Therefore, when a company is incorporated in accordance with the law of the country in which the company was founded, its judicial personality is generally recognized at the conflict law level in Japan.

However, whether the company, which was given its judicial personality from foreign laws, may actually do business in Japan is deemed to be a different problem. In other words, a company's judicial personality must be approved by Japanese substantive law in order for the company to carry out its business in Japan[4]. This matter is referred to as "Approval of a Foreign Judicial Person (Gaikoku-Hojin-no-Ninkyo)." In addition, a foreign company that is approved by Japanese substantive law may be treated differently from a Japanese company in some areas such as supervision by the country or the rights it can hold. This matter including "Approval of a Foreign Judicial Person" is deemed to be a substantive law (alien law: "Gaijin-Hou") problem, which is different from the conflict of law problem.

"Approval of a Foreign Judicial Person (Gaikoku-Hojin-no-Ninkyo)" is

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2) In the drafting process of current Japanese international private law (Hou no Tekiyou ni Kansuru Hou), it was considered to establish a provision for determination of applicable law to judicial persons. However, this has been shelved. *See* Naoshi Takasugi, *Kokusai-Shihou niokeru Houjin*, 106-2 JOURNAL OF INTERNATIONAL LAW AND DIPLOMACY 1 (2007).

3) *Supra note*. 1, at 157.

4) Ryoichi Yamada, KOKUSAI SHIHOU 3rd ed., 225 (2004).

stipulated under Article 35[5] of the Japanese civil law. Paragraph 1 of the article lists the types of foreign judicial persons that can be approved as: (a) any state, any administrative division of any state, (b) any commercial corporation, and (c) any foreign juridical persons that are approved pursuant to the provisions of a law or treaty. Also, based on Paragraph 2 of the article, those approved judicial persons "shall possess the same private rights as may be possessed by the juridical person of the same kind which can be formed in Japan." Accordingly, Article 35 of the Japanese civil law provides that judicial persons will be approved irrespective of the country that they belong to[6]. In addition, there are no procedures required to obtain the approval stipulated in Article 35 of the civil law.

This "approval" is interpreted as that "to approve the judicial personality so that a foreign judicial person can carry out its business and possess rights and duties in Japan as a judicial person."[7] Furthermore, once the foreign judicial person is approved, not only may it possess rights and duties as a judicial person and become a party in lawsuits but it may also pursue its purposes, which include carrying out continuous transactions in Japan[8]. However, this only means that foreign judicial persons are approved to do their business within a general and abstract sense. Therefore, specific and concrete problems such as what kinds of rights they can possess or what types of businesses they can actually pursue are considered to be different from the "approval[9]".

To repeat, the judicial personality of a foreign company in Japan is recognized

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5) The following is a translation of Japanese civil law Article 35, available at http://www.japaneselawtranslation.go.jp/law/detail/?ft=2&re=01&dn=1&yo=%E6%B0%91%E6%B3%95&x=0&y=0&ia=03&ky=&page=3

(Foreign Juridical Person)

Article 35 (1) With the exception of any state, any administrative division of any state, and any commercial corporation, no establishment of a foreign juridical person shall be approved; provided, however, that, this shall not apply to any foreign juridical person which is approved pursuant to the provisions of a law or treaty.

(2) A foreign juridical person which is approved pursuant to the provision of the preceding paragraph shall possess the same private rights as may be possessed by the juridical person of the same kind which can be formed in Japan; provided, however, that, this shall not apply to any right which may not be enjoyed by a foreign national, or a right for which special provision is made in a law or treaty.

6) This is called General Approval (Ippan Ninkyo Shugi), *see supra* note. 1, at. 171.

7) *Supra* note. 1, at 170.

8) *Supra* note. 4, at 246.

9) *Supra* note. 4, at 247, *supra* note. 1, at 171.

at the conflict of law level based on incorporation theory and approved by Article 35 of the civil law. Also, as was previously stated, the approved foreign company may carry out its business continuously in Japan, although it may be restricted in terms of what kind of rights or businesses it can obtain or pursue.

Based on the fact that a foreign company is recognized and approved both by the conflict of law and substantive law, the company still has to follow the rules provided in company law. For example, a foreign company has to designate a representative in Japan (Article 817, Paragraph 1), and to register itself (Articles 818 and 933, Paragraph 1). If it does not follow these rules, it may not carry out its business continuously in Japan even though it is approved by Article 35 of the civil law. In addition, when a foreign company is deemed to be a pseudo-foreign company, it is not allowed to carry out its business continuously in Japan (Article 821, Paragraph 1)[10]. Therefore, these company law rules override Article 35 of the civil law.

