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Regulatory Competition Puzzle: The European Design

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REGULATORY COMPETITION PUZZLE: THE EUROPEAN DESIGN

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Abstract

In this paper, we examine the inconclusive debate on regulatory competition in Europe. We demonstrate that the recent expansion in the EU company law has created archetypal underpinning for formation of regulatory competition: the ground-breaking "triptych" of the ECJ on *Centros*, *Überseering,* and *Inspire Art,* on the top of previously infamous cases, has paved a way to a regulatory arbitrage throughout the EU, and a *petite* migration of companies abroad is already an evidence. We elucidate that few European states are putting into practice some facilitation in company registration procedure, including a significant cut in the minimum capital requirements, aiming to keep up with foreign options. This is the very process called regulatory competition, though it is not for charters and not for re-incorporations, but for capital requirements and for start-ups. Our idea is that these actions are only some, but promising, first steps *en route* to expansion towards regulatory competition in Europe also for large companies and for their reincorporation options. Hitherto, we reject the existence of an "EU Delaware", though we demonstrate that few EU and EEA Member States have potential to take the lead in forthcoming chartermongering activities and are preparing for that: we claim for the appearance of more then one "European Delawares" at least for the time being. The then competition result will largely depend on the further advancements in the EC programs on this field, and/or on another "spectacular crusade" of the ECJ in particular, be it a reality. Thus, it is still soon to conclude the competition and prize the winner, but considerable network externality effects that drive a path dependent evolution suggests that it is likely to see a state that will become the "basin of attraction" for most of the companies later on. As a focal point, in the EU it is implausible to see a regulatory competition without Brussels meddling down from the top, which affects such developments negatively, unfortunately.

Key words: freedom of establishment, regulatory arbitrage, regulatory competition, company law, (re)incorporations, EU, EEA

JEL#: G34, G38, K22, L22, L51, M14

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I. INTRODUCTION

The debate on regulatory competition, restarted some three decades ago, has attracted much attention from both academicians and policymakers. The voluminous literature on this phenomenon addresses mostly the situation on the left side of the Atlantic, where the subject in discussion has started more then a century ago. Only recently, this debate moved to Europe in the wake of the famous "triptych" of the ECJ on *Centros*, *Überseering*, and *Inspire Art* on the top of the few other innovative cases before.[1] Although the first bedrock ideas of the debate on the US regulatory competition appeared around a dozen of decades ago, it is still an entirely open-ended *mêlée* of arguments for all constituencies. Yet, the EU debate with its recent developments needs to be studied to explain not only the existence of cornerstones for regulatory competition here, but also to clarify the roles, sizes and the affect of those factors on the overall evolution, since the started controversy on this are is still on.

Despite much attention has been devoted to the separate studies on the US and the EU realities, there are, though few, studies trying to link these two developments together and to explain their interrelations and possible co-developments. Besides, for European case, the peculiarities of the regulatory subject are still not exactly clarified and explained. The literature hitherto gives different interpretations on the state of the art of, and the possible developments for, freedoms of companies to move, as well as on the recognition of their rights by the states' authorities and the whole set of rules correlated with that.

More to the point, the legislation on these aspects is subject to continuous change: especially the recent landmark intervention of the ECJ on the above-mentioned triad of cases with its "predecessors", gave birth to new interpretations and likely advancements on this area. Thus far, law and economics scholars quarrel about the exact affect of these rulings on the actual reality and its possible furtherance; yet, the debate on the necessity, means and the ways of company law harmonization creates counterarguments; yet, the level and the content of the law making practice at the EU or at the Member States' level needs to be re-qualified and redefined; yet, the regulatory arbitrage and the rights of companies to (re)incorporate in other Member States and beyond need to be analysed with added details; yet, the motivations, possibilities and manners of Member States to attract companies through their company law needs to be reassessed; yet, the existence of a Member State as the most attractive charter-offer, and the likelihood of it to become as such need to be revealed; yet, many other questions concerning this debate needs more and careful attention from all constituencies.

Against this background, this paper seeks to combine the whole puzzle of the regulatory competition debate in the EU. To this aim, in comparison with the US corporate law formation and evolution, it analyses the corporate legislation of the EU with particular attention on its development, harmonization, and the state of the art concerning possible shortfalls and forthcoming supplements. In this study, we demonstrate the breadth and the depth of the EU company law, highlighting its peculiarities. The comparison to the US reality

[1] See the appropriate section below for discussion of these cases.

allows demonstrating that the starting conditions, the stages, and ways of the development, as well as the overall content of the EU company law is enough different in order not to be argued for analogous developments here. Put another way, it is very unlikely to expect a mirror- competition in Europe with regard to charter offering activities: EU has its own path to proceed.

In particular, this paper elucidates the ECJ recent famous rulings concerning the freedom of establishment and companies' migration, explaining that these innovative interference has created strong precedents, and to a great extent opened up real possibilities for radical changes with regard to companies' movements throughout the EU and probably also beyond (see these in Part II).

Among other things, this paper reveals the differences between the "place of incorporation theory" and the "real seat theory" in the EU Member States. We demonstrate not only their affect on the Member States' possible charter offering activities, but also the changing dominance of these doctrines throughout the Europe because of above-mentioned ECJ rulings. We support the argument that these rulings have just started, but did not completed the end of the real seat doctrine, which affects negatively to the free migration of companies as well as the (possible) competition among the Member States' on charter offering activities.

Meanwhile, we claim the existence of the regulatory competition in Europe, but not as it is understood in the US: to be sure, there is a *petit* evidence that few Member States attract companies from abroad through eliminating the barriers for registration, facilitating the whole process, as well as decreasing dramatically the requirement for minimum capital. These factors are of great importance for start-ups, and satisfactory reasons for incorporating abroad, the evidence suggests. Though, such factors are unlikely to be significant for already established and operating companies in order to be sufficient reason to reincorporate abroad: the empirical evidence is still salient for the case of these companies and their movements. Our analyses suggest that, absent the very reason for regulatory competition – franchise revenues - states are already started their competition to take on the competition with foreign legal forms. On the one hand, we demonstrate that the Member States lack most of the reasons to attract corporations, as it is the case in the US, while on the other hand we present some other arguments that could become sufficient reasons to create such a competition.

Furthermore, we tried to enlarge the topic with regard to countries other then the EU Member States, such as the ones in the EEA. Revising these states' conditions, in this paper we argue that there exist at least an archetypal underneath for these states to enter in a charter offering practice and also to become a "basin of attraction" for companies, offering those peculiar conditions.

Besides, we answer to the questions concerning the existence of a "EU Delaware" negatively, and emphasize the unlikelihood of such happening soon. We argue that for the time being not only there is no state in Europe to be called as such, but also there will not be at least in the short run. Instead, we demonstrate some classic characteristics of few European states that could allow them attracting some portion of companies from other states. That is to say,

for the moment, rejecting existence of "EU Delaware", we introduce the nearby appearance of "European Delawares". Given the diversity of starting conditions of companies, in the EU as well as in the EEA, at least for some time, the concentration of companies is likely to be seen in more then one state. The then competition result will largely depend on the further advancements in the EC programs on this field, and on possible "spectacular crusade" of the ECJ in particular: thus, it is still soon to conclude the competition and prize the winner (see these in Part III). The last part concludes.

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…[M]ost EC corporate law can be categorized as optional, marketmimicking, unimportant, or avoidable. In other words, there is (almost) nothing nontrivial that EC corporate law requires to do, forbids, or enables to do.

Luca Enriques, *2005* [2]

II. THE COMPANY LAW IN THE EU

A. WHAT IS ACTUALLY THE EUROPEAN COMPANY LAW?

In order to answer to this question we deem proper to begin with a clarification of the nature and the meaning of "company law" in the EU context, since if "company law" in a particular state could be, and very often is, a certain legal act, it is not so in the EU context. Besides, here at least the scope of "company law" differs from jurisdiction to jurisdiction.[3]

In reality, the combined legal acts that are considered to be the "European company law" include nine Company Law Directives (from One to Twelve, excluding the Fifth, Ninth and Tenth), five Capital Market Law Directives,[4] a Regulation on the Statute for a European

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[2] *See* Enriques, L. (2005), "EC Company Law Directives and Regulations: How Trivial are They", ECGI Law Working Paper N39/2005, May 2005

[3] *See* among others e.g. Kraakman R. et al, (2004), THE ANATOMY OF CORPORATE LAW (Oxford: OUP), at 15-17. As the pointed out, the corporate law does two basic things: establishes the structure of the corporate form (particularly the property rules that separate corporate assets from the assets of individuals associated with the company), and seeks to prevent opportunism within voluntary relationships between participants, which generally includes at least shareholders and directors and at most also creditors, employees.

[4] It is beyond the borders of this paper to discuss the Capital Market Law Directives, but we find necessary to mention shortly the coverage of these directives that deal with: i) the prospectus that has to be issued whenever securities admitted to regulated markets, or whenever they are publicly offered in other not regulated markets, its contents, publication and mutual recognition; ii) the admission requirements for official listing on a stock exchange and the ongoing duties arising therefrom (mainly transparency of major blockholdings, ad hoc disclosure and interim reports), which are increasingly extended to situations in which securities are admitted to regulated markets (i.e. a larger area comprising official listing); iii) secondary market problems, i.e. problems related not to the issue or first admission of securities but to trading, namely the duties or intermediaries, which consist mainly of advising individual investors (Investment Services Directive), and some basic prohibitions applying to all players and enhancing the confidence of the public at large in capital markets (Market Abuse Directive); iv) the duty to make a bid to all shareholders od the target company (i.e. to treat them equally (and

company (*Societas Europaea* or *SE*), as well as other directives/regulations on corporate taxation and insolvency.

The basis for the topic in question is the provisions of the EC Treaty protecting (primary and secondary) freedom of establishment mainly through two articles: Article 43[5] (ex Article 52) and Article 48[6] (ex Article 58).

Generally, company law's regulatory choices are complementary to other aspects of a corporate governance system and of the regulation of the other areas of an economy, including tax, labour, competition, securities, and pension regulation, and corporate ownership structure.[7] These complementarities together with the diversity of Member States' corporate governance systems, implies that different rules and regulations are likely to considered the best for different systems,[8] while suggesting that the adoption of a European act would not be that much helpful.[9]

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strict regime for defensive measures (Takeover Directive). *See* e.g. Grundmann, S., (2004), "The Structure of European Company Law: From Crisis to Boom", 5 EBOR 601-633, at 604

[5] It reads: "...restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State. Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies and firms within the meaning of the second paragraph of Article 48, under the conditions laid down for its own nationals by the law of the country where such establishment is effected..."

[6] It reads: "Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of [the chapter on freedom of establishment], be treated in the same way as natural persons who are nationals of Member States.

"Companies or firms" means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making".

[7] For the definition of complementarity, see Milgrom, P. and J. Roberts, (1995) "Complementarities and Fit. Strategy, Structure, and Organizational Change in Manufacturing." Journal of Accounting and Economics 19, 179–208. Concerning the legal rules, complementarity means that the effect of one legal rule depends on other legal rules.

[8] *See* among others e.g. Amable, B., THE DIVERSITY OF MODERN CAPITALISM (Oxford: OUP, 2003); Carlin, W. and C. Mayer (2002), "How do Financial Systems Affect Economic Performance?" in J. McCahery *et al* (eds.), CORPORATE GOVERNANCE REGIMES: CONVERGENCE AND DIVERSITY (Oxford: OUP, 2002), 325; Fioretos, O. (2001) "Varieties of Capitalism in the European Community" in P.A. Hall and D. Soskice (eds.), VARIETIES OF CAPITALISM (Oxford: OUP, 2001); Schmidt, R. H. and G. Spindler, (2004) "Path Dependence and Complementarity in Corporate Governance" in J. N. Gordon and M. J. Roe (eds.), CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE (Cambridge: CUP, 2004).

[9] See e.g. the recommendations of the High Level Group of Company Law Experts on adoption of a European corporate governance code: "The adoption of such a code would not achieve full information for investors about the key corporate governance rules applicable to companies across Europe, as these rules would still be based on and part of national company laws that are in certain aspects widely divergent. We also doubted whether additional Europe-wide voluntary rules would contribute to the improvement of corporate governance, as Europe would either have to allow many alternative rules, depending on the various company law systems, or to confine itself to abstract, and perhaps largely meaningless, rules which would be compatible with all of these systems." HLG "Report on a Modern Regulatory Framework for Company Law in Europe" (4.11. 2002) 101

The EU company law has been considered as incomplete and rather ineffective set of provisions.[10] Among the reasons for this, several explanations have been mentioned already, e.g. the disagreement among Member States concerning some important issues, not complete implementation of EU directives by Member States, political aspects, etc.

In order to describe the depth and the breadth of the EU company law, we find necessary to refer shortly to the history and the development of the normative regulatory acts composing the company law, which is provided below.

B. HOW IT HAS BEEN DEVELOPING?

Most of the initiatives of company law making at the EU level have been based on Article 44 (2) g (ex 54) of the Treaty establishing the EC. Leaving apart the question of who supplies the company law in the EU,[11] hereby we discuss the development of the core of the company law – the directives of the EU, as well as of the case law.

1. *Four generations of directives*

It is acknowledged that the EU directives adopted until now are divided by four parts - four generations as it is accepted in the literature.[12] The first generation of directives includes first two directives, for which the rigid and complete harmonization was characteristic.[13] The First Directive, adopted in 1968, set up some minimum standards concerning disclosure of information, as well as some other standards for state laws concerning the validity of obligations entered into by the company with third parties, and the bases for the nullity of a company. The Second Directive, adopted in 1976, underlined several requirements for public companies, such as the obligation of having a minimum paid up share capital as well as rules relating to the maintenance of capital.

Meanwhile, two years after the adoption of the First directive, the EC proposed the introduction of the European Company, to allow firms operating in different Member States easily move from one to another: the battle between EC and Member States on this took some decades.[14]

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[10] *See*, e.g., Hopt, K. L. (2002), "Common Principles of Corporate Governance in Europe", in McCahery J. A. *et al* (eds.), CORPORATE GOVERNANCE REGIMES: CONVERGENCE AND DIVERSITY (Oxford: OUP, 2002); Coffee, J. C. Jr., (1999) "The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications", 93 NW. U. L. REV. 641;

[11] *See* for the detailed discussion on the law making of the EU company law, among others e.g. Wouters, J. (2000) "European Company Law: Quo Vadis?" 37 Common Mkt. L. Rev. 257; and Enriques (2005) *supra note* 2 (concerning the development of the EU company law)

[12] *See* Villiers, C., EUROPEAN COMPANY LAW: TOWARDS DEMOCRACY! (Aldershot: Dartmouth, 1998)

[13] Here we talk about First and Second Company Law Directives only, but this generation of directives include also First Council Directive (1968) *OJ* Spec Ed (I) (disclosure of corporate data); Second Council Directive [1977] *OJ* 26/1 (protection of capital).

[14] *See* the appropriate section on Societas Europea hereby in this paper for more detailed discussion on the results of this battle.

With the accession to the Union of other States, the tendency of uniformity resulted to approaches that are more flexible. The successive waves of directives have followed. The second-generation is named as "accounting", since that includes the Fourth Directive (adopted in 1978), the Seventh Directive (adopted in 1983), and the Eight Directive (adopted in 1984)[15] that mainly highlighted basic accounting and audit standards. But soon, the rigid approach of the first and second-generation directives showed its limitations, and the harmonization of core areas of company law, like the structure and responsibility of the board of directors, cross-border mergers, representation of employees, and bankruptcy procedures, proved to be predictably slow and ineffective.[16]

While harmonizing the several differences of its members, the EC introduced the Regulation of the European Economics Interest Grouping (EEIG), creating a European framework that provides existing firms with an easy vehicle for cross border restructuring, which sought to become a pan-European business form, but actually, ended up as rather an unpopular one.[17]

With the second enlargement, the EU adopted a new model of integration based on centralized federalism.[18] The two directives compose the third generation of directives concerning the disclosure of branches and formation of single member companies, which were marginal to domestic company law arrangements.[19] They were a kind of new revelation formed by minimum harmonization and mutual recognition principles, and passed close to adoption of the Single European Act (SEA) in 1986 as well as the initiation of the single market program. These two directives established the "reference to standards" principle, i.e. a product, which conformed to a standard set by a European-level body, or, failing that, with the relevant national standard, also complied with EC law. In line with these developments, the Company law was among other areas to which this decentralizing approach was applied. This period is characterized as one of inadequate regulatory responses to market evolution.

