WHO SHOULD MAKE CORPORATE LAW?
EC LEGISLATION VERSUS REGULATORY COMPETITION

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by

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Abstract
This paper makes a case for the future development of European corporate law through regulatory competition rather than EC legislation. It is for the first time becoming legally possible for firms within the EU to select the national company law that they wish to govern their activities. A significant number of firms can be expected to exercise this freedom, and national legislatures can be expected to respond by seeking to make their company laws more attractive to firms. Whilst the UK is likely to be the single most successful jurisdiction in attracting firms, the presence of different models of corporate governance within Europe make it quite possible that competition will result in specialisation rather than convergence, and that no Member State will come to dominate as Delaware has done in the US. Procedural safeguards in the legal framework will direct the selection of laws which increase social welfare, as opposed simply to the welfare of those making the choice. Given that European legislators cannot be sure of the 'optimal' model for company law, the future of European company law-making would better be left with Member States than take the form of harmonized legislation.

Keywords: European law, company law, regulatory competition, corporate insolvency, *Centros*, *Inspire Art*.

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1. Introduction

The beginning of the twenty-first century has brought with it an extraordinary set of stimuli for company law reform in the EU. A series of well-publicised recent scandals on both sides of the Atlantic have shaken faith in existing company law frameworks. Contemporaneously, in the wake of the ECJ's decisions in the *Centros* line of cases,[1] EU Member States are, for the first time, seemingly on the threshold of regulatory competition over the content of company law. The result has been protracted debates about the optimal 'model' for company law, informing an unprecedented volume of reform activity, both at EU and Member State level. A logically prior question concerns the allocation of jurisdiction to *make* the relevant reforms across the vertical, or 'federal', dimension—as between the EU and Member States.[2] This question is the subject of the current paper.

The analysis begins from the starting point that, given diversity amongst firms and national systems of corporate governance, a federal legislator cannot be sure which, if any, regulatory measures will be optimal. The paper's basic argument is that regulatory competition between Member States' company laws is likely to be a better way stimulate the development of appropriate legal rules than is the European legislative process.

Whilst the theoretical possibilities for regulatory competition are now fairly well understood, a number of commentators have argued either that it is unlikely to be a significant force in Europe, or that if it is, it may be of the pathological, 'race to the bottom', variety.[3] My basic argument is that regulatory competition is likely to be both a significant and a beneficial mechanism for the development of European company law. A recurring theme will be that national diversity implies that the process will operate differently from the way it has done in the US: whilst there will be regulatory competition, no Member State will come to dominate as Delaware has done.

This argument will be developed in three stages. First, I will suggest that the EU is rapidly moving towards a framework within which companies will be both willing and able to locate their registered offices so as to secure a company law that is favourable to their requirements. For 'start-up' enterprises, this follows in the wake of recent landmark ECJ cases, and is motivated by entrepreneurs' desire to avoid barriers to entry created by capital maintenance rules. Moreover,

it seems likely that EC legislation will soon also permit established companies to change their registered offices. For these firms, arbitrage will plausibly be motivated by a desire to ensure an appropriate 'fit' between ownership structure and the applicable governance regime. Most specifically, continental European companies which wish to shift from concentrated to dispersed ownership may find reincorporation in the UK to be an attractive option.

Secondly, I will argue that some Member States, and in particular the UK, will have incentives to engage in regulatory *competition* to attract companies, or to prevent them from being attracted elsewhere. For the UK, this will not be driven by tax revenues, as is the motivation for Delaware, but rather by professional services firms facing an increasingly competitive global environment. Other Member States are likely to respond with 'defensive' competition, either by removing inefficient rules or by further developing the complementarities of their systems. In the case of 'start-up' companies, recent and proposed legislative changes to European capital maintenance regimes provide evidence that this is already taking place.

My third claim is that the European regulatory competition will not result in a destructive 'race to the bottom'. In particular, proposed EU legislation governing the *process* by which established companies will be able to change their registered offices will give affected constituencies the ability to influence the outcome, so that arbitrage will be motivated by a desire to increase total value rather than the private interests of one group. The only way Member States will succeed in attracting such companies will be through providing company laws which enhance firm value. National legislators will therefore have incentives to engage in mutual learning: generally (sub)optimal rules will come to be (discarded) adopted; at the same time, particular national specialisations will tend to be enhanced.

Finally, I will extend the argument, rather more tentatively, to the case of corporate insolvency law. The better view is that Member States will not be able to preserve restrictive creditor protection rules from scrutiny under EC free movement law merely by recharacterising them as insolvency law, rather than company law. Moreover, I will suggest that the framework of the European Insolvency Regulation could permit a degree of regulatory competition to take place over aspects of corporate insolvency law—in particular, the nature of any 'corporate rescue' proceedings that may be available. It is sensible to consider their selection as part and parcel of the company law arbitrage, because there may be complementarities between the two.

The rest of the paper is structured as follows. Section two sets the scene for the analysis by considering the scope of 'company law', the rationale for EU company law legislation, and the mechanisms of regulatory competition. Section three contains the basic argument and section four is the extension to corporate insolvency. Section five concludes with the suggestion that regulatory competition is likely to be superior than EC legislation for all aspects of company law on which there is no EU-wide consensus as to the appropriate regulatory choices.

2. Setting the Scene

(a) What is 'company law', and what does it do?

In order to make sense of the issues, it is necessary to begin with a working definition of 'company law'. From a traditional domestic perspective, this may be thought to be obvious: namely that which is found in the companies legislation. Yet from a European perspective, this traditional answer is unsatisfactory, because the scope of 'company law' is understood differently in different jurisdictions.[4] It is therefore helpful to begin with a framework that is neutral across jurisdictions. For this purpose, a functionalist approach is useful.

A functionalist account of a particular set of legal rules or legal institutions focuses on the purposes served for society by the institution in question. Company law's role is to regulate and facilitate the operation of business firms. Thus, a functionalist explanation of the subject seeks to explain how the rules in question do this. A leading functionalist account of corporate law views the subject as doing two basic things:[5] establishing the structure of the corporate form (and in particular, property rules which partition corporate assets from the assets of individuals associated with the company),[6] and seeking to prevent opportunism within voluntary relationships between participants. All company laws view 'participants' as including shareholders and directors; most include, to some extent, creditors, and some—the German system, for example—also include employees.[7]

Thus company law establishes a fund of corporate property, and provides a set of rules to govern the voluntary arrangements between the individuals associated with the business. A contentious question at the level of domestic corporate law is whether the rules governing the 'terms' of these relationships—that is, the rules that seek to minimise opportunistic conduct—are adequate. The debate typically turns on whether such rules should be mandatory in their content, or whether 'default' terms will suffice, and in either case, what the preferred content of the rule should be.[8] In relation to each of the

axes along which the law has an impact—shareholder-creditor; director-shareholder; shareholder-employee, and so on, it is possible to find a welter of academic and political opinion in either direction.[9] Moreover, it seems highly plausible that for any given regulatory issue, there may be no single 'best' approach for all European systems. Company law's regulatory choices are complementary to other aspects of a corporate governance system and of the regulation of the economy more generally—including tax, labour, competition and pension regulation and corporate ownership structure. The diversity of national corporate governance regimes,[10] coupled with such complementarities, implies that different legal rules are likely to be best for different systems.[11] For the purposes of this paper, we need not engage in seeking answers for these debates, but may simply ensure that we keep their existence in mind by adopting, as an heuristic device, a perspective of 'regulatory agnosticism': that is, we can be sure of the desirability of neither rule nor content in any given case.

(b) EU company law

The European Community was established with the goal, *inter alia*, of forming a genuinely common market between Member States. This entailed the removal of barriers to trade and competition, and of other less direct distortions.[12] The variety of different national solutions to the questions of company law formed the original impetus for the European company law programme.[13] In particular, there was concern that different national law structures might encourage harmful regulatory arbitrage, whereby companies were given incentives to relocate their operations or legal personality in other jurisdictions, not for sound economic reasons, but simply to avoid complying with domestic rules of company law. The plethora of different national law rules leads to a further distorting effect: namely, the increased transaction costs incurred by companies and their advisers when doing cross-border deals involving aspects of company law (for example, corporate finance or inward investment). The solution was to press for 'harmonization' of national laws so as to minimise these costs.

The early years of the European project saw a consensus that the solution to these distorting effects of differences in national company law systems was to be found in the 'federal' (that is, EC-level) prescription of company law rules, which would ensure mutual compatibility.[14] This technique was employed in the early company law harmonisation efforts, such as the First and Second Company Law Directives on safeguards for third parties and share capital respectively.[15] As the European project has evolved, political consensus has become harder to find, with the result that progress has only been possible in the company law legislative programmeby first focusing on specific areas.[16]

From the early 1990s onwards, a range of less intensive techniques started to be employed, such as so-called 'framework' measures, which specify only general principles and leave Member States to specify the details at a later date. These less prescriptive measures have the manifest benefit of permitting greater adherence to the principle of subsidiarity, as well as being more politically feasible. The most interesting recent developments include the provision of a 'menu' of federal rules (as with the Takeover Directive),[17] and the 'comitology' process of devolution of legislative competence to a committee of experts in relation to securities regulation.[18] A third, and even less prescriptive form of approximation, is what has been termed 'procedural' harmonization.[19] This involves rules which, rather than seek to impose substantive solutions on Member States, aim instead to govern or influence the *process* by which legislation is passed.

In the wake of a series of high-profile corporate collapses, the European Commission announced in the summer of 2003 an 'Action Plan' for company law reform in Europe.[20] Much of the programme consists of measures for updating earlier EC legislation, but it contains a limited number of proposals for further substantive harmonisation. Most interesting for present purposes is the Commission's explicit recognition of the importance of national diversity, and the championing as part of the reform programme of measures which will allow companies to increase their jurisdictional mobility.[21] These measures, which will stimulate regulatory competition, can be understood as a form of procedural harmonisation—that is, regulation intended to influence indirectly the way in which Member States legislate by establishing an orderly framework within which regulatory competition can take place.

(c) Regulatory competition

As a third 'building block' for the argument that follows, we shall now consider what is meant by 'regulatory competition'. This may seem an obvious point, but it is one that is frequently misunderstood, or at least is used in different senses in different contexts. A brief scene-setting exercise may therefore be helpful.

Regulatory *competition* implies that national legislatures compete to attract firms to operate subject to their laws.[22] The preconditions for this occurring are as follows. First, firms must engage in regulatory *arbitrage*: that is, they select the law that governs their activities in a way that will minimise their costs of operation. In turn, this implies that firms are permitted to do so, and that the costs of switching jurisdictions are less than the savings thereby achieved. Secondly, even if such arbitrage occurs, for regulatory competition to follow, individual jurisdictions must have something to gain (lose) by firms (not)

conducting business subject to their laws. If both conditions are met, then jurisdictions will seek to enact laws designed to encourage firms to 'use' their regulations, as opposed to those in other jurisdictions. The key point is that the law reform process will come to be driven, at least in part, by the preferences of firms that are subject to the regulation in question.

Applied to company law, regulatory competition can operate with respect to the law governing a company's internal affairs, the so-called *lex societatis*, where firms are able to select this freely as between different jurisdictions. The US experience in this regard forms a well-known example.[23] It is worth considering in a little detail the institutional foundations of this case study. First, arbitrage. Federal conflicts rules rely on a 'place of incorporation' connecting factor in relation to the 'internal affairs' of a corporation, whereby a US corporation's governance arrangements will be subject to the law of the state where it was formed. Moreover, almost all US states permit corporations (i) to reincorporate 'inwards' from another jurisdiction and (ii) to reincorporate 'outwards' in favour of another jurisdiction. These rules combine to permit a corporate entity to reincorporate in State B and have the laws of that state govern its internal affairs, even though the entirety of its business is physically located in State A, and its only connection with State B is incorporation there. It is not costly for firms to reincorporate, and a significant number of firms have chosen to do so, almost all in favour of the same jurisdiction: Delaware.[24]

Secondly, competition. Delaware is a small state, which derives a significant proportion of its tax revenues from charges levied on the grant of corporate charters.[25] It does not prohibit companies from switching out of Delaware once they have chosen to establish their registered office, should Delaware law cease to be attractive. Moreover, there is no viable alternative source of revenue to replace the charter dollars. Romano argues that the state's willingness to render itself vulnerable to the loss of this revenue, should it cease to satisfy its corporate 'customers' is part of its initial attractiveness. This is thus a 'hostage' given to them in order to signal Delaware's willingness to engage in continuous reform to its corporate law so as to reflect the preferences of firms that have incorporated there.[26] In addition, the Delaware bar are said to enjoy substantial revenues from the work they do in relation to firms incorporated in that state. As a well-organised and influential lobby-group, their concerns are thought to be taken seriously by the Delaware legislature.[27]

The process of regulatory competition is viewed with suspicion by some, who label it pejoratively as a 'race for the bottom'.[28] Indeed, the desire to avoid such an outcome was one of the original rationales for the European company law

harmonization project.[29] It is easy to show why this might be the case if it is assumed first that a particular variety of regulation is unequivocally in the public interest and, secondly, that compliance imposes a net private cost on regulated firms. If regulatory arbitrage occurs along the margin of minimisation of private costs by regulated firms, then regulatory competition will undermine the ability of such regulations to further the public interest.