In short, the applicable laws of foreign companies are determined as laws that they were based on when they were incorporated and their judicial personalities provided by the foreign laws are recognized by the Japanese conflict of laws. Then, these foreign companies are approved by Article 35 of the Japanese civil law so that they may carry out transactions continuously in Japan. However, they still have to follow the rules under company law. Their capability to carry out continuous transactions is denied especially when they are deemed to be pseudo-foreign companies.

1.2 Treatment of Foreign Companies in Germany

There are no written conflict of law rules in Germany to determine applicable laws to judicial persons. Also, no treaties or community regulations regarding this problem have come into force[11]. Therefore, this problem is still open to interpretation.

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10) The following is an English translation of Article 821 of Japanese company law, available at http://www.japaneselawtranslation.go.jp/law/detail/?ft=1&re=01&dn=1&x=93&y=12&co=01&ia=03&ky=%E4%BC%9A%E7%A4%BE%E6%B3%95&page=14

(Pseudo-Foreign Company)

Article 821 (1) A foreign company that has its head office in Japan or whose main purpose is to conduct business in Japan may not carry out transactions continuously in Japan.

(2) A person who has carried out transactions in violation of the provisions of the preceding paragraph shall be liable, jointly and severally with the foreign company, to perform obligations that have arisen from such transactions to the counterparty.

11) *Jan Kropholler*, Internationales Privatrecht, 6. Aufl., Tübingen 2006, S. 568 ff.

Germany has adopted real seat theory for a long time[12]. According to real seat theory, applicable laws to a foreign judicial person are determined to be the laws of the country where the person has its actual administrative place (real seat). The important factor to determine the real seat is the place where the fundamental administrative decisions are actually turned into the continuous business transactions[13]. In contrast, neither internal decision making nor the place of business that just follows the order is important[14]. Also, foreign entities, which are given judicial personality by the law of the real seat, are automatically recognized in Germany and no additional procedures are required for recognition (Anerkennung)[15].

According to this real seat theory, a company that was founded based on foreign law but has its real seat in Germany or a company that was founded based on German law but has it seat in other country generally do not have their judicial personality recognized in Germany. However, for a company that has its real seat in the country where it was incorporated, its judicial personality is automatically recognized in Germany without any additional procedures.

Despite these general rules regarding the treatment of foreign companies, when the companies were incorporated in the contracting state of the FCN, should the way they are treated be different? This will be discussed in the next section on how companies are treated under FCN treaties in Japan and Germany.

2. Treatment of Foreign Companies under FCN

2.1 Treatment of Companies under U.S.-Japan FCN

The Treaty of Friendship, Commerce and Navigation (FCN) is deemed to be the most basic and general bilateral treaty to enhance economic cooperation between contracting states. It generally provides basic matters to achieve its purpose, such as the entrance, residence and business of natural persons or judicial persons of the contracting state in the other state, protection of properties, importation, tariffs and international jurisdiction, among other matters. In addition, these provisions are stipulated based on the basic idea of freedom and non-discrimination[16].

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12) *Id*. at S. 578 ff.

13) *Supra* note. 11, at S. 571 ff.

14) *Ibid*.

15) *Ibid*.

16) Shunji Yanai, *Yukou Tsushou Joyaku -Sono Ruikei to Waga-kuni ga Teiketsu Shiteiru monono Gaikyo-*, 632 TOKINO HOUREI 35 (1968).

The U.S.-Japan FCN is the first FCN that Japan concluded after WW II and it came into force on October 10th in 1953. Its preamble provides its purpose by stating "The United States of America and Japan, desirous of strengthening the bonds of peace and friendship traditionally existing between them and of encouraging closer economic and cultural relations between their peoples, and being cognizant of the contributions which may be made toward these ends by arrangements promoting mutually advantageous commercial intercourse, encouraging mutually beneficial investments, and establishing mutual rights and privileges, have resolved to conclude a Treaty of Friendship, Commerce and Navigation, based in general upon the principles of national and of most favored-nation treatment unconditionally accorded." Most importantly, this treaty is based on "the principles of national and of most favored-nation treatment."[17)]

The FCN grants various legal statuses to nationals and companies of the contracting state to achieve the purpose provided in the preamble. Regarding the definition of such "companies" that enjoy this status, Article 22, Paragraph 3 states:

"As used in the present Treaty the term "companies" means corporations, partnerships, companies and other associations, whether or not with limited liability and whether or not for pecuniary profit. Companies constituted under applicable laws and regulations within the territories of either party shall be deemed companies thereof and shall have their juridical status recognized within the territories of the other party."