The development of subsidiarity principle in the Maastricht Treaty of 1992 was a new stage in the evolution of federalism that constrained the EC's role.[20] This principle envisages

[15] Apart from the mentioned directives, the second generation directives include also the Third (1978) *OJ* L295/36 and Sixth Council Directives (1982) *OJ* L378/47 on Mergers and Split-Offs.

[16] *See* Wooldridge, F. (2003), "Überseering: Freedom of Establishment of Companies Affirmed", 14 Eur. Bus. L. Rev. 221;

[17] The EEIG is adopted in 1985 (Council Reg (EEC) 2137/85 on the European Economic Interest Grouping (EEIG) [1985] OJ L199/1). Currently there are about 1400 registered EEIGs throughout the EU, of which 362 are in Belgium, 243 in France, 163 in Great Britain and 143 in Germany.

[18] *See* Inman, R. P. and D. Rubinfeld, (1998), "Subsidiarity and the European Union", in P. Newman (ed.), The New Palgrave Dictionary of Economics and the Law, London: Macmillan Reference Limited, vol. 3: 545-551.

[19] These are Eleventh Council Directive [1989] *OJ* L395/36, and Twelfth Council Directive [1989] *OJ* L395/40.

[20] This treaty also introduced the co-decision procedure. Consequently, the European Union's decision-making structure closely resembles the constitutional form of democratic federalism in which central government policies are agreed to by a simple majority of elected representatives from lower-tier governments. *See supra note 18*, at 550; Alter, K. J., ESTABLISHING THE SUPREMACY OF EUROPEAN LAW – THE MAKING OF AN INTERNATIONAL RULE IN EUROPE (Oxford, OUP 2001); Bernard, N. (1996), "The Future of European Economic Law in the Light of the Principle of Subsidiarity" 33 CMLR 633; Hopt, K. J. (1996) "Company Law in the European Union – Harmonization and/or Subsidiarity?" 1 International and Comparative Corporate Law Journal 41; Van Den Bergh, R.J. (1998) "Subsidiarity as an Economic Demarcation Principle and the Emergence of European Private Law", 5 Maastricht Journal of European and Comparative Law 129;

distribution the competencies at EU level or at member state level, with regard to areas that are not of the exclusive competence of the EU.[21] The principle provides for an efficiency test to determine competencies and to constrain the EC executive power,[22] although soon after the EC proposed additional method for governance and regulation at the EU level to reinforce the subsidiarity principle, and meantime strengthening the EC's role as a driving force.[23]

The fourth generation directives were somewhat a general approach against the rigidity of the regulatory rules, in the meantime involving new techniques. One of the characteristic aspects of this generation is that it was to tie the regulatory interventions to the activities and processes of autonomous rule-making bodies, such as industry-level associations and self-governing professional organizations in the financial sector.

Recently the EU Commission following the recommendation of the High Level Group of Company Law Experts,[24] proposed 14th Company Law Directive of the Commission, which aimed to provide appropriate safeguards in the Member States to allow companies to exercise their freedom of establishment by transferring their registered office across the borders, and so acquiring legal personality under the law of the host state in order to be governed by that law and without having to be dissolved in the home state.[25] According to the Commission, each Member State would have to recognize the right of a corporation governed by its own law to opt, by decision of the general meeting taken in accordance with the formalities and procedures for altering the articles of incorporation and the by-laws, to transfer its registered office to another Member State in order to acquire a new legal personality in place of its original one.[26]

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[21] The subsidiarity principle is embodied in the Article 5 of the Treaty. Areas within the exclusive competence of the EU are subject to the proportionality test: "ARTICLE 3 b: In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community. Any action by the Community shall not go beyond what is necessary to achieve the objectives of this Treaty." Available at http://www.eurotreaties.com/maastrichtec.pdf page 3.

[22] To this end, it should be determined whether there is a power under the Treaty to take action, then, the whether and how the Community may act; it must be shown that the objectives of the proposed action cannot be sufficiently achieved by the member states; the finding must then justify the further conclusion that in view of the measure the objective can be better achieved at Community level; eventually, the proportionality test has to be satisfied.

[23] *See* European Commission "European Governance: White Paper", Brussels, 25.7.2001 COM(2001) 428 final

[24] In their final report to the Commission, the High Level Group, or Winter Group has recommended that the Commission consider adopting a proposal for a directive on the transfer of the registered office. See HLG "Report on a Modern Regulatory Framework for Company Law in Europe" (4.11. 2002) 101.

[25] The EU Commission's Public Consultation relating to the outlined of the planned proposal for the 14th Company Law Directive is now closed. In April 1997 the EC presented an internal proposal for a Fourteenth EC Company Law Directive, which it revised on November 11 of the same year: "Commission Proposal for a Fourteenth European Parliament and Council Directive on the Transfer of the Registered Office of a Company from One Member State to Another with a Change of Applicable Law". Both proposals were intended to enable corporations to change their nationality without having to liquidate first. However, the relevant Directive has not yet been adopted.

[26] Besides these, the most recent proposal of the EU on this area is the Proposal for a Directive of the European Parliament and of the Council on the Exercise of Voting Rights by Shareholders of Companies Having their

2. *ECJ Rulings*[27]

The significant contributor to the EU company lawmaking - the European Court of Justice (hereinafter the ECJ or the Court) – interferes greatly in this area. The recent rulings of the ECJ concerning the topic in discussion are almost "world-shattering" in their character, and although many publications refer to one or some of them, we find necessary to provide hereby a short overview of all the appropriate cases.

a) Cassis de Dijon[28]

Following its landmark decision in the *Cassis de Dijon*, which is considered to be the one of the first indirect main references concerning this topic, the Court, developing so-called "imperative requirements" doctrine, has massively expanded its jurisdiction in this area referring also to the areas of product regulation, environmental protection and labour standards. Under this doctrine, national measures restricting the fundamental freedoms are compatible with Community law if four conditions are met, the so-called "four-factor test" of Gebhard.[29] In determining whether a measure is justified by an imperative requirement, the Court uses a balancing test, such as "the restrictions imposed must be "proportionate to the objective pursued"".[30] This case is noteworthy also because through the introduction of the principle of the "mutual recognition" by the decision on this case the "rule of origin" was introduced into the product markets, which started a debate whether the free choice of the consumers between products with different national regulations does lead to a regulatory

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Registered Office in a Member State and Whose Shares are Admitted to Trading on a Regulated Market and Amending Directive 2004/109/EC, COM (2005) 685 (Jan. 5, 2006). We will skip the discussion of this directive in this paper.

[27] *See* for the full collection of the cases on the freedom to provide services, as well as for the full collection of the cases on freedom of establishment at http://www.europa.eu.int/

[28] *See* Case 120/78 Rewe-Zentral AG v. Bundesmonopolverwaltung für Brantwein [1979] ECR 649. The "imperative requirements" or "mandatory requirements" doctrine was first developed in this case, with regard to the free movement of goods. Thereafter, the ECJ started to use such a reasoning on other cases concerning the freedom of establishment, e.g. Case C-250/95, Futura Participations SA et al. v. Administration des Contributeurs, 1997 E.C.R. I-2471, 2501 (the effectiveness of fiscal supervision constitutes an "overriding requirement of general interest" capable of justifying restrictions on the exercise of fundamental freedoms guaranteed by the Treaty); Case 106/91, Ramrath v. Ministre de la Justice, 1992 E.C.R. I--3351, para. 29, [1992] 3 C.M.L.R. 173, 192 (1992) (freedom of movement for persons may be restricted only by rules which are "justified in the general interest"); Case 71/76 Thieffry v. Conseil de l'ordre des avocats à la Cour de Paris, 1977 E.C.R. 765, 776 ("Freedom of establishment, subject to observance of professional rules justified by the general good, is one of the objectives of the Treaty".)

[29] The "four-factor test" was first applied in 1995 by the ECJ in Case C-55/94, Gebhard v Consiglio dell' Ordine degli Avvocati e Procuratori di Milano, ECR I-4165 in the context of Article 43 of the EC Treaty. In the Centros case, the Court extended the test to restrictions on companies' freedom of establishment guaranteed by Article 48 of the EC Treaty and reconfirmed it in Inspire Art case. To pass the "four-factor test": "they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it."

[30] For the balancing test see, e.g., Case 470/93, Verein gegen Unwesen in Handel und Gewerbe Koln v. Mars GmbH, 1995 E.C.R. I-1923, para. 15, [1995] 3 C.M.L.R. 1, 14 (1995) (noting that the restrictions imposed must be "proportionate to the objective pursued").

competition. Allied with this, the introduction of "mutual recognition of regulations has been seen as an alternative means to the harmonization for removing barriers to trade within the Member States.[31]

b) Segers[32]

In the case, known as *Segers*, the Court interpreted the provisions of the Articles 52 and 58 of the EEC Treaty as prohibiting the Dutch social security organization from excluding a director of the D. H. M. Segers from a national sickness insurance benefit scheme solely on the ground that the Company was formed in accordance with the UK law, where it also has its registered office, but does not conduct any business. This was the second indirect reference for our debate made by the Court and a kind of "approaching" to the more fundamental changes to come.

c) Daily Mail[33]

Three years after the ruling on *Segers* another impressive ruling of ECJ contributed greatly to this debate, which is referred highly by many as the first one in the quartet of the most important contributions of the ECJ into this case law, thus I will open up this case a bit more.

In the case known as *Daily Mail*, a UK registered investment holding company proposed to transfer its central administration and control to the Netherlands, in order to avoid the UK capital gains taxes on assets, since it intended to sell after having completed the movement to the new jurisdiction. Although the UK is an incorporation state that permits companies to move to another jurisdiction without dissolution requirement, that is keeping its legal personality there, in order to complete that movement a company needs the consent of the Treasury to allow that transfer. The point is that the company asked appropriate officials for permission for the movement, but it moved without receiving a reply from them, since based on the Articles 43 and 48 of the Treaty, it believed that the movement could be done without authorization from the state body.

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[31] *See* Heine, K and W. Kerber (2002), "European Corporate Laws, Regulatory Competition and Path Dependence", 13 European Journal of Law and Economics, 47, at 48

[32] *See* D.H.M. Segers v. Bestuur van de Bedrijfsvereniging voor Bank- en Verzekeringswezen, Groothandel en Vrije Beroepen, case 79/85 of 10 July 1986, ECR, 1985, 2375. (The ECJ has ruled that the provisions of the Article 52 and 58 of the EEC Treaty must be interpreted as prohibiting the competent authorities of a Member State from excluding a director of a company from national sickness insurance benefit scheme solely on the ground that the company in question was formed in accordance with the law of another Member State, where it also has its registered office, even thought it does not conduct any business there.)

[33] *See* The Queen v. H.M. Treasury and Commissioners of Inland revenue, ex parte Daily Mail and General Trust plc, Judgment of 27 September 1988, Case 81/87, ECR, 1988, 5483. (The ECJ ruled: 1) In the present state of Community law, Articles 52 and 58 of the Treaty, properly construed, confer no right on a company incorporated under the legislation of a Member State and having its registered office there to transfer its central management and control to another Member State. 2) Council Directive 73/148 of 21 May 1973 on the abolition of restrictions on movement and residence within the Community for nationals of Member States with regard to establishment and the provision of services, properly construed, confers no right on a company to transfer its central management and control to another Member State.)

As a result, the ECJ ruled that the freedom of establishment did not apply to a company that transfers its central management and control to another Member State, thus the state authorities had the right to decline the company's request to move out. As the Court reasoned: "unlike natural persons, companies are creatures of the law…. They exist only by virtue of the varying national legislation which determines their incorporation and functioning".[34]

Here the Court seemed to have frozen the issue of the cross border seat transfer: faced with the large differences in national law systems, the Court was of the opinion that this was not an issue to be solved under the Community law rules on freedom of establishment, but had to be dealt with by future legislation or conventions.[35]

d) Centros[36]

It took eleven years until the ECJ demonstrated its innovative nature again concerning the topic in discussion. This time it was the *Centros*[37] case, which dealt with a cross border transfer of a seat, more precisely with cross border transfer through branch establishment, i.e. with a secondary establishment.[38] The Court considered incompatible with the freedom of establishment the ruling of the Danish authorities imposing stricter requirements as applicable to Danish companies on a UK company, although it had no main business office in the UK, but essentially operated out of its Danish office. Actually, what happened in

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[34] *See ibid*, Para 19.

[35] *See ibid*, Para. 23

[36] A short summary of the facts is: Danish residents seeking to set up a company to do business in Denmark tried to avoid the 200,000 Danish Crown minimum capital requirements by organizing a corporation in the UK, since the latter does not impose a minimum capital requirement for private corporations. Therefore, the newly formed British corporation, which did not, and was never intended to do business in the UK, applied then for registration in Denmark. The Danish Registry Office refused registration, concluding, that the incorporation in the UK was merely a means to avoid the Danish minimum capital requirement.

There is a huge literature on this case. See among many others, in line with the discussed papers herein, e.g. Ebke, W. (2000), "Centros - Some Realities and Some Mysteries", 48 Am. J. Comp. L. 623; Micheler, E. (2000), "The Impact of the Centros Case on Europe's Company Laws", 21 Company Law 179; Xanthaki, H. (2001), "Centros: Is this Really the end for the theory of the Siege Reel", Comp. Law. 2; etc.

[37] *See* Case C-212/97, Centros Ltd v. Erhvervs-og Selskabssyrelsen [1999] ECR I- 1459, [2000] Ch 446. (The ECJ ruled: 1) It is contrary to Articles 52 and 58 of the EC Treaty for a Member State to refuse to register a branch of a company formed in accordance with the law of another Member State in which it has its registered office but in which it conducts no business where the branch is intended to enable the company in question to carry on its entire business in the State in which that branch is to be created, while avoiding the need to form a company there, thus evading application of the rules governing the formation of companies which, in that State, are more restrictive as regards the paying up of a minimum share capital. 2) That interpretation does not, however, prevent the authorities of the Member State concerned from adopting any appropriate measure for preventing or penalizing fraud, either in relation to the company itself, if need be in cooperation with the Member State in which it was formed, or in relation to its members, where it has been established that they are in fact attempting, by means of the formation of a company, to evade their obligations towards private or public creditors established in the territory of the Member State concerned).

[38] The Articles 43 (1) and 48 of the EC Treaty guarantees companies the primary freedom of establishment, that is, the right to carry out their principal business activities through a headquarter or main establishment (generally determined by reference to the central administration concept) in another Member State and the secondary freedom of establishment, that is, the right to set up agencies, branches or subsidiaries in a host Member State.

reality is that a UK company *Centros* opened an office in Denmark, its main and only office, and wanted to be registered with the Danish authorities, since according to the UK law, one can incorporate a private company limited with £1 capital, while in Denmark, as in many other EU states, one has to put up considerable amounts of capital, while other organisational requirements (e.g., to have a board of directors) are applicable. The registration was refused, unless the company complied with local Danish requirements, especially to show a legal capital complying with the Danish minimum capital rules. The ECJ held the Danish position contrary to EU law. It seems that companies created in one EU state are free to establish themselves in any other state without any additional obligation being imposed, as it was analysed by many as the endorsement of the incorporation doctrine in EU law. The argument of the Danish government, based on the "general good doctrine", that the capital requirement was necessary to protect creditors as had been recognised in the Second European Company Law directive on capital was rejected: if a UK company had established a branch in Denmark, freedom of establishment would have prevented the Danish law to impose any local capital requirement, that is to say that the creditors in this case should not enjoy a better protection in Denmark. This reasoning has been read by some as a serious criticism of the doctrine of legal capital, keeping in mind that the UK imposes no minimum requirement for private companies limited.

In conjunction with this case, many scholars argue that the ECJ seems to have taken an additional step in the direction of the incorporation theory. The Court's opinion privilege the state from which the company is "crossing the border", but this is not the "incorporation theory" as such, and the differences with this have been identified.