However, both assumptions are unrealistic when applied to company law. First, 'regulatory agnosticism' implies that we cannot be sure about the relationship between regulatory provisions and the public interest.[30] Secondly, regulations which further the public interest will not necessarily impose net private costs on firms. In particular, regulations that seek to correct a market failure may, if they work effectively, result in a net *benefit* to firms that comply. This will be felt through the price mechanism of the market in question. For example, measures designed to ameliorate the costs of information asymmetries between shareholders and managers ('agency costs') may result in firms being able to lower their costs of corporate finance.[31] Where regulation seeks to correct market failure, and if the federal legislature has no privileged knowledge as to the 'best' type of regulation, then regulatory competition can act as a 'race to the top'. Under these assumptions, the 'market' for the regulatory provisions can act, in the fashion celebrated by Hayek, to stimulate innovation and to aggregate the information available to firms about regulatory effectiveness.[32] Similarly, if diversity of systems means that there *is* no global 'best' regulatory choice, but rather simply locally-optimal solutions, then a 'market' for regulatory provisions may result in greater specialisation, if states perceive the best way to attract incorporations as being to capitalise on complementarities.[33] Again, innovation and mutual learning may be expected. Under these preconditions, then, regulatory competition can promote the beneficial development of national company laws where a federal legislator is faced with regulatory agnosticism.

The crucial precondition for beneficial regulatory competition is that the price mechanism operate as a binding constraint on firms' choices. An extended and ultimately inconclusive debate on this point has taken place in relation to the case of Delaware. Critics of the US system point to the fact that reincorporation decisions are typically taken by a simple majority shareholder vote, responding to an agenda which will have been put forward by the board of directors.[34] Therefore, they suggest that there may be a tendency for companies to tend to select corporate laws that favour managers, for example through permitting the use of defensive tactics following hostile takeover bids.

The empirical literature has, however, not given strong support to the critics' claims. A number of studies have reported that reincorporation in Delaware appears to have a positive impact on a firm's stock price, suggesting that the move is viewed by the market as value-increasing.[35] Others have sought to examine factors which determine a decision to reincorporate in Delaware, as opposed to remaining in the initial 'home state'. Some found that firms are more likely to remain in their home state where this has adopted an anti-takeover statute, implying inefficient decisions.[36] Yet others have found weak evidence that firms *avoid* states with antitakeover statutes,[37] and choose to incorporate in jurisdictions with more flexible corporate laws and better-quality judiciary.[38] However, it is unnecessary for present purposes to form a firm view on the merits of US regulatory competition. This is because, as we shall see, the process will operate differently in the EU, such that the concerns of the US critics are unlikely to be replicated.[39]

3. The Basic Argument

Following from these ideas, I shall now argue that as a general matter, regulatory competition in European company law can be both feasible and desirable.

(a) To what extent does EU law permit companies to migrate?

Until recently, it was thought that the legal obstacles to regulatory arbitrage over company law within the EU were profound.[40] First, the conflicts of law rules of the vast majority of Member States made use of the so-called 'real seat' theory in determining the existence and proper law of a company. In contrast to the 'incorporation theory' used in the US, this applies the law of the place where the company has its main place of business or 'real seat'. When combined with rules on the recognition of the existence of corporate persons, it effectively prevented regulatory competition from taking place at all. For example, if a company incorporated in Member State A (which applied the incorporation theory) then carried on business in Member State B (which applied the real seat theory), the courts of Member State B would reason that the company's proper law would be that of Member State B, and consequently, because it was not incorporated under that law, it was not validly formed at all.

However, matters have changed dramatically following the ECJ decisions in *Centros, Überseering* and *Inspire Art*.[41] These cases relate to company law arbitrage at the point of *formation*. Each of the decisions concerned the treatment by Member State B of companies incorporated in Member State A, but having their 'real seat' in Member State B. The ECJ considered that the application of the real seat theory so as to deny recognition of the existence of

the company in Member State B because it was not validly incorporated amounted to an interference with the company's freedom of establishment. Essentially, the Court ruled that as a matter of EC law, a company, once validly formed under the laws of *any* Member State, becomes a 'person' and is consequently entitled to exercise the Treaty Freedoms.[42] Moreover, the mere fact that the company was incorporated in Member State A solely to avoid laws which would otherwise apply, were it incorporated in Member State B, does not constitute an 'abuse' of that freedom. The consequence is that any laws of Member State B which tend to make the exercise of that freedom less attractive to companies incorporated in Member State A will therefore be struck down unless they satisfy the four-stage criteria set out in *Gebhard*:[43] that is, they are (i) applied in a non-discriminatory manner; (ii) are justified by imperative requirements of the public interest; (iii) secure the attainment of their objective; and (iv) are not disproportionate in their effect.

As the dust gradually settles from the ECJ's recent crusade in this area, it is coming to be appreciated that analyses of regulatory competition in European company law must consider the question in relation to two quite different contexts.[44] The first, heralded by the recent ECJ caselaw, is that of entrepreneurial 'start-up' companies, over which the competition will be for *formations*. The second context is that of established firms. Notwithstanding the developments in relation to 'start-up' companies, there remain a number of legal obstacles to *reincorporation* by established companies from Member State A to Member State B. First, and most obviously, the laws of many Member States (including the UK) do not permit such corporate 'emigration'.[45] The ECJ's ruling in *Daily Mail*,[46] as affirmed in *Überseering* and *Inspire Art*, seems to establish that this does not interfere with companies' freedom of establishment, for the Court has held that companies are 'creatures' of the national law under which they are formed and can exercise Treaty freedoms only consistently therewith. Secondly, many Member States impose 'exit taxes' on companies which seek to relocate either their registered or head office (again, as evidenced by the rule challenged in *Daily Mail*), which act as a financial disincentive to so doing.

However, it is my view that these legal obstacles to change of primary establishment by existing companies are unlikely to persist. At the national level, some member states—such as the UK—are proposing to change their company laws so as to permit free jurisdictional (e)migration.[47] At the European level, a limited power to reincorporate in another jurisdiction has already been introduced by the Regulation implementing the European Public Company, or *Societas Europaea* ('SE').[48] SEs may be formed under the laws of any Member

State by transformation from an existing public company, or through the merger of two or more such companies. Moreover, once established, an SE may subsequently change its jurisdiction of registered office.[49] More pertinently, the proposed Tenth Directive on Cross-Border Mergers,[50] and/or the draft Fourteenth Directive on Transfer of Registered Office,[51] are likely to introduce mechanisms by which a transfer of registered office may be achieved without necessitating a transfer of head office.

Turning to exit taxes, it seems most likely that, once companies are granted freedom to relocate by European legislation (thereby bypassing *Daily Mail*), such fiscal rules will come to be viewed as unlawful restrictions on the freedom of establishment which companies would otherwise be able to exercise: a sort of corporate equivalent of the recent *de Lastreyie du Saillant* ruling which outlawed exit taxes levied by French law upon a natural person.[52] In a similar vein, the Merger Tax Directive outlaws tax impediments to cross-border mergers.[53]

Table 1 summarises the current and anticipated position. Not only is it legally possible for 'start-up' companies to engage in company law arbitrage on formation, but it seems likely that it will also soon be possible for established companies to do so through re-incorporation.

Table 1: Current and anticipated legal framework for company law arbitrage

Formation: 'start-up' companies			**Reincorporation: established companies**	
Barriers	*Removal*		*Barriers*	*Removal*
Real seat theory	*Centros* etc: national laws must permit *immigration*		*Daily Mail*: no need for national law to permit *emigration*	10th, 14th Directives will shortly permit emigration
Unnecessary and disproportionate measures failing *Gebhard* test	Case-by-case challenge		Exit taxes commonly levied	Likely to fail *Gebhard* test; prohibited by Merger Tax Directive; also likely to be prohibited by 14th Directive

(b) Even if regulatory arbitrage is legally possible, will firms wish to take advantage?

For it to be legally *possible* for regulatory arbitrage to occur is, of course, only the starting point. If firms are actually to exercise this option, the benefits to them from doing so must exceed the costs. A number of scholars doubt whether this will be the case, at least on any significant scale. First, it is argued that there may be little legal benefit to be had from 'jurisdiction-shopping'. The existing harmonization initiatives have reduced the differences between Member States' company laws, at least compared with those that existed between States' corporate laws in the US in the late nineteenth and early twentieth century, when Delaware developed its dominant position.[54] Moreover, litigation by minority shareholders being much rarer in Europe than in the US,[55] the expected benefits from switching to a more 'favourable' company law regime may be small.

A second factor concerns the nature of share ownership patterns. Unlike their Anglo-American counterparts, public companies in continental Europe typically have concentrated share ownership, with control being exercised by a single large blockholder or a coalition of blocks.[56] This alters the nature of the corporate law 'product' in which that such firms would be interested.[57] Rather than being concerned with protecting dispersed shareholders against the risk of managerial misbehaviour, shareholders in a blockholder system are more interested in the extent to which a majority is able to exert control.[58] If, as is likely, corporate laws and ownership patterns have co-evolved over time in European jurisdictions, there are likely to be strong complementarities between the two.[59] Thus, it is argued, there will be little to be gained by a firm re-incorporating under a different corporate law that will be likely to be mal-adapted to its particular governance requirements.[60]

Thirdly, some argue that problems over litigation will act as a brake on regulatory arbitrage.[61] A company whose centre of business is located in Member State B but which has reincorporated in Member State A would then have to decide where disputes should be litigated. To do so in Member State A would, it is thought, be undesirable in many cases, because of the need to retain different lawyers, to follow a different procedural system, and to consider issues in a different language.[62] On the other hand, litigation in Member State B would have the obvious drawback of having judges in Member State B decide questions on the laws of Member State A, with accompanying problems of linguistic and conceptual translation. To be sure, jurisdiction or arbitration agreements could be used to structure matters in most cases so that the problem is minimised, but on issues relating to the validity of the corporate constitution

and the acts of its organs, the exclusive jurisdiction rule of Article 22(2) of the Judgments Regulation[63] would mandate that litigation take place in Member State A.[64] Thus the problems could not be avoided entirely.

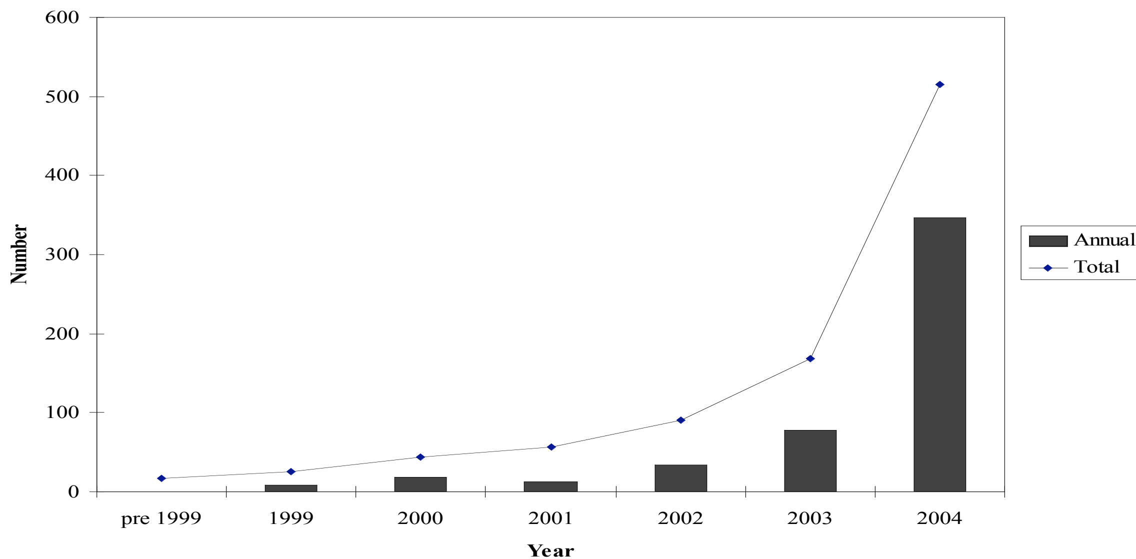
A fourth and closely related difficulty with regulatory arbitrage is thought to be the difficulties involved in getting appropriate legal advice both in relation to the possibility of making the change and in structuring affairs subsequently.[65] The languages of possible states of reincorporation are likely to be different from that spoken by the company's management. Moreover, any suggestion regarding change is likely to encounter hostility from incumbent legal advisers. What lawyer would propose reincorporation in a different jurisdiction, if this will result in legal work being transferred to another adviser? If the company's existing legal team are unable to advise, it will be necessary to retain another law firm, which is likely to be based in the state of reincorporation, to advise instead. This may entail considerable risk, if the company does not have a good knowledge of the reputations of law firms in the new jurisdiction.

I shall suggest that the arguments of the pessimists are unconvincing, and particularly so if it is posited that the UK might be the jurisdiction of choice for reincorporation. Once more, it is helpful to divide the discussion into the separate cases of arbitrage by formation and by re-incorporation. As far as formation is concerned, the driver of regulatory arbitrage by entrepreneurs is clearly the restrictive capital adequacy and maintenance requirements of many continental jurisdictions. As the Second Company Law Directive does not apply to private companies, there is considerable scope for variety between Member States' laws, and the UK undoubtedly has a more permissive regime than most continental European jurisdictions. Thus, for an entrepreneur wishing to form a company without complying with expensive minimum capital requirements, the UK is clearly likely to be the jurisdiction of choice.

To be sure, such a selection will entail increased legal risk owing to the need to litigate some issues in the UK, as opposed to local courts, and the need to obtain UK legal advice. There are reasons for thinking, however, that these costs are unlikely to act as a significant brake. First, there is likely to be little risk of litigation over the company's internal affairs in the UK if it is owned only by a small group of shareholders, who might bind themselves with a shareholder agreement for good measure. External affairs could be directed towards the jurisdiction of choice through jurisdiction clauses as part of the company's standard terms. As far as legal advice is concerned, it would appear that there is a market opportunity for lawyers serving the needs of such entrepreneurs to start to offer their services. An entrepreneur is unlikely to consult a lawyer

frequently, and so the idea of 'incumbent lawyer resistance' is not particularly compelling. The indications are that specialist 'formation agents' are already targeting their services at continental European entrepreneurs in an attempt to win this business.[66] Further evidence comes from the recent dramatic increase in the number of companies located in continental Europe incorporating in the UK. To exemplify this, Figure 1 reports numbers of'German' companies incorporating in the UK.

