"COST-BASED" AND "RULES-BASED" REGULATORY COMPETITION: MARKETS FOR CORPORATE CHARTERS IN THE U.S. AND IN THE E.U.

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I. INTRODUCTION

The internationalization of economic activities has blurred national boundaries, creating the potential for regulatory arbitrage. Much of the legal debate over these developments has focused on the resulting potential for regulatory competition among legal systems.[1] Regulatory competition is a reconceptualization of the traditional view of the law-making process, in which legislatures, policy-makers and judges are cast as market actors competing to implement and enforce the most efficient rules. Economists have developed numerous analytical models of these "markets for rules,"[2] especially with

1. On the difference between regulatory arbitrage and regulatory competition, see Stephen Woolcock, *Competition Among Rules in the Single European Market, in* INTERNATIONAL REGULATORY COMPETITION AND COORDINATION 289 (William Bratton et al. eds., 1996) (implying an active, competitive effort by regulators).

2. While several authors have proposed economic models to describe this market, the most recent, complete and clear attempt is by Oren Bar-Gill et al., *The Market for Corporate Law,* 162 J. INSTITUTIONAL & THEORETICAL ECON. 134 (2006). A less recent, but still interesting attempt to create such a model can be found in William Carney, *The Political Economy of Competition for Corporate Charters,* 26 J. LEGAL STUD. 303 (1997).

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respect to certain substantive areas of the law and specific geographic contexts.[3]

The paradigmatic example of this regulatory competition phenomenon is the market for corporate charters in the United States. In this system, corporations[4] are free to choose - independent from their physical location - the state of incorporation and therefore the substantive rules applicable to their internal corporate affairs.[5] Incorporation or

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3. Extensive literature exists on regulatory competition in different substantive areas of the law. For a general framework on the role of regulatory competition, see Joel P. Trachtman, *International Regulatory Competition, Externationalization, and Jurisdiction*, 34 HARV. INT'L L.J. 47, 59-81 (1993). For a discussion of regulatory competition and the possible effects of regulatory arbitrage in securities regulation, see Frederick Tung, *Lost in Translation: From U.S. Charters Competition to Issuer Choice in International Securities Regulation*, 39 GA. L. REV. 525 (2005) (discussing regulatory competition and the possible effects of regulatory arbitrage in specific areas). *See also* Merrit B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investment Empowerment*, 85 VA. L. REV. 1335 (1999); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998); Joel P. Trachtman, Regulatory Competition and Regulatory Jurisdiction in International Securities Regulation, (December 9, 1999), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=193688. On tax law, see Daniel Shaviro, *Money on the Table?: Responding to Cross-border Tax Arbitrage*, 3 CHI. J. INT'L L. 317 (2002) and Daniel Shaviro, *Some Observations Concerning Multi-Jurisdictional Tax Competition* (New York Univ. Ctr. for Law & Bus., Working Paper No. CLB-00-001), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=204889. On bankruptcy, see Barry E. Adler & Henry N. Butler, *On the "Delawarization of Bankruptcy" Debate*, 52 EMORY L. J. 1309 (2003) and Marcus Cole, *"Delaware is Not a State": Are We Witnessing Jurisdictional Competition in Bankruptcy?*, 55 VAND. L. REV. 1845 (2002). On environmental law, see Daniel C. Esty, *Revitalizing Environmental Federalism*, 95 MICH. L. REV. 570, (1996).

4. In this article, we will primarily use the U.S. expressions "corporation" and "limited liability corporation" in their American meanings, even when referring to business associations from European jurisdictions that do not use a similar terminology. Occasionally, however, the terms "company" and the expressions derived from it, such as "limited liability company," will be used to underline that we are referring to European types of corporations.

5. For an institutional but complete discussion of incorporation and the choice of the laws governing the internal affairs of the corporation see 1 JAMES D. COX & THOMAS LEE HAZEN, COX & HAZEN ON CORPORATIONS §§ 2.13, 3.02 (2d ed. 2003) and FRANKLIN A. GEVURTZ, CORPORATION LAW § 1.2 (2000). Freedom of incorporation in the U.S., and its possible consequences, will be further discussed in the following pages. It should be pointed out, however, that this freedom is not absolute. Some states have

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reincorporation in a jurisdiction different from that where the firm physically operates is quite simple and inexpensive. The company needs only file the articles of incorporation with the secretary of state of the jurisdiction, pay an incorporation fee and a franchise tax, [6] and complete some additional minor

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enacted what might be referred to as "pseudo-foreign corporations" rules, stipulating that some corporate law rules of the state with which the corporation has significant contacts shall apply (for instance, because the majority of the shareholders are resident of the state), even if the corporation is incorporated elsewhere. *See, e.g.*,N.Y. BUS. CORP. LAW §§ 1317-19 (McKinney 2006); CAL. CORP. CODE § 2115 (McKinney 2006). *See also* Cox & Hazen, *supra*, § 2.13; Joanne M. Smith, Note, *Corporations: Domestic Regulation of Foreign Corporations: Concept of "Domiciled Foreign Corporations": New York Business Corporation Law of 1961*, 47 CORNELL L. Q. 273, 273 (1962); Michael Halloran & Douglas L. Hammer, *Section 2115 of the New California General Corporation Law—The Application of California Corporation Law to Foreign Corporations*, 23 UCLA L. REV. 1283 (1976). There are questions as to the constitutionality of these statutes, particularly with respect to the Commerce Clause, but so far they have not been ruled unconstitutional. *See* Richard M. Buxbaum, *The Threatened Constitutionalization of the Internal Affairs Doctrine in Corporation Law*, 75 CAL. L. REV. 29, 47-57 (1987); Phaedon John Kozyris, *Corporate Wars and Choice of Law*, 1985 DUKE L.J. 1, 30-86 (1986). *See also* Cox & Hazen, *supra*, § 2.13, at 116 (noting that "a California court has upheld the constitutionality of the state's pseudo-corporation provision" and that "the Delaware courts have enshrined the internal affairs doctrine in the Constitution"); Gevurtz, *supra*, § 1.2, at 37-38 ("States can exclude or admit subject to conditions corporations which wish to do business within a state, but the [Commerce Clause] prohibits states from excluding or requiring qualification of a corporation which does no business within a state and whose sole connection with the state is entirely through interstate transaction."); Jens C. Dammann, *Freedom of Choice in European Corporate Law*, 29 YALE J. INT'L L. 477, 485 (2004) (drawing a parallel between the U.S. and Europe in light of recent cases decided by the European Court of Justice with respect to the issue of the validity of pseudo-foreign corporation statutes). For a discussion of those recent cases, see *infra* note 13. For more on the comparison between the real seat and incorporation principles, see *infra* Part V.1-2.

6. As pointed out by Philip S. Garon et al., *Challenging Delaware's Desirability as a Haven for Incorporation*, 32 WM. MITCHELL L. REV. 769, 774 (2006), Delaware . . . imposes an initial incorporation fee based upon the monetary value of the corporation's par-value stock. For example, a company with authorized capital stock having an aggregate par value of $10 million would pay an initial incorporation fee of $1,200. If the stock has no par value, Delaware charges a fee based on the number of authorized shares of the corporation.