Another thing is noteworthy: at first sight it could seem strange, that in this case the ECJ did not directly refer to the previous *Daily Mail* case, since there are so similar in nature, but this fact can be explained in two ways: these cases are different because they refer first, to primary (in *Daily Mail*) and secondary (in *Centros*) establishment, and second, to emigration and immigration issues accordingly.

e) Überseering[39]

[39] A short summary of facts on this case is the following. The company, Überseering, was incorporated in the Netherlands in 1990. It purchased land in Germany and contracted with the Nordic Construction Company (NCC) to carry out building works on a garage and motel located on the site. When the work was completed, Überseering complained that it was defective. In the meantime, all of the shares in the company were transferred to two German nationals who lived in Dusseldorf. In 1996 Überseering begun proceedings against NCC in the Regional Court in Dusseldorf claiming damages for breach of contract. The defendant company successfully pleaded that the claim should be struck out on the basis that German private international law followed the real seat doctrine. It was argued that the real seat of the company, following the transfer of shares, was Dusseldorf, and because it was a company incorporated in the Netherlands, German law did not recognize its legal capacity, and so Überseering cannot bring the action. The Regional Appeal Court upheld the decision to strike the action out. On appeal, the Federal Supreme Court referred the issue, in the form of two questions, to the ECJ under EC Treaty, art 234 for preliminary ruling. First, are EC Treaty, arts 43 and 48 (the principle of freedom of establishment) to be construed so as to prevent a Member State determining legal personality and standing according to a company's real seat? Second, did freedom of establishment require Member States to apply the incorporation doctrine to determine a company's legal personality and standing? See the following footnote for the reference on the ECJ ruling on this case.

Soon after, yet another very important case law point of reference concerning this debate on the matters of the cross border establishment of a EU company held, which is known as the *Überseering* case. Here the ECJ again applied the rules on freedom of establishment regarding to the German law, since German court held that a company that had its real seat in Germany but was not founded in one of the forms that German company law offered, was null and void. [40]

On the one hand, it holds that a Member State may not deny access to its legal order on the basis that it considers a company from another Member State to have transferred its seat to its territory, unless the additional requirement would be based on the "four-factor test". On the other hand, in this case the Court indicates its support for the *Daily Mail* rule and clearly distinguishes the emigration from the immigration issue.

In reality, what happened is the following. This was a referral by the German Supreme Court. German company law adheres to a rather strict reading of the real seat doctrine: foreign companies establishing themselves in Germany should either reincorporate according to German law, or will be denied existence, including ability to act as a legal person. They would be considered as unincorporated entities resulting in indefinite liability of their members. There was some shift in recent case law stating that this company might be qualified as a company with restricted legal personality. In this case, a Dutch company had moved its seat to Germany, and actually, it was denied access to German justice by the German judiciary. The ECJ considered the German legal reasoning incompatible with the Treaty's fundamental freedom of establishment, stating that a company legally incorporated in one jurisdiction is free to move its headquarters to any other jurisdiction in the Union and the other states should recognise it according to the law in accordance with which it has been created.

A controversial discussion started on whether that company should be considered according to Dutch law or whether the company should adapt its organisation to German law, as its seat was henceforth located in Germany. Although there is still some controversy about this,

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[40] *See* the Case C-208/00, Überseering BV v. Nordic Construction Company Baumanagement GmbH (NCC) [2002] ECR I-9919; (The ECJ has ruled: 1) Where a company formed in accordance with the law of a Member State ("A") in which it has its registered office is deemed, under the law of another Member State ("B"), to have moved its actual center of administration to Member State B, Articles 43 EC and 48 EC preclude Member State B from denying the company legal capacity and, consequently, the capacity to bring legal proceedings before its national courts for the purpose of enforcing rights under a contract with a company established in Member State B. 2) Where a company formed in accordance with the law of a Member State ("A") in which it has its registered office exercises its freedom of establishment in another Member State ("B"), Articles 43 EC and 48 EC require Member State B to recognize the legal capacity and, consequently, the capacity to be a party to legal proceedings which the company enjoys under the law of its State of incorporation ("A").)

See for discussion on this case among many others, in line with the discussed papers herein such as *supra note* 16, e.g. Andenas, M. (2003), "Free Movement of Companies", 119 Law Q. Rev. 221; Bachner, T. (2003), "Freedom of Establishment for Companies: a Great Leap Forward", 62 Cambridge L.J. 47; Robertson, D.E. (2003) ''Überseering: Nailing The Coffin On Sitztheorie'', Comp Law 184; Micheler, E. (2003), "Recognition of Companies Incorporated in Other EU Member States", 52 Int'l. & Comp. L.Q. 521; Roth, W.-H. (2003), "From Centros to Überseering: Free Movement of Companies, Private International Law, and Community Law", 52 Int'l. & Comp. L.Q. 177; Gildea, A. (2004), "Überseering: A European Company Passport", 30 Brooklyn J. Int'l L. 257, 6; Dyrberg, P. (2003) "Full Free Movement of Companies in the European Community At Last", E. L. R. 528; etc.

the Court ruled on that in its second holding: created in one state, the company can move to another state and should be recognised according to the law where it has been created. Some scholars believe this holding clearly states that the "real seat"[41] is pre-empted by the freedom of establishment. There was a further looking guess that given today's modern technology and superior communication the idea of "real seat" is outdated.[42] All in place, however it is difficult to believe that this holding could wipe out the "real seat" doctrine completely, at least in the nearest future.

The application of this case for the start-ups in Europe is noteworthy. On the one hand, the start-ups were somewhat in the shadow in the SE statute, which relates more to established companies then the start-ups. Since this statute does not allow the start-ups to move out from e.g. a "real seat" state immediately just after their formation, but requires to live in that State for at least two years before awarding such an option. The situation changed after the Überseering, and the new companies received yet another option vs. "old" companies. After the said case, a company from a "real seat" state can register a shell corporation in a "place of incorporation" state, set up its headquarters in any state, and move its headquarters to any state. As one scholar noted, the *Überseering* allows new companies to forum-shop for mobility and later move their headquarters to a state with the labour resources, natural resources, consumer markets, tax regime, and/or corporate regulations necessary to ensure continued success in the ever-expanding and ever-changing European marketplace.[43]

After the *Überseering* case, several questions, e.g. how much harmonized company law the EU needs and how much diversity would seem to be desirable for the proper functioning of the Single Market have become one of the most important ones for legislatures and corporate law scholars alike, and it sill needs to be discussed in depth and breadth.

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[41] *See* hereby in this paper other versions of this term, such as centre of administration, administrative seat, central management and control, headquarter.

[42] *See* in support of this idea, among others e.g. M. Neville, N. Winther-Sørensen and K.E. Sørensen (2001), "Free Movement of Companies under Company Law, Tax Law and EU Law", in M. Neville and K.E. Sørensen (eds.), THE INTERNATIONALISATION OF COMPANIES AND COMPANY LAWS, (Copenhagen, 2001), 181, 185-88.

[43] *See* citations at *supra note* 40.

f) Inspire Art[44]

The last, and we believe not the least, and the most recent - *Inspire Art*[45] case – is yet another landmark ruling in the area of the freedom of establishment and demonstrated that, within the EU, both capital requirements and directors' liability are governed by the law of the corporation's home state.

Inspire Art is a case of a so-called letterbox company. Since The Netherlands follow the incorporation doctrine, it admits companies created in other EU states without restrictions. However, in order to combat letterbox companies entering from abroad, but in fact managed in the Netherlands, legislation was passed imposing additional disclosures on these companies, while holding their directors liable in case of wrongful trading according along the same rules as applicable to domestic companies. Also these companies should be identified e.g. in their letterheads by adding that they are "formally foreign companies".[46] The Court held once more that these provisions of Dutch law were not compatible with the

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[44] A short summary on this case is the following. Inspire Art Ltd. was incorporated in July 2000 as a private limited company in England. Its registered office was at Folkestone and its sole director was domiciled in The Hague. The company traded exclusively in the Netherlands. The company registered in the commercial register of the Chamber of Commerce without stating that it was a foreign company within the meaning laid down by Article 1 of the WFBV (Articles 1–5 of the Netherlands statute (WFBV (Law on Formally Foreign Companies)) impose stricter conditions on private companies, including foreign companies, than are required under the UK Companies Act 1985). The Chamber of Commerce therefore petitioned the Kantongerecht Amersterdam on 30 October 2000 for an order that the register be rectified so as to state that Inspire Art Ltd. is a foreign company. The Kantongerecht held that Inspire Art Ltd. was a pseudo-foreign company within the meaning of Article 1 and it stayed the proceedings in order to refer to the ECJ the following two questions. First, whether EC Treaty arts 43 and 48 are to be construed as precluding the Netherlands from attaching additional conditions such as those contained in Articles 2–5 of the WFBV to the establishment in the Netherlands of a branch of a company incorporated in the UK with the sole purpose of securing advantages which that offers as compared to incorporation under Netherlands law? In this regard, Netherlands law presumes that purpose from the fact that the company carries on its operations entirely or almost entirely in the Netherlands and does not have any real connection with the State in which it is incorporated. Second, if the provisions of the WFBV are construed as being incompatible with Community law, must EC Treaty art 4621 be interpreted as meaning that EC Treaty arts 43 and 48 do not affect the applicability of the Netherlands rules laid down in the WFVB, on the ground that the provisions in question are justified for the reasons stated by the Netherlands legislature? See the following footnote for the reference on the ECJ ruling on this case. There is again a huge list of literature touching upon this issue, some are mentioned also herein as footnotes.

[45] *See* the Case C-167/01, Kamel van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd [2003] ECR I-10155. (In this case the ECJ has ruled: 1) It is contrary to Article 2 of the Eleventh Council Directive 89/666/EEC of 21 December 1989 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State for national legislation such as the Wet op de Formeel Buitenlandse Vennootschappen (Law on Formally Foreign Companies) of 17 December 1997 to impose on the branch of a company formed in accordance with the laws of another Member State disclosure obligations not provided for by that directive. 2) It is contrary to Articles 43 EC and 48 EC for national legislation such as the Wet op de Formeel Buitenlandse Vennootschappen to impose on the exercise of freedom of secondary establishment in that State by a company formed in accordance with the law of another Member State certain conditions provided for in domestic company law in respect of company formation relating to minimum capital and directors' liability.)

[46] These types of corporations are called pseudo-foreign or quasi-foreign corporations, i.e. a corporation that is incorporated in a state but carries out main part or almost all of its business activities in another state. The pseudo-foreign corporation statute declares some or all of the jurisdiction's corporate law to be applicable to the internal affairs of pseudo foreign corporations.

Treaty's provision on free establishment, provided these companies had been formed in the Union.

In this case, the Court put end to attempts by the legislature of the Netherlands to impose certain legal obligations on corporations that were incorporated in another Member State but carry on their business activities exclusively or almost exclusively in the Netherlands. As one scholar argued, in light of *Inspire Art*, it is fair to conclude that all other internal affairs of such a pseudo-foreign corporation are also governed by the law of the State of incorporation, its *lex societatis*.[47] Unlike the *Centros* and *Überseering*, however, the *Inspire Art* involved questions of substantive company law. It is noteworthy that the *Inspire Art* holds out few implications for cases involving domestic companies wishing to leave their state of incorporation.

g) Additional remarks

As it seems from these rulings, the path of the ECJ is clear: companies enjoy free movement in Europe. The prerequisite is that these companies have been formed in their state of origin, somewhere in the EU. The latter point is important as it refers to the Union as a whole, not to any particular state. General interpretation of these could be that as if the court had adhered to the traditional incorporation doctrine. Although, from another side, there is yet another interpretation: all these cases only deal with matters of cross border establishment, not with conflict of law techniques. The ECJ states that companies that have been created according to the law of one of the states of the union, independently from it is an incorporation state or a real seat state, can freely move to any other state within the Union, thus essentially applying above-mentioned article 48 of the Treaty.

Moreover, the last mentioned most important three cases all dealt with immigration, and whether immigration and emigration should be dealt with separately is yet controversial. From the one side, in case of immigration, the case law holds that the host state cannot restrict entry by EU companies by imposing additional requirements. Companies coming from another EU state should be free to enter any other EU jurisdiction, without being exposed to local requirements, except on the basis of the "general good exception". But still some questions are left aside. What will be the effect of a transfer of the company into a "real seat" state: should it be obliged to adapt itself to the legal environment of the host state? Adopt a local charter as would be flowing from the "real seat" doctrine? Should it comply with other local requirements? Will it enjoy all privileges recognized in the host state? The second holding in *Überseering* clarifies that this company continues to exist according to its original legal regime. The host state may not impose any additional requirements, except based on the "general good". Hence, it would continue to function under its original charter, enjoy the privileges recognized under its home regime, and so on. Although these points can

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[47] *See* Ebke W. (2005), "The European Conflict-of-Corporate-Laws Revolution: Überseering, Inspire Art and Beyond", European Business Law Review, at 33

be deducted from the case law mentioned, they will remain controversial until further decisions are rendered.[48]

From the other side, the case of emigration has not been settled clearly. As we demonstrated, emigration was first dealt with in the *Daily Mail* case: it was held to be a matter of essentially domestic concern. Thus, the home state can forbid the company to leave its jurisdiction except after having paid all taxes that might arise according to the home state's tax law. Indeed, the home state, granting the privileges of incorporation, can decide how far this privilege reaches and under what conditions it will be granted or withdrawn. But excessive restrictions might flow from tax provisions e.g. relating to taxes that would only be due in case of emigration.

Overall, if the ECJ by now has drawn the general principles relating to company mobility, the moving parts remain to be worked out. What are the complete conditions for companies to move to another jurisdiction? What is clear procedure for the transfer in terms of registration and disclosure? What are the rules and regulations to be applied under the new jurisdiction? We will try to address some of these concerns herein, with understanding that the complete and precise solutions for these cannot be expected until the EU lawmaking authorities interfere in these directly and formulate the future developments.

3. *Societas Europaea*

It took decades until the EC "won the battle" against Member States over the introduction of a new European legal form – the European Company: in October 2001 the European Company Statute finally has been approved, which regulates the issues concerning the setting up of a company within the territory of the Community in the form of a European public limited-liability company (hereinafter *Societas Europaea* or *SE*) that entered into the force in October 2004.[49] As a result, the first corporation to have transformed in to this form is an Austrian construction company "Strabag".[50]

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[48] *See* Wymeersch, E., (2004) Presentation "Regulatory Competition and Subsidiarity in Corporate Governance in a Transatlantic Perspective" held on 12 July, 2004 in Brussels, Belgium, available at http://www.ecgi.org/tcgd/launch/wymeersch_speech.php

[49] *See* Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European Company (SE) (O.J. L 294, 10/11/2001, 1), supplemented by Council Directive 2001/86/EC of 8 October 2001 (O.J. L 294, 10/11/2001, 22), on the involvement of employees. For the discussion on the history of the SE see Edwards, V. (2003), "The European Company - Essential Tool or Eviscerated Dream?", 40 C. M. L. Rev. 443; Werlauff, (2003) "The SE Company - A New Common European Company from 8 October 2004", 14 EBLR 85; Lombardo, S. and Pasotti, P. (2004), "The Societas Europaea: A Network Economic Approach", European Company and Financial Law Review 1: 169-205

[50] On October 8, 2004, only six countries had implemented the regulations at the national level. Until the rest do so, many corporations operating in more than one Member State will be denied the option of being established as an SE and thus of being able to operate throughout the EU with one set of rules and a unified management and reporting system. Only Belgium, Austria, Denmark, Sweden, Finland, and Iceland have taken so far the necessary measures to allow European Companies to be founded on their territory. See Tollet, N. (2005) "The Societas Europea: Europanization via Americanization", Global Jurist Topics, vol/5 No: 2, Article 3, 2005

At the end of the day, the long lasting controversy among Member States not only left just seventy out of some four hundred rules to adopt from the first proposal of 1970, where about half of which are only references to national law or repetitions of what has been harmonized in other measures, but it also implies the so-called *renvoi*[51] technique, that is the directive regulates some issues of the *SE*, but simply refers several other aspects of it to the legislation of the Member States. This technique includes not only legislation of the Member States but also the judicial review of their courts with the result that single, national *SEs* will also be the object of regulation by way of case law developed by judicial review. That is to say, where single national legislations will not cover all the questions, the national courts, and the ECJ will have to intervene.

The academic debate concerning the arguments for and against this new form entered its new era. On the one hand, as to one prominent scholar[52], there are three possible reasons why European businesses might want to opt for the *SE* legal form as: i) this new legal form allows multinational firms to save on transaction costs for the formation and maintenance of subsidiaries in each Member State, ii) it facilitates cross-border joint ventures and mergers, and iii) another, perhaps even stronger, reason for choosing the *SE* legal form could well be that it makes it easier to shop around for a friendlier company law.