Figure 1: 'German' companies incorporating in UK



These were identified by searching data from Companies House for companies with largely German-language names,[67] but ending with the word 'Limited'.[68] To be sure, the data are only impressionistic;[69] moreover, they respresent only a tiny fraction of the total number of companies incorporated in the UK.[70] What is significant about the figures is the way in which the rate of such incorporations surged after the *Überseering* and *Inspire Art* decisions in 2002 and 2003 respectively.

Turning to larger companies, the discussion necessarily becomes more speculative. However, if a typical listed company is taken as the paradigm, there are still good reasons for thinking that the UK may be an attractive reincorporation choice to many, notwithstanding the foregoing objections. First, despite the early harmonization efforts, many feel that the UK's company law still has a substantially more flexible character than the company laws of many other European jurisdictions.[71] To be sure, the difference is nowhere near as significant as the regulation gradient between Delaware and its competitors in the early twentieth century. Yet it is not simply the content of corporate law that

makes reincorporation attractive. Commentators in the US have argued that a significant part of Delaware's advantage comes from the way in which adjudication is conducted. This includes the quality, expertise and 'business-friendliness' of its judiciary.[72] Thus it is notable that Delaware is the only state in the US to have a specialist court for the trial of corporate matters,[73] and Kahan's recent empirical study of incorporation decisions suggests that judicial quality is at least as important to firms choosing where to incorporate as the relative flexibility of key provisions in the corporate code.[74] Other related factors are the existence of a rich body of precedents accumulated over many years of judicial law-making, which enhance the certainty of legal rules, and the availability of high-quality legal advice through Delaware's specialist corporate law bar.[75]

Throughout Europe, the UK is perhaps uniquely positioned to capitalise on these procedural aspects of corporate law choice.[76] Similarly to Delaware, the UK has a specialist court list devoted solely to corporate matters.[77] This is presided over by judges who have spent many years in practice specialising in corporate matters, in contrast to the practice in many other Member States of appointing judges direct from law school.[78] In terms of certainty, it appears that English judges place even greater weight on precedents than their American counterparts.[79] This combination of legal flexibility and certainty permits UK companies to structure their affairs as they wish and with a low risk of legal challenge.

However, for European companies considering reincorporating, these factors may be less salient than for their US counterparts, owing to the relatively low litigation rates in Europe.[80] Yet to focus on 'hard law' alone would be to miss entirely the juiciest part of the 'carrot' that will attract such firms. This is because much of what is important about the English approach to regulating the control of listed companies is not found in the companies legislation at all, but in the body of 'soft law' rules and codes that apply to companies listed on the London Stock Exchange. The most important of these are the UK Listing Rules and the City Code on Takeovers and Mergers. These deal with a range of matters that might equally well be regulated by company law,[81] including rules regarding substantive corporate governance,[82] and most obviously, takeovers.[83]

As compared with 'true' company law, these self-regulatory rules offer two key advantages in terms of functionality. First, they are capable of being continuously updated in response to developments in the market, and secondly, they are promulgated and enforced by persons with relevant business and market expertise. Both the Listing Rules and the City Code originated as self-

regulatory rules.[84] They owe their content and mode of enforcement largely to the preferences of UK institutional investors, who hold in excess of 60 per cent of the shares listed on the London Stock Exchange.[85] These institutions have sufficiently large interests to make it worthwhile to become involved both in setting up self-regulatory structures and lobbying government to avoid further encroachment of legislation.[86] The regulatory structures which have emerged are those which these institutions consider serve their interests, as is most obviously the case with the Combined Code on Corporate Governance and the City Code on Takeovers. These codes are regularly updated by reviews which respond rapidly to changes in the way in which the market operates,[87] and invariably take into account the wishes of institutional investors.

It seems that the self-regulatory aspect of the UK system is in practice far more significant for companies than the content and enforcement of company law itself. To illustrate: during the year 2002-3, the Takeover Panel were involved in advising on 305 transactions raising issues in relation to the Takeover Code, of which 108 resulted in published takeover or merger proposals.[88] Yet in the same period, there were only four cases decided in UK courts raising issues of company law involving listed companies.[89] This is not, however, to say that company law is irrelevant. Rather, it is a feature of the UK's *system of company law* that it permits such activities as takeovers to be regulated by the Code and enforced by the Panel as opposed to by the company law and the judiciary respectively.

The implications of this picture for our discussion are as follows. For a company with dispersed equity ownership, or which wishes to move towards it, the UK system provides an extremely attractive set of solutions to the managerial agency problem: hostile takeovers, shareholder control of related party and significant transactions, and pre-emption rights protection. This is combined with a system of company law that is relatively flexible, and is enforced by a highly specialist judiciary. At present it is possible for a company to opt into the Listing Rules by applying to join the UK Official List regardless of where its registered office or seat is located.[90] In contrast, it is not currently possible for a company that is not 'resident' in the UK—a test equivalent to the 'real seat'—to be subject to the Takeover Panel's jurisdiction. With the implementation of the Takeover Directive, however, this will change. The Takeover Panel will shortly take jurisdiction over offers in respect of any company with its real seat within the EU that is listed in the UK and which has a registered office in the UK.[91]

Such a system is, to be sure, most unlikely to be attractive to a continental company subject to stable control by a large blockholder.[92] Such a blockholder is likely to enjoy significant 'private benefits of control'.[93] Compliance with the UK Listing Rules would lessen their ability to enjoy these, through the one-share one-vote rules that outlaw complex and opaque ownership structures, and the restrictions on related party transactions. Moreover, the body of rules directed towards minimising managerial agency costs would be irrelevant for such a company, where the large blockholder will already be well-placed to keep management under careful scrutiny.

However, if such a blockholder wished to 'unwind' their holding, reincorporation in the UK would, by contrast, seem a much more attractive option to consider. This is because there is likely to be limited liquidity in any market for large blocks of shares.[94] Much greater liquidity could be obtained by breaking up the block and selling the shares to many small dispersed shareholders. To do so in a blockholder system would not, however, raise the maximum possible revenue. This is because, in a system which permits private benefits of control to be extracted, a dispersed ownership structure is unstable—that is, there are gains to be made by acquiring a controlling block and extracting the private benefits.[95] Shares generally would then trade at a discount in anticipation of the unfavourable possibility of being in the minority when control had been taken by a blockholder.[96]

Thus the argument is that controlling shareholders in continental European companies that wish to liquidate (or diversify) their holdings could do so most effectively through listing and reincorporating in the UK.[97] The extent to which such blockholdings will unwind is, of course, contentious. Nevertheless, there are strong reasons for thinking that significant numbers of blockholders in continental Europe will wish to make this transition. The value of the rents which a blockholder may extract are declining owing to European integration's enhancement of product market competition;[98] at the same time, reductions in capital gains taxes have eliminated a former penalty to divestment of blockholdings.[99] Consistently with these suggestions, the early evidence suggests that even within the strongly blockholder system of Germany, there has been a reduction in ownership concentration over the past 10 years.[100]

The preceding discussion does of course beg the question of whether blockholders wishing to avail themselves of opportunities for regulatory arbitrage will be able to obtain appropriate legal advice. Indeed, the idea of 'lawyer resistance' is one of the most heavily-pressed reasons for thinking that regulatory competition will not occur. However, it overlooks the transformation

that has recently been effected in the European market for legal services. Large London-based law firms have aggressively expanded by merging with, or taking over, their continental counterparts.[101] Whilst the so-called 'magic circle' of London law firms have maintained offices in locations around the world for many years, these had until recently been little more than symbolic outposts. However, since the late 1990s, several of them have changed strategy in favour of practising 'local law'. As a result, they are now truly multi-jurisdictional in their orientation.[102] Table 2 shows the dramatic increase in the number of 'overseas' fee-earners in these firms over the period 1999-2005. This expansion in geographic scope has been mirrored by a similarly dramatic encroachment of their brand names upon continental European markets for legal services. For example, nearly all of the 'top 10' German firms in 2004 were organisations that had either merged with, or formed a 'strategic alliance' with, a London firm.[103]

Table 2: The international transformation of large 'London' law firms

Name	% fee-earners outside UK		
	1999	2003	2005
Clifford Chance	41	63	62
Freshfields Bruckhaus Deringer	50	61	66
Linklaters	n/a	52	55
Allen & Overy	35	48	53
Lovells	23	55	57

Source: International Financial Services London, *City Business Series: Legal Services, 1999-2005*.

This transformation has been driven by globalisation and consolidation in the financial services sector, with law firms growing in size as they seek to capture economies of scale associated with increased deal size.[104] The process of globalisation has brought with it increasingly direct competition with American law firms, which are able to draw upon work from deals generated by an economy approximately seven times the size of that of the UK. It seems a natural response for UK firms to seek to integrate the European market for legal services.[105] Thus these former 'London' firms are now pan-European, multi-jurisdictional and multi-language in their operations, and ideally placed to mediate between European jurisdictions.[106] Against this background, jurisdictional arbitrage is an obvious service offering.[107] If a particular system of corporate law does offer cost advantages for large corporate clients (be they procedural or substantive), then these firms may be expected to offer this

aggressively to their clients. The 'lawyer hostility' problem is greatly reduced where the incumbent and the new adviser are both within the same firm.[108]

To recapitulate: regulatory arbitrage is already occurring at the level of 'start-up' incorporations. Moreover, there are good reasons for thinking that once reincorporation becomes legally possible for large companies, continental firms that wish to shift from blockholder to dispersed ownership may wish to engage in regulatory arbitrage in favour of the UK, the system which offers the best-adapted legal and regulatory environment for this ownership pattern. In so doing, they will be able to obtain advice from international law firms.

(c) Will Member States have incentives to compete to attract (re)incorporations?

Regulatory arbitrage is a necessary but not sufficient condition for regulatory competition. True regulatory competition requires that lawmakers respond to the threat or opportunity posed by firms' arbitrage activities so as to retain or attract incorporations. Once again, a number of scholars have voiced the opinion that such regulatory competition will not emerge to any significant extent within Europe. In other words, the necessary preconditions for the *supply* of corporate law in response to companies' preferences will not exist.[109] Unlike the position in the US, EU Member States are unable to derive significant amounts of revenue from 'charter taxes' levied on companies because these are prohibited by EU law, save in the Member State where the company has its real seat.[110] Moreover, it is thought that there is little prospect that the relevant Directive will be repealed, because business interest groups are likely to lobby against such change.[111]

There seems little doubt that the particular conditions which originally gave rise to Delaware's ascendancy at the turn of the twentieth century will not be replicated in Europe. Yet simply because no European state will have the same incentives as Delaware does not mean that regulatory competition cannot emerge. Once again, it is helpful to segment the analysis into law reforms that will make a jurisdiction attractive to incorporations, and those which will be relevant for larger, established companies. It appears that continental legislatures have already become concerned at the prospect of large-scale evasion of their legal capital requirements through incorporations in the UK. Some, such as France and Spain, have already relaxed their capital maintenance regimes;[112] others, such as Germany, are considering ways to respond.[113] The UK government, which has already acknowledged its desire to ensure English company law is internationally 'competitive',[114] has recently announced further deregulation of legal capital requirements in relation to private companies,

including outright abolition on the prohibition on the giving of financial assistance by such a company for the acquisition of its own shares.[115] These sorts of changes are by definition, regulatory competition.

To be sure, once—as seems highly likely to happen—legal capital rules are relaxed for private companies by other Member States, it seems unlikely that the UK's emergent 'competitive advantage' in this field will remain. With this obstacle removed at home, entrepreneurs will no longer have a compelling reason to incur the transaction costs of incorporating abroad. This will be more a case of 'defensive' regulatory competition that the 'active' version exhibited by Delaware, but it will be regulatory competition nevertheless.

Let us now consider the same issue in relation to the law relating to listed companies. I have suggested that the UK is likely to be the jurisdiction of choice for firms wishing to reincorporate so as to optimise their company law regime to a dispersed ownership structure. There are two reasons for thinking that the UK will have powerful incentives to adjust its company law environment so as to attract them, notwithstanding the lack of franchise taxes.

The first factor is the importance of legal services revenues to the UK economy. Having so much at stake, the UK-oriented pan-European law firms constitute a powerful interest group in lobbying for or against legal change that is likely to affect the competitiveness of English law.[116] The power of legal professionals' ability to drive regulatory competition has recently been demonstrated by Sitkoff and Schanzenbach's study of the dramatic evolution of tax-haven trust structures in the US, a practice which, given the function of these vehicles, is clearly not motivated by tax revenues derived by the states which are 'competing'.[117]

In this regard, it is worth pointing out that the UK's legal profession is also much better placed to spur regulatory competition than is Delaware's. Kahan and Kamar have argued that Delaware lawyers, as an interest group, are not a significant motor for regulatory competition.[118] On their analysis, the marginal revenues to lawyers practising in Delaware from legal business related to out-of-state incorporations attracted to Delaware are insignificant.[119] Yet the revenues of lawyers practising in Delaware are likely to be a small fraction of the total economic value derived from Delaware law by US legal practitioners. Most of the legal advice to listed firms incorporated in Delaware is not provided by lawyers practising in Delaware, but in large cities such as New York.[120] In contrast, a much larger proportion of the legal services revenues generated by UK company law would be captured by the UK. This is because London, the

financial centre where many of the legal service providers are based, is geographically within the UK. As voters, taxpayers and experts, London lawyers may therefore be expected to be an influential interest group in the development of UK company law.[121]

The second reason for thinking that the UK company law environment will be highly responsive is closely related. It centres on the 'soft' or 'private' nature of crucial regulation such as the Takeover Code. Private legislatures are able to capture a much greater proportion of the economic benefits of marginal revenues generated by 'users' of their laws than do public legislatures.[122] A public legislature is required to use tax revenues to provide public services, and so faces a steeply declining marginal utility curve from extra tax income. A private legislature, on the other hand, is effectively providing a service as a business and so derives a much greater marginal utility than its public counterpart from additional revenues generated by 'users'. It can therefore be expected to be much more responsive to the preferences of those who make use of it. This, coupled with the potential size of the professional services revenues, makes it likely that the UK has incentive enough to compete for reincorporations of listed companies.