The more onerous fee for a Delaware corporation is the annual franchise fee, which, subject to possible reduction under an alternative computation, is based upon the number of authorized shares. A corporation with ten million authorized shares, for example, must pay an annual franchise tax of

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paper work, all of which is usually accomplished through local legal and commercial support services that specialize in providing such assistance.

Given the minimal effort required, this system is referred to as allowing "freedom of incorporation," because it allows companies significant liberty in determining where they want to incorporate. This freedom, in turn, creates the opportunity for individual states to compete to attract corporations. States are primarily motivated by the revenues derived from franchise taxes and by the income generated by legal and commercial support services related to corporate activities. This competition has been famously dubbed the very "genius" of U.S. corporate law, [7] and represents one of the most distinguishable features of the U.S. system in comparison with other legal systems. While the existence of this market for corporate charters is widely acknowledged, significant debate continues over whether it produces corporate laws that are inherently superior,[8] or rather inefficient rules that only maximize the welfare of those selecting them.[9]

$62,550, or such lower amount calculated under Delaware's alternative formula. The maximum annual franchise fee is $165,000. According to one study, a state that dominates the incorporation market can not capture entirely the benefits deriving from the choice of that state as incorporation venue, and is therefore forced to cap the franchise tax. *See* Bar-Gill et al., *supra* note 2, at 16.

7. *See* ROBERT ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (1993).

8. *See* Ralph K. Winter, *State Law, Shareholder Protection, and the Theory of the Corporation,* 6 J. LEGAL STUD. 251, 290 (1977); Ralph K. Winter, *The "Race for the Top" Revisited: A Comment on Eisenberg,* 89 COLUM. L. REV. 1526, 1528 (1989); FRANK H. EASTERBROOK & DANIEL R. FISHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 212-227 (1991); Romano, *supra* note 3.

9. Skepticism regarding the effect of regulatory competition in this field has been expressed by the author who initiated the debate on the market for rules in corporate law. *See* William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware,* 83 YALE L.J. 663 (1974). Lucian A. Bebchuk, one of the scholars who has challenged the rationales of the "race to the top," has explored its effects *vis-à-vis* takeover regulation. *See* Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law,* 105 HARV. L. REV. 1435, 1486-88 (1992). *See also* Lucian Arye Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers,* 99 COLUM. L. REV. 1168 (1999); Lucian A. Bebchuk et al., *Does the Evidence Favor State Competition in Corporate Law?,* 90 CAL. L. REV. 1775, 1820 (2002) (showing that (1) there is not necessarily a correlation between the decision to (re)incorporate in Delaware and an increase in the

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Conventional wisdom holds that in Europe the degree of regulatory competition among single Member States is far lower than in the U.S. Several features of the various European systems, which will be considered more analytically in the following pages, contribute to this situation. One of the most frequently invoked explanations is that most States in continental Europe follow the so-called "real seat" principle. Under this regime, a corporation must be incorporated in, and be subject to the laws of, the State where it has its "real seat." While the criteria for determining the "real seat" of a corporation may differ among jurisdictions, generally it includes examining the center of the administration and/or the place where most corporate affairs are performed.[10] In this respect,

prices and/or value of the corporation; (2) to the extent such a correlation might exist, it does not imply causation and might not be due to the market's appreciation of the new substantive corporate rules; (3) and the positive effect on the prices might be determined by the corporate transactions that lead to reincorporation, such as a merger or a takeover). For an interesting analysis of the reasons why regulatory competition could not work with respect to disclosure rules, whose mandatory nature shall be retained, see Fox, *supra* note 3 (responding to Romano's contention that issuers should have been allowed to choose freely the securities law regime applicable, as they may with respect to the choice of the governing corporate law rules). On the possible reasons why regulatory competition, at its present stage, might be less likely to lead to efficient rules in Europe, see Marco Ventoruzzo, *Experiments in Comparative Corporate Law: The Recent Italian Reform and the Dubious Virtues of a Market for Rules in the Absence of Effective Regulatory Competition*, 40 TEX. INT'L L. J. 113, 149-55 (2004).

10. Extensive literature exists on the real seat approach and its implications. *See, e.g.*, Dammann, *supra* note 5, at 483-86 (discussing the real seat approach). The real seat approach has been explained thusly:

The real seat doctrine and the incorporation theory are two competing approaches to determining which state's laws will govern a company's internal affairs when it has contacts with more than one jurisdiction. This determination of a corporation's "nationality" becomes relevant when corporate conflict-of-laws problems arise, particularly in the European Union, where significant differences exist in the substantive laws of the Member States. Under the seat theory, the controlling law will be that of the country where the company's headquarters are located. By contrast, the incorporation theory requires the use of the law of the incorporation state. Many EU Member States, including Germany [and] France . . . adhere to the real seat doctrine, while the Netherlands, Great Britain, Ireland, and Denmark follow the incorporation theory. Nicole Rothe, *Freedom of Establishment of Legal Persons Within the European Union: An Analysis of the European Court of Justice Decision in the* Überseering *Case*, 53 AM. U. L. REV. 1103, 1110 (2004). *See generally* Carsten Frost, *Transfer of Company's Seat - An Unfolding Story in Europe*, 36 VICT. U.

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the choice of where to place the real seat of the corporation is not "free," or, more precisely, does not depend exclusively on a selection of the applicable corporate laws; moving the real seat can be expensive, if not impossible. For these reasons, European corporations do not enjoy nearly as much liberty in shopping around for the most desirable corporate rules as their American counterparts. As a result, according to this view a market for corporate rules is prevented from developing in Europe. [11]

This conventional view is being abandoned, however, in light of recent developments.[12] Over the past several years, the European Court of Justice has issued some ground-breaking decisions in favor of corporations' freedom of movement, of which three are considered revolutionary: *Centros, Überseering* and *Inspire Art.*[13] A growing body of empirical evidence sug-

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WELLINGTON L. REV. 359, 363-64 (explaining the real seat theory in more detail); Eddy Wymeersch, *The Transfer of the Company's Seat in European Company Law*, 40 COMMON MKT. L. REV. 661 (2003).

11. As one commentator has explained, "First, the state can refuse to recognize as legal entities corporations created under other laws, where the real home of the corporation is local. This would have the effect of barring the entity from suing in local courts or conveying title in its own name. More importantly, it would render those involved in the firm personally liable for its obligations. The effectiveness of this approach will depend to some extent on the definition of pseudo-foreign corporations. If it depends on the location of corporate headquarters, or where corporate meetings are held, shifting the 'real seat' of the business can occur at relatively low cost. If the definition depends on the location of productive assets, moving will be far more costly, and exit from the jurisdiction far more difficult. Carney, supra note 2, at 309-10. In addition, "even if the state recognizes pseudo-foreign corporations, it can apply local corporate laws to them, thus raising their costs to the level of locally chartered firms." Id.