On the other hand, the *SE* highlights a major step towards convergence of one-tier and two-tier organizational structure, but due to many constraints regarding its foundation and the complicated unknown legal territory it is questionable whether it will be a run on this new legal form, which according to the *Ciampi* group[53] assumes to save some thirty billion dollars a year.[54]

Besides, the HLG noted that the SE may not meet all expectations of the business community, in particular SMEs, and referred to the development of a "European Private Company" (EPC), which, as a new legal form at EU level, would primarily serve the needs of SMEs that are active in more than one Member State.[55] This concept has received widespread

[51] Under the doctrine of *renvoi*, a court in resorting to foreign law adopts rules of foreign law as to conflict of laws, which rules may in turn refer the court back to the laws of the forum. *See* Karollus M. (1995), "Judicial Interpretation and Application of the CISG in Germany 1988-1994", Cornell Review of the Convention on Contracts for the International Sale of Goods (1995) 51-94. For the discussion on the *renvoi* technique and the SE see section 2.1 of the Lombardo and Pasotti (2004), *supra note* 49;

[52] *See* Enriques, L. (2004), "Silence is Golden: The European Company As a Catalyst for Company Law Arbitrage", 4 J Corp LS 77.

[53] Competitiveness Advisory Group, Enhancing European Competitiveness (Luxembourg, Office of Official Publications EC, 1995). The group called after its Chairman, Italian ex-premier Ciampi.

[54] *See* Braendle, C. U. and J. Noll (2004), "The Societas Europaea - A Step Towards Convergence of Corporate Governance Systems?" SSRN Working paper N704881

[55] *See* Report of the High Level Group of Company Law Experts "A Modern Regulatory Framework For Company Law in Europe", Brussels, 4 November 2002. The private initiative concerning the EPC has resulted a proposal, which has been presented by the Paris Chamber of Commerce and Industry and the French business confederation MEDEF (formerly CNPF) in September 1998.

interest and support not only from the private sector and the introduction of such a form is regarded as easier to achieve than the European Company Statute.[56]

Following the recommendations of the HLG, in the wake of several high-profile corporate scandals, the EC announced its "Action Plan" in summer of 2003 for company law reform, where among other things expressed its intention to actively support the ongoing legislative process concerning the development of new European legal forms of enterprises.[57]

Some other scholars[58] are still sceptical whether the *SE* will eventually become an attractive vehicle for company law shopping in the EU, although they think that Member States could take steps to make *SE* more attractive by adopting clear and effective provisions of laws that specifically implement EU measures relating to *SE* and so engage in regulatory competition. They believe that the legislation, and particularly *SE* statute, is unlikely to pose a competitive threat to Member States, since: i) the Statute does not contain tax provisions, ii) the actual problem of double taxation of its branches in other than its home state, and iii) costs concerning moving, because of legal uncertainty present, and etc.

In line with these, the poor statistical evidence suggests that this form still did not gain popularity among companies for its numerous uncertain and/or complicated characteristics.

C. THE HARMONIZATION PROCESS

One of the ultimate aims of the EC establishment is the formation of genuinely common market among its members, which suppose the elimination of all type of barriers for trade and competition in particular. Among the actions towards this aim, years ago there was a fear that this process, with the presence of different national legislative structures, could encourage harmful regulatory arbitrage: i.e. companies could (re)incorporate in other jurisdictions not for sound economic reasons, but in order to avoid to comply the "bad" jurisdiction and minimize their costs of operation. The concern was that in this case, there would be huge increase of transaction costs while companies tried to evolve across borders. On the other hand, the possible process of harmful regulatory competition was viewed with suspicion by some, and thus, the desire to avoid such an outcome, as well as to minimize the

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[56] It is needed to make a clear difference between different European forms, e.g. the SE from the European Cooperative Society (SCE, see the Council Regulation (EC) n° 1435/2003 of July 22, 2003; European Directive (EC) 2003/72/CE of July 22, 2003) and the European Economic Interest Group (GIEE, see the Council Regulation (EC) n°2137/85 of July 25, 1985 (Official Journal No L 199 of 31 July 1985)). The SCE is a legal instrument that allows its members (generally customers or suppliers) simultaneously work together and be independent of each other. These members will be directly and personally involved in the activities and the management of the SCE, which must have as its principal purpose the satisfaction of its members' needs and/or the development of their economic and social activities, and not the remuneration of a capital investment. While the GIEE is a legal corporate vehicle allowing companies to cooperate with partners based in other Member States for the realization of a specific project in a loose, flexible form of association and on an equal legal footing while maintaining their economic and legal independence. See Tollet (2005) *supra note* 50;

[57] *See* EC Commission, Modernizing Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward COM (2003) 284 final, Brussels 21.5.2003.

[58] *See* e.g. McCahery, J. A. and E. P. M. Vermeulen (2005), "Does the European Company Prevent the "Delaware effect"?", TILEC discussion paper No: 2005/010

said transaction costs, were the original rationales for the European company law harmonization project.

Almost concurrently, when the first attempts have been made to develop the Member States' company law program, the newly born "race to the bottom" school in the USA has been accumulating more and more supporters, and it happened that the idea for harmonization in the Member States' company law almost repeated the arguments made by these supporters, having a great affect of them. Thus, e.g. Schmitthoff's assessment was that without harmonization, standards of shareholder and creditor protection within the EU would be eroded, so, in order not to repeat the Delaware case, harmonization should aim for the "virtual unification of national company laws".[59]

Aside the fears of a race to the bottom, the justification for harmonization is in fulfilling the following conditions: i) there are market failures to correct; ii) Members States alone cannot or unwilling to correct them; and iii) the proposed harmonized rules would indeed correct them, by making society overall better-off that in their absence, also taking the costs arising from the harmonised rules into account.[60]

Actually, as it has been already noted,[61] the legal foundation for the harmonization is found in EC Treaty's Article 44 (the reference to this article can be found in almost all company law directives), in Article 95 (the reference to this can be found in the Regulation 1606/2002/EC and Directive 2003/6/EC) or in both (the reference to both these can be seen in the Directives 2001/34/EC, 2003/71/EC and 2004/109/EC).

Of course, there were several critiques on the necessity of harmonization process as well, particularly summarised by Behrens as the fourfold crisis: conceptually, in relation to competence, legitimacy and loyalty.[62]

On the other hand, in the European context it is possible to see how harmonization may complement and even encourage the process of evolutionary adaptation in laws at state level. Certain types of "reflexive harmonization" may in the end be the most effective

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[59] *See* Schmitthoff, C. (1973) "The future of the European company law scene", in C. Schmitthoff (ed.) THE HARMONISATION OF EUROPEAN COMPANY LAW, (London: UKNCCL, 1973)

[60] *See* for general discussion on harmonization process e.g. Enriques, L. and M. Gatti (2006), "The Uneasy Case For Top-Down Corporate Law Harmonization in the European Union", 2006, at 19. Actually the authors add four other aims to which harmonization may serve: i) it may level the playing field; ii) it may lower transaction costs in inter-corporate relationships and in the relationships between corporations and (prospective) investors; iii) it may achieve uniformity in areas where the value of a single set of rules is much higher than the content of the rule itself; iv) it may substitute certain local provisions that practically impede the creation of a European integrated market; at 26

[61] *See* Enriques, L, (2005), "Company Law Harmonization Reconsidered: What Role for the EC?" ECGI Law Working Paper No. 53/2005, SSRN Working paper N850005, at 4

[62] See Wouters (2000) *supra note* 11, at 275, citing Behrens, (1996), "Krisensymptome in der Gesellschaftsrechtsangleichung" (1996) EuZW, 193; (stating that the company law harmonization is currently undergoing a crisis on all fronts: conceptually (e.g. participation versus consultation of employees), in relation to competence (subsidiarity), legitimacy (new preference for decentralized development of the law), and loyalty (Member States' resistance to implementation)).

guarantor of diversity between national systems, and hence of experimentation in regulatory design.[63] By contrast, so the argument goes, unregulated competition between jurisdictions could well eliminate the most significant differences between them, but without any guarantee that the system, which eventually prevailed, would be the most efficient. The apparently paradoxical conclusion of Deakin is that the harmonization of company law may represent the best chance of capturing beneficial aspects of regulatory competition, in terms of evolutionary adaptation, within the framework of the single market.

The dominant view among some corporate law scholars has been that the EU's approach to harmonization has the advantages of encouraging simplicity and lowering administrative costs for firms. In contrast to this, some others[64] argue that uniform rules often leads to higher costs for different types of firms and that this approach to legal change is cumbersome and not sufficient to regulate externality problems.

The two types of harmonization, namely negative and positive, have been in place during all these processes but having different affects overall.[65] The former generally restricts the choice-denying techniques. The above mentioned famous rulings of the ECJ impose Member States to recognize outside corporations legal capacity and allows for restrictions from their part only under extreme circumstances, when the four criteria of *Gebhard* is in place. While through positive harmonization the EC obliges (through directives) its members to adopt certain rules, or it directly imposes such rules on EU citizens and firms through regulations. This type of harmonization, as Enriques and Gelter called, can be substantive, whenever it defines the content of national corporate laws, or it can relate to choice of law itself, either by promoting or by reducing it.

In with these, one can agree that the role of the EC in lawmaking, in particular the harmonization process, make a strong candidate in the possible game of charter offering in order to attract companies, similar the one in the US, called regulatory competition. So, even in the US reality the states play crucial role in most of the corporate law making, the role of Washington is still not well defined, similarly it is not well defined the role of the EC in the European lawmaking practice. Thus, the argument is that whenever we could talk about the possible involvement of one or more states into an activity directed to turn that state into a basin of attraction for the European companies, the role of crucial and heavy player as the EC is, should be highly considered and explained. In the game of charter offering activity the important role of the EC is unavoidable and largely also depend on that. So to say, unlike the US, in the EU it is not probably to see a competition without Brussels meddling down from

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[63] *See* Deakin, S. (2001), "Regulatory Competition versus Harmonization in European Corporate Law", in Esty, D. and D. Geradin, (edt.) REGULATORY COMPETITION AND ECONOMIC INTEGRATION COMPARATIVE PERSPECTIVES, (Oxford, OUP. 2001)

[64] *See* e.g. Hertig, G. and J.A. McCahery (2003), Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition? SSRN Working paper N438421, at 6

[65] See Deakin, S. (1999) "Two Types of Regulatory Competition: Competitive Federalism versus Reflexive Harmonisation. A Law and Economics Perspective on Centros" 1 CYELS, Hart Publishing, 231-260; and Enriques, L. and M. Gelter (2006), "How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law", ECGI Law Working Paper N°. 63/2006, (for discussion on positive and negative harmonization at 14-21)

the top, and the emerging of a possible regulatory competition is also largely conditioned by the EC behaviour on these issues.

D. SOME PECULIARITIES OF THE EC CORPORATE LAW

Until only few years ago, there were several unbreakable obstacles for regulatory arbitrage and for regulatory competition within the EU, and that was in part because of "real seat" doctrine vs. "place of incorporation" doctrine challenge in determining the existence and proper law governing a company in Member States jurisdictions. However, the picture after the famous ECJ rulings has dramatically changed. Considering the above-mentioned ECJ rulings and the discussion on them, here below, we summarize few particular aspects of the EC corporate law that deserve special attention.

Still, there are instances, in which core provisions in the directives themselves cannot reasonably be construed uniformly, because, as it has recently been pointed out, different versions in different languages are incompatible.[66] Typical to this is the interpretation of Alexander, discussing the Article 2 of the Fourth Directive showing that, not only are the English and the German versions in no way direct translations of one another, but they "do not appear to say or mean the same thing."[67]

Besides, Enriques shows that secondary EC corporate law has thus far been trivial, i.e. has had and having very little impact upon EU companies' governance and management: i) they do not cover core areas such as fiduciary duties and shareholder remedies; they are underenforced; ii) in the presence of very sporadic judiciary interpretation by ECJ, the EC corporate law tends to be implemented and construed differently in different Member States, i.e. according to local legal culture and consistently with pre-existing corporate law, etc.[68]

Another argument concerning the typical features of the company law in the EU is that unlike the US, the EU Member States are unable to derive significant amounts of revenue from "charter taxes" levied on companies, because these are prohibited by EU law, except from the one where the company has its headquarter.[69] It is noteworthy to state again that the franchise fees were and still are the ultimate aim at least for Delaware for chartermongering activity, while that very reason in Europe is absent.

III. REGULATORY COMPETITION IN THE EU?

Regulatory competition is an economic theory of government organization that equates decentralization with efficient results and is originated in public economics with the Tiebout

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[66] *See* Enriques (2005), *supra note* 2, at 14

[67] *See* Alexander, D. (1993), "A European True and Fair View?", 1 EUR. ACCT. REV. 59, (where the author shows that the interpretation of the true and fair view principle is different in the UK, Germany and France)

[68] See Enriques (2005) *supra note* 2, at 54

[69] *See* Council Directive 69/335/EEC of 17 July 1969 concerning indirect taxes on the raising of capital, OJ L 249/25, 03.10.1969 (prohibiting the levying of taxes or above-cost charges for the formation or registration of a company except in the case of prescribed "capital duties" levied in the country where the company has its centre of management).

(1956)[70] seminal publication, arguing that a decentralized governmental system with horizontally arrayed jurisdictions competing to attract residents on the basis of differing tax and benefits structures, produces efficient outcomes. It has been brought to bear on the entire range of federalism discussions, usually to support a devolutionary initiative or to oppose a proposal for federal intervention.[71] In general, the theory of regulatory competition has been analysed in many aspects before[72] and here we will refer to them without entering into details. Instead, we will concentrate on fundamental pieces of European puzzle to build a viewable picture.

A. PLACE OF INCORPORATION VS. REAL SEAT

One of the fundamental differences of the Member States' company law systems is the difference between what is known as "Place of incorporation" theory and "Real seat" theory. The former connects a company to the jurisdiction in which it has been formed (see elsewhere in this paper also synonyms such as incorporated, registered), so that the company may develop whatever activities it performs in other states without losing its original status, and where it recognizes all the foreign legal entities according to the rules applicable in the home state. In contrast, the later starts from social and economic reality and applies its legal order to all entities that are effectively directed from within its territory and where it also refuses to recognize companies that claim to belong to another jurisdiction, which is not the one in which their real seat is established.

1. *Place of incorporation theory*

This theory implies that it is the law of the state of incorporation that applies to company. Place of incorporation doctrine has been established as early as the eighteenth century, when British companies were conducting business far away from their motherland, thus they made use of this rule without having to forego the benefits of British law.

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[70] *See* Tiebout, Ch. (1956), "A Pure Theory of Local Public Expenditures", Journal of Political Economy, 64, 416-24.

[71] For the specific discussion on regulatory co-opetition see Geradin, D. and J. A. McCahery (2005), "Regulatory Co-opetiton: Transcending the Regulatory Competition Debate", SSRN Working paper series N 821087 (criticizing the regulatory competition and developing an alternative model to it, which has three dimensions: (1) inter-governmental (reflecting the dynamics of competition and cooperation among governments, both horizontally and vertically arrayed); (2) intra-governmental (arising from the give-and-take between departments and officials within governments); and (3) extra-governmental (driven by the simultaneously cooperative and competitive relations between governmental and non-governmental actors).

[72] Only the list of these publications will take several pages, so for few representative ones, see e.g. Oates, W. E. and R. M. Schwab, (1988). "Economic Competition among Jurisdictions: Efficiency Enhancing or Distortion Inducing?" Journal of Public Economics 35, 333–354; Siebert, H. and M. J. Koop (1990), "Institutional Competition. A Concept for Europe?" Aussenwirtschaft, 45, 439–462; Kenyon, D. A. and Kincaid, J. (eds.), COMPETITION AMONG STATES AND LOCAL GOVERNMENTS, EFFICIENCY AND EQUITY IN AMERICAN FEDERALISM, (Washington, D.C., 1991); Vanberg, V. and W. Kerber, (1994),"Institutional Competition Among Jurisdictions: An Evolutionary Approach" Constitutional Political Economy 5, 193–219. Sinn, H.-W. (1997), "The Selection Principle and Market Failure in Systems Competition" Journal of Public Economics. 88, 247–274, as well as Heine and Kerber (2002) *supra note* 31

In a "place of incorporation" jurisdiction the transfer of the seat of the company has no legal meaning. The company remains subject to the jurisdiction of the state in which it was incorporated, in which it has its registered office. Generally, a company is free to establish an operational seat or residence in another jurisdiction without incurring dissolution of the company, or any other consequence. However, there are some specific phases to be passed, e.g., the emigrating company may be invited first to settle its accounts with the tax authorities.

One specific point of this theory is that an emigrating company will always remain subject to the law under which it was incorporated. This is considered as an advantage of the incorporation technique from the companies' point of view: whatever happens, the company can act according to its original, familiar company law system, which, with few exceptions, applies to the internal affairs of the corporation.