(c) Will safeguards be in place to ensure a 'race to the top' rather than 'to the bottom'?

My prediction is that, following the likely liberalisation of rules regarding transfer of registered office, there is real potential for a market in European company law to develop, and a significant possibility that the UK will be the favoured state of immigration for many continental listed companies. This in turn raises the question of whether this will be desirable. In other words, will the 'race' be to the bottom or to the top?

Once again, my suggestions will be sanguine. It is apposite to begin with the theoretical critique of regulatory competition in US state corporate law. Bebchuk and others argue that because shareholders have insufficient control over the reincorporation decision, choices are likely to be made in favour of jurisdictions that entrench managers, as opposed to maximising the value of firms. Under most corporate codes in the US, a decision to reincorporate may be made by a simple majority of the general meeting, following a proposal put by the board. Bebchuk's claim is that, in an environment of dispersed share ownership, a simple majority is too low a threshold to overcome the owner-manager agency problem.[123] Thus managements' proposals for reincorporation will tend to be biased towards jurisdictions with pro-manager provisions—especially laws that facilitate defences to hostile takeovers (as does Delaware).

Put more generally, the potential problem is this: laws that embody restrictions which will maximise value in the face of agency costs are unlikely to be adopted where the choice of law is itself pervaded by the same agency problem. Indeed, it is possible that such agency problems could be present not just along the manager-shareholder axis, but also along shareholder-shareholder, shareholder-creditor and the shareholder-employee axes. The solution in each case is to ensure that procedural safeguards are in place so that the group who stand to be potentially disadvantaged by a change in corporate law will have been able to exercise genuine voice in the process. Thus Bebchuk argues that the perceived problem in the dynamics of US reincorporation could be solved by a federal rule that increases shareholder involvement in decisions about reincorporation, thus making it considerably more likely that the choice will benefit shareholders by enhancing the firm's overall value, as opposed simply to transferring wealth from shareholders to managers.[124] In the EU context, this sort of federal rule, which seeks to influence the *process* by which state law develops, as opposed to the *substance* of the rules themselves, has been termed by Deakin 'procedural harmonisation'.[125] Put most generally, this refers to rules intended to direct regulatory competition towards 'the top' rather than 'the bottom'.[126]

It seems highly likely that in the EU context, the opening of the road to regulatory competition in corporate law will be accompanied by the implementation of procedural safeguards to protect affected constituencies from proposed changes driven by opportunistic motives. Once again, it is helpful to distinguish the contexts of 'formation choice'—already permitted under EU law—and 'midstream reincorporation', which it has been argued will soon be generally facilitated by the proposed Cross-Border Mergers and Transfer of Registered Office Directives. Put at its most general, the difference is this: on formation, all parties are able to bargain for appropriate protection. Midstream changes, however, can be passed without unanimous consent of the affected parties, and so offer the possibility of opportunistic dilution of agreed protections.[127] For policy purposes, the analysis of a company's choice of governing law is no different from the way in which any other aspect of a company's constitution might be selected.

Consider, first, competition over 'formation choice'. Here, every shareholder, creditor and employee has the opportunity to bargain with the new enterprise, and either to secure for herself terms that are satisfactory, or to decline to become involved. Provided adequate notice is given, then in principle any selected law should be value-maximising. To be sure, there may be problems of

information asymmetry, or inequality of bargaining power. To the extent that such problems exist, they can be ameliorated either by substantively harmonized provisions, as has been the case with employment law rules and securities regulation, or by Member State national laws that are capable of satisfying the *Gebhard* criteria: that is, they are both 'effective and proportionate' at achieving the goal of ameliorating the market failure in question.

Now consider 'midstream changes'. The concern here is encapsulated by the following hypothetical: protections for a particular constituency (say, codetermination rights for the employees) are embodied in the company law of Member State B. Such provisions may be economically justified—for example, in relation to firms where employees are asked to make significant investments in firm-specific human capital. Entitlements to influence the firm's governance may reassure the employees that the firm will not renege on any implicit promises to share supracompetitive profits with the employees *ex post* in return for the latter's *ex ante* investments.[128] Regardless of whether this reasoning justifies mandatory (as opposed to default) protection for employees,[129] any such protection will be rendered entirely worthless if the firm has the option to renege on its commitments *ex post* simply by reincorporating in a jurisdiction where codetermination is not recognised.

This problem, in relation to employees, has long been a roadblock to negotiation of the Tenth and Fourteenth Directives. However, the solution agreed in respect of the Societas Europaea will probably form a blueprint for the final versions of the other two proposals.[130] For employees, the principal protection is given through the provision for structured bargaining on formation of an SE.[131] This requires the management of pre-SE entities to engage in precursory negotiations with a body of employee representatives, with a view to agreeing employee participation rights in relation to the new entity.[132] If no agreement is reached after six months,[133] then as a default, a set of employee information/consultation and/or participation rights is put in place, the content of which is determined by the most employee-favourable of the regime(s) applying to the pre-SE entity or entities from which the European public company is formed.[134] The effect is to encourage an agreement that is no less favourable to the employees than their entitlements under the pre-SE entities.[135] Of course, if the employees can be persuaded to agree, then it is possible to abandon, or at least modify, the existing participation rights.[136] Thus the negotiation structure permits the parties to abandon participation rights if it is efficient to do so—that is, the benefits of such change exceed the costs to the employees, who will need to be compensated in order to induce them to

agree.[137] The SE legislation, albeit complex, therefore provides a sound blueprint for the protection of employee interests.[138]

Moreover, it is quite plausible that, with such procedural protection in place, a certain amount of *specialisation* might occur in national corporate law structures. Thus, it has been argued that German codetermination structures provide a means of offering employees a 'credible commitment' that their investments infirm- specific human capital will be protected. Firms for which such commitments are valuable will have no incentive to renege upon them by reincorporating in jurisdictions such as the UK, which do not have codetermination rules. But the process rule model of the SE legislation would permit firms for which such codetermination is inappropriate to opt out by reincorporating, provided that the value realised in so doing is greater than the cost imposed on the employees.[139] By so protecting the interests of employees in any firm that seeks to switch 'out' of codetermination, the SE's structured bargaining mechanisms will ensure that this cannot be used as a tactic to undermine the credibility of such commitments.[140]

Similar safeguards can be put in place to protect shareholders from opportunistic transfer of governing laws by management. Again, the SE legislation provides an instructive model. Under the SE regulation, at least a supermajority (two-thirds) shareholder vote is required in order to transfer the registered office,[141] or to form an SE by merger.[142]A similar rule would apply under the proposed Fourteenth Directive.[143] Under the proposed Cross-Border Mergers Directive, the 'general meeting' must approve the terms of any proposed merger, but the contours of the process which followed will be left to the national laws of the member states governing the companies concerned.[144]

As regards creditors, the SE Regulations, and the proposals for the Tenth and Fourteenth Directives, will leave the question of any safeguards prior to transfer of registered office to the national laws of the company concerned.[145] However, the treatment of creditors is complicated by the fact that many countries choose to protect them through corporate insolvency law, and so the discussion of the desirability of regulatory competition in relation to this constituency is postponed until the next section, where the question is tackled directly in relation to insolvency law.

To summarise, this section has suggested that (i) regulatory competition is already occurring in relation to 'start-up' companies; (ii) the existing legal obstacles to regulatory competition in relation to company law for public companies are likely to be removed in the next few years; (iii) the UK is likely

to be the jurisdiction of choice for many such companies, although there will also be new possibilities for jurisdictional specialisation in particular ‘models’ of company law; and (iv) procedural harmonization at the EU level (summarised in Table 3) will ensure that the ‘race’ is not to the bottom.

Table 3: Procedural protection for constituencies in company law arbitrage

<table>
<tr><th></th><th>Formation</th><th>Reincorporation</th></tr>
<tr><td>Shareholders</td><td rowspan="2">-Initial bargain with firm
-‘Effective and proportionate’ restrictions under national law (if any)</td><td>-Supermajority vote requirement</td></tr>
<tr><td>Employees</td><td>-‘Acquired rights’ carried over or waiver agreed by employees</td></tr>
</table>

4. Extending the argument: Insolvency law and creditor protection

In the final part, the analysis turns to the extent to which regulatory competition may and should be permitted to operate in relation to Member State laws designed to protect creditors. The issue is considered separately because in many jurisdictions, the protection of corporate creditors is understood to be a matter of corporate insolvency law. This body of law is often treated separately from company law, typically being understood either as a procedural matter or as part of commercial law. This impression of partition is reinforced by the fact that jurisdiction and choice of law in European insolvency proceedings is governed by *sui generis* legislation, the European Insolvency Regulation (‘EIR’).[146] Significantly for present purposes, the EIR is widely thought to be based upon connecting factors that bear more in common with the ‘real seat’ theory than the incorporation theory.

Two salient questions arise. First, can it be argued that corporate insolvency law constitutes an entirely separate regime from company law, such that the principles established in the recent ECJ corporate freedom of establishment cases do not apply to it? If so, then this might have the effect of stopping the nascent regulatory competition for ‘start-up’ formations dead in its tracks: in place of company law creditor protection rules that impede freedom of

establishment, Member States could simply substitute identical rules located in their corporate insolvency law.

I will argue that no such presumptive partition can be supported. This is in keeping with the functional approach to the scope of company law which formed the first 'building block' for our analysis.[147] Corporate insolvency law supplies rules which govern companies experiencing financial distress, and so it is appropriate to consider it as being within the scope of a functional account of 'company law'.[148] In particular, there may be complementarities between insolvency law and other aspects of a country's corporate governance regime,[149] which implies that if it is desirable to permit companies to select a company law regime so as to achieve a better 'fit' with their corporate governance requirements, it is likely also to be desirable for them to be able to select the associated corporate insolvency law. This in turn leads on to the second question: to what extent might it be possible for regulatory arbitrage—and thence competition—to take place in relation to rules of insolvency law? In this regard, it will be suggested—contrary to the popular perception—that the EIR's scheme could indeed permit a significant and valuable degree of regulatory competition.

(a) Is insolvency law a constraint on company law arbitrage?

To prepare the way for the discussion that follows, it is first necessary to give an overview of the EIR's operation. The Regulation establishes uniform rules for jurisdiction and choice of law in relation to international insolvencies occurring within the EU, and provides for their automatic recognition by the courts of other Member States.[150] Choice of law largely follows the allocation of jurisdiction, so that the *lex concursus* (law of the jurisdiction where insolvency proceedings are opened) will govern most of the effects of the proceedings, both procedural and substantive.[151] Thus the rules concerning the allocation of jurisdiction are fundamental.

The EIR's jurisdiction-allocation scheme has two tracks. The first provides that 'main' proceedings shall be opened in the jurisdiction in which the debtor's 'centre of main interests' ('COMI') is located.[152] Main proceedings are to have universal effect throughout the EU, except and insofar as a territorial 'carve-out' created by the second track is utilised. This provides that 'secondary' proceedings may be opened in any Member State (other than that of the COMI) in which the debtor has an 'establishment'.[153] Any such secondary proceedings are limited in their effect to the territory of the Member State in which they are opened and must be conducted in cooperation with the main proceedings.[154] Main proceedings may encompass either liquidation (that is, the sale of the

debtor's assets and distribution of proceeds amongst creditors) or 'corporate rescue' (that is, a 'crisis governance' procedure seeking to preserve the company or its business from failure) proceedings. In contrast, secondary proceedings may only involve liquidation of local assets.[155] Table 4 summarises the key features of the foregoing discussion.

Table 4: Summary of the EIR's scheme

	Main proceedings	**Secondary proceedings**
Scope	Universal (EU-wide)	Territorial
Type of procedure	Rescue or liquidation	Liquidation only
Jurisdiction allocation	COMI	Place(s) of establishment(s)

We shall now consider whether the EIR's jurisdiction allocation scheme conforms to the 'real seat' or the incorporation theory. Given the centrality of the concept of the debtor's COMI to the scheme's operation, it is most unfortunate that its definition is shrouded in ambiguity, reflecting an ugly drafting compromise between Member States' preferences as between these two theories.[156] Thus, the preamble to the EIR provides that the COMI shall 'correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties.'[157] On the other hand, Article 3(1) raises a presumption in the case of corporate debtors that the COMI is the place of the registered office. The uncertainty concerns the degree of strength that should be accorded to this presumption. Member States' jurisprudence—even in the UK—has to date tended to treat the presumption as easily rebutted by factual evidence concerning where the debtor conducted business.[158] Thus, as currently interpreted in national caselaw,[159] the notion of COMI conforms more to the real seat than the incorporation theory. Moreover, it is clear that even if a corporate debtor's COMI were not in the jurisdiction of its 'real seat', the debtor would nevertheless certainly have an 'establishment' there, so that secondary proceedings could be opened.