12. *See, e.g.*, Hanne Søndergård Birkmose, *A 'Race to the Bottom' in the EU?*, 13 MAASTRICHT J. EUR. & COMP. L. 35, 37 (2006) ("The most serious obstacle to competition between legal orders in the EU has been, and still is, the national conflict of law rules, where a majority of the Member States apply the 'real seat' or 'head office' doctrine. But the consequences of this are now severely limited.").

13. *See* Case C-212/97, Case C-212/97, Centros Ltd v. Erhvervs-og Selskabsstyrelsen, 1999 E.C.R. I-1459, 1999 2 C.M.L.R. 551 (1999); Case C-208/00, Überseering BV v. Nordic Constr. Co. Baumanagement CmbH, 2002 E.C.R. I-9919; Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd, 2003 O.J. (C 275) 10. Extensive analysis exists on these decisions. *See* Frost, *supra* note 10, at 364; Eva-Maria Kieninger, *The Legal Framework of Regulatory Competition Based on Company Mobility: EU and US Compared*, 6 GERMAN L. J. 742 (2005); Andrea J. Gildea, Überseering*: A Euro-*

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gests that, largely as a consequence of the doctrines affirmed in these cases, regulatory competition in corporate law is on the rise in Europe. For instance, research by economists Becht, Mayer and Wagner reveals that "the average number of private limited companies from all Member States incorporating in the U.K. per year has increased from 3,360 firms pre-*Centros* to 19,860 firms post-*Centros*."[14] Other authors have pointed out that several firms now offer, for a few hundred euros, on-line "incorporation" services for incorporating in the U.K.[15]

In addition, as will be discussed further, recent EU legal reforms such as the directive on cross-border mergers [16] and

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pean Passport, 30 BROOK. J. INT'L L. 257, 275 (2004) (discussing *Centros*); Patrick S. Ryan, Case C-167/01. Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd, 11 COLUM. J. EUR. L. 187 (2005) (discussing *Inspire Art*); Seth Chertok, *Jurisdictional Competition in the European Community*, 27 U. PA. J. INT'L ECON. L. 465, 472 (2006) (discussing *Centros*); Tito Ballarino, *From* Centros *to* Überseering: *EC Right of Establishment and the Conflict of Laws*, 4 Y.B. OF PRIVATE INT'L L. 203 (2002); Tito Ballarino, *Les Règles de Conflit sur les Sociétés Commerciales à L'Épreuve du Droit Communautaire D'Établissement: Remarques sur Deux Arrêts Récents de la Cour de Justice des Communautés Européennes*, 92 REVUE CRITIQUE DE DROIT INT'L PRIVÉ 373 (2003); Wulf-Henning Roth, *From* Centros *to* Ueberseering: *Free Movement of Companies, Private International Law, and Community Law*, 52 INT'L & COMP. L.Q. 177 (2003); Stefano Lombardo, *Libertà di stabilimento e mobilità delle società in Europa*, 21 (6) NUOVA GIURISPRUDENZA CIVILE COMMENTATA II/353 (2005).

14. Marco Becht et al., *Where Do Firms Incorporate?*, 24 (European Corporate Governance Inst., Working Paper No. 70/2006, 2006) (counting the number of private and public companies incorporated in the U.K. from all 25 EU countries in order to identify the "real" nationality of the firms), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=906066.

15. *See* Giuseppe B. Portale, *La riforma delle società di capitali tra diritto comunitario e diritto internazionale privato*, 1 EUROPA E DIR. PRIV. 101, n.70 (2005). *See also* Coddan Home Page, http://www.ukincorp.co.uk (a British agent offering "all included" services to form a private limited company); Jeff McGeachie, *England*, *in* CORPORATE BUSINESS FORMS IN EUROPE. A COMPENDIUM OF PUBLIC AND PRIVATE LIMITED COMPANIES IN EUROPE 65 (Frank Dornseifer ed., 2005) ("[C]ommonly the total cost of acquisition [of a shelf company] will be about £1,250 and the transaction can be done in a matter of hours provided the acquirer is able to provide new directors and shareholders willing to take a transfer of the subscriber shares.").

16. A change in the governing corporate law rules can be the consequence of a cross-border merger. In this respect, the Tenth Directive on Cross-border Mergers may facilitate regulatory competition. [T]he new Directive will have a considerable effect on regulatory competition in corporate law in the EU. . . . [R]egulatory competition in European corporate law

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the introduction of a European-level corporation (the *Societas Europea*, or *SE*), as well as proposed European legislation [17], might make it easier for a corporation to change its applicable corporate laws. These changes have, in turn, prompted legal reforms by individual Member States to make their corporate law more attractive.[18]

Predictably, these developments have sparked an intense debate, similar to that in the U.S., about whether an efficient market for rules is possible and desirable in Europe. Most existing analysis assumes that removal of the rules that limit the ability of the corporations to shop around for the most desirable corporate laws (epitomized by the real-seat principle), will result – to a greater or lesser extent – in increased regulatory

is mainly centered around re-incorporating existing corporations. Although a direct change of the corporate domicile is also not feasible in the U.S., reincorporation is possible, because it is a well-established procedure for a new corporation to be founded, for instance, in Delaware, and to then merge with the expiring corporation of the other state. A similar method of reincorporation could now evolve in the EU. The directive on cross-border mergers makes it, in general, possible for corporations to change their corporate law by founding a new corporation and merging it with the existing corporation. Mathias M. Siems, *The European Directive on Cross-Border Mergers: An International Model?*, 11 COLUM. J. EUR. L. 167, 179 (2004/2005).

17. Consensus has not been yet reached on a directive on the transferability of the registered office within the European Union. *See* Press Release, EUROPA, Company Law: Commission Consults on the Cross Border Transfer of Companies' Registered Offices (Feb. 26, 2004) (announcing online consultation launched by the European commission on the directive), *available at* http://ec.europa.eu/internal_market/company/seat-transfer/index_en.htm. The debate, however, has been reinvigorated by the aforementioned cases, and it is not unlikely that a comprehensive regulation addressing this issue will soon be drafted.

18. Evidence of regulatory competition responses to the U.K.'s ability to attract closely-held corporations have been found in Germany, Netherlands and France. *See* Becht, *supra* note 14, at 29. As reported by Portale, in France, after these decision, a statute, Article L. 223-2 of the Commercial Code (as modified by the law of August 1, 2003), abolished minimum legal capital for limited liabilities corporations. *See* Portale, *supra* note 15. In Spain law NO. 7/2003 of April 1, 2003, allows the "Sociedad Limidada Nueva Empresa" to be incorporated with a capital of little more than 3,000 euros. *See* Rodrigo Uría, et al., CURSO DE DERECHO MERCANTIL, vol. I, Madrid (2006), at 1131 ff.); Peter Mankowski, *Entwicklungen in Internationalen Privat- und Prozessrecht*, 7 RECHT DER INTERNATIONALEN WIRTSCHAFT 481, 486 (2004). *See also* Ventoruzzo, *supra* note 9 (noting that recent amendments to Italian law have added flexibility to the rules governing the formation of capital and the financial structure of the corporation).