Besides, the "place of incorporation" principle is considered beneficial for several reasons. E.g., this theory allows a company to move its headquarters freely from one state to another state without losing its legal identity; it makes easier to ascertain the law applicable to a company's internal affairs because the applicable law does not change even if the company moves to a new jurisdiction; this is a positive result for third parties, such as creditors, who want predictability as to which law will apply to an entity with a head-office in more than one state;[73] this is a positive result for companies because they avoid complicated *res judicata* issues when all European courts apply a uniform set of laws to their internal affairs.[74]

The main criticism in respect of this theory is that it encourages the formation of "letterbox" companies in countries where the incorporation procedure is easier, cheaper and with lax requirements. This is thought to be harmful for employees, creditors, and investors who deal with such companies in the country where they have their central administration and probably carry out their principal business activities.

"Place of incorporation states" are Denmark, Ireland, the U.K., the Netherlands,[75] Sweden,[76] and somewhat also Italy and Switzerland.[77]

2. *Real Seat theory*

This theory implies that the law of the real seat state that applies to the company. Even if a company is incorporated under the law of a foreign state the law of the host state applies, if the company has its main establishment/seat/central administration in that state.

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[73] *See* Rameloo, S., (2001), CORPORATIONS IN PRIVATE INTERNATIONAL LAW, at 16-17

[74] *See* Ebke, W. (2000), "Centros - Some Realities and Some Mysteries" 48 AM. J. COMP. L. 623, at 654

[75] *See* Charny, D. (1991), "Competition Among Jurisdictions in Formulating Corporate Law Rules: An American Perspective on the "Race to the Bottom" in the European Communities", 423 Harv. Int'l L. J. 423; Ebke, W. (2002) "The "Real Seat" Doctrine in the Conflict of Corporate Laws", 36 Int'l Law 1015,

[76] *See* Heine & Kerber (2002) *supra note* 31

[77] *See supra note* 47, at 14, citing Grossfeld, B. "Praxis des Internationalen Privat - und Wirtschaftsrechts: Rechtsprobleme Multinationale Unternehmen" (Rowohlt Reinbek bei Hamburg 1975) 46;

Jurisdictions adhering to the "Real seat" or "Siège réel" or Sitztheorie[78] doctrine are mainly based on the idea that the company should have a serious real link with the state of whose legal system it claims application. It is believed for this theory that a corporation mostly affects the State where it is "sitting", and so the said State should have the power to govern the internal affairs of it. Therefore, this doctrine stresses the importance of uniform treatment by requiring the incorporation under such a State's law.

The specificity of this system concerning the transfer of the seat is that it should logically be allowed, as soon as the "real seat" is transferred to another jurisdiction. Save the taxation issues, in practice many European such jurisdictions do not allow the seat to be transferred without the dissolution of the company, and generally such systems are more oriented towards exercising close control over the entities that operate within their jurisdiction.

The "Real seat" principle is believed to be favourable for a number of reasons. First, from the Member States' point of view, this doctrine allows them to regulate closely all the companies seating in their territory. Second, from some constituencies' point of view, it allows them to feel much "quiet" concerning the legislation governing the company, in comparison with the situation when the company moves to another State. Another reasoning, from companies' point of view, it keeps them from seeking out other legal systems (that among other negative effects, could be more favourable to management, but less favourable to other stakeholders). There is a view, that if the "real seat" doctrine ceased to exist, many managers would reincorporate under lenient foreign legal systems to the detriment of local constituencies.[79]

The real seat doctrine can be symmetric or asymmetric:[80] in the former case, a jurisdiction does not accept foreign firms' choice of its own corporate law unless they establish their real seat within its territory (such as Germany), that is to say, this doctrine implies a self-imposed export ban on one jurisdiction's corporate law. While in the asymmetric case, no such export ban is self-imposed and foreign firms are free to choose the relevant jurisdiction's corporate law no matter where their real seat is located (such as Italy).

Most of the EU Member States are considered as "Real Seat states", e.g. Portugal, Greece[81] and according to the classification of Wymeersch[82] also: i) Germany and Austria - states that

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[78] The German Supreme Court construed the term real seat as referring to the place where "the fundamental business decisions by the managers are being implemented effectively into day-to-day business activities". See for more details *ibid*, at 13

[79] *See* Holst, C. (2002), "European Company Law after Centros: Is the EU on the Road to Delaware?" 8 Colum. J. Eur. L. 323

[80] *See* Enriques, L. and M. Gelter (2006), "How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law", ECGI Law Working Paper N°. 63/2006, at 7-8

[81] *See* Kieninger E.-M. (2005), "The Legal Framework of Regulatory Competition Based on Company Mobility: EU and US Compared", 6 German Law Journal 741, at 744

[82] *See* Wymeersch, E. (2003) "The Transfer of the Company's Seat in European Company Law", ECGI Law Working Paper No. 08/2003, at 10

do not allow any seat transfer; ii) France and Italy - states that explicitly allow seat transfer; iii) Belgium and Luxembourg - states in which no explicit provision exists.

3. *A short remark*

Alongside these arguments, the huge variation between these two types of doctrines has been and, seems will be, playing a great role not only on the harmonization process overall, but also on our particular topic in discussion. It is natural to believe that, even taking into consideration the recent innovative contribution of the ECJ concerning the favourable treatment towards place of incorporation doctrine vis-à-vis the real seat one, this important variety does not seem to disappear from this area very soon, thus discouraging the regulatory arbitrage of European companies. Towards this end, it give the impression that not only the harmonization in the corporate law area will take time and probably not so short, but also the ECJ would very probably need to play its innovative game again.

B. REGULATORY ARBITRAGE IN THE EU[83]

1. *Reasons to reincorporate*

In order for regulatory competition to exist, the necessary but not sufficient condition is that companies must be firstly engaged in **regulatory arbitrage**, that is to say they have to have good reasoning for moving out from the home state and home jurisdiction, for numerous reasons such as e.g. costs minimization, the factors of labour or natural resources, tax regime, etc. Putting another way, in order for Member States to spend on innovations in their corporate legislation and offer their charters to engage in regulatory competition, they have to be sure that a sufficient amount of firms would be willing to opt out from their home jurisdiction and opt in a new and more friendlier one.

Generally, the US reality suggests that the reasons for existing companies to reincorporate are, among others, in particular the anti-takeover defences, mergers and acquisitions, public offerings, as well as several specific factors, such as employee participation, minority protection etc. The situation in the EU is a bit different.

There are numerous factors that affect (re)incorporation decisions. These factors affect both negatively and positively, depending on the particular case. Firstly, one of the most important arguments to be considered before deciding to opt out and opt in is the **company law**. Though, on the one hand, here in the EU, unlike the US, the company law seems of lesser significance to be a reason to move. In addition to this is the fact that the very feature, which is thought to stipulate migration of particularly US companies to Delaware, i.e. **threat**

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[83] Regulatory arbitrage refers to firms' choice of the legal regime that best suits their preferences, whereas regulatory competition refers to regulators' attempt to attract or not to loose firms due to a more favourable legal environment. *See* Woolcock, S. (1996) "Competition among Rules in the Single European Market", in INTERNATIONAL REGULATORY COMPETITION AND COORDINATION 289 (W.W. Bratton et al. eds, 1996)

[84] *See* Ministero della Giustizia, La durata dei procedimenti civili in Italia 5 (2000), http://www.giustizia.it/statistiche/statistiche_dog/2001/completa.pdf

of litigation on above-mentioned matters, is almost missing in the EU. Actually, one of the characteristics of the EU vs. US is that litigation by minority shareholders is still uncommon and takeover disputes are rarely get to courts. It seems that in a typical European type company with concentrated ownership, for controlling holders and their "army-friends"-managers, who together plan and implement the movement of the company, the company law should be much less of a concern. On the other hand, the existing variety of company law characteristics across the states is an important feature still, taking into consideration e.g. the German codetermination.

Another decisive factor for incorporation is the **expected benefits** from migration. Among other factors to support the unlikelihood of companies to move, one can mention particularly little (if any) legal benefits that migrating companies would expect to receive. This is largely due to the long lasted harmonization process that has reduced the differences of Member States' company laws largely, and so, the meaning to migrate is lost ex ante.

More to this point, related to the battles of corporate nature, the time factor for such proceedings must be mentioned to make a clear picture. Unlike the US, here in Europe the **duration of proceedings** particularly in corporate matters is unbearable big, although it varies in different Member States. E.g., if in Delaware Chancery Court the average duration of a case takes around a month, then the duration of civil proceedings (cognizione ordinaria) in Italy is in between 2.13 to 4.46 years depending on the type of the court in which the action was brought.[84] This fact is crucial for many aspects, but particularly for the reincorporation decisions. From one hand, at least some of the Italian corporations would try to reincorporate in order to escape from such a "problematic and long" proceedings, while on the other hand, at least some other European corporations would not choose such a situation and incorporate in Italy in particular.

From the other side, discussing these issues, one should make a difference in the **stage of formation of a company**: that is to say that "start-ups" and already formed companies differ substantially also in this sense. E.g. if in the first case, when they are trying to incorporate, in the list of the factors enumerated by their significance one can see the minimum capital and maintenance requirements among the top ones (if not the top ones), then the second case, when already formed company is trying to re-incorporate, the enumeration of such factors changes its structure. For the latter case, e.g. Enriques[85] suggested that even after October 2004, reincorporation is far from easy for listed companies; legal and especially tax hurdles will be far from irrelevant for companies considering regulatory arbitrage, which is now a realistic option only for start-ups and, tax issues aside, for companies at the IPO stage.

In general, for the decision about the location of a company headquarter, the "goodness" of the corporate law of that place is only one factor, as we have already mentioned above. Moreover, the factor of "goodness of corporate law" often can be considered as a minor one among **others** that affect such a decision, which are e.g. **taxes** (e.g. corporate and other taxes), **other applicable laws** (e.g. labour and environmental laws), the advantage of the place in the sense of **geographical location** (e.g. the accessibility and the cost of raw materials, qualified

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[85] *See* Enriques, L. (2004), "EC Company Law and the Fears of a European Delaware", Eur. Bus. L. Rev., at 1262

work force etc), **personal preferences of company's governors** (e.g. when the controlling shareholder, and/or a director/CEO/CFO are from a destination country, where they have experience and substantial knowledge on such matters), etc.

In line with all these arguments, if one tries to shape some formulating trends in companies' mobility, then one should agree that, as the recent developments propose, it is natural to expect that companies would likely to consider forum shopping for mobility if there is at least one factor strongly preferred for them (in a following part we will see that some companies are already executing their freedom to choose the most appropriate law for them, and migrate). Below, we will discuss some tendencies of European companies that during the recent years, but especially after the *Centros* case, started to be involved in regulatory arbitrage, as well as the ways of their (re)incorporation.

2. *Ways to reincorporate*

Unlike the US, where the "Place of Incorporation" is dominating, in the EU the domination of the "Real Seat" vis-à-vis the "Place of Incorporation", create specific challenges for companies' transfer of the seat and reincorporation in another Member State. And unlike the US, where reincorporation of an existing company is implemented via cross border merger with a shell company, in the EU the picture is a bit different due to numerous factors. Specifically, leaving apart the *SE* option, there may be four possible cases to discuss composing all the existing variations for companies transfers of its headquarter, that is: i) when the home and the host states are "place of incorporation" states, ii) when the home is a "place of incorporation" state and the host is a "real seat" state, iii) the case vice versa, i.e. when the home is a "real seat" state and the host is a "place of incorporation" state, and finally iv) when both the home and the host are "real seat" states.

Generally in the first case, companies now are able to move without major challenges, keeping its status according to the home state rules. Although the host state could impose special guarantees for creditors or special capital requirements, it cannot require companies to reincorporate as a prerequisite to recognition.[86] In addition to the *Centros* case, in the *Inspire Art* case the ECJ found that extra requirements for foreign corporations imposed by the Netherlands were discriminatory and gave more strict interpretation to the exception known as "general good", thus narrowing the circle of possible exceptions.[87]

In the second case, the situation changed after the *Überseering* case: now the host state will have to recognize that company's legal capacity, which was not the case before. In this case the company will remain subject to the jurisdiction of its home state, meanwhile will continue "to live" in the host one. But even the previous holding of the ECJ did not cover the questions e.g. to what extent the home state can impose its company law or other regulations

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[86] For example, after the Centros case, "Denmark has enacted a tax law that requires foreign corporations to put up a guarantee…the equivalent of the minimum capital requirement", and "Germany is still may find a way to require labour participation in foreign companies that are doing business in Germany without offending the freedom of establishment", See Kersting, C. (2002), "Corporate Choice of Law - a Comparison of the United States and European Systems and a Proposal for a European Directive" 28 Brook. Int'l L. 37, at 63;

[87] *See* subsection on Inspire Art hereby in this paper for more detailed discussion.

on the company, or how far the host state must go in recognizing the legal capacity of the company (e.g. can a host state refuse to apply the laws of the place of incorporation without offending the freedom of establishment)[88], or whether the current case law sufficiently requires Member States to apply the law of a corporation's place of registration.[89]

In the third case, according to the traditional conflict of law rules, such a company would lose its legal capacity under the former and might not regain it under the law of the latter jurisdiction, and a solution could be found by stressing the continuing existence of the company on the basis of the *Überseering* ruling, thereby maintaining the company's status under the home state jurisdiction.[90] In line with Roth[91], others also questioned the fairness of immigration freedom to another state vs. limited emigration ability from their home state of European companies, and suggested that the four-part "necessity test" in *Centros* be used to evaluate state restrictions on the emigration of domestic companies.

In the fourth case, such a transfer will lead to complete submitting the company to the host state company law. Nevertheless, it is now beyond doubt that the host state cannot deny this company its legal existence, and oblige it to reincorporate. The company will exist in the host state, even if in the home state it would no longer be recognized as a company resident in that state.

Against these options, one short note is to be added on the possibility to form a *SE*, i.e. merging the operating unit into a shell company subsidiary in another state.[92] This option deserved a specific attention to be studies with due care taking into consideration its somewhat confused details: in order for this merger to be done, there are specific requirement and regulations, concerning the employees' protection, as well as other specificities connected to having the companies' headquarter in the host state and being subject of, as one scholar suggested, yet highly complicated and uncertain regulation of the *SE* for at least two years.[93]

3. Barriers to reincorporate

There are numerous challenges for European corporations concerning their reincorporation decisions and processes. These barriers are of different types, measures, and characters in comparison to the ones in the US. [94]

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[88] *See* Cerioni, L. (2003), "The "Überseering" Ruling: The Eve of a "Revolution" for the Possibilities of Companies' Migration Throughout the European Community?", 10 Colum. J. Eur. L. 117, at 125--27

[89] *See* Dammann, J.C. (2003), "The U.S. Concept of Granting Corporations Free Choice among State Corporate Law Regimes as a Model for the European Community", SSRN Working paper N 418860, at 15

[90] *See* Wymeersch (2003), *supra note* 82 at 27,

[91] *See* Roth (2003), *supra note* 40, at 206

[92] *See* Council Regulation (EC) No 2157/2001 and Council Directive 2001/86/EC *supra note* 49

[93] *See* Enriques (2004), *supra note* 52, at 80-81.

[94] *See*, among many others cited herein, e.g., Charny, D. (1991), "Competition Among Jurisdictions in Formulating Corporate Law Rules: An American Perspective on the "Race to the Bottom" in the European Communities", 423 Harv. Iint'l L. J. 423, at 456; and Woolcock (1996) *supra note* 83 at 302-303. (for some arguments that obviously limit the ability of firms to choose a foreign legal business form.)

Among many other obstacles for reincorporations, some are of typical legal nature. One of this is the **law** governing the internal and external affairs of a corporation. This issue is governed by the Council Regulation on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters.[95] The Article 23(1) of this Regulation allows for a mutually agreement to choose a forum state, but the Article 22(2) contains an exemption from this general rule for the internal matters of a corporation, stating that certain internal matters, e.g. the dissolution of the corporation and the validity of the decision of its organs must be litigated in the courts of the state of incorporation.[96] Thus, this fact is also a certain constraint for at least some of the corporations to reincorporate.

Strictly connected with this is the factor-barrier already discussed above, i.e. the existence and interrelationship of **two types of theories-systems** in the EU, namely "real seat" and "place of incorporation". Although some scholars already "destroyed" the existence of the former one, interpreting the ECJ "crusade" with its famous rulings, some others still are sceptical to put the final mark on the end of this still dominating doctrine in Europe, and as we have seen above, there are much more questions to be answered and interpreted until the history of this controversy will finished, which itself is a strong barrier for incorporations.