It follows that if a company is incorporated in Member State A, but carries on all its business in Member State B, then creditors who lend to it in Member State B can be assured that the insolvency law of Member State B will apply, at the very least to assets situated in that jurisdiction. This leads some

commentators to suggest that corporate insolvency law should be treated as falling outside the scope of the regulatory competition recently ushered in by the ECJ.[160] If this view, which we might term the 'partition theory', were correct, it would follow that Member States wishing to preserve restrictive creditor protection rules should simply transfer them from 'company' to 'insolvency' sections of their civil codes. The only limit to such recycling would be a casuistic determination whether the rules in question were properly characterised as 'company law' or 'insolvency law'.[161] The unappealing implications of this analysis may be seen by considering its application to the issues in *Inspire Art.* As will be recalled, that case concerned the application of the Dutch WFBV or 'law applicable to formally foreign companies', under which companies operating in the Netherlands but with only a nominal connection to their jurisdiction of incorporation were required to comply with minimum capital requirements consistent with those imposed upon companies incorporated domestically. Were the partition theory valid, then it could plausibly be argued that the WFBV's impact could be preserved by enacting an 'insolvency version' of the statute.[162] That is, to legislate that should a company that failed the relevant capitalisation requirements enter insolvency proceedings, the liquidator should have an action to make the directors liable to contribute the 'missing capital' for the benefit of the company's creditors.[163]

The better view is that the impact of *Inspire Art* cannot be constrained in the way suggested by the partition theory.[164] The EIR does not purport to govern the content of insolvency laws, merely the connecting factor for choice of jurisdiction and choice of law. The ECJ's judgment in *Inspire Art* is framed not in terms of connecting factors in company law, but of legal provisions that impede corporate freedom of establishment. Why should this apply any differently to rules formally characterised as 'corporate insolvency law' than to rules of 'company law'? The correct question, after *Inspire Art*, is not whether a rule is properly taxonomised as 'company' or 'insolvency', but rather whether its effect is to impede the exercise of corporate freedom of establishment, subject of course to the exception for provisions which satisfy the four-stage *Gebhard* test.[165]

Whether a rule that is characterised as part of the host state's 'insolvency law' would fail this test will depend upon the impact that (non-) compliance would have on the shareholders and/or directors of a foreign company that wishes to establish its business in that state. In terms of the ECJ's freedom of establishment jurisprudence, a rule that has such an effect which is more than 'indirect and uncertain' will fail this test.[166] It is the nature of insolvency proceedings that they only take place if the debtor is unable to pay their debts.

Assuming that the company is solvent at the point it wishes to establish itself in the host state, most rules which operate in insolvency would be likely to be no more than 'indirect and uncertain' in their impact on the company's establishment decision, because of the small probability that they would ever apply.[167] Yet there are situations where the impact might be more direct. The most obvious would be where the insolvency code imposes retrospective liability for actions (not) taken during the period of the company's existence which go beyond the obligations imposed by the home state company law during solvency and are excessive compared to the requirements of the debtor's home state. It seems that re-enacting the WFBV as 'insolvency law' would be precisely such a situation. It is not difficult to see that in such a case, shareholders and directors of companies such as Inpsire Art Ltd would be deterred from establishing their company in the host state because of the risk that, had they failed to capitalise it in accordance with the WFBV, they would face concomitant liability to contribute to its assets in insolvency. They could only safely avoid such potential liability by incurring a significant cost at the time of (re)establishment. In contrast, insolvency liabilities for (in)actions immediately preceding entry to insolvency proceedings—such as, for example, for wrongful trading—would be unlikely to have a direct and certain impact, because they would only be incurred in relation to (in)actions during the 'twilight period', which would be no more than a distant possibility at the time of (re)establishment.

(b) Could regulatory arbitrage in corporate insolvency law be possible?

The foregoing discussion suggests that insolvency law is capable of imposing only an indirect constraint on arbitrage (and hence competition) for company law. We now turn to the second question: that is, whether regulatory competition in relation to corporate insolvency law itself would be feasible within the EU. Given the EIR's scheme, the answer will turn upon the proper interpretation of the notion of COMI. If this were tightly bound to a company's registered office, then a company which was registered in Member State A but which had its real seat in Member State B would thereby be able to engage in some arbitrage over corporate insolvency law as well as company law. However, the EIR's two-track scheme imposes an outer boundary on the extent to which such arbitrage would be possible. This is because, even if the company's COMI is in Member State A, the corporate insolvency law of Member State B will still be available for secondary proceedings conducted in that jurisdiction. The choice of COMI will therefore matter primarily for (i) the availability, and nature, of any corporate rescue proceedings (because the secondary proceedings under Member State B will be limited to liquidation); and (ii) the insolvency law rules applicable in third countries.

It is not implausible, notwithstanding the prevailing view in the national caselaw, that a corporate debtor's COMI could be interpreted as tightly bound to its registered office. As the concept is a creature of EC legislation, it will bear an autonomous meaning in European law. The ECJ has been called to rule upon the application of COMI in the pending case of *Bondi*.[168] There are good reasons for suggesting that the Court should treat the presumption created by Article 3(1), that a corporate debtor's COMI shall ordinarily be the state of its registered office, as a strong one. According to the Virgos-Schmidt Report, the unofficial interpretive guide to the Regulation, insolvency is a foreseeable risk to creditors, and therefore that it is important that the jurisdiction in insolvency be one which they are able to predict easily.[169] *A priori*, it is hard to see how a test based on where business is in fact conducted renders creditors of international businesses more certain as to where insolvency proceedings will be conducted than a rule based on state of incorporation. This point is strengthened when it is borne in mind that local creditors will in any event be protected by the possibility of territorial secondary proceedings in any jurisdiction where business is carried on. Where a debtor conducts substantial business activities in more than one jurisdiction, the registered office will often be easier to determine than where the majority of the debtor's financial arrangements were conducted. What is worse, a purely geographic connecting factor is subject to change simply by the physical movement of the debtor, with the possibility that a transfer may be effected to a 'debtor-friendly' jurisdiction on the eve of insolvency.[170]

In contrast, tying COMI to the place of registered office would be readily ascertainable by creditors even where business is conducted in more than one state. Moreover, because the registered office is a legal rather than a geographic matter, corporate debtors could be prevented from 'switching COMI' to the detriment of their creditors through the simple expedient of a rule banning changes of registered office in contemplation of insolvency.[171] Most fundamentally, even in cases where such particular problems do not arise, equating COMI with registered office would promote certainty amongst creditors at least as well as the geographic location of business test in a day and age when all that is required to determine the relevant information is an internet search.

(c) Would regulatory arbitrage in corporate insolvency law be desirable?

Were COMI interpreted in accordance with these suggestions, it would then become possible for companies to select the law which would govern any main insolvency proceedings in the same way as they can (or in the case of established companies, soon will be able to) do in respect of their company

laws. It might be objected that having the law of Member State A (the home state) govern insolvency proceedings is impractical when the debtor's assets and business are located in Member State B (the host state). Yet it should be recalled that secondary proceedings could be opened in the host state. Rather, the only significant question which would be determined in this case by the COMI would be the availability, and nature of, any corporate rescue proceedings.

More fundamentally, it might be feared that permitting arbitrage over choice of insolvency law will lead to a 'race to the bottom', with companies incorporating in jurisdictions with weak insolvency laws so as to be able to benefit shareholders at the expense of creditors. To understand this, it is helpful to segment creditors into 'adjusting' and 'non-adjusting' categories.[172] The objection focuses upon the perceived plight of non-adjusting creditors—that is, those parties who extend 'credit' involuntarily (the paradigm case being tort victims), or in such small amounts that the transaction costs of becoming informed and adjusting their positions outweigh the benefits of doing so. The argument would assert that many Member States' insolvency regimes contain mechanisms designed to protect such creditors,[173] and that permitting companies to engage in regulatory arbitrage would allow them to undermine this protection.[174] Were this possible, shareholders would be able to benefit themselves at the expense of such creditors by selecting an insolvency law that would offer minimal protection. If this were unchecked, then it would clearly be an example of a 'race to the bottom'.

Yet such an outcome would not eventuate. First, under the EIR's scheme, insolvency priority rules designed to protect nonadjusting creditors would in any event be available to them through territorial proceedings in the jurisdiction in which they claim. Thus they will be made no worse off by permitting regulatory arbitrage over corporate rescue proceedings. Secondly, vulnerable creditors can be protected more effectively and precisely by mechanisms other than the re-ordering of priorities in insolvency.[175] If such regulatory requirements constituted *prima facie* restrictions on freedom of establishment, there seems little doubt that carefully-targeted provisions would satisfy the requirements of the *Gebhard* formula to be justified in the overriding public interest.

Thus, the limited regulatory arbitrage which the EIR could permit over insolvency law would not impose costs on non-adjusting creditors. Not only would it not *harm* these groups, but it would also bring significant benefits. To understand these, it is necessary to consider the way in which sophisticated—

‘adjusting’—creditors might be expected to respond to such arbitrage.[176] The could be expected to adjust the terms of their credit transaction to reflect the effect of a debtor’s choice of COMI. Where this is harmful to such creditors, the debtor will incur a higher cost of credit, or find it difficult to raise credit at all. Where the regime leaves gaps, such creditors may be expected to contract for protection in the form of loan covenants, security interests, and the like. If the costs of such contracting are high, then the debtor will have an incentive to select an insolvency regime which creditors would prefer. Member States wishing to attract, or not to deter, companies would respond by providing insolvency codes that offer the appropriate protection: regulatory competition resulting in a ‘race to the top’, rather than to the bottom.

As we have seen, the choice of COMI will matter, from creditors’ point of view,principally in regard to corporate rescue proceedings. There are reasons for thinking that this area is one in which the operation of regulatory competition would be particularly fruitful.[177] The extent to which a legal regime should seek to foster ‘rescue’ of troubled companies, and the way in which control of the distressed company should be organised therein, are highly contentious matters. A vocal group of US scholars has argued that debtors should be permitted to design their own insolvency regimes by contract with their creditors, as opposed to being able to participate only in mandatory state-sanctioned insolvency procedures.[178] Permitting regulatory competition over insolvency laws would be an approximation to this result, with the added benefit that each regime on the ‘menu’ from which debtors could select would come with a ready-made body of case law interpreting and applying it, enabling the market to assess the likely consequences with confidence. Moreover, to the extent that corporate rescue regimes complement other aspects of a corporate governance system, permitting firms to opt into these as well as the other parts of the regime will further promote specialisation if this is indeed the direction taken by European regulatory competition. Thus corporate rescue procedures seem a prime candidate for a stance of regulatory agnosticism at the EU level, and for the forces of regulatory competition to be harnessed so as to permit a learning process as to the most appropriate legal regime.

To recapitulate: permitting regulatory arbitrage over corporate insolvency law to the extent which it could take place within the EIR framework would be a desirable step. The structure of the EIR means that it would principally affect the availability, and form of, any corporate rescue proceedings. This is a matter which adjusting creditors can be expected to take into account in pricing the firm’s cost of credit, thereby forcing firms to internalise the impact of insolvency on creditors in their arbitrage decisions.[179] The position of non-

adjusting creditors would be protected through territorial measures which are either given effect to in secondary proceedings, or which are necessary and proportionate in their impact—thus satisfying the *Gebhard* test. The EIR's jurisdictional-allocation scheme, if COMI is interpreted in accordance with the argument of this paper, would thus act as a form of procedural harmonisation in corporate insolvency law, so as to guide the process of the development of insolvency laws towards *beneficial* regulatory competition. The availability of secondary proceedings truncates the possibilities for a 'race to the bottom', leaving only opportunities for a 'race to the top' over corporate rescue proceedings.[180] Member States' regulatory responses could be expected to follow a pattern of mutual learning, permitting a beneficial evolution and the ultimate adoption of the most appropriate corporate rescue regimes.

5. Conclusion

The question this paper set out to address was whether European corporate law would in future best be made by 'federal' legislation or regulatory competition between Member States. As EC legislation carries with it well-known problems, the answer to the question depends on an assessment of the prospects for European regulatory competition in the field. If regulatory competition would be pathological, then EC legislation might be justified as a 'lesser evil'. Therefore, although 'crystal ball gazing' is a risky activity, I have sought—perhaps recklessly—to offer a view of the likely future development of European regulatory competition.

My conclusions on regulatory competition are largely sanguine. It seems plausible that regulatory competition will come to be a motor for the development of Member States' company laws and corporate governance systems. Arbitrage by 'start-up' firms is already legally possible, and this is starting to lead to responsive changes throughout Europe in laws applicable to private companies. For established companies, arbitrage will in all likelihood soon be facilitated by European legislation, in the form of the Tenth and Fourteenth Company Law Directives. This will not be attractive to all companies, because difference in ownership structure complement differences in national governance systems. However, it seems plausible that the UK, with a governance system adapted to dispersed ownership, will be an attractive destination for companies whose owners wish to exit blockholdings and shift to dispersed ownership. This process will be facilitated by the newly pan-European law firms. Hence the UK's professional services sector has a powerful incentive to ensure that the governance regime—most especially, the self-regulatory aspects—is kept attractive to firms thinking about moving there. Other Member States, faced with this apparent challenge, are likely to respond

by ‘defensive’ regulatory competition. Precisely how this will develop is unclear, but it seems plausible that a likely strategy would be to enhance further those aspects of their systems which will complement firms with concentrated ownership. This would yield a process of path-dependent specialisation, rather than convergence.

Underpinning this process will be EC legislation governing how established firms will be able to make their reincorporation decisions. This ‘procedural’ regulation will ensure that affected constituencies are parties to the decision-making process, and so transfers of jurisdiction motivated by a desire to expropriate them will not succeed. This will remove the prospect of a detrimental ‘race to the bottom’.

Some Member States may seek to recharacterise creditor protection rules as part of their corporate insolvency codes, but the better view is that this will not insulate them from the possibility of being held to constitute unlawful impediments to corporate freedom of establishment. Indeed, perhaps my most radical suggestion is that the framework of the European Insolvency Regulation could actually permit a certain amount of arbitrage—and thence competition—over corporate rescue proceedings. As the relevant rules may complement other aspects of corporate law, it seems desirable that they should be subject to a similar process of development.

A positive assessment of regulatory competition makes the drawbacks of harmonized EC legislation all the more stark. Harmonized legislation runs two risks which are avoided by a process of benign regulatory competition. First, such legislation tends to encourage Member States to converge their laws on a central model, which may be inappropriate where one ‘size’ does not ‘fit’ all. Decentralised solutions can permit Member States to continue patterns of diversity, whilst regulatory arbitrage allows individual firms for which the national model is inappropriate to opt out. Secondly, harmonization presupposes that the European legislator is able to specify the ‘best’ regulatory solution to any given problem. In an area such as company law, where the configuration of the optimal rules is hotly debated, regulatory competition can promote innovation and mutual learning between national legislatures.