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competition.[19] Relatively less attention is devoted to the other elements that explain the basic features of the market for charters in Europe (to the extent that one exists), and that might affect its future development.[20]

While it is almost tautological to say that greater freedom of movement will affect regulatory competition, the additional economic and legal variables that define the features of a possible European market for corporate charters are largely still to be explored, analyzed, and tested empirically. The goal of this Article is thus to explore the fundamental differences separating regulatory competition in corporate law in Europe and in the U.S. In a nutshell, the U.S. market for charters primarily affects the re-incorporation of large corporations, already operating in different States and often publicly-held or about to go public. The European situation, on the other hand, shows the recent development of a market for "first incorporation" of smaller business associations, often closely-held by a few shareholders who are also directors and mangers of the corporation. Understanding these divergences and their causes is essential to properly model the two markets, to foresee their potential evolution, and to assess the practical and policy implications of those differences.

To that end, this Article will proceed in five parts. In Part II, I will explain what I intend to convey with the expressions "rule-based" and "cost-based" regulatory competition. I will analyze the reasons why the European market for rules in corporate law is an example of cost-based competition, and examine some empirical evidence confirming this distinction. Part III will consider the distinctive features of the European charters competition from the "demand-side", i.e., from the

19. An original perspective on charter competition in Europe is offered by John Armour, *Who Should Make Corporate Law? EC Legislation Versus Regulatory Competition* (European Corporate Governance Inst., Working Paper No. 54/2005, June 2005) (arguing that a virtual race-to-the-top will develop in Europe, with the U.K. leading the competition, even if no state will acquire a dominant position similar to the one held by Delaware in the U.S.,) *available at* http://www.ssrn.com/abstract=806444.

20. There are some notable exceptions, however. *See, e.g., id.*; Birkmose, *supra* note 12; Kieninger, *supra* note 13; Luca Enriques, *EC Company Law and the Fears of a European Delaware*, 15 EUR. BUS. L. REV. 1259 (2004). These works extensively discuss specific elements besides the adoption of a freedom of incorporation and reincorporation approach that might affect a market for corporate charters in the European Union.

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point of view of corporate decision-makers deciding where to incorporate or reincorporate. In Part IV, I will take look at the same phenomenon from the "supply-side", considering the incentives that individual states might have to attract corporations. [21] Finally Part. V will discuss the existing constraints to freedom of movement, and regulatory competition, as well as their possible evolutions.[22] A discussion of the possible implications of the analysis will close the Article in Part VI.

The following analysis does not aim to provide a definitive discussion of all the possible variables influencing the type and degree of regulatory competition in corporate law. There might be other relevant variables, and moreover the elements identified, mainly in the form of hypothesis, might be subject to further distinction and analytical dissection. The Article will, however, develop a general theoretical scheme that identifies the causes of the differences between the two markets for corporate charters and the underlying reasons why the European and U.S. markets can be regarded, respectively, as "cost-based" and "rule-based."[23]

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21. For a somewhat similar distinction, albeit with a different scope and variables, between "incentives" for a corporation to forum shop and incentives for member states to compete, see Birkmose, *supra* note 12.

22. The distinctions among elements driving regulatory competition from the "demand-side," from the "supply-side," and constraints to regulatory arbitrage, should not be taken too literally. Of course, these different elements interplay, and the resulting classification may appear, in some instances, partially arbitrary. For instance, a rule limiting the ability of a corporation to "abandon" the chosen jurisdiction, and reincorporate in a different one, falling in the last category, might also be an element at which corporate decision-makers look in deciding where to incorporate for the first time, or reincorporate; complex interrelations exist between causes and consequences of the development of a market for rules. In addition, a circular relationship ties the elements (rules at the state and federal level, institutions, economic situation, language and cultural barriers) that determine the intensity and type of regulatory competition in our field, and the effect that a given competitive scenario has on those very elements. For instance, the absence of proper incentives for regulators to develop a market for corporate law might result in a lack of competition, which prevents a dominant state from emerging. On its turn, this prevents or limits the development of a particularly specialized judiciary in the field, and adversely affects possible network positive externalities related to incorporation in the most widely chosen jurisdiction, precluding the development of an active market for rules.

23. The elements that will be pointed out are, in large part, hypotheses based on intuitive considerations about the European and American sys-

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II.
THE U.S. "RULE-BASED" AND EUROPEAN "COST-BASED" MARKETS FOR CORPORATE LAW

The basic distinction between corporate charters' competition in Europe and in the U.S., which is particularly evident when viewing the two markets from the demand-side, is that in the United States regulatory competition occurs primarily at the re-incorporation stage and involves, for the most part, larger or quickly growing corporations. These companies are often publicly held or about to go public; on the other hand, small, closely held U.S. corporations, especially at their start-up, usually incorporate in the state where they operate.[24] It is only afterwards, if at all, that these smaller corporations select a different jurisdiction, most often choosing to reincorporate in Delaware.[25]

In Europe, by contrast, the companies that shop around and incorporate in a jurisdiction with which they have no physical connection tend to be smaller, closely-held firms with few shareholders. Corporate mobility in Europe, in other words, "is for new company formation, not for established companies", and "[m]igration is driven by differences in the regulation of new company formation, but most likely not at all by

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tems. In future research, empirical testing of these hypotheses might contribute to developing a deeper understanding of the two markets' corporate laws.

24. *See* COX & HAZEN, *supra* note 5, § 3.02, at 123-25; GEVURTZ, *supra* note 5, § 1.2.2, at 39-40. Gevurtz notes that "small corporations which do all their business in one state tend to incorporate in the state where they are doing business" because of the taxes and additional expenses that incorporation in a state different from the principal place of business might raise. *Id.* at 39. A further consideration is that "incorporating in a jurisdiction other than where one intends to conduct business subjects the corporation to suit in two jurisdictions – where it does business and where it is incorporated." *Id.* The observation that "[d]efending a suit in the latter location could be very inconvenient for the small company" is one that we should keep in mind, and to which we will return. *See infra* Part III.8. Professor Ayres points out that "[s]trong structural forces tie a small business' incorporation to the state where it conducts most of its business." Ian Ayres, *Judging Close Corporations in the Age of Statutes*, 70 WASH. U. L.Q. 365, 374 (1992).

25. Reincorporation is usually attained through a merger in which the existing corporation is merged into an existing shell corporation that is incorporated in the desired jurisdiction. *See* Kieninger, *supra* note 13, at 761.