In connection with this is the other factor: the **legal advisers** of corporations, who are also path dependent. As numerous studies have concluded, in general lawyers have a significant voice (if not the significant voice) in reincorporations decisions.[97] In continuation of this argument some views have been introduced that home state lawyers will tend to oppose a decision to emigrate. Besides, there is a specific cost connected with changing of a corporation's lawyer, but this cost works in Europe a bit differently vis-à-vis the US. Firstly, because in the US cases corporations are less likely to change their lawyers while reincorporating, since as a general practical rule most of the lawyers are familiar with basically two corporate laws of their home state and of Delaware state, and this basically covers most part of the incorporations there, while a European lawyer is very unlikely to be familiar with a corporate law of another EU Member State. Moreover, and more importantly, changing a corporation's lawyer is very likely to be much more expensive in Europe compared to the one in the US. Besides, in addition to what we have said with regard to "lawyers" factor, one more argument is noteworthy: local lawyers specialised in the corporate law of their home state, by definition will be unwilling to see their clients incorporating in another state.

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[95] *See* Council Regulation 44/2001 of 22 December 2000 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, 2001 O. J. (L 12) 1, 1--23

[96] *See* Article 22(1) (stating that these matters have to be litigated in the Member State where the corporation's "seat" is located.) Of course, this wording leads to the question of whether the real seat or the statutory seat is to be decisive. Article 22(2) answers that question by stipulating that the courts shall apply their own national rules of private international law to determine the seat of a corporation. According to the state of incorporation doctrine, however, a corporation's "seat" is understood to be its statutory seat.

[97] *See* among others e.g. Heine & Kerber (2002), *supra note* 31; Romano, R. (1985), "Law as a Product: Some Pieces of the Incorporation Puzzle", 1 Journal of Law, Economics & Organization 225; Kobayashi, B. H. and Ribstein, L. E. (1996). "Evolution and Spontaneous Uniformity: Evidence from the Evolution of the Limited Liability Company." Economic Inquiry 34, 464–483.

One of the first non-legal factors to take into consideration while thinking of reincorporation is the **cost of migration**. These costs actually vary from case to case depending on quite a lot of factors, such as the size of the corporation, number of its shareholders, cost of resource migration and so on, and so forth. The last point is a specific one, since it also varies greatly depending on several other aspects, among which are: i) whether the corporation is migrating only legally or also physically (that is the corporation is changing only the applicable jurisdiction or also its headquarters, facilities, etc.), ii) whether the corporation migrates from and to the similar or different states (in the sense of states adhering incorporation or real seat theory), iii) whether the corporation migrates from and to the state similar or different in corporate jurisdiction (e.g. the cost of a company migrating from Italy to Netherlands should be higher than if the same company would migrate from Ireland to Netherlands, at least because the corporation lawyers could rather assist in the second cases then in the first one, where the change of the said lawyers could be necessary), etc.

Among these, one can note also the applicability of **direct and indirect taxes**.[98] It is well known that tax constraints are among the most important barriers to reincorporations. On one hand, the above-mentioned ruling in *Daily Mail* shows that reincorporations will trigger exit taxes on hidden reserves, effectively restricting the demand for chartering.[99] On the other hand, there is evidence that corporate law does not significantly constrain tax-driven firm mobility.[100] Nevertheless, some argue that the ECJ recent rulings on freedom of establishment can and do challenge the existing EC tax landscape, stating that since 2000, the ECJ has repeatedly ruled that tax provisions were precluded by the freedom of establishment principle if they discriminated between domestic and foreign subsidiaries, and more generally between domestic and international groups.[101]Still, commentators are confident that the current tax barriers to cross-border reincorporation will be removed shortly by the ECJ.[102]

Yet, another very important factor affecting such decisions is **path dependency** of several factors other then lawyers, which is widely discussed especially by evolutionary economists and a few times applied also to the corporate filed.[103] Path dependency may result from the fact that a corporation is used to "live" in that environment, it has learned how to "live"

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[98] *See* in support of this argument e.g. McCahery, J. A. and E. P. M. Vermeulen (2004), "The Changing Landscape of EU Company Law", TILEC discussion paper DP 2004 -023

[99] *See* Case 81/1987, Regina v. H. M. Treasury and Comm'rs of Inland Revenue, ex parte Daily Mail and General Trust Plc, [1988] ECR 5483.

[100] *See* Simpson, G.R. "EU's Tax Changes Scatter Corporations", The Wall Street Journal (European ed.), October 9, 2003 at A6.

[101] *See* Hertig, G. and J. McCahery (2006), "Legal Options Approach to EC Company Law", at 11, available at http://repositories.cdlib.org/blewp/art180

[102] *See* Schön, W. (2003), "EC Company Statute and Taxation: Tax Issues and Constraints to Reorganizations and Reincorporations in the EU", Max Planck Institute Working Paper

[103] We will not refer to voluminous literature discussing the path dependency factor, but will refer only to some representative publications closely related to the discussed topic, e.g. Heine and Kerber (2002) *supra note* 31; Bebchuk, L. and M. Roe, (1999), "A Theory of Path Dependence in Corporate Ownership and Governance", 52 Stan. Law Rev. 127; Hathaway, O. (2001). "Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System." Iowa Law Review. 86, 601–665; Gillette, C. P. (1998). "Lock-in Effects in Law and Norms." Boston University Law Review. 78, 813–842.

there, especially has gained expertise in handling legal problems within the old jurisdiction. Besides, there may be **reputational and emotional factors** as well that are especially important for the "old economies" in Europe, which have a long tradition of national corporate law.[104] It is also about the **"age" and predictability of the state corporate law**, as well as the court system, based on the type of the legal system of the country. More to the point, there is another **cultural-emotional factor**; let us call it "**brand-ness**" of a company that is the characteristic of a company's products and services in relation to its geographical location. E.g. famous Volkswagen did not set up a new plant in Portugal, despite the incomparable cheaper labour costs and more flexible labour market, preferring to keep its production in Germany, arguing that it believes there is a kind of "Germanoid" factor of its product that customers value, which otherwise would have been deteriorated. Similarly, Ford did not move its production of Jaguars to the US, saying that Jaguar is a "British brand". Thus, unlike the US, in Europe the path dependency has much more significance and effect, since here the differences between corporate laws and adjudication system vary greatly from one Member State to another.

Not less significant factor affecting negatively the regulatory arbitrage and so the (re)incorporations in the EU, unlike the US, is the **language** difference among Member States[105], although some scholars have argued that this is not the case.[106] Definitely, here the language factor plays a stronger role in comparison with the US reality. This (dis)advantage of European countries matters enough to be considered as one of the actual and long-lasting factors towards this end.

Or yet, one more aspect that is important is the **trade unions** that at least in some Member States, would oppose this decision vociferously.[107]It has been widely demonstrated that such subjects have detrimental effect in several cases throughout the history of particularly some Member States, where they still maintain strong power and are very active. It is obvious that such changes with the corporation are a subject to be discussed with trade unions and receive their no-objection or at least a conditional agreement.

In line with these factors, in Europe there is the certain **political advantage** that controlling shareholders, directors and managers enjoy in their home state, which they will prefer not to lose.[108] Of course, especially in some countries where they path-dependently maintain such an advantage, these contingencies are (the) key players and decisionmakers in such kind of issues for the corporation.

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[104] *See* Kirchner, C., R. Painter, W. Kaal (2004), "Regulatory Competition in EU Corporate Law after Inspire Art: Unbundling Delaware's product for Europe", SSRN Working Paper N617681

[105] *See* among others e.g. Enriques (2004) *supra note* 85, at 1265; Baudisch, M. (2003) "From Status to Contract? An American Perspective on Recent Developments in European Company Law" in F. Snyder (ed), L'UNION EUROPÉENNE ET LA GOUVERNANCE (Bruxelles, Bruylant, 2003);

[106] *See* Dammann (2003) *supra note* 89, at 44

[107] *See* Enriques (2004) *supra note* 85, at 1265

[108] *See* for similar argument e.g. Daines, R. (2002), "The Incorporation Choices of IPO Firms", 77 New York University L Rev, p 1559; Bebchuk, L. A. and A. Cohen (2003) "Firms' Decisions Where to Incorporate", 46 J L and Economics 384

Last but not the least is the factor of **general uncertainty**, which can prevent from opting out for another corporate law, taking into consideration the still-existing general differences of the Member State with regard to the common culture, similar economic and financial and legal systems (as Common Law and Civil Law (with Roman, German and Scandinavian traditions)), and in particular to corporate laws.

Thus, as we have seen, there are plenty of barriers on the way for European companies vis-à-vis US companies, affecting the decision to reincorporate. To be sure, some of them are already, or at least in the near future will be, passed over, taking into consideration the evolution of the EU company law, the innovative actions of the ECJ, as well as several other harmonization effects: all these will open up much wider possibility for other European companies to consider the probability of reincorporation.

More to this point, some concentration of start-up companies has been seen across borders in the past recent years, which is considered as a clear evidence of regulatory arbitrage in the EU.[109] But in general, the arguments for and against the reincorporations of existing companies are yet lack of clear and complete empirical support, since the statistics still does not provide the necessary foundation for a clear documentation of the existence, the level, the trends, and the developments of these movements. Nevertheless, against above-mentioned arguments-barriers for incorporation decisions, we still think that companies would execute their "rights" of regulatory arbitrage once a strong attractive factor appears in one or more states. We think that despite these counterarguments, the regulatory arbitrage will not only survive, but also will become a strong base for the possible charter offering activities of the EU Member States. Below we will turn to the possibilities and the state of the art of such kind of activities.

C. COMPETITION AMONG MEMBER STATES?

Some of the questions this paragraph tries to answer are: Do EU Member states have enough incentives to attract companies? Do EU Member States compete in this? Is there a "race"? If yes, then what is the difference in comparison with the US race? Is it to the top or bottom or..? If there is no race, then is it forthcoming?

1. *"Still a myth, not a reality"* [110]

In the EU, unlike the US, there are several important factors-challenges on a way of a Member State to be involved in charter-offering activities: the first look on this reality apparently suggest that there is no, and it is very unlikely to have, a race among these states to attract companies. Here are some of these challenges.

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[109] *See* e.g. Becht, M, at all (2006) "Corporate Mobility and the Costs of Regulation", SSRN working paper N906066

[110] This is the provided answer by Kieninger (2005) *supra note* 81.

First and foremost: the very driving force of charter offering – **the franchise fees**. Conventionally recognized fact is that these fees were the main argument for the founding idea of the charter offering from the beginning of such activities started in the US more then a century ago, and it is still one of the main arguments nowadays.[111] While, as we have noted above, franchise fees do not play a major role in the European context so far, and even are in contradiction with the European law if not collected by the Member State where the administrative headquarters are located:[112] that is to say, the registered office in the Member State of incorporation is currently not an admissible criterion to link up to for franchise tax purposes.[113]

Another major argument is the **path dependency** of several factors, the significance of which cannot be underestimated: this is crucial in Europe, vis-à-vis the US, and especially so in the states, whose legal, cultural and economic systems resist change. It is hard to expect easy and frequent systemic changes in several countries of "old, kind Europe", where at least four legal traditions exist.[114] More specifically, among barriers for Member States to enter the charter market one can mention also the **language barriers** (e.g. it will be difficult for a Member State whose courts do not conduct proceedings e.g. in English language); differences between **legal systems**, i.e. common and civil law approaches (this is a barrier especially for civil law countries); **procedural differences** between European courts (path dependence in European legal education produces lawyers who are familiar with procedures in their own courts, but unfamiliar with procedures in courts of other Member States); etc.[115]

Of course, one should not forget one of the crucial components, such as **budgetary resources**. This is especially truth for some states with scarce budged, since a certain amount of expenditures should go for development of status drafting, adjudication designing, special training, and other similar type of programs and developments. It is obvious that for many states, such kind of expenditures is not a customary practice and they obviously did not plan budgetary expenditures on these matters for ages not to say at all.

Yet, another challenge on this way is the **political peculiarities** of the States, which is different than that of the US. A typical and most famous case is Germany with its codetermination principle. At the first site, one can find little reason to believe that employees will abuse their influence in the corporation to migrate to another jurisdictions

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[111] Almost all the scholars publishing on these issues accept the franchise fees as the driving force of states' charter offering activities. For the beginning of this debate, where New Jersey started to attract companies in the US to register there, and where the only reason for that was the collection of franchise taxes see Stoke, W. H. (1930), "Economic Influences Upon Corporation Laws of New Jersey", 38 J. Pol. Econ. 551

[112] *See* Council Directive 69/335, OJ L 249, 3 Oct 1969, p 25 (… fees for the formation of companies cannot be higher than the cost of the service provided by the State).

[113] *See* Tröger, T. (2005), "Choice of Jurisdiction in European Corporate Law – Perspectives of European Corporate Governance", European Business Organization Law Review 6: 3-64, at 19

[114] These legal traditions are: Common Law, Code Civil, German Civil Code, and Scandinavian law. Below this highly aggregated level, it is possible to cluster groups of countries that have more or less similar features of corporate law, e.g. (1) France, Belgium, Italy and Spain, (2) Germany and Austria, or (3) U.K. and Ireland.

[115] Here again we would refer only to few of the publications concerning the importance of the path-dependency effect on these issues, e.g. citations on *supra note* 103; Liebowitz, S. J. and S. E. Margolis (1995) "Path Dependence, Lock-In, and History", 11 Journal of Law, Economics and Organization 205-226; etc.

with less efficient corporate law. Even the in-depth laws of codetermination in Germany does not empower employees to force the corporation to incorporate, that is to say the power of these rules to consider the voice of employees does not ensure that they can decide to reincorporate and even if they were able, they would have no much choice to move to, since the other Member States have incomparable less demanding laws with respect to codetermination or do not have any such rules at all. Moreover, nor is it likely that any state will seek to attract corporate charters by adopting stricter rules on codetermination. Given that even in Germany employees will hardly ever be able to choose the state of incorporation, such an approach would not be particularly promising as a strategy to attract corporations. Thus, in general employee opportunism is extremely unlikely to fuel a race to the bottom in the EU.[116] More to the point, even if the ruling on the *Inspire Art* case is thought to reshape the state of the art on codetermination, since the companies can escape from the German law by incorporating in another States in the EU, this in no way guarantees that Germany will start to reform completely its peculiar system to make it desirable for the non German entities at least not for the nearest future. Same kind of reasoning can be done for other Members, including France, Italy, Sweden, etc.

Another interesting argument is that the potential for the Member States to engage in charter competition is limited, since upon joining the EU they entered into a **long-term non-competitive agreement** regarding company lawmaking.[117]

No race can reasonably be expected to develop among Member States in this field, argues Enriques, stating in particular that the bottom-up and top-down **harmonization** of company law within the EU makes it difficult for any jurisdiction to devise really attractive company law rules.[118]

Examining the recent trends in regulatory arbitrage and competition in Europe it has been argued that a competitive environment for reincorporations has yet to develop and even if incentives to compete are present, state competition may be subject to structural barriers that inhibit the evolution of rules.[119] But, while the real seat doctrine will continue to restrict firms' mobility despite recent ECJ case law, Member States have started to show interest in supplying new business statutes.[120] The following paragraph explains some first steps of European states towards attraction of companies from abroad.

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[116] *See* Dammann, J.C. (2004), "Freedom of Choice in European Corporate Law", 29 Yale J. Int'l L. 477, at 499

[117] *See* McCahery and Vermeulen (2005), *supra note* 58

[118] *See* Enriques (2004) *supra note* 85, at 1273

[119] *See* Hertig, G. and J. A. McCahery (2003), "Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition?" SSRN Working Paper N438421

[120] *See ibid*. The authors motivation are threefold: (1) to improve the environment of small and medium size businesses by actively attempting to attract investment or business; (2) to promote the competitiveness of indigenous industries by adopting the most favourable business form: (3) to respond to competitive threats posed by offshore jurisdictions. They argue that should the future bring an increase in the number of firms migrating to the most favourable jurisdictions, as envisaged by the ECJ in Centros and Überseering, the pressure from interest groups on states to adopt responsive legislation can be expected to increase.

2. *"First swallows"*

Against the background of the "myth" explained in the paragraph above, here below we will try to put together some pieces of a picture of regulatory competition in Europe.

Among few scholars arguing for high likelihood of such competition e.g. Armour argues that **regulatory competition** between Member States' company laws **is likely to be a better way** to stimulate the development of appropriate legal rules **than is the European legislative process**.[121]. Supporting the case of the UK, he thinks that other Member States are likely to respond with "defensive" competition, either by removing inefficient rules or by further developing the complementarities of their systems, claiming that this will not result in a destructive "race to the bottom". The example of this is the case of Denmark, which after the *Centros* case has enacted a tax law that requires foreign corporations to put up a guarantee as an equivalent of the minimum capital requirement.