In conclusion, then, the answer to our starting question is that the future of European company law-making would better be left with Member States than take the form of European legislation, save for areas in which a uniform consensus has emerged regarding the appropriate regulatory choice. Thisdoes not seem inconsistent with the thinking behind the European Commission’s

recent Company Law Action Plan, which recognises the benefits of national diversity and proposes EC legislation only in certain limited areas. It is to be hoped that time will be permitted to demonstrate the soundness of this approach.

Notes

[1] Case C-212/97, *Centros Ltd* v. *Erhvervs-og Selskabssyrelsen* [1999] ECR I-1459, [2000] Ch 446; Case C-208/00, *Überseering BV* v. *Nordic Construction Company Baumanagement GmbH (NCC)* [2002] ECR I-9919; Case C-167/01, *Kamel van Koophandel en Fabrieken voor Amsterdam* v. *Inspire Art Ltd* [2003] ECR I-10155.

[2] There is a second dimension, which may be termed the *horizontal*, or *domestic*, aspect. This concerns the selection of the appropriate body, within a given jurisdiction, for formulating the rules that govern the operation of corporate enterprise: namely, legislators, judges, regulators or private parties.

[3] See, eg, L. Enriques, 'EC Company Law and the Fears of a European Delaware' (2004) 15 EBL Rev 1259; M. Gelter, 'The Structure of Regulatory Competition in European Corporate Law' forthcoming (2005) 5 JCLS; E.-M. Kieninger, 'The Legal Framework of Regulatory Competition Based on Company Mobility: EU and US Compared' (2005) 6 German LJ 740; T.H. Tröger, 'Choice of Jurisdiction in European Corporate Law: Perspectives of European Corporate Governance' (2005) 6 EBOR 3.

[4] On differences in the scope of company law in other jurisdictions, see R. Kraakman *et al*, *The Anatomy of Corporate Law* (Oxford: OUP, 2004), 15-17. The proper scope of the subject has been extensively debated at the domestic level in the course of the UK's recent Company Law Review. See, e.g., Company Law Review Steering Group ('CLSRG'), *The Strategic Framework*, URN 99/654 (London: DTI, 1999), 33-55; CLSRG, *Final Report, Vol I*, URN 01/942 (London: DTI, 2001), 41. See also DTI, *Company Law Reform*, Cm 6456 (London: TSO, 2005), 10.

[5] Kraakman *et al*, ibid., 1-31.

[6] See also H. Hansmann and R. Kraakman, 'The Essential Role of Organisational Law' (2000) 110 *Yale LJ* 387; J. Armour and M.J. Whincop, 'The Proprietary Foundations of Corporate Law', ESRC Centre for Business Research Working Paper 299 (2005).

[7] See generally Kraakman *et al*, *supra* n 4, 61-67. On employees, see H. Gospel and A. Pendleton, 'Corporate Governance and Labour Management—An International Comparison' in Gospel and Pendleton (eds.), *Corporate Governance and Labour Management* (Oxford: OUP, 2004), 1.

[8] See generally, F.H. Easterbrook and D.R. Fischel, *The Economic Structure of Corporate Law* (Cambridge, MA: Harvard University Press, 1991); B.R.

Cheffins, *Company Law: Theory, Structure and Operation* (Oxford: OUP, 1997), 126-262.

[9] For an impressionistic introduction, see (i) on manager-shareholder conflicts, P.A. Gompers *et al*, 'Corporate Governance and Equity Prices', NBER Working Paper No 8449 (2001) (weaker shareholder rights imply reduced performance); *cf.* D.F. Larcker *et al*, 'How Important is Corporate Governance?' Wharton School Working Paper (2004) (corporate governance indicators poor explanators of performance); (ii) on shareholder-creditor conflicts, R. La Porta *et al,* 'Legal Determinants of External Finance' (1997) 52 *Journal of Finance* 1131 (relationship between debt finance and creditor protection ambiguous); Kraakman *et al*, *supra* n 4, 77-96 (different systems of creditor protection); and (iii) on employee-shareholder conflicts, B. Frick and E. Lehmann, 'Corporate Governance in Germany: Ownership, Codetermination and Firm Performance in a Stakeholder Economy' in Gospel and Pendleton (eds.), *supra* n 7, 122, 133-34 (evidence on codetermination inconclusive).

[10] See O. Fioretos, 'Varieties of Capitalism in the European Community' in P.A. Hall and D. Soskice (eds.), *Varieties of Capitalism* (Oxford: OUP, 2001), 213-246; W. Carlin and C. Mayer, 'How do Financial Systems Affect Economic Performance?' in J.A. McCahery *et al* (eds.), *Corporate Governance Regimes: Convergence and Diversity* (Oxford: OUP, 2002), 325, 334-36.

[11] See R.H. Schmidt and G. Spindler, '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), 114-126; B. Amable, *The Diversity of Modern Capitalism* (Oxford: OUP, 2003), 54-66.

[12] See Preamble and Arts. 2, 3 EC; C. Barnard, *The Substantive Law of the EU: The Four Freedoms* (Oxford: OUP, 2004), 6 (citing Comité Intergouvernemental Créé par la Conférence de Messina, Rapport des Chefs de Délégation aux Ministres des Affaires Etrangères, Brussels, 21 April 1956 (the 'Spaak Report') Mae 120 f/56, 14).

[13] V. Edwards, *EC Company Law* (Oxford: OUP, 1999), 3-5.

[14] See H.C. Ficker, 'The EEC Directives on Company Law Harmonisation' in C.M. Schmitthoff (ed.), *The Harmonisation of European Company Law* (London: UNCCL, 1973), 66.

[15] First Council Directive 68/151/EEC, OJ L 65/8, 14.03.1968; Second Council Directive 77/91/EEC, OJ L26/1, 31.01.1977.

[16] See J. Wouters, 'European Company Law: *Quo Vadis*?' (2000) 37 CML Rev 257, 268-76; S. Grundmann, 'The Structure of European Company Law: From Crisis to Boom' (2004) 5 EBOR 601; J.A. McCahery and E.P.M. Vermeulen, 'Does the European Company Prevent the "Delaware-effect"?' (2005) TILEC Discussion Paper 2005-010, 10-18.

[17] Directive 2004/25/EC, OJ L142/12, 30.04.2004. See J.A. McCahery and G. Hertig, 'Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts or Regulatory Competition?', ECGI Law Working Paper No 12/2003.

[18] See E. Ferran, *Building an EU Securities Market* (Cambridge: CUP, 2004), 58-126.

[19] S. Deakin, 'Regulatory Competition Versus Harmonisation in European Company Law' in D. Esty and D. Gerardin (eds.), *Regulatory Competition and Economic Integration* (Oxford: OUP, 2001), 190, 209-13.

[20] EC Commission, *Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward* COM (2003) 284 final, Brussels 21.5.2003. See also K. Hopt, 'Modern Company and Capital Market Problems: Improving European Corporate Governance After Enron' (2003) 3 JCLS 221.

[21] EC Commission, *ibid*.

[22] See generally, Esty and Gerardin (eds.), *supra* n 19; D.D. Murphy, *The Structure of Regulatory Competition* (Oxford: OUP, 2004). The classic model of regulatory competition responding to arbitrage by regulated parties is due to Tiebout: C. Tiebout, 'A Pure Theory of Local Expenditures' (1956) 64 *Journal of Political Economy* 416.

[23] See generally R. Romano, *The Genius of American Corporate Law* (Washington, DC: AEI Press, 1993); R. Drury, 'A European Look at the American Experience of the Delaware Syndrome' (2005) 5 JCLS 1.

[24] See, e.g., R. Romano, 'Law as Product: Some Pieces of the Incorporation Puzzle' (1985) 1 J L Econ & Org 225, 244 (82% of reincorporating firms chose Delaware); C. Alva, 'Delaware and the Market for Corporate Charters: History and Agency' (1990) 15 Del J Corp L 885, 887 (over 40% of NYSE listed firms and over 50% of Fortune 500 firms incorporated in Delaware).

[25] W.L. Cary, 'Federalism and Corporate Law: Reflections on Delaware' (1974) 88 Yale LJ 663, 664; Romano, *supra* n 23, 15-16; *cf.* M. Kahan and E. Kamar,

'The Myth of State Competition in Corporate Law' (2002) 55 Stanf LR 679, 687-94.

[26] Romano, *supra* n 23, 38.

[27] J. Macey and G.P. Miller, 'Toward an Interest-Group Theory of Delaware Corporate Law' (1987) 65 Tex L Rev 469, 472; Romano, *supra* n 23, 28-31; R. Daines, 'The Incorporation Choices of IPO Firms' (2002) 77 NYU L R 1559; *cf.* Kahan and Kamar, *ibid*., 694-700.

[28] The phrase was first coined in relation to corporate law by Bill Cary, lamenting the 'Delaware effect' in the US: Cary, *supra* n 25, 666.

[29] Edwards, *supra* n 13, 3.

[30] See *supra*, text to nn 9-11.

[31] R.K. Winter, 'State Law, Shareholder Protection, and the Theory of the Corporation' (1977) 6 J. Leg. Stud. 251; Romano, *supra* n 24; Easterbrook and Fischel, *supra* n 8, 212-227.

[32] See Deakin, *supra* n 19, 216-17; R. Romano, 'The States as Laboratory: Legal Innovation and State Competition for Corporate Charters', ECGI Law Working Paper No 34/2005.

[33] See S. Choi, 'Law, Finance and Path Dependence: Developing Strong Securities Markets' (2002) 80 Tex L Rev 1657, 1705-6; K. Heine and W. Kerber, 'European Corporate Laws, Regulatory Competition and Path Dependence' (2002) 13 Eur. J.L. & Econ. 47.

[34] L.A. Bebchuk, 'Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law' (1992) 105 Harv. L.R. 1435.

[35] See, e.g., R. Daines, 'Does Delaware Law Improve Firm Value?' (2001) 62 J Fin Econ 525. Earlier studies are reviewed by Romano, *supra* n 23, 16-24. However, see also G. Subramanian, 'The Disappearing Delaware Effect' (2004) 20 J L Econ & Org 32 (arguing that any beneficial effect on firm value of Delaware reincorporation has diminished over time).

[36] G. Subramanian, 'The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching' (2002) 150 U. Pa. L.R. 1795; L.A. Bebchuk and A. Cohen, 'Firms' Decisions Where to Incorporate' (2003) 46 J. L. & Econ. 383.

[37] Daines, *supra* n 27, 1596-97; M. Kahan, 'The Demand for Corporate Law: Statutory Flexibility, Judicial Quality, or Takeover Protection' (2004), NYU Law and Economics Working Paper No 04-015

[38] Kahan, *ibid.*

[39] See *infra*, section 3(c).

[40] See, e.g., Cheffins, *supra* n 8, 426-431.

[41] *Supra*, n 1.

[42] A voluminous literature has grown up on the legal consequences of the *Centros* line of cases. See, e.g., E. Wymeersch, '*Centros*: A Landmark Decision in European Company Law' in T. Baums *et al* (eds.), *Corporations, Capital Markets and Business in the Law* (London: Kluwer Law International, 2000), 629; E. Micheler, 'The Impact of the *Centros* Case on Europe's Company Law' (2000) 21 Co Law 179; K. Baelz and T. Baldwin, 'The End of the Real Seat Theory (*Sitztheorie*): the European Court of Justice Decision in *Überseering* of 5 November 2002 and its Impact on German and European Company Law' (2002) 3(12) German LJ; M. Siems, 'Convergence, Competition, *Centros* and Conflicts of Law: European Company Law in the 21st Century' (2002) 27 EL Rev 47; T. Bachner, 'Freedom of Establishment for Companies: A Great Leap Forward' (2003) 62 CLJ 47; C. Kersting and C.P. Schindler, 'The ECJ's *Inspire Art* Decision of 30 September 2003 and its Effects on Practice' (2003) 4 German LJ 1277; W.-H. Roth, 'From *Centros* to *Überseering*: Free Movement of Companies, Private International Law, and Community Law' (2003) 52 ICLQ 177; E. Wymeersch, 'The Transfer of the Company's Seat in European Company Law' (2003), ECGI Law Working Paper No 08/2003; J. Lowry, 'Eliminating Obstacles to Freedom of Establishment: The Competitive Edge of UK Company Law' (2004) 63 CLJ 331; S. Rammeloo, 'At Long Last: Freedom of Establishment for Legal Persons in Europe Accomplished' (2004) 11 MJ 379; D. Zimmer, note on *Inspire Art*, (2004) 41 CML Rev 1127; W.F. Ebke, 'The European Conflict-of-Corporate-Laws Revolution: *Überseering, Inspire Art* and Beyond' (2005) EBL Rev 9.

[43] Case C-55/94, *Gebhard* v. *Colsiglio dell'Ordine degli Avvocati e Procuratori de Milano* [1995] ECR I-4165.

[44] See T.H. Tröger, *supra* n 3; Gelter, *supra* n 3; Kieninger, *supra* n 3, 763-65.

[45] On the UK, see P. Smart, *Cross-Border Insolvency*, 2nd ed. (London, Butterworths, 1998), 348-49.

[46] Case 81/87, *The Queen* v. *H.M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc* [1988] ECR 5483.

[47] See DTI, *Company Law Reform*, *supra* n 4, 48-9.

[48] EC Council Regulation 2157/2001, OJ L 294/1, 10.11.2001.