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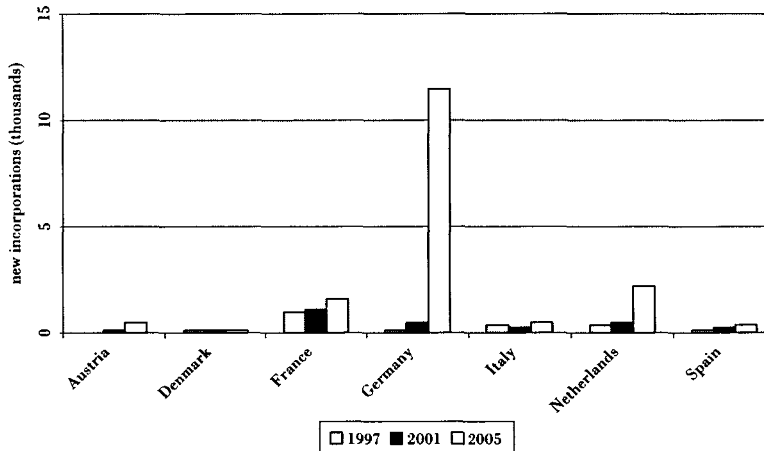
more specific differences in company law."[26] Empirical evidence strongly supports these claims, indicating how, in the last few years, there has been a steady increase in the number of smaller, closely-held corporations that operate in continental Europe and incorporate in the U.K.,[27] while the same phe-

26. Becht et al., *supra* note 14, at 25 ("[E]ntrepreneurs are not seeking to take advantage of specific features of U.K. company law, as seems to be the case when small companies migrate to Delaware from other U.S. states. The formation agents used by Centros-type companies offer boiler plate contracts . . . .").

27. *See id.* at 3 ("Between 2002 and 2005 over 55,000 new private limited companies have been set up from other E.U. Member States in the U.K. In absolute terms the largest flows of companies come from Germany, France, the Netherlands and Cyprus, with over 26,000 firms from Germany alone. Most of the new foreign Limited companies are small, having only one or two directors."). The data are very telling:



This empirical research raises several interesting questions, in particular, with respect to the reasons that might justify a larger number of corporations "emigrating" from certain systems. In the above graph, it is clear that among the strongest "net exporters" of corporations are Germany, France and the Netherlands. Relatively fewer corporations operating in Austria, Denmark, Italy and Spain are incorporated in the U.K. The distinction cuts across states following the real seat approach and the incorporation theory, which do not show a strong correlation with the propensity of the corporations to shop for corporate laws. This might be considered consistent with the assumption of this paper that the elements that contribute to the creation of a market for rules are not simply related to the adoption of the incorporation theory. It shall additionally be observed that, in terms of trends, while all the countries considered show an increase in the number of incorporations in the U.K., in some countries, like Italy and Spain, the growth has

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nomenon did not involve the reincorporation of larger, publicly held corporations.[28]

The reasons for these different outcomes in the European and U.S. markets can be understood through examining the dynamics of regulatory competition. Economic models that describe regulatory competition in corporate law point out how managers and controlling shareholders, in deciding if and where to incorporate or reincorporate, look at different variables that represent the competitive leverages of the competing jurisdictions.[29] While there are obvious overlaps, these variables can be roughly divided into two categories.

In the first category, which can be described as comprising the financial costs associated with the incorporation process itself, the variables include jurisdictions' franchise taxes and the other fees due upon incorporation, the costs of the legal services necessary in order to perfect the incorporation process, the length of the incorporation process and, most im-

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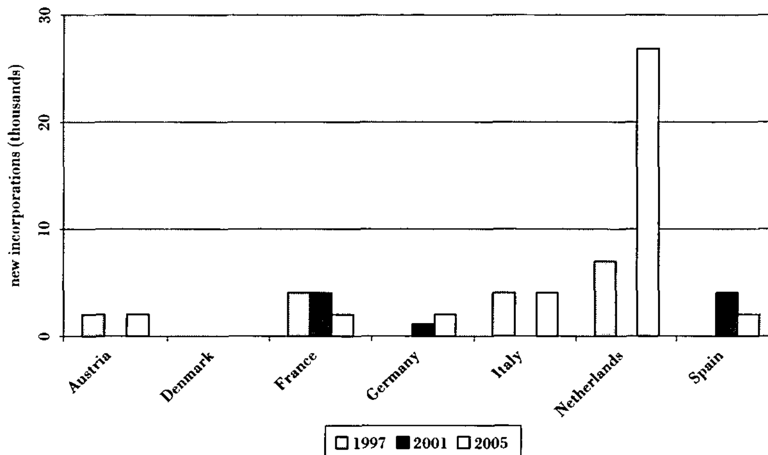
been very limited. As will be discussed, this does not mean that, in the not too distant future, the trend might also pick up in these countries. The difference might also partially be explained in light of the greater distance, in terms of features of the corporate law system, but also geographically and culturally, between the latter states and the U.K.

28. As demonstrated below. the small number of (re)incorporations in the U.K. of publicly held, "foreign" corporations confirms the distinction drawn in this paper:



29. *See, e.g.*, Bar-Gill et al., *supra* note 2, at 141-42.

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portantly, the necessity to subscribe and pay in a "minimum legal capital" determined by the state of incorporation.[30]

In the second category are rules that affect more directly the internal affairs and the life of an existing and already operating corporation, particularly in respect to its corporate governance.[31] In this context, "rules" does not refer only to statutory rules, but also to the body of precedents and case-law, and, more generally, to the existing legal infrastructure used to enforce those rules (such as expertise of the judiciary, network externalities related to the general knowledge in the financial industry of the chosen legal rules, and the like). Some of the most important rule-based variables influencing where to incorporate are rules relating to directors' liability and conflict of interest, distribution of powers between shareholders and mangers, protection of minorities, and defensive measures in case of takeover.

Even while recognizing the potential overlap and blurring at the margins of these two categories, they can be helpful in explaining differences between the markets for charters in the United States and the European Union. When smaller, private companies first incorporate, they are concerned about costs, whereas larger corporations are more concerned about the rules regulating their internal corporate governance. In the U.S., costs can be reduced by incorporating at home, whereas in Europe, given the fact that significant differences still exist among the Member States, certain incorporation costs can be reduced by picking jurisdictions with low minimum capital requirements and relatively easy and fast incorporation processes. On the other hand, larger corporations are relatively insensitive to issues such as franchise taxes, other incorporation-related costs and minimum legal capital, all of

30. *See* Luca Enriques & Jonathan R. Macey, *Creditors Versus Capital Formation: The Case Against the European Legal Capital Rules*, 86 CORNELL L. REV. 1165 (2001).

31. It should be noted that this distinction between rules affecting the ability of managers to extract private benefits from the corporation and rules that do not have a similar effect overlaps with the one proposed by Lucian A. Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARVARD L. REV. 1435 (1992) and used by Bar-Gill et al., *supra* note 2. In general terms, it might be argued that rules that determine the cost of incorporation have a lesser impact on the ability of managers to extract private benefits from the corporation.

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which have a minor impact on their larger budgets.[32] Small, closely-held corporations are presumably less concerned – at least in their *ex-ante* evaluation – about takeover defenses, protection of minorities, or directors' liability.