In his turn, Ebke finds that the lack of a comprehensive body of harmonized laws relating to the "internal affairs" of corporations and other business enterprises in the EU will increase the competition. He believes that ECJ recent judgments have created not only jurisdictional competition, but also regulatory competition among the corporation laws of the 25 EU Member States and the 3 EEA Member States (i.e. Iceland, Liechtenstein, and Norway) are very likely to become an integral part of the new competitive market place for corporation laws.[122]

Against these arguments, in the subsection below we explain the "behaviour" of some states that have been implementing several changes in their corporate legislation. In particular, these changes mainly target facilitation of company registration and elimination of the minimum capital requirements for them. These developments have been interpreted as a part of a program directed to encourage entrepreneurship and overall business environment, in particular targeting small and medium size enterprises. But, on the other hand, one can clearly see that such reforms should affect the overall picture of the state's attractiveness by already established and large foreign companies and be reasons for their reincorporations there. Although these reasons should not be seen as sufficient and the only ones in order to make decisions to reincorporate based on that, since for established companies the minimum capital requirements and the easy procedure to set up a company in general hardly will play enough role in order to reincorporate, vis-à-vis the start-up companies, for whom these factors are of significant value. In line with these, we suggest that few states have some incentives to engage in regulatory competition to attract companies, or to prevent them from being attracted from elsewhere. The only difference from US reality and existence of Delaware there, that in the European design the motivation is not the franchise revenues, but other important factors explained below.

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[121] *See* Armour, J. (2005) "Who Should Make Corporate Law? EC Legislation versus Regulatory Competition", ESRC Centre for Business Research, University of Cambridge, Working paper No. 307

[122] *See supra note* 47, at 52-54

Thus, discussing the possible appearance of "EU Delaware" in the section D below, we will discuss also the factors that show the already started "movement" of European states to amend their legislation in order to attract companies from other states: how can one call this process, we will see below.

3. *Besides…*

Besides, there is another aspect concerning the theoretical (particularly economic) foundations of the competition debate, which is not taking place in this paper sufficiently. The idea is of competition as a learning and discovery process, having its foundations in ideas of Schumpeter, Hayek, Kirzner and others.[123] The core of this approach is that firstly it takes into consideration **dynamics** of the system. That is to say, the competition is evaluated for the whole process whereby information is generated and circulated, and insofar as the privately held information can be mobilised through the market process, that much it will increase the wealth of the society. This leads to a model, where the diversity is a precondition and the very basis for mutual learning and change. This diversity generates a pool of different approaches/solutions and thus, the wider and deeper this pool, the more probable to have a potential solution and so, to achieve dynamic efficiency. In general, we eager to see the heterogeneity of company law makers in the EU as a strong argument to be preserved and not to diminished by insisting programs, such as the harmonization across these countries, and we support the idea that this diversity is one of the very values to be preserved for dynamic learning and evolution for better.[124]

To make a viewable picture of the puzzle, it should be noted that the factor of **complementarity** makes the case of path dependency in corporate law making (future) competition stronger. Complementarity of legal rules means that the effect of one legal rule also depends on other legal rules, i.e. that a body of law, in which legal rules are complementary, has to be consistent. While, complementarity in corporate law implies that the value of the corporate law depends not only on single corporate law rules, but also on the specific mixture of the rules, their smoothly working together, and the fitness of the corporate law into the whole body of business law.[125] Thus, it is possible to distinguish between two sorts of complementarity: (1) The legal rules within corporate law, i.e. single rules can only be replaced by others, if they fit to the other elements of corporate law. (2) The entire corporate law can be complementary to other sets of legal rules, i.e. the whole corporate law of one country has to fit into its legal environment. In both cases, the complementarity of legal rules leads to path dependences in the evolution of law, because it

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[123] *See* among others Schumpeter, J. A. THE THEORY OF ECONOMIC DEVELOPMENT. AN INQUIRY INTO PROFITS, CAPITAL, CREDIT, INTEREST, AND THE BUSINESS CYCLE, (Cambridge, 1934); Hayek, F. A. v. (ed.), NEW STUDIES IN PHILOSOPHY, POLITICS, ECONOMICS AND THE HISTORY OF IDEAS, (Chicago, 1978); Hayek, F. A. v., LAW LEGISLATION AND LIBERTY (London: Routledge, 1980); Kirzner, I. HOW MARKETS WORK: DISEQUILIBRIUM, ENTREPRENEURSHIP AND DISCOVERY, (London: IEA, 1997).

[124] *See below note* 160

[125] *See e.g.* Roe, M. J. (1998), "Comparative Corporate Governance" In P. Newman (ed.), THE NEW PALGRAVE OF ECONOMICS AND THE LAW, vol. 1, London, at 345; Bebchuk, L. A. & Roe, M. J. (1999). "A Theory of Path Dependence in Corporate Ownership and Governance." Stanford Law Review 52, at 140;

is difficult to replace single (sets of) legal rules by others.[126] The closer the interrelation between the national corporate law and the other components of the national legal system is, the more problematic it is to exchange the corporate law without changing the entire legal environment simultaneously. This factor is especially stronger in Europe vis-à-vis the US, due to at least two factors: 1) the different legal traditions in Europe, and 2) the still existing "real seat theory" that has induced a national development of corporate laws without interference of fierce regulatory competition by other corporate laws, etc.

Thus, against the background mentioned above, if one can argue that currently the states still do not show great interest in retaining "their" and/or attracting "others'" corporations, one cannot reject the interest of few other countries in such activities, continuing their innovative developments and updates of their corporate legislation. Of course, this cannot be considered as a race, or even charter offering activity, but rather evolutionary adaptation of the legislation. Those few cases still concern incorporations of start-ups for whom the total costs to set up the company (including minimum capital requirements and setting up costs) are of decisive importance. While the statistics, as far as the functioning corporations are concerned, has to be analysed with due care in order to find support and evidence for reincorporations. Although, it should be noted that some necessary and sufficient rudiments for such a possible race already exist. The recent developments support the idea that the innovative practice of corporate lawmaking targeted the retaining and/or attracting of corporations will probably continue to play a role and there is a probability for Member States to start to offer their charters, which would possibly turn to become a race.[127]

Apart from above arguments, this debate is still silent about some other countries that could possibly enter into the regulatory competition game, such as the ones that are in the "heart and neighbourhood" of the EU, but are not members states still. The literature is still inadequate concerning possible enlargement of this debate to cover these countries as well. Although, the current policy developments of the EU try to involve these countries into its "boundaries" as well, and some fundamental interrelationship has already predetermined here, it seems that further advancements could allow these countries also be interested in and become a part of the general game in the future, since there are several founding principles already set up for all these. This enlargement of the debate still needs to be analysed and evaluated by all constituencies, since it seems likely that this area will contribute to this debate soon.[128]

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[126] *See* Heine and Kerber (2002) *supra note* 31, at 64

[127] The recent working paper of Becht et all (2006) *supra note* 109, using the data for 1.96 million private and public limited companies incorporated in the U.K. between 1997 and 2005 shows that there is a strong tendency for mainly start-up and smallest limited liability companies to incorporate in the U.K. mostly due to minimum capital requirements, setup costs, time to obtain legal status and similar variables. But this evidence is not a proper mobility of companies, since the case is not of re-incorporation of existing companies (to which this paper refers mainly), but of incorporation of new start-ups. Besides, as the authors agree as well, such a tendency is explained only by very specific factors and driven only by the differences in the regulation of new company formation and not at all by more principal and core differences in company law and/or corporate environment in general.

[128] In another forthcoming paper, we analyse the possible enlargement of this debate to include the countries other then the EU Members, the ones in the EEA and Accessing countries, in particular analysing the cases of

D. "EU DELAWARE": WAITING FOR GODOT?[129]

This is a long discussed and a controversial part of this debate: the Delaware phenomenon and the "EU Delaware". It is sill attracts opponents to explain, argue, debate and suggest what is this phenomenon, and what is the European reality concerning the possibilities of seeing such a "demon" in Europe, sooner or later. Below we will discuss the European part of the question only.

1. *Apparently, so!*

As it has been argued, the prospects of US-style regulatory competition emerging are remote, even if the real seat doctrine were to fall after *Centros* case: co-evolution, so the argument goes, based on diversity at the level of national legal systems, coupled with encouragement from transnational norms for devolved solutions, is a more likely path for European company law than the type of convergence around a single, dominant regime which appears to characterize the Delaware effect in the US context.[130]

More scholars believe in "Godot" phenomenon, arguing that it is very unlikely to see a "EU Delaware" at anytime soon. E.g. Enriques believes that even having established that there is indeed a demand, however little, for a friendlier company law, it is far from sure that a "European Delaware" will emerge, arguing that it is most unlikely that any EU Member State will emerge as an active player in the market for corporate law, owing to a number of features of the European institutional framework that were absent more than a century ago when some US States engaged in a race for (re)incorporations.[131]

In his turn, Tröger argues that no Member State occupies at present, or has proper incentives and political manoeuvring space to assume in the future, a similarly preponderant position like the winner of the historical American competition for corporate charters: although the individual preferences of decision-makers may motivate some cross-border (re)incorporations, no dominant State of incorporation will emerge in the EU in the medium term.[132]

Besides, as McCahery and Vermeulen has pointed out, the Member States upon joining the EU enter into a long-term non-competitive agreement regarding company lawmaking, thus preventing "Delaware effect": member States, so the argument goes, considering their long

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Armenia, Israel, and Switzerland. It seems that there are noteworthy factors to be considered seriously towards this direction.

[129] See http://samuel-beckett.net/ for the famous absurdist tragicomedy of Samuel Beckett called "Waiting for Godot", where the "Godot" is associated with an eponymous but unseen character. The meaning of "Godot-Delaware" is that it is not appearing as far as the "show is going on", i.e. it is highly unlikely to see a "European Delaware" at anytime soon.

[130] *See* Deakin (2001) *supra note* 63

[131] *See* Enriques (2004) *supra note* 85, at 1273

[132] *See* Tröger (2005) *supra note* 113

tradition of independency, are unwilling to relinquish their lawmaking autonomy and taking all the steps to avoid "European Delaware".[133]

Armour raise up another interesting factor, arguing that regulatory competition is likely to be both a significant and a beneficial mechanism for the development of European company law and that, given the diversity of the Member States' systems, whilst there will be a regulatory competition, no Member State will become the "European Delaware".[134]

2. *Some "Delawares" around?*

Against the above-mentioned background, there are some scholars arguing for likely winner(s) of the state competition of charter offering.

Concerning the possible "European Delaware" appearance, recently some arguments demonstrated that the best chances may be accorded to **Liechtenstein**, which is a member of the EEA and its companies have a right to the freedom of establishment; it follows the theory of incorporation and is very active (and successful) in attracting companies through a largely deregulated and permissive company law, and derives substantial part of its budget from taxes imposed on corporations with a registered office there.[135] As a member of the EEA, so the argument goes, it has to comply with the EU-company law directives, but since those are only applicable to certain forms of corporations, the most successful kinds of Liechtenstein corporate bodies (*Anstalten*, *Stiftungen*) are not affected by European legislation.

Supporting the case of Liechtenstein, it can be mentioned that the latter has an extremely favourable corporate income tax system, but with regard to genuine business organizations, the Principality's corporate law system does not provide any advantages and a crackdown on the tax trade might force Liechtenstein to look for new sources of income. With the provision of good corporate law to attract incorporations becoming an option, however the current state of affairs does not provide significant advantages for Liechtenstein if it should consider embarking on such endeavour.[136]

On the top of these factors, there are some others that make this case stronger, such as: Liechtenstein, as Delaware, obtains a large part of its tax income from a company tax that is comparable to the franchise tax in the US; having only an extremely small territory with negligible industrial potential, financial services are the main foundation of its wealth. One more point: we are not arguing for the possibility of Liechtenstein to be involved in company-attracting activities only because it is a small state and have "small" budget, as it could have been e.g. for the case of South Dakota that has a population slightly lower than Delaware's and a much smaller state budget, while Delaware's 2005 franchise tax revenues

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[133] *See* McCahery and Vermeulen (2005) *supra note* 58;

[134] *See* Armour (2005) *supra note* 121.

[135] *See* for this point Kieninger E. (2005), "The Legal Framework of Regulatory Competition Based on Company Mobility: EU and US Compared", 6 German Law Journal 741 (between 1985 and 1998, the franchise taxes to the state budged increased from 15.4% to 26.6%)

[136] *See* Tröger (2005) *supra note* 113, at 46

constitute 61% percent of South Dakota's total revenues from taxes,[137] but which could not have been capable to capture appropriate number of (re)incorporations and revenues consequently. We argue for all the above-mentioned arguments above, that at least those arguments could make stronger the case of Liechtenstein to become "the attractor" of European companies. Thus, it the first sight observance suggests that Liechtenstein is a potential winner of the "European Delaware" cup!

Similarly, it can be argued that, e.g. **Luxemburg** can be a potential candidate as well, taking into consideration that the latter, similar to Liechtenstein, also has favourable tax regime, [138] but if one takes as granted that the ultimate reason to attract corporations is the taxes to the state budget, then one hardly can believe that Luxemburg will ever be dependent on franchise fees in order to race for that, though other reasons cannot be neglected.

Continuing the argument of Vermeulen,[139] Hertig and McCahery[140] argue that the **UK** could become the leading jurisdiction for European corporations, stating that UK legislators have moved fast to develop a menu of new corporate forms that caters to the needs of entrepreneurs, while its courts are respective and productive, and moreover, the additional incorporations will mean increased revenue for UK accountants and lawyers.

At this point again, we again find necessary to divide the discussion into incorporation of a start up and re-incorporation of an existing company. As we have mentioned before, for the first case, the top level of significant factors' list is devoted to capital adequacy and maintenance requirements. It seems that for private limited companies, eager to escape from expensive minimum capital requirements, a state like the UK can naturally become the jurisdiction of choice.[141] Typical set up costs for incorporation as a private limited company in the UK is equal to €425, while the minimum capital required and the paid up capital (that must be paid up upon registration of the company) are equal to €2 only. Noteworthy fact is that a major part of these companies are incorporated electronically, which definitely facilitate all the process and is a particularly positive factor for (re)incorporating firms.[142]

On the other hand, e.g. **France** has already made some changes in order to facilitate the procedures to incorporate companies in there, e.g. it is now possible to create *Société à Resposabilité Limité* (limited liability private company) within 24 hours with a minimum capital of €1, which was €7500 before.[143] The formalities of incorporation are reduced to a minimum and even application registration via Internet is possible. Together with other simplifications in the legislation, these changes are to encourage start-ups, though it seems

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[137] *See* U.S. Census Bureau 2005 (2006), http://www.census.gov/

[138] See *ibid* at 46

[139] *See* Vermeulen E. (2003), "The Evolution of Legal Business Forms in Europe and the United States" 153, at 155-157

[140] *See* Hertig and McCahery (2003) *supra note* 119, at 10-11

[141] *See* in support of this idea the Figure 1: "German" companies incorporating in UK" in the Annex of this paper.

[142] *See* "Companies House Annual Report and Accounts 2005/06", at 7

[143] To create such a company the minimum capital requirement, as well as the paid-up capital are equal to €1, and the setup cost for such a company is €450.

that these developments are not aimed to attract companies from abroad. Some other states have been doing such action continuously.

Thus, e.g. in **Spain** similar legislation exists since 2003, though here the minimum and (strangely enough) maximum capital limits are defined as €€3,012-120,200. As these changes were interpreted, there is no a slightest hint concerning the participation in charter competition.[144] Still, the cross-country differences of costs for company incorporation are large even within the EU.[145]

Of course, the selection of the **UK** options, itself contain specific issues: e.g. concerning the need to litigate some issues there, and/or to "buy" legal advise in the UK from the "most important legal market" of the EU. Again considering start-ups (for the case of incorporations) and already incorporated companies (for the case of reincorporations), it seems that these costs do not seem to be the most important factors for the UK case. For the first case, it is partly because of small probability of the need to litigate in the UK: this is due to the nature of a typical European company owned not by several thousands of minor shareholders, but by few larger shareholders, where they can escape from such "worries" as the litigation in the UK is (one of the solutions could be a shareholder agreement on this matters). And, partly because litigation practice by itself, as we have mentioned already, is not so widespread in the EU as opposed to the US, so the fear of that is not that much destroying. As far as "buying" of legal advice is concerned, then for the start-ups the first necessary and also satisfactory procedure is to be properly incorporated and receive appropriate information and advice at that starting step: especially for this, it seems that the number of agencies offering incorporation services in the UK is increasing continuously, and the prices for these services are enough satisfactory,[146] thus, there is still not necessity for these start ups look for legal advice from expensive lawyers.