[49] *Ibid.*, Art. 8. However, the extent to which this may be used as a mechanism of regulatory arbitrage is limited by the requirement that the head office—that is, the 'seat'—must always be in the same jurisdiction as the registered office: Art. 7. See L. Enriques, 'Silence is Golden: The European Company Statute as a Catalyst for Company Law Arbitrage' (2004) 4 JCLS 77, 79-84 (arguing that SE statute may itself facilitate regulatory competition); *cf.* McCahery and Vermeulen, *supra* n 13, 18-22.

[50] European Commission, 'Proposal for a Directive of the European Parliament and of the Council on Cross-Border Mergers of Companies with Share Capital' COM (2003) 703 final, 18.11.2003, Art.3 and p. 6. The Tenth Directive received approval from the European Council on 25.11.2004 (see European Commission, 'Commission welcomes Council agreement on making cross-border mergers easier' Press Release IP/04/1405, 25.11.2004).

[51] See European 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' (1997), doc no XV/D2/6002/97-EN REV.2, Art. 2; European Commission, 'Company Law: Commission Consults on n the Cross-Border Transfer of Companies' Registered Offices', IP/04/270, 26th February 2004.

[52] Case C-9/02, *Hughes de Lastreyie du Saillant* v. *Ministère de l'Économie, des Finances et de l'Industrie* [2004] 3 CMLR 39.

[53] Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, OJ L 225/1, 20.08.1990. It is unclear whether the Merger Tax Directive applies to the formation of a SE by merger: see L. Enriques, *supra* n 3, 1261-62. However, an overwhelming majority of the respondents to the Commission's consultation as respects Transfer of Seat were in favour of the express application of the Merger Tax Directive: see European Commission, 'Public consultation on the outline of the planned proposal for a European Parliament and Council directive on the cross-border transfer of the registered office of a company' (2004), question 14.

[54] See Cheffins, *supra* n 8, 433; Enriques, *supra* n 53, 1269; Keininger, *supra* n 44, 769.

[55] Enriques, *supra* n 53, 1262.

[56] See R. La Porta *et al*., 'Corporate Ownership Around the World' (1999) 44 J. Fin. 471, 491-98; F. Barca and M. Becht (eds.), *The Control of Corporate Europe* (Oxford: OUP, 2001); M.J. Roe, *Political Determinants of Corporate Governance* (Oxford: OUP, 2003).

[57] Romano, *supra* n 23, 136-138.

[58] See Kraakman *et al*, *supra* n 5, 22, 53-54, 60-61.

[59] L.A. Bebchuk and M.J. Roe, 'A Theory of Path Dependence in Corporate Ownership and Governance' (1999) 52 Stan LR 127.

[60] Gelter, *supra* n 3.

[61] J.C. Dammann, 'Freedom of Choice in European Company Law' (2004) 29 Yale J Int'l L 477, 492-502; C. Kirchner *et al*, 'Regulatory Competition in EU Corporate Law after *Inspire Art*: Unbundling Delaware's Product for Europe' (2004), working paper, Humboldt University, Berlin and University of Illinois, 23-35.

[62] Kirchner *et al*, *ibid.*

[63] Council Regulation (EC) No 44/2001, OJ L 12/1, 16.01.2001. Art 22(2) grants exclusive jurisdiction to the courts of the Member State where the company has its 'seat'. For jurisdictions using the incorporation theory, the 'seat' will be interpreted as meaning the place of incorporation. This rule is mandatory, and may not be ousted by a jurisdiction clause: *ibid.*, Art. 23(5).

[64] Dammann, *supra* n 61, 495.

[65] Dammann, *supra* n 61, 503-507; Enriques, *supra* n 3, 1264. These arguments are based on evidence from the US that the a company's legal advisers are often key players in its decision (not) to reincorporate: see Romano, *supra* n 22, 274; Daines, *supra* n 37, 1580-81.

[66] A typical example of many such agents found by a Google search is Coddan CPM UK, which offers, via the internet, same-day incorporation of a UK private company for a fee of £42. The website has versions, explaining arbitrage opportunities, in Spanish and German. See www.ukincorp.co.uk.

[67] Companies House DVD-ROM Directory (April 2005 edition). The relevant companies were identified by searching for names including the following

terms: ‘AG’, ‘GmbH’, ‘Gesellschaft’, ‘und’, ‘mit’ and ‘handel’. This methodology follows Kirchner *et al*, *supra* n 61, 6-7, but by searching on a wider range of German words, a larger number of companies were identified. The results were checked manually to ensure that the names were in German.

[68] The suffix ‘Limited’ excludes firms incorporated in Germany but registered in the UK as an ‘overseas company’.

[69] The data may be both under- and over-inclusive. On the one hand, the search methodology does not capture all German-language names. On the other hand, the data do not tell us whether these companies in fact carry on any business in the UK.

[70] There were over 2 million companies registered in the UK in 2003-4: DTI, *Companies in 2003-4* (London: TSO, 2004), 33.

[71] See, e.g., CLSRG, *The Strategic Framework*, *supra* n 4, 96-98; Dammann, *supra* n 61, 525.

[72] See Romano, *supra* n 23, 39-40; Kahan, *supra* n 37.

[73] Kahan and Kamar, *supra* n 72, 708-715.

[74] Kahan, *supra* n 37.

[75] Romano, *supra* n 23, 41; *cf.* E. Kamar, ‘A Regulatory Competition Theory of Indeterminacy in Corporate Law’ (1998) 98 Colum LR 1908.

[76] Cheffins, *supra* n 8, 442-443.

[77] See Rt Hon Lord Justice Brooke (ed.), *Civil Procedure*, *Vol. 2* (London: Sweet and Maxwell, 2004), paras 1-143, 2G-14.

[78] M. Shapiro, *Courts: A Comparative and Political Analysis* (Chicago: University of Chicago Press, 1981), 150; M. Cappelletti, *The Judicial Process in Comparative Perspective* (Oxford: Clarendon Press, 1989), 220.

[79] See P.S. Atiyah and R.S. Summers, *Form and Substance in Anglo-American Law* (Oxford: Clarendon Press, 1987), 118-127; R. Posner, *Law and Legal Theory in England and America* (Oxford: OUP, 1996), 84-92.

1996), 84-92.

[80] See *supra*, n 55, and text thereto.

[81] 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).

[82] UKLA, *The Combined Code on Corporate Governance* (July 2003), available at www.fsa.gov.uk/pubs/ukla/lr_comcode2003.pdf.

[83] The Takeover Panel, *City Code on Takeovers and Mergers and the Rules Governing Substantial Acquisitions of Shares*, 7th ed. (Bowne International: London, 2002) plus updates. A regularly updated version of the City Code can be viewed at www.thetakeoverpanel.org.uk.

[84] The Listing Rules are now, of course, promulgated and enforced by the Financial Services Authority. The implementation of the Takeover Directive will see a statutory basis put in place for the Takeover Panel's jurisdiction, but will not, it seems, result in significant changes to the Panel's composition or mode of operating: see DTI, *Implementation of the European Directive on Takeover Bids* URN 05/511 (TSO: London, 2005), 11-24.

[85] M. Becht and C. Mayer, 'Introduction' in Barca and Becht (eds.), *supra* n 56, 1, 26 (62%).

[86] See B.S. Black and J.C. Coffee, 'Hail Britannia? Institutional Investor Behavior Under Limited Regulation' (1994) 92 Mich LR 1997, 2034-41; G.P. Stapledon, *Institutional Shareholders and Corporate Governance* (Oxford: Clarendon Press, 1996), 55-153; Cheffins, *supra* n 8, 364-421; P. Davies, 'Shareholder Value, Company Law, and Securities Markets Law: A British View' in K. Hopt and E. Wymeersch (eds.), *Capital Markets and Company Law* (Oxford: OUP, 2003), 261, 279-87; J. Armour and D.A. Skeel, 'Who Makes the Rules for Hostile Takeovers, and Why?' working paper, University of Cambridge/University of Pennsylvania School of Law (2005).

[87] Thus, the 'Combined Code' of corporate governance has been revised three times since its first incarnation as the 'Cadbury Code' in 1992 (following the Greenbury Report in 1995, the Hampel Report in 1998 and the Higgs Report in 2003). Similarly, the Code Committee of the Takeover Panel meets four times annually to review the workings of the City Code and propose revisions (see Takeover Panel, *Report on the Year Ended 31st March 2004*, 10-12).

[88] The Takeover Panel, *Report on the Year Ended 31st March 2003*, 14.

[89] *Criterion Properties plc* v. *Stratford UK Properties LLC* [2002] EWCA Civ 1883, [2003] 2 BCLC 129 (validity of corporate transaction); *Chaston* v. *SWP Group plc* [2002] EWCA Civ 1999, [2003] 1 BCLC 675 (financial assistance); *PNC Telecom plc* v. *Thomas* [2002] EWHC 2848 (Ch), [2004] 1 BCLC 88

(whether notice of EGM served by fax valid); *Re Marconi plc* [2003] All ER (D) 362 (scheme of arrangement). These were identified using LEXIS. A further 12 cases involved issues of insolvency law relating to companies that had formerly been listed.

[90] Listing Rules, r. 3.2.

[91] See Takeover Panel, *Explanatory Paper: Implementation of the European Directive on Takeover Bids* (20 January 2005), 5-6.

[92] See L.A. Bebchuk, 'A Rent-Protection Theory of Corporate Ownership and Control' NBER Working Paper No 7203, July 1999.

[93] For evidence relating to continental Europe, see K. Gugler, 'Beneficial Block-Holders versus Entrenchment and Rent Extraction?' in K. Gugler (ed.), *Corporate Governance and Economic Performance* (Oxford: OUP, 2001), 26.

[94] See M. Becht, 'European Corporate Governance: Trading off Liquidity Against Control' (1999) 43 *European Economic Review* 1071.

[95] Bebchuk, *supra* n 92.

[96] See Bebchuk and Roe, *supra* n 59, 142-53.

[97] Another plausible scenario is that a private equity firm would purchase the blockholder's stake, and then having restructured the firm, seek to take the company public again in a way that would the value of the share price. See H. Timmons, 'Private Equity Investors are Reshaping the Landscape of European Business', *New York Times*, 5 May 2005, C12.

[98] See M.J. Roe, 'The Shareholder Wealth Maximization Norm and Industrial Organization' (2001) 149 U Pa LR 2063.

[99] Frick and Lehmann, *supra* n 9, 123.

[100] See D. Wojcik, 'Change in the German Model of Corporate Governance: Evidence from Blockholdings 1997-2001' (2003) 35 *Environment and Planning A* 1431; S. Thomsen, 'Convergence of Corporate Governance during the Stock Market Bubble: Towards Anglo-American or European Standards?' in A. Grandori (ed.), *Corporate Governance and Firm Organization* (Oxford: OUP, 2004), 297, 306-312.

[101] Linklaters, for example, merged in Germany, Belgium and Sweden (The Lawyer, *The Lawyer UK 100*, 2004).

[102] International Financial Services London, *City Business Series: Legal Services* (London: IFSL, 1999, 2003, 2005).

[103] See *JUVE Handbook of German Commercial Law Firms 2004*, 'Ranking National Review', www.juve.de.

[104] R.S. Thomas, *et al*, 'Megafirms' (2001) 80 NC L Rev 115; A. Hodgart, 'Globalization and the Future of International Law Firms—The Perspective of a Management Consultant' in J. Drolshammer and M. Pfeifer (eds.), *The Internationalisation of the Practice of Law* (London: Kluwer Law International, 2001), 173, 194-202. On the historical background in London, see R.G. Lee, 'From Profession to Business: The Rise and Rise of the City Law Firm' in P.A. Thomas (ed.), *Tomorrow's Lawyers* (Oxford: Blackwell, 1992), 31.

[105] However, the US firms are also competing aggressively throughout Europe: see, e.g., C. Griffiths, 'The UK firms are thinking global, but the savvier US practices are starting to act local', *The Lawyer Global 100,* 2004.

[106] See E. Wymeersch, 'Company Law in Turmoil and the Way to "Global Company Practice"' (2003) 3 JCLS 283, 286-87.

[107] Hence the marketing of English law to clients can credibly be seen as a means of saving the client money as opposed to maximising fee income ('rents') for the lawyers.

[108] To be sure, there may be an inter-branch agency problem within such a firm. That is, lawyers in the branch in Member State B will naturally be loath to recommend to their local clients that they reincorporate in Member State A and thereby transfer their account to a different branch. This effect will be pitted against the firm's need to survive as a whole, which will depend upon successfully implementing its strategy. Lawyers in Member State B may therefore find their remuneration being structured so as to overcome such opposition, or being encouraged to re-tool in the law of Member State A. Future generations of lawyers in Member State B may indeed seek to qualify or learn the law of Member State A instead: Delaware's is the substantive corporate law taught at law schools throughout the US.

[109] Romano, *supra* n 23, 133-34; Enriques, *supra* n 53, 1266-73; Dammann, *supra* n 54, 520-521; Gelter, *supra* n 3; Tröger, *supra* n 3.

[110] 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: arts 2(1), 10).

[111] G. Hertig, 'Efficient Fostering of EU Regulatory Competition', (2004) SZW/RSDA 5 *Kurzbeiträge*, 369, 370.

[112] See J. Simon, 'A Comparative Approach to Capital Maintenance: France' (2004) 15 EBL Rev 1037; Kieninger, *supra* n 44, 768.

[113] Rammeloo, *supra* n 42, 409.

[114] See CLSRG, *Final Report, Vol I*, *supra* n 4, xi, 6; DTI, *Company Law Reform*, *supra* n 4, 9.

[115] DTI, *ibid*, 41-43.

[116] Cheffins, *supra* n 8, 437-38.

[117] R. Sitkoff and M.M. Schanzenbach, 'Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes', Northwestern Law & Econ Research Paper No 05-07 (2005).

[118] Kahan and Kamar, *supra* n 72, 694-698.

[119] *Ibid*, 698-699.