Based on these observations, it becomes clear that not all competition is the same. On the demand side, there are two types of "consumers." On the one hand, there are small businesses, generally at the stage of first incorporation, that put an emphasis on the front-load costs of incorporation. On the other hand, larger corporations, which are generally reincorporating, often in light of a corporate event such as going public, are more interested in some specific substantive rules governing the internal corporate affairs. These two types of "consumers" react, in theory and in general terms, to distinctive competitive leverages and thus determine, demand-wise, two different markets that we will call "cost-based" and "rule-based."[33] It is fair to conclude that a primarily "cost based" market is developing in Europe. Even if a rule-based market is not entirely absent in Europe, it is presently less common and less relevant than in the U.S. In the U.S., while the cost-based market has a limited scope, the rule-based market plays a significant role in shaping corporate laws.

III. DEMAND-SIDE DRIVERS OF REGULATORY COMPETITION

What are the possible elements explaining, from the demand-side point of view, this difference between the European

32. As mentioned previously discussed, dominant states do not raise franchise taxes and other fees in order to entirely capture the benefits of the corporations choosing that state. *See* sources cited *supra* note 6.

33. In this Article, the expressions "cost-based" and "rule-based" competition should not be taken to signify two different types of markets, based on distinctive and independent variables. It is perfectly clear that the terms are blurred and that most rules do result, in one way or in another, in a possible "cost" (or "benefit") affecting the corporation, and that most costs are set forth by rules, e.g., franchise taxes, minimum legal capital, etc. The expressions are used as a "catch-phrase" to underline synthetically that, in one type of market, corporations seem to be more sensible to elements related to the short-term, immediate costs of the incorporation; while in the other they seem to react more to the rules dealing with the internal affairs of the corporation and, in particular, with directors' powers and liability, defensive measures in case of takeover and, more generally, rules that might be relevant in case of shareholders' litigation.

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and the U.S. markets for corporate charters? To identify what elements corporate decision-makers consider in deciding where to incorporate or reincorporate, it is necessary to first distinguish among different types of corporations. Factors such as a corporation's size, status as publicly or privately held, general ownership structure, and stage of its life-cycle can all affect corporate decision-makers' assessments of where to incorporate or reincorporate. It is also necessary to bear in mind that, as a general rule, the decision makers dealing with the initial incorporation of a small- or medium-sized business association will be the controlling and founding shareholders themselves, often operating also as directors or managers of the corporation. In larger, publicly held and well-established corporations, those who decide where to reincorporate, or at least those who initiate the process, will be directors and managers. These decision-makers may or may not be controlling shareholders. In systems characterized by a widespread ownership structure, the two roles will tend not to overlap, however, in those systems characterized by concentrated ownership structures, even in large listed corporations, overlap is likely.[34]

The following sections will analyze some basic distinctive features of the European and the American rule-based markets in light of the different decision-makers involved. This discussion will illuminate why the U.S. scenario is compatible with rule-based competition affecting reincorporation decisions of larger corporations while the European system is more compatible with cost-based competition affecting the first incorporation of smaller businesses.

1. *Minimum Legal Capital*

One of the most relevant elements shaping regulatory competition in Europe is the regulation of minimum legal capital. Extensive literature exists debating the effectiveness and efficiency of a mandatory requirement of minimum legal capital as a protective device for creditors and investors.[35]

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34. *See* Bar-Gill et al., *supra* note 2, at 16.

35. For an analysis of the whole capital system, and not just the issue of the minimum capital threshold mandated by law, see Enriques & Macey, *supra* note 30. The authors concluded, "[T]he European Union should repeal the Second Directive and replace it with flexible, contractarian rules modeled after modern statutes like the Model Business Corporation Act. In

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Apart from the merits of the debate, it can hardly be doubted that shareholders – especially in the case of smaller businesses – might perceive the obligation to subscribe and pay an up-front, minimum amount of capital as a significant cost of the incorporation process.[36]

It should be also pointed out that systems that require a non-trivial amount of minimum legal capital as a condition of incorporation impose an additional set of rules regulating, for instance, eligible contributions in kind, the evaluation of contributions in kind, and the consequences of a loss of capital. These rules, though necessary for the coherence of a system based on minimum legal capital, might also be regarded as costs, especially by controlling shareholders and managers. [37]

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the meantime, Member States should dismantle all legal capital protections that the Second Directive does not require." *Id.* at 1203-04. On this issue, see generally, Massimo Miola, *Legal Capital and Limited Liability Companies: The European Perspective*, 2 EUR. CO. & FIN. L. REV. 413 (2005).

36. In the *Centros* case, which started the European movement toward regulatory arbitrage and competition, one of the parties explicitly admitted in court that one of the motivations to incorporate in the U.K. was the lower minimum legal capital provided for by British corporate law, in comparison with Danish law. *See* Birkmose, *supra* note 36, at 44 This assumption, based on the short term expectations of some shareholders, would hold true also if it would be possible to argue that minimum legal capital, lowering the perceived risk of creditors and investors, positively affects the cost of capital during the life of the corporation—a statement that is far from being proven.

37. These distinctive features of the U.S. and Europe are seen as favoring unsecured creditors, as an interested group. Carney synthesizes the major differences between the two systems as follows: More details are required in articles of incorporation, and minimum capital is required before business can begin, an anachronism still present in a few U.S. state laws. Par value appears to be taken as seriously in Europe as it was in the United States in the late nineteenth and early twentieth centuries, although American lawyers have come to believe such protections are largely illusory. The directives require all shares to be subscribed at the time of incorporation. Such legal capital rules preclude the kind of financing flexibility made possible by concepts of authorized but unissued shares and blank preferred shares, both of which delegate to the board of directors total discretion over new financings. Provisions requiring experts to report on the value of consideration other than cash received for shares and for publication of these reports also provide a benefit to creditors. Distributions to shareholders are strictly regulated using concepts similar to the old legal capital rules of the Model Act, which were eliminated as useless in 1980, and attempt to protect local creditors that have not obtained contractual protections. The directives also limit repurchases of shares to no more than 10 percent of subscribed capital and

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In the U.S. there are no significant differences regarding minimum legal capital among the individual states. Virtually none of the states require minimum legal capital, and the rules concerning the formation of the capital of the corporation are not particularly rigorous. [38]

In Europe the situation is markedly different. The Second Directive on legal capital,[39] implemented by all Member States, requires the corporation to provide for minimum legal capital of 25,000 euro, which shall consist of "assets capable of economic assessment."[40] Several States impose an even higher minimum capital requirement.[41] The directive, however, applies only to public corporations. Therefore, with respect to closely-held, non-listed corporations, significant comparative differences exist among Member States.[42] In contrast to the

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require a shareholders' meeting to consider winding up the company whenever capital is impaired. Similarly, capital reductions are constrained by rules requiring existing creditors to have security in the event of a capital reduction. These rules provide the strongest evidence of interest group influence, because they provide unsecured creditors with security without bargaining for it and may serve to dilute the security interests of those creditors who bargained for such protection. Carney, *supra* note 2, at 323-24.