Thus, "companies" in this treaty means any associations including corporations or companies constituted under the applicable law of the contracting state and the other contracting state has to recognize their judicial status in its territories. Hence, companies incorporated pursuant to the applicable law of some state in the United States are recognized to have judicial status in Japan.

These companies are granted several legal statuses in the territories of the other party of the treaty and one of them is called "Freedom of Business," which is provided under Article 7, Paragraph 1 of the treaty that states:

"Nationals and companies of either Party shall be accorded national treatment with respect to engaging in all types of commercial, industrial, financial and other business activities within the territories of the other Party, whether directly or by

17) *See*, Takeshi Kanematsu, *Chikujo Kaisetsu Nichi-bei Yukou Tsushou Joyaku (1)*, 97 TOKINO HOUREI 2 (1953).

agent or through the medium of any form of lawful juridical entity. Accordingly, such nationals and companies shall be permitted within such territories: (a) to establish and maintain branches, agencies, offices, factories and other establishments appropriate to the conduct of their business, (b) to organize companies under the general company laws of such other Party, and to acquire majority interests in companies of such other Party, and (c) to control and manage enterprises which they have established or acquired. Moreover, enterprises which they control, whether in the form of individual proprietorships, companies or otherwise, shall, in all that relates to the conduct of the activities thereof, be accorded treatment no less favorable than that accorded like enterprises controlled by nationals and companies of such other Party."

Paragraph 2 of Article 7[18] lists up the types of businesses that the contracting party can place on limitations on the status provided in Paragraph 1 of the article. These businesses include shipbuilding, air or water transport, banking involving depository or fiduciary functions, or the exploitation of land or other natural resources. In other words, companies of the contracting party can do all types of businesses in the territories of the other party except for the ones listed in Paragraph 2 of Article 7.

Therefore, companies founded in the United States are approved in Japan to do all types of businesses with some exceptions, based on national treatment. This means that not only are the legal personalities of U.S. companies recognized but their legal status is also approved for them to carry out their business in Japan[19].

According to the major theory in Japan, this is interpreted as "approval pursuant to the provisions of a treaty (Joyaku-jo no Ninkyo)" provided in Article

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18) Article 7, Paragraph 2 of the U.S.-Japan FCN states:
Each Party reserves the right to limit the extent to which aliens may within its territories establish, acquire interests in, or carry on public utilities enterprises or enterprises engaged in shipbuilding, air or water transport, banking involving depository or fiduciary functions, or the exploitation of land or other natural resources. However, new limitations imposed by either Party upon the extent to which aliens are accorded national treatment, with respect to carrying on such activities within its territories, shall not be applied as against enterprises which are engaged in such activities therein at the time such new limitations are adopted and which are owned or controlled by nationals and companies of the other Party. Moreover, neither Party shall deny to transportation, communications and banking companies of the other Party the right to maintain branches and agencies to perform functions necessary for essentially international operations in which they are permitted to engage.

19) Ryoichi Yamada, *Jouyaku niyoru Gaikoku Houjin no Ninkyo*, 57-2 JOURNAL OF INTERNATIONAL LAW AND DIPLOMACY 21 (1953).

35, Paragraph 1 of the civil law[20]. As stated in Subsection 1.1, approval (Ninkyo) means that the foreign judicial person that is approved may not only possess rights and duties as a judicial person and become a party of lawsuits but it may also pursue its purposes, which include doing continuous transactions. Therefore, companies approved pursuant to the treaty are eligible to carry out transactions continuously in Japan.

However, Article 821 of the company law forbids pseudo-foreign companies from "continuously" carrying out business in Japan. Hence, companies founded in the United States will be forbidden from carrying out their business continuously in Japan when they are deemed to be pseudo-foreign companies, which can be contrary to the national treatment provided by "Freedom of Business" in the treaty.

However, this conclusion cannot be evidenced by preceding studies in Japan. However, there have been judgements made by the Federal Court of Justice in Germany regarding the interpretation of the provisions of the FCN. The next subsection discusses the treatment of companies under the FCN between the United States and Germany by referring to judgements made by the Federal Court of Justice in Germany regarding to the "Freedom of Establishment" provided in the treaty.