[120] Whilst leading New York M&A firms such as Cravath, Swaine & Moore, Davis, Polk & Wardwell, Simpson, Thacher & Bartlett, Sullivan & Cromwell and Wachtell, Lipton, Rosen & Katz do not have offices in Delaware, their practices encompass high-profile M&A transactions and associated litigation under Delaware law (source: law firm websites, consulted 1 May 2005).

[121] The Company Law Committees of the Law Society and the City of London Law Society are well-organised and powerful lobby groups that are in a position to offer effective arguments in favour (against) a change that will enhance (decrease) the attractiveness of English law to their clients. See, e.g., responses to the DTI's 2002 White Paper, *Modernising Company Law* (Cm 5553), available online at http://www.dti.gov.uk/cld/modern/index.htm.

[122] G. Hadfield and E. Talley, 'On Public Versus Private Provision of Corporate Law', USC Law and Economics Working Paper No 04-18, USC CLEO Research Paper No C04-13 (2004).

[123] Bebchuk, *supra* n 34, 1459-61, 1470-75.

[124] L.A. Bebchuk and A. Farrell, 'A New Approach to Takeover Law and Regulatory Competition' (2001) 87 Va LR 111, 152-53, 161-63; L.A. Bebchuk, 'The Case for Increasing Shareholder Power' (2005) 118 Harv LR 833, 868-69.

[125] Deakin, *supra* n 19, 209-213.

[126] It should be noted that Bebchuk's pessimistic assessment is vigorously disputed by others in the US: see, e.g, Romano, *supra* n 32. For present purposes, it is unnecessary to take a view on the merits of the US debate. The discussion in the text is simply concerned to show that European regulatory competition will not result in a 'race to the bottom': this is done most effectively by demonstrating that the concerns of the US pessimists will not be replicated in Europe.

[127] See L. Bebchuk, 'Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments' (1989) 102 Harv LR 1820 (arguing for restrictions on post-formation alterations of corporate constitution, owing to greater shareholder information costs).

[128] See, e.g., M.M. Blair, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century* (Washington, DC: Brookings Institution, 1995), G. Kelly and J. Parkinson, 'The Conceptual Foundations of the Company: A Pluralist Approach', [1998] CFILR 174; W. Njoya, 'Employee Ownership and Efficiency: An Evolutionary Perspective' (2004) 33 Ind LJ 211.

[129] Mandatory rules of a 'one size fits all' character are inappropriate where there exist a substantial number of firms for which the relevant rule is inappropriate. The extent to which firms rely upon firm-specific human capital is an empirical question, but it seems likely that in any system there will be many firms for which this rationale for employee-friendly governance rules is not present.

[130] European Commission, Proposal for a Tenth Directive, *supra* n 51, Art. 14 (incorporating provisions of SE regulation and Directive in relation to employees); European Commission, 'Company Law: Commission Consults on the Cross-Border Transfer of Companies' Registered Offices', IP/04/270, 26th February 2004.

[131] See generally, P.L. Davies, 'Workers on the Board of the European Company?' (2003) 32 Ind. L.J. 75.

[132] Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees, OJ L 294/22, 10.11.2001, Arts. 3-5. See also V. Edwards, 'The European Company—Essential Tool or Eviscerated Dream?' (2003) 40 CML Rev 443, 459-462.

[133] The parties may consensually extend the negotiating period to one year: Directive 2001/86/EC, Art. 5(2).

[134] *Ibid.*, Art. 7 and Annex.

[135] Davies, *supra* n 131, 84-90; Deakin, *supra* n 19, 212-13.

[136] See C. Teichmann, 'The European Company—A Challenge to Academics, Legislatures and Practitioners' (2003) 4 German LJ 309, 319-21. An exception is where the SE is created by transformation of an existing public company, in which case the new entity must provide at least as much participation for employees as they enjoyed beforehand (Directive 2001/86/EC, Art. 4(4)). However it would be simple enough to evade this requirement by creating an SE by merger into a shell company: see Enriques, *supra* n 49, 5.

[137] On the use of bargaining levers to protect employee interests, see generally J. Armour and S. Deakin, 'Insolvency and Employment Protection: The Mixed Effects of the Acquired Rights Directive' (2003) 22 Int Rev L & Econ 443, 448-62, 458-60.

[138] See M. Edbury, 'The European Company Statute: A Practical Working Model for the Future of European Company Law Making?' (2004) 15 EBL Rev 1283.

[139] *Supra*, text to nn 136-137.

[140] Indeed, there is no legal reason why firms which are unable to offer such commitments under their governing law but would like to do so could not switch to German company law.

[141] Regulation 2157/2001, arts. 8(6), 59(1). Two-thirds is a mandatory floor, which may be raised if the relevant national law requires a higher majority.

[142] *Ibid.*, Art. 17(2) (incorporating by reference the approval procedure prescribed by the Third Council Directive, 78/885/EEC of 9 October 1978, concerning mergers of public limited-liability companies, OJ L 295/36, 20.10.1978). See Edwards, *supra* n 132, 452-454. It is unnecessary to consider the other three methods of forming an SE, namely holding or subsidiary SEs and transformation of an existing public company, as these cannot bring about a change of registered office without subsequent invocation of the Art. 8 procedure.

[143] Proposal for Fourteenth Directive, *supra* n 51, Art. 6.

[144] Proposal for Tenth Directive, *supra* n 51, Art. 6 ('the general meeting' shall approve proposed mergers); see also Art. 2 (provisions of national law shall govern the decision-making process relating to the merger, save as otherwise provided in the Directive).

[145] Regulation 2157/2001, Art. 8(7); Proposal for Tenth Directive, *supra* n 51, Art. 2; Proposal for Fourteenth Directive, *supra* n 51, Art. 8.

[146] EC Council Regulation 1346/2000 OJ L160/1, 30.6.2000. Jurisdiction over insolvency proceedings was specifically excluded from the Brussels Convention (now consolidated as EC Council Regulation 44/2001on jurisdiction and the recognition and enforcement of judgments in civil proceedings: OJ L12/1, 16.01.2001). See *ibid*, Art. 1(2)(b).

[147] *Supra*, text to nn 4-7.

[148] A point which has been emphasised by David Skeel: see D.A. Skeel, 'Rethinking the Line Between Corporate Law and Corporate Bankruptcy' (1994) 72 Tex LR 471; 'Corporate Anatomy Lessons' (2004) 113 Yale LJ 1519, 1550-62. See also Armour and Whincop, *supra* n 6, 25.

[149] See D.A. Skeel, 'An Evolutionary Theory of Corporate Law and Corporate Bankruptcy' (1998) 51 Vand LR 1325; J. Armour *et al*, 'Corporate Ownership Structure and the Evolution of Corporate Bankruptcy Law: Lessons from the UK' (2002) 55 Vand LR 1699.

[150] See generally, I.F. Fletcher, *Insolvency in Private International Law* (Oxford: Clarendon Press, 1999), 246-301; G. Moss *et al*, *The EC Regulation on Insolvency Proceedings* (Oxford: OUP, 2002); M. Martinez Ferber, *European Insolvency Regulation* (Osterspai: Ditmar Weis, 2004); P. Omar, *European Insolvency Law* (Aldershot: Ashgate, 2004).

[151] Reg. 1346/2000, Preamble para 23, Art. 4(2). To this principle there are a number of 'carve outs', including the effects of insolvency on: (i) rights *in rem,* reservation of title claims, contracts relating to immoveables and rights of third-party purchasers of such assets (each governed by the *lex situs*: Arts. 5, 7, 8 and 14); (ii) rights of set-off (governed by the law applicable to the insolvent debtor's claim: Art. 6); (iii) contracts of employment (governed by the proper law of the contract: Art. 10) and (iv) rights subject to registration (governed by the law of the place of the register: Art. 11).

[152] *Ibid.*, Art. 3(1).

[153] *Ibid.,* Art. 3(2).

[154] *Ibid*, Arts. 16, 17, 27.

[155] Compare *ibid.*, Annex A (proceedings which may be opened in COMI, including corporate rescue procedures) with Annex B (secondary proceedings,

including only liquidation procedures). Both Annexes have recently been amended by EC Regulation 603/2005, OJ L 100/1, 20.4.2005.

[156] See Fletcher, *supra* n 150; 260-262; Omar, *supra* n 150, 97-99.

[157] Reg. 1346/2000, Preamble para. 13.

[158] See *Re Daisytek-ISA Ltd* [2004] BPIR 30 at [16]-[17] ('where the debtor enters into the majority of his financing arrangements'); see also *Re BRAC Rent-A-CarInternational, Inc.* [2003] EWHC (Ch) 128, [2003] 1 WLR 1421 at [4]-[5]. For a thorough survey of other Member States' jurisprudence, see Martinez Ferber, *supra* n 150, 31-74.

[159] This understanding is questioned *infra*, text to nn 168-171.

[160] See, e.g., Kersting and Schindler, *supra* n 42, 1290; T. Koller, 'The English Limited Company—Ready to Invade Germany' (2004) 15 ICCLR 334, 341-343; Martinez Ferber, *supra* n 150; 86-111; Rammeloo, *supra* n 42, 403-406; Zimmer, *supra* n 42, 1137-38.

[161] There is some relevant ECJ jurisprudence, albeit directed to the sibling question of the scope of the exclusion from the Brussels Convention for 'insolvency proceedings' (*supra*, n 146). In *Gourdain/Nadler* (C-133/78, [1979] I ECR 733), the ECJ held that the French *action en comblement du passif* (loosely: failure by directors to take steps to initiate insolvency proceedings sufficiently quickly) was properly characterised as part of insolvency proceedings, on the ground that the action was open only to the liquidator, and that the proceeds went to enlarge the assets available to the creditors.

[162] As the Dutch legislature appears to have attempted: see Rammeloo, *supra* n 42, 407-8 and Lowry, *supra* n 42, 343 fn32.

[163] It would be at least arguable that such a provision could be brought within the ECJ's characterisation of 'insolvency proceedings' in *Gourdain/Nadler*: see *supra* n 161.

[164] A point also made by Kieninger, *supra* n 44, 752-54.

[165] This can also be seen by considering the tax cases: in *de Lastreyie du Saillant* (*supra* n 52), the Court ruled that tax laws impeding individuals' freedom of establishment would be struck down; the reason for not so ruling in *Daily Mail* (*supra* n 46) was on the basis of the court's peculiar conception of the 'status' of a company as governed by the provisions of its state of incorporation: see *supra*, text to nn 45-46.

[166] See, e.g., *Kraus* v. *Land Baden-Württemerg* [1993] ECR I-1663; Case C-190/98, *Graf* v. *Filzmoser Mashinenbau GmbH* [2000] ECR I-493; Joined cases C-51/96 and C-191/97, *Deliège* v. *Ligue Francophone de Jude et Disciplines Associées ASBL* [2000] ECR I-2549.

[167] This point is hinted at by Tröger, *supra* n 3.

[168] C-341/04, *Bondi* v. *Bank of America NA*; application for urgent decision under the accelerated procedure refused, 15 September 2004.

[169] M. Virgos and E. Schmit, *Report on the Convention on Insolvency Proceedings* (reprinted in Moss *et al.* (eds.), *supra* n 150, Appendix 2), para 75.

[170] See *Skjevesland* v. *Geveran Trading Co Ltd* [2003] BPIR 924 at [4]; *Shierson* v. *Vlieland-Boddy* [2004] EWHC 2752 (Ch), [2004] All ER (D) 420 at [13]-[23], esp. at [21]: '..the creditors are always at risk of such a change [of COMI], and they cannot safely make any assumptions as to the insolvency law which will apply in due course.' (*per* Mann J).

[171] Such a rule would, on this paper's analysis, be a good candidate for EU legislation as a 'procedural harmonisation' provision.

[172] The terminology is derived from L.A. Bebchuk and J.M. Fried, 'The Uneasy Case for the Priority of Secured Claims in Bankruptcy' (1996) 105 Yale LJ 857. The possibility that the presence of nonadjusting might distort firms' investment incentives so as to exploit them was first noted in J.H. Scott, Jr., 'Bankruptcy, Secured Debt and Optimal Capital Structure' (1979) 32 J Fin 1.

[173] For example, the 'prescribed part' of floating charge assets which must be set aside for unsecured creditors in UK corporate insolvencies following the Enterprise Act 2002: see Insolvency Act 1986, s 176A.

[174] See, e.g., L. LoPucki, 'Cooperation in International Bankruptcy: A Post-Universalist Approach' (1999) 84 Cornell LR 696, 720-23.

[175] For tort victims and environmental claims, mandatory insurance or statutory guarantee requirements for those engaging in hazardous activities provide clearly-targeted incentives. For unsophisticated voluntary creditors, such as consumers, employees and trade creditors, credit insurance can be provided—either through statutory mandate or by market providers—by sophisticated creditors who then price the risk into their transactions with the debtor.

[176] A.T. Guzman, 'International Bankruptcy: In Defence of Universalism' (2000) 98 Mich LR 2177, 2180-81.

[177] See Skeel, 'Rethinking the Line', *supra* n 148, 517-23.

[178] See, e.g., R.K. Rasmussen, 'Debtor's Choice: A Menu Approach to Corporate Bankruptcy', (1992) 71 Tex LR 51; A. Schwartz, 'Contracting About Bankruptcy', (1997) 13 J L Econ & Org 127. The argument is extended to the context of international insolvencies in R.K. Rasmussen, 'A New Approach to Transnational Insolvencies' (1997) 19 Mich J Int'l L 1.

[179] This would be the case both for formation and reincorporation choices, as adjusting creditors could easily include loan covenants specifying that reincorporation without their consent would constitute an event of default.

[180] The structure is designed to protect local creditors, but not to permit them to stymie rescue proceedings. Thus the insolvency practitioner conducting main proceedings is empowered to stay secondary proceedings so as to effect a rescue, provided that adequate protection is offered for the interests of creditors in the secondary proceedings: Reg. 1346/2000, Art. 33.