38. The US and UK systems, in order to protect creditors, rely more, in comparison to civil law systems, on the doctrines of veil-piercing, which allows shareholders to be held liable for the obligations of the corporation. For an overview of veil-piercing, see COX & HAZEN, *supra* note 5, § 7.07, at 271-74 and GEVURTZ, *supra* note 5, at 69. Piercing the veil is also, however, possible in some civil law countries, at least under specific circumstances. Under German law, for instance, the concept is referred to as *Durchgriffshaftung. See* René Reich-Graefe, *Changing Paradigms: The Liability of Corporate Groups in Germany*, 37 CONN. L. REV. 785, 785-86 (2005); Bernd Singhof, *Equity Holders' Liability for Limited Liability Companies' Unrecoverable Debts — Reflections on Piercing the Corporate Veil Under German Law*, 22 LOY. L.A. INT'L & COMP. L. REV. 143, 143 (1999). *See generally* Sandra K. Miller, *Piercing the Corporate Veil Among Affiliated Companies in the European Community and in the U.S.: A Comparative Analysis of U.S., German and U.K. Veil-Piercing Approaches*, 36 AM. BUS. L.J. 73, 95-108 (1998) (describing Germany's statutory scheme for veil-piercing). As for the recently enacted rules concerning piercing the veil in Italian corporate groups, see Ventoruzzo, *supra* note 9, at 143.

39. Second Council Directive 77/91, 1977 O.J. (L 26) 1 (EC).

40. *Id.* at art. 7.

41. *See* Enriques & Macey, *supra* note 30, at 1174.

42. According to the national reports published in a recent comparative research, the following amounts of minimum legal capital are required in some of the major European systems for the basic corporate form: England, £50,000 for a public limited liability company, but no minimum capital is required for a private limited liability company; France: €37,00 (SA); Ger-

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states that provide for a rather substantial amount of minimum legal capital, the United Kingdom follows the common law approach providing for a very low level of minimum legal capital, and, more generally, is quite lax in the related rules regarding formation of legal capital.[43]

These differences create significant room for regulatory arbitrage, especially for smaller firms incorporating for the first time, as it is possible that some shareholders would prefer to incorporate in a state with lower capital requirements even if they are operating exclusively in other jurisdictions.[44] Regulatory responses to this form of a market for rules have already been adopted in some countries, particularly in Spain and France, with the enactment of statutes significantly simplifying the incorporation of smaller firms and lowering the minimum capital requirements, at least for limited liability corporations.[45] Also, in Italy the above mentioned 2003 reform of cor-

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many: €50,000 (AG); Greece: €60,000 (AE); Ireland: €38,092 (Plc); Italy: €120,000 (SpA); Netherlands: €45,000 (NV), €18,000 (BV); Norway: €12,000 (AS), €120,000 (ASA); Spain: €60,101.21 (SA). CORPORATE BUSINESS FORMS IN EUROPE: A COMPENDIUM OF PUBLIC AND PRIVATE LIMITED COMPANIES IN EUROPE [hereinafter COMPENDIUM] (Frank Dornseifer ed., 2005). Even without taking into account the rules regarding limited liability corporations, listed corporations or corporations in regulated industries, such as banks and insurance firms, it appears clear that there are significant comparative differences, which may, in turn, lead to regulatory arbitrage. For the different gaps existing between minimum legal capital of limited liability companies and public companies in several European states, see Miola, *supra* note 35, at 434 n.103.

43. *See* Michael P. Roch, *Establishing an Extraterritorial Presence: Choosing Business Entities Abroad, in* 1 TRANSNAT'L BUS. TRANSACTIONS § 3:19 (2006) ("In the United Kingdom, public corporations have a minimum capital requirement of GBP 50,000, private corporations have no minimum capital requirement, although as a practical matter such companies are capitalized at least with GBP 1 per shareholder."). For a comparison of different amounts of minimum legal capital in different European states, see Frost, *supra* note 10, at 372.

44. On the other hand, the difference mentioned above among the minimum capital requirements provided for public companies in different systems do not seem relevant enough – for instance for an established listed corporation – to drive regulatory arbitrage. *See* Luca Enriques, *Silence Is Golden: The European Company Statute As a Catalyst for Company Law Arbitrage* 12 (European Corporate Governance Inst., Paper No. 07/2003, Mar. 2003) (labeling these kinds of rules as "unimportant . . . especially for well-established businesses"), *available at* http://www.ssrn.com/abstract=38401.

45. *See supra* note 18.

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porate law introduced some new rules concerning capital endowment of a limited liability corporation,) intended to render the formation of this type of corporation easier and less expensive. For instance, one such rule deals with allowing contributions of services, even if with specific guarantees.

2. *The Length and Other Costs of the Incorporation Process*

Consistent with the different minimum legal capital standards, there are also a range of regulatory approaches to the incorporation process. On the one hand, common law systems such as the U.S. and the U.K. provide for a relatively simple and expedited process. In those systems, the content of the articles of incorporation, the type and severity of controls on the relevant documentation, and the related legal fees are relatively minor and not particularly cumbersome.[46] In general terms, those systems protect investors and stakeholders through *ex post* litigation rather than *ex ante* controls on the lawfulness of the articles of incorporation.

By contrast, civil law systems are characterized by more analytical and therefore more lengthy and expensive control in the pre-incorporation phase. Depending on the system, either judges or notaries are responsible for controlling the lawfulness of the articles of incorporation, and the whole process

46. *See* Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 Nw. U. L. Rev. 542, 585 (1990) Wells M. Engledow, *Handicapping the Corporate Law Race*, 28 J. Corp. L. 143, 150 (2002). As reported on the official website of the State of Delaware, The Division of Corporations offers a variety of services including 1-Hour, 2-Hour, Same Day and 24-Hour. Division of Corporations – Expedited Services. *See* Division of Corporations – Expedited Services, http://www.state.de.us/corp/expserv.shtml (last visited Nov. 9, 2006). Same day incorporation, according to the same website, costs in between $50.00 and $100.00. *See* Division of Corporations Fee Schedule, http://www.state.de.us/corp/newfee.pdf (last visited Nov. 8, 2006). As for the relative simplicity of the process, it should be noticed that in the U.S. incorporation does not require a technical *ex ante* control on the lawfulness of the articles of incorporation or the bylaws by a notary public or a judge; the purpose of the corporation can simply be the one of engaging in any legal activity, and there is no maximum duration requirement. While also many European systems are evolving toward similar rules, it can be fairly stated that the incorporation process still requires some more extensive *ex ante* control in most system based on minimum legal capital. *See* Cox & Hazen, *supra* note 5, at 119-51, 223-62 (discussing the consequences of defective formation of corporations).

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might take up to several weeks.[47] These systems rely more on *ex ante* quasi-administrative controls than *ex post* litigation to protect creditors.

While there is extensive debate on the subject, it is difficult to evaluate the relative merits of these two approaches in the abstract. For instance, from the point of view of the controlling shareholder, while the incorporation process is longer and more burdensome in civil law systems, once the incorporation is perfected, it is more difficult for creditors and investors to pierce the corporate veil and hold shareholders liable for the obligations of the corporation.[48] Regardless of these merits, however, elements such as the length of the incorporation process and the additional, minor expenses related to a longer and more analytical process are more likely to be relevant considerations for smaller businesses as opposed to larger corporations pondering reincorporation.