2.2 Treatment of Companies under U.S.-Germany FCN

The Treaty of Friendship, Commerce and Navigation between the United States of America and the Federal Republic of Germany (hereafter called the "U.S. -Germany FCN") came into force on July 14th, 1956. Similar to the U.S.-Japan FCN, its preamble asserts its purpose by stating "The United States of America and the Federal Republic of Germany desirous of strengthening the bonds of friendship existing between them and of encouraging closer economic and cultural relations between their peoples, and being cognizant of the contributions which may be made toward these ends by arrangements promoting mutually advantageous commercial intercourse, encouraging mutually beneficial investments, and establishing mutual rights and privileges, have resolved to conclude a Treaty of Friendship, Commerce and Navigation, based in general upon the principles of national and of unconditional most-favored-nation treatment reciprocally accorded."

In order to achieve this purpose, the treaty grants citizens and companies of the

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20) Yoshio Tameike, KOKUSAI SHIHOU KOUGI 3rd ed., 306 (2005), Yamada *supra* note. 4, at 248, Nishitani *supra* note. 1, at 172.

contracting party several legal statuses and the definition of "companies" is stipulated in Article 25, Paragraph 5[21], which is identical to Article 22, Paragraph 3 of the U.S.-Japan FCN. Also, citizens and companies of the contracting party are granted national treatment to carry out all types of commercial, industrial, financial and other activities in the territories of the other party under Article 7, Paragraph 1 of the treaty[22], which is almost identical to Article 7, Paragraph 1 of the U.S.-Japan FCN. As will be stated later, the national treatment provided by Article 7, Paragraph 1 of the U.S.-Germany FCN is called "Freedom of Establishment." Therefore, both the U.S.-Germany FCN and U.S.-Japan FCN are very similar to

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21) Article 25, Paragraph 5 of the U.S.-Germany FCN states:;
"As used in the present Treaty, the term "companies" means corporations, partnerships, companies and other associations, whether or not with limited liability and whether or not for pecuniary profit. Companies constituted under the applicable laws and regulations within the territories of either Party shall be deemed companies thereof and shall have their juridical status recognized within the territories of the other Party."

22) Article 7, Paragraph 1 and 2 of the U.S.-German FCN states:
"Nationals and companies of either Party shall be accorded, within the territories of the other Party, national treatment with respect to engaging in all types of commercial, industrial, financial and other activity for gain, whether in a dependent or an independent capacity, and whether directly or by agent or through the medium of any form of lawful juridical entity. Accordingly, such nationals and companies shall be permitted within such territories: to establish and maintain branches, agencies, offices, factories and other establishments appropriate to the conduct of their business; to organize companies under the general company laws of such other Party, and to acquire majority interests in companies of such other Party; and to control and manage enterprises which they have established or acquired. Moreover, enterprises which they control, whether in the form of individual proprietorships, companies or otherwise, shall in all that relates to the conduct of the activities thereof, be accorded treatment no less favorable than that accorded like enterprises controlled by nationals or companies of such other Party."
"Each Party reserves the right to limit the extent to which aliens may establish, acquire interests in, or carry on enterprises engaged within its territories in communications, air or water transport, taking and administering trusts, banking involving depository functions, or the exploitation of land or other natural resources. However, new limitations imposed by either Party upon the extent to which aliens are accorded national treatment, with respect to carrying on such activities within its territories, shall not be applied as against enterprises which are engaged in such activities therein at the time such new limitations are adopted and which are owned or controlled by nationals or companies of the other Party. Moreover, neither Party shall deny to transportation, communications and banking companies of the other Party the right to maintain branches and agencies, in conformity with the applicable laws and regulations, to perform functions necessary for essentially international operations in which they engage."

each other in terms of the time when they came into force and their provisions.

However, the consequence of real seat theory, which is that judicial personality of the U.S. companies that have their real seat in Germany is denied seems to be contrary to the Article 25, Paragraph 5 of the treaty, which recognizes such companies incorporated in the U.S..

The next subsection discusses how the Federal Court of Justice in Germany interpreted the relationship between domestic law rules and provisions of the FCN.

2.2.1 Judgement by Federal Court of Justice in Germany

There are two judgements made by the Federal Court of Justice in Germany (Bundesgerichtshof: hereafter called "BGH") that are discussed in this subsection: Judgement on January 29th, 2003 and Judgement on July 5th, 2004.