However, the case of incorporated companies is a bit more complicated. Some good reasons could direct these companies to go for reincorporations in the **UK**: among others one can mention e.g. the general character of the UK law, which is still considered commonly as more flexible vis-à-vis other European states' company laws. Nevertheless, this factor by itself is unlikely to make a big difference. As the US practice suggests, the Delaware attractiveness is composed not only by its corporate law, but also, and more importantly, by it peculiar practice of adjudication, which includes the quality, professionalism, incomparable expertise and "business-friendliness" of its judiciary.[147] It is acknowledged that a huge part of peculiarity of Delaware is conditioned by its court system, especially by its Chancery court. In addition to these are the rich body of precedents accumulated during the long practice on more than one century cases, as well as the availability of top-notch legal advise on all these. In comparison, one has argued that only UK is positioned to be

[144] *See* Kieninger (2005) supra note 81, at 768

[145] *See* Djankov, S. R. La Porta, F. Lopez-de-Silanes, and A. Shleifer, "The Regulation of Entry," Q. J. Econ. 117, 1:1-37, Feb. 2002; and the Figure 2 in the Annex of this paper.

[146] A typical incorporation agency is providing this service for just around £40.

[147] *See* for some of these arguments Romano, R. THE GENIUS OF AMERICAN CORPORATE LAW, (Washington, D.C., AEI Press, 1993)

somewhat closer to one (some) of these peculiar factors of Delaware.[148] More to this point, the UK, similar to Delaware, has a specialist court list devoted solely to corporate matters presided over by judges specialized in such matters.[149]

It is noteworthy that accepting the certainty of Delaware precedents, Armour argues for the existence of similar qualification for the **UK** practice, citing other scholars as well.[150] Taking into consideration all these factors, one can suggest that companies incorporating in the UK would enjoy the combination of such a legal flexibility and certainty to structure their affairs with a low legal risk, though it is obvious these factors cannot by themselves be the reason for reincorporations here.

Another important factor concerning the **UK** company law and reincorporations of existing companies is that a large part of the regulation of the control of listed companies is not in the "hard law" but rather in the "soft" one. These are e.g. the UK Listing Rules,[151] Combined Code of Corporate Governance,[152] and the City Code on Takeovers and Mergers,[153] dealing with specific issues of company matters, and having the advantage of being regularly updated as opposed to the "hard law".

Apart from these, it is suggested to be plausible and confirmed by anecdotal evidence that foreign limited companies may be incorporated in the UK for purposes of fraud and tax evasion.[154]

Though, Ebke demonstrates that **England**, once thought by many to be a natural candidate for the position of Europe's "Delaware", is facing substantial competition: its acts on wrongful trading and directors disqualification are pushing off from the UK to equally or even more accommodating laws of Luxembourg, the Netherlands, and maybe even Spain and Italy.[155]

To this point, it is worth to recall the recent specific changes e.g. in **France** dropping down the minimum capital requirement for French limited companies to €1, which resulted to

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[148] *See* e.g. Cheffins, B., COMPANY LAW: THEORY, STRUCTURE AND OPERATION (Oxford: OUP, 1997), at. 442-443 (arguing that the UK is perhaps unique to capitalise on these procedural aspects of corporate law choice)

[149] *See* for general discussion on the UK court system e.g. Rt Hon Lord Justice Brooke (ed.), CIVIL PROCEDURE, Vol. 2 (London: Sweet and Maxwell, 2004), 2G-14; Shapiro, M., COURTS: A COMPARATIVE AND POLITICAL ANALYSIS (Chicago: University of Chicago Press, 1981), 150; Cappelletti, M., THE JUDICIAL PROCESS IN COMPARATIVE PERSPECTIVE (Oxford: Clarendon Press, 1989), at 220.

[150] *See* among others e.g. Armour (2005) *supra note* 121 at. 14; Atiyah, P.S. and R.S. Summers, FORM AND SUBSTANCE IN ANGLO-AMERICAN LAW (Oxford: Clarendon Press, 1987), at 118-127; Posner, R., LAW AND LEGAL THEORY IN ENGLAND AND AMERICA (Oxford: OUP, 1996), at 84-92.

[151] *See* UK Listing Rules, rr. 10.5, 10.37 (significant transactions requiring shareholder approval); ch. 11 (related party transactions requiring shareholder approval); rr. 4.16-4.21 (pre-emption rights); Ch. 15 (share repurchases); and Ch. 12 and Model Code (directors' share dealings).

[152] *See* UKLA, The Combined Code on Corporate Governance (2003), at www.fsa.gov.uk

[153] *See* The Takeover Panel, City Code on Takeovers and Mergers and the Rules Governing Substantial Acquisitions of Shares, 7th ed. (Bowne International: London, 2002) www.thetakeoverpanel.org.uk

[154] *See* Becht et all (2006) *supra note* 109, at 25.

[155] *See* Ebke (2005), *supra note* 47, at 53

some increase in the numbers of incorporations there. On the other hand, several changes are in the preparation process in **Germany**, where the Government tries to reform the company law and make it easier to set up companies under German law but on UK limited terms. Another remarkable case seems that of the **Netherlands**, since the governmental authorities explicitly state the necessity to make changes in order to compete with the UK, as far as the company law and incorporation procedures are concerned: e.g. a joint press release from the Dutch Ministry of Justice and the Dutch Ministry of Economic Affairs called for a simple and flexible law on private companies with limited liability suggesting to abolish the minimum capital requirement of €18,000 and other relevant obligations", since "the Dutch private limited company must take on the competition with foreign legal forms".[156]

Moreover, if one considers the factors affecting the (re)incorporation decisions as minimum capital requirements and typical setup costs, then the first quintet of the most optimal places are **Cyprus, the UK, France, Malta** and **Ireland**, following by the second quintet including the **3 Baltic countries, Spain and Slovakia**.[157] It seems, that e.g. the first quintet could include one/some of the countries to become a basin of attraction for European companies. Considering the fact that in France, after dropping down the minimum capital requirement, only very few companies registered by that "extremum" of €1 (only 4.9%), while registering with higher capital of €501-1000 (25.7%), €1001-3000 (27.4%) or €3001-7500 (28.8%),[158] one can make parallels arguing that in this sense one or some countries from the second quintet could be considered in line with the first group of five (in particular, e.g. **Spain**).

3. *And, moreover…*

As soon as a state start to attract companies out of its borders, and also to keep "their" companies inside their borders, the situation will change and the developments are likely to become faster then ex post. That is to say, once corporations start such a migration towards one or more jurisdictions, the appropriate Member State will gain from a network effect and thus will become more attractive for other corporations. As a result, that state will gain from dynamic economies of scale and will become "basin of attraction" for companies. Such network externality effect is widely discussed in the law and economics (particularly in evolutionary economics) literature.[159] Examples of typical network externality effects on

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[156] *See* at http://english.justitie.nl

[157] *See* Figure 2: Minimum Capital Requirements and Incorporation costs in the EU in Annex of this paper.

[158] *See* Création et pérennité des SARL à libre capital à Paris Août 2003-août 2004 : le greffe tire le bilan, Tribunal de Commerce de Paris, and Observatoire des SARL "Initiative économique" Bilan de l'année 2005, Tribunal de Commerce de Paris 2005.

[159] Among numerous scholars of Evolutionary Economics School, who largely discuss this effect, see e.g. *supra note* 115; Dosi, G., Chr. Freeman, R. Nelson, G. Silverberg and L. Soete, TECHNICAL CHANGE AND ECONOMIC THEORY (London, 1988); Garrouste, P. and S. Iovannides, (eds.), EVOLUTION AND PATH DEPENDENCE IN ECONOMIC IDEAS: PAST AND PRESENT (Edward Elgar Publishing, 2001); Dopfer, K. (edt.) THE EVOLUTIONARY FOUNDATIONS OF ECONOMICS, (CUP, 2006); David, P. (1985), "Clio and the Economics and QWERTY", 75 Amer. Econ. Rev. (1985); Arthur, B. (1990) "Positive Feedback in the Economy" 262 Scientific American 92 (on Beta vs. VHS); Cowan, R., (1990) "Nuclear Power Reactors: A Study in Technological Lock-in" 50 J. Econ. His. 541; Katz, M. L. and C. Shapiro (1985) "Network Externalities, Competition, and Compatibility", 75 Am. Econ. Rev. 424. With regard to regulatory competition, see apart from the ones mentioned in the footnotes above in this paper, e.g. Klausner, M. (1995), "Corporations, Corporate Law, and Networks of

regulatory competition are: with the increase of incorporations in a state, the demand for corporate matters will increase by default; this will increase the cases in the courts on this matters; simultaneously, the judges will gain substantial experience on these matters; these will increase the predictability of the corporate law there; these factors will facilitate the evaluation of governing rules of those companies incorporated in that state: last but not least, the state's authorities will invest in innovations of their system and legislation more, trying to keep its attractiveness. And so the circle will move again and to up! Though, to talk about such effect in the European reality is a bit soon, but in line with developments in this area, it could become notable as well.

Against the above-mentioned, if the name of the game is regulatory competition, then in all these matters the role of the EC as a lawmaker should be considered highly. Unlike Washington in the US, here the role of Brussels with regard to such issues is not thoroughly and completely demonstrated, save few attempts. In its place, Brussels should be considered as not only one of the equal lawmakers, but also the one that is dictating from the top, insisting with its wide harmonization tool. So, our argument is, even if in Europe would start a regulatory competition where one of the states would become the "basin of attraction" for many companies, that state would face the Brussels-lawmaker adversary. This is one of the arguments towards the explanation that considering Brussels's heavy harmonization in particular of company law throughout the EU, there remain very few chances hoping for regulatory competition to become true. Instead, out idea is that regulatory competition in company law making in the EU would likely to be more fruitful and rewarding then that of the existing system.[160]

Thus, discussing the possibility of the appearance of the "EU Delaware", we have seen that there are, and there would be a number of other well-formulated arguments for and against the possibility of that. To be sure, some scholars still believe that what are they expecting is the "Demon" that is almost arriving, while others believe it is the "Godot" that will not appear at least until "the show is going on". Instead, our analyses demonstrated that more then one "Godot" appearance is likely in the European context.[161]

IV. CONCLUSION

In this paper, we have sought to analyse the regulatory competition phenomenon in Europe. To this aim, we studied the corporate law of the EU with particular attention on its creation, development, harmonization process, and its state of the art concerning possible shortfalls and forthcoming supplements. These analyses speak up for the unlikelihood to see a similar

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Contracts", 81 Va. L. Rev. 757 (who was the first one to apply the network externality argument to regulatory competition debate); Kahan, M. and Klausner, M. (1997). "Standardization and Innovation in Corporate Contracting (or "The Economics of Boilerplate")." Virginia Law Review. 83, 713–770; Lemley, M. and D. McGowan (1998) "Legal Implications of Network Economic Effects", 86 CAL. L. REV. 479, 483; Kobayashi, B. H. and Ribstein, L. E. (1999) "The Fable of the B.A.'s: Network Externalities and the Choice of Business Form", Working Paper, George Mason University, Law School; Vermeulen, E. (2005) "Network Effects and Regulatory Competition" TILEC Discussion paper DP 2005-028;

[160] This and similar questions are analysed in another forthcoming paper of ours. *See supra note* 128

[161] Besides, our guess is that there is no need to have fear of such "Delawares" appearance, *see ibid*

evolution in the EU concerning regulatory competition, as it was (is) in the US: EU has its own way to grow.

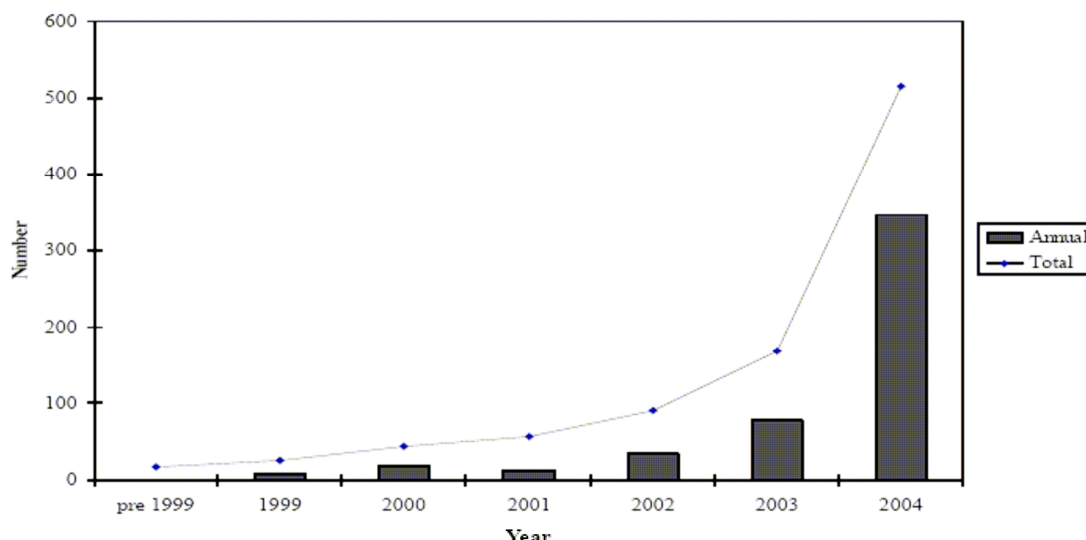
On the other hand, we demonstrated that recent innovative interference of the ECJ has created strong precedents, and largely opened up real possibilities for radical changes concerning regulatory arbitrage and companies' (re)incorporation throughout the EU. Some patterns of companies' movement (though only start-ups) are already evidence that prove the existence of regulatory arbitrage, although this movement include only few states. The case for established companies' reincorporation still needs to be analysed with due care before arguing for existing regulatory arbitrage for such companies throughout the EU as well. But our analyses suggest that the operating companies also would likely to execute their freedom to choose the most appropriate environment for themselves soon. Even though we have demonstrated numerous factors that affect negatively to decisions to reincorporate, against only few positive ones, our idea is that the latter will play greater role.

We revealed that recent developments have created a situation that encourages Member States to take actions towards regulatory competition. We explained numerous arguments for and against the possibility of states' competition to attract foreign companies from abroad, and/or keep their "own" companies within their borders. Though the very driving force for the companies' attraction – fiscal component similar to franchise tax of Delaware - is absent and prohibited in the EU, there still remain good reasons for Member States to attract companies. Some states have already started to amend their legislation to facilitate the companies' registration process and to decrease some capital requirements, and at least one of them aimed to take on the competition with foreign legal forms. This is the very phenomenon called regulatory competition, though this is not still a competition via offering their corporate charters!

We demonstrated numerous characteristics of few EU Member States, as well as other European states, comparable with the ones that condition the leading position of Delaware, but we argue that at present none of these states is placed in the way to be called "EU Delaware". Nevertheless, we argued that it is likely to have an appearance of one or even more "EU Delaware"s, and on the cases of those states, we demonstrated that there are potential pretenders to become "basins of attraction" for companies. The later competition largely depends on the further advancements in the EC programs on this field, and/or on another "spectacular crusade" of the ECJ in particular, be it a reality: in Europe it is implausible to see a regulatory competition without Brussels negative affect, unfortunately.

ANNEX

FIGURE 1: "GERMAN" COMPANIES INCORPORATING IN UK



Source: Armour (2005), at 13

FIGURE 2: MINIMUM CAPITAL REQUIREMENTS AND INCORPORATION COSTS IN SOME EU COUNTRIES (FOR PRIVATE AND PUBLIC LIMITED COMPANIES) IN EURO.

	Private limited companies			Public limited comp-s	
Country / Costs	Minimum capital	Paid-up capital	Setup costs	Minimum capital	Setup costs
Cyprus	2	2	n.a.	8850	n.a.
United Kingdom	2	2	425	75450	779
France	1	1	450	37000	550
Malta	1160	232	n.a.	46400	n.a.
Ireland	1	1	1500	38092	5000
Estonia	2560	2560	n.a.	25560	n.a.
Latvia	2880	2440	n.a.	35950	n.a.
Lithuania	2900	2900	n.a.	43440	n.a.
Spain	3010	3010	600	60100	1200
Slovakia	5230	4230	4000	26140	5000

Source: built on Becht at al (2006) and EVCA (2004) "Benchmarking European Tax and Legal Environments. European Private Equity & Venture Capital Association. Brussels" at www.evca.com

Note: Typical setup costs (resulting from taxes, duties and notary fees) are the upper bounds of figures reported in EVCA (2004).