2.2.1.1 Judgement on January 29th, 2003[23)]

The plaintiff was a corporation incorporated pursuant to the law of the state of Florida. It purchased shares of another company and sold them to the defendant. While the plaintiff claimed the defendant should pay for the price of the shares, the defendant refused to do so by stating that the plaintiff had its real seat only in Germany and did not have admissibility to legal proceedings in Germany. The district court admitted the plaintiff's claim. However, since the court of appeal dismissed the plaintiff's claim, the plaintiff appealed to the BGH.

As stated in Subsection 1.2, Germany has adopted real seat theory to define applicable laws to judicial persons, which has led to foreign judicial persons that have their real seat in Germany not having their judicial personalities recognized unless they are reincorporated pursuant to German law. However, the BGH stated that Article 25, Paragraph 5 of the treaty is not connected to real seat theory but to incorporation theory. Hence, companies incorporated in the territories of the contracting state are recognized as a legal entity in the other contracting state and corporations incorporated pursuant to the rules of the U.S. are recognized to have a legal capacity in Germany[24)]. Also, the BGH, referring to the Überseering case judgement[25)] made by the European Court of Justice (hereafter called the "ECJ"[26)]), stated that "Freedom of Establishment" (Niederlassungsfreiheit) deals with absolute

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23) BGH-Urteil v. 29.01.2003, BGHZ, 353.

24) *Id*. at para. 11.

25) Case C-208/00; *Überseering v. NCC* [2002] ECR I-9919.

26) It is now called "Court of Justice of European Union (CJEU)."

recognition of the legal capacity and admissibility to legal proceedings and thus, the legal capacity and the admissibility to legal proceedings of the plaintiff must be judged in accordance with the law of the U.S.[27)]

2.2.1.2 Judgement on July 5th, 2004[28)]

The defendant was a shareholder of S corporation, which was incorporated pursuant to the law of the state of Delaware and whose representative was situated in Munich. The plaintiff consigned S to deposit shares owned by himself in an account situated in the U.S. The plaintiff required the defendant to return the deposited shares to him by stating that S should not have been treated as a U.S. corporation but as a German partnership (OHG) since S retained its seat in Germany, and therefore, the defendant bore S's liability to return the shares under the German Commercial Code.

In this case, the existence of the liability of the shareholder of the Delaware corporation, which had its real seat in Germany was disputed. In other words, if the corporation was deemed to be a Delaware corporation, the liability of the shareholder was limited under Delaware law but if it was deemed to be a partnership in Germany where it had its real seat, the defendant had a liability for obligation of the partnership under German law.

The BGH stated that according to Article 25, Paragraph 5 of the U.S.-Germany FCN, a company that was incorporated pursuant to the law of the contracting state in its territories was valid as a company of that state and its legal status was recognized as it was in the other contracting state[29)]. Also, the court stated that in the scope of the U.S.-Germany FCN, applicable laws to companies were connected to the laws of incorporation and this not only applied to the legal capacity or admissibility to legal proceedings but also a shareholder's liability[30)]. Therefore, the Court made it clear that real seat theory was replaced by incorporation theory within the scope of the FCN[31)].

Furthermore, the Court stated that this was also followed by the fact that the FCN clearly approved each company of the contracting state the "Freedom of Establishment" in the territories of the other contracting state, and in this respect,

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27) *Supra* note. 23, at para. 13.
28) BGH-Urteil v. 05.07.2004, NJW-RR 2004, 1618.
29) *Id*. para. 6.
30) *Ibid*.
31) *Ibid*.

the same within the scope of the "Freedom of Establishment" stipulated under EC treaty Articles 43 and 48 applied here[32].

In addition, the Court ruled that a "Genuine Link" between the company and the country of incorporation was required for the applicability of FCN. However, it also stated that this requirement was fulfilled by doing some transactions in the country of incorporation. In this case, a "Genuine Link" between S and the U.S. was not denied since S preserved shares in the account situated in the U.S.[33]

In conclusion, the applicability of German commercial code was precluded and the applicable law of S was judged to be Delaware law, which determined that the shareholder had limited liability. Hence, the defendant did not have liability over S corporation's obligations[34].

It became clear from the two judgements in Germany that 1. The U.S.-Germany FCN adopted incorporation theory and overrode real seat theory, 2. "Freedom of Establishment" meant the absolute recognition of the legal capacity and admissibility to legal proceedings of companies incorporated in the other contracting state, and 3. The requirement of a "Genuine Link" between the company and the country of incorporation was fulfilled by doing some transactions in the country of incorporation. Therefore, it seems that "Freedom of Establishment" in Germany is considered as a matter of conflict of law.

Moreover, both judgements on "Freedom of Establishment" in the FCN referred to the ECJ judgements on "Freedom of Establishment" in the EC treaty. This could mean that in Germany, both "Freedom of Establishment" in the FCN and the EC treaty (the current provision is stipulated in Articles 49 and 54 of the "Treaty on the Functioning of the European Union") are deemed to have the same meaning.

From the above, is it possible to apply these interpretations by BGH to the interpretation of "Freedom of Business" in Japan? It will attempted to compare the interpretation of the FCNs in Japan and Germany in the next section.

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32) *Ibid*. The court made a reference to the Überseering case judgement (Case C-208/00; *Überseering v NCC* [2002] ECR I-9919) and also the Inspire Art case judgement (Case C-167/01; *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd* [1998] ECR I-10155).

33) *Supra* note. 28, at para. 7.

34) *Id*. para. 8.

3. Comparison between "Freedom of Business" and "Freedom of Establishment"

Both the U.S.-Japan and U.S.-Germany FCNs provide "Freedom of Business" or "Freedom of Establishment" (Article 7, Paragraph 1), which means that national treatment to carry out any business, except for a limited area of business, is granted to companies of the contracting state in the territories of the other. Also, both treaties stipulate the definition of "companies" that can enjoy national treatment by stating "the term "companies" means corporations, partnerships, companies, and other associations, whether or not with limited liability and whether or not for pecuniary profit. Companies constituted under applicable laws and regulations within the territories of either party shall be deemed companies thereof and shall have their juridical status recognized within the territories of the other party" (Article 22, Paragraph 3 of the US-Japan FCN and Article 25, Paragraph 3 of the US-Germany FCN).

In contrast, "Freedom of Business" in Japan and "Freedom of Establishment" in Germany are considered differently. In Germany, it is deemed to be a conflict of law matter: real seat theory is overridden by incorporation theory within the scope of the FCN. Since incorporation theory has been adopted in Japan as its conflict of law rule, there is no change in interpretation even if the FCN is interpreted as adopting incorporation theory. In other words, "Freedom of Business" is considered as a matter of substantive law in Japan whereas "Freedom of Establishment" is considered as a matter of conflict of law in Germany. However, it may be unreasonable to interpret "Freedom of Business" and "Freedom of Establishment" in different ways even though both FCNs have almost identical provisions for the same subject. Therefore, it cannot be impossible to consider that "Freedom of Business" or "Freedom of Establishment" applies both at the level of conflict of law and also substantive law.

Nevertheless, it is still difficult to apply German interpretation of the FCN directly to the Japanese interpretation of the FCN since "Freedom of Business" and "Freedom of Establishment" are considered to be matters involving different legal levels.

By contrast, the requirement for a "Genuine Link" was also referred to for the applicability of the FCN in the German court judgements, and this requirement could only be applied to a Japanese interpretation of the FCN.

Conclusion

Although this article started from the question that Japanese regulations on pseudo-foreign companies could be incompatible with "Freedom of Business,"

which grants the companies of a contracting state national treatment to carry out business with continuous transactions in Japan, since this could not be proven by precedent studies or court cases, the author tried to obtain inspiration from the German interpretation of the FCN, which had an almost identical provision called "Freedom of Establishment."

As a result, it became clear that "Freedom of Business" is considered to be a substantive law problem in Japan whereas "Freedom of Establishment" is considered to be a conflict of law problem and the interpretation in Germany is difficult to directly apply in Japan. This is because Japan and Germany have adopted different conflict of law rules regarding the determination of applicable laws to judicial persons including companies.

Despite this, the requirement for a "Genuine Link" between companies and the country where they were incorporated regarding the applicability of the FCN was pointed out in the judgments of the Federal Court of Justice in Germany. This requirement can be applied to the interpretation of the U.S.-Japan FCN: when no "Genuine Link" between a U.S. company and the U.S. is recognized, the applicability of the FCN is denied, which leads to the consequence that there are no longer any conflicts between Japanese regulations on pseudo-foreign companies and the "Freedom of Business" of the FCN. A requirement of "Genuine Link" is fulfilled in the German judgements when the company is doing "some transactions" in the territories of the state of incorporation. However, it is still not clear what specific requirements should be fulfilled. A future issue still remains, which is to analyze the interpretation of "Genuine Links" in Germany.