In Europe, therefore, there is a meaningful regulatory difference in this respect, in particular between continental civil law systems and the U.K. Analogous differences do not exist ,or exist to a lesser extent, among individual states in the U.S.; as a result, for smaller businesses deciding where to incorporate in the U.S., there is less room for regulatory arbitrage.

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47. In France, for instance, the incorporation process can take up to five weeks, depending on the type of corporate entity chosen. *See* Philippe Derouin & Edouard Chapellier, *Joint Ventures in France*, *in* Practicing Law Institute: Tax Law & Estate Planning Course Handbook Series 393, 413. However, "[s]ince 2003, it has been possible, in France, to found a new form of *Société à Responsabilité Limitée (S.A.R.L)* within 24 hours and with a nominal minimum capital of 1 Euro (the normal minimum capital for a *S.A.R.L.* is €7500)." Kieninger, *supra* note 13, at 768. Kieninger also points out how similar reforms, designed to create an incentive for incorporating small and medium size firms, have also been introduced in Spain. *Id.* at 768. However, significant differences still characterize the average duration of the incorporation process, and its approximate costs. For instance the incorporation process in the U.K. when a shelf corporation is used lasts a matter of hours, while in Germany it might last between a few weeks and even two or three months. *See* COMPENDIUM, *supra* note 42, In Italy, on the other hand, an average duration might vary between a couple of weeks to approximately six weeks, depending on the area. *See id.*

48. It should be underlined, however, that, as a general rule-of-thumb, piercing the corporate veil is easier in the U.S. than in the U.K. *See* Miller, *supra* note 38, at 79 ("Overall, U.K. courts appear more hesitant than U.S. Courts to pierce the corporate veil.").

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3. *Coordination with "Local" Laws and Rules: Securities Regulation, Stock Exchanges and Taxation.*

Another important element that corporations might take into account in deciding whether to (re)incorporate is the clarity of the compatibility of the applicable corporate statutes and case law with other applicable laws that might not follow the choice of law made through incorporation. It is obviously impossible in the space of this Article to analyze the multi-dimensional matrix in this area that could affect the outcome of regulatory competition. There are, however, three aspects worth mentioning: securities regulation, stock exchange rules, and tax law.

In Europe, a corporation incorporated in State X with its real seat in State Y might be subject to the securities regulations of a system different from that whose laws govern the internal corporate affairs. This might be true, in particular, if the corporation performs certain activities, such as a public offering, or is listed in a country different from either X or Y. In the U.S., securities laws might provide a disincentive for out-of-state incorporation of a business that operates solely within the boundaries of the state where it has its real seat. In fact, as Ian Ayres explains:

> [F]oreign incorporation might substantially increase the company's costs of capital. The Securities Act of 1933 exempts issuers from all registration and disclosure obligations under federal law when both the issuer and the offerees are within the same state and when the proceeds are to be used in that state. This exemption is automatically forfeited if the business incorporates in a state where it does not conduct business. . . . Thus, the intrastate-offering exemption might provide a strong deterrent to foreign incorporation for those smaller businesses that would benefit from the exemption.[49]

While this deterrent effect may have a significant impact on smaller corporations, however, larger corporations already operating in different states, which are also more likely to go public and to have capital needs that require a multi-state public offering, are less likely to be affected. As a result, larger corporations do not have a similar disincentive to reincorporate in a different state.

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49. Ayres, *supra* at 24, 375.

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Once this decision is taken, the existence of a single regulatory regime at the federal level is either neutral or a factor that favors reincorporation in Delaware. There are still securities laws at the state level (so-called "Blue Sky Laws") that might theoretically apply to offerings by an already listed issuer, but the most important body of regulation in the field is at the federal level.[50] In fact, notwithstanding the possibility in principle that "state blue sky laws can come into conflict with federal securities laws,"[51] as a matter of fact, "[t]he state securities acts generally exempt securities listed on a national or qualifying regional stock exchange." [52] The federal system is harmonized and compatible with any applicable corporate laws, independently from the state of incorporation of the issuer. In addition, the most important U.S. stock exchanges have a national dimension, and their rules and procedures are integrated with applicable corporate statutes.

A principal consequence of these features of the U.S. system is that for corporations subject to securities regulation, either because they are publicly held or because they are planning an important public offering of securities, the costs and uncertainties related to possible divergences between corporate law and securities regulation are relatively low. Reincorporation is therefore not discouraged. To the contrary, some states might offer corporate laws that better fit the specific needs of a listed corporation in light of the common securities regulation framework.

In Europe, on the other hand, every individual Member State has its own securities regulation regime, each with different regulatory authorities and local stock exchanges. These different systems, while partially harmonized, still have relevant differences. Moreover, each of them is primarily designed to apply within the given system of local corporate laws.[53] Of course, this situation is quickly evolving and noteworthy harmonization efforts are being made, as demon-

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50. Thomas Lee Hazen, THE LAW OF SECURITIES REGULATION § 8.1, at 388 (1996).

51. *Id.* at 392.

52. *Id.* at 400.

53. For a comparative analysis of securities litigation and prospectus liability in several European countries, issues not yet completely harmonized, see LITIGATION ISSUES IN THE DISTRIBUTION OF SECURITIES: AN INTERNATIONAL PERSPECTIVE (William G. Horton & Gerhard Wegen eds., 1997). *See* also

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strated by the recent regulation of securities offerings and prospectuses which allows the application of the laws of the "home State" to securities offerings[54] and the "Markets in Financial Instruments," also known by the acronym "MiFid." [55] Securities regulators are also constantly improving their coordination. In the same vein, national stock exchanges are going through an extensive process of aggregation that is likely to ultimately lead to a few competing markets.[56] The harmonization, however, is far from being complete, and not even close to reaching the U.S. situation,[57] as demonstrated by the Thirteenth Directive on takeovers.[58]

Marco Ventoruzzo, LA RESPONSABILITÀ DA PROSPETTO NEGLI STATI UNITI D'AMERICA TRA REGOLE DEL MERCATO E MERCATO DELLE REGOLE 208 (2003).

54. *See* Council Directive 2003/71/EC, 2003 O.J. (L 345) (implemented by the Commission Regulation 809/2004, 2004 O.J. (L149) 1 (EC)).

55. See Council Directive 2004/39, 2004 O.J. (L 149) 1 (EC), which Member States shall adopt within 2007.

56. For an account on the recent developments of the consolidation process among European stock exchanges, see *European Exchanges: Crowding the Dance Floor*, ECONOMIST, May 20, 2006, at 77; *Battle of the Bourses*, ECONOMIST, May 27, 2006, at 65. A theoretical discussion of some of the problems underlying the aggregation of national exchanges is offered by Mahmood Bagheri & Chizu Nakajima, *Competition and Integration Among Stock Exchanges: The Dilemma of Conflicting Regulatory Objectives and Strategies*, 24 OXFORD J. LEGAL STUD. 69 (2004).

57. *See Day of the MiFID*, ECONOMIST, Sept. 9, 2006, at 13 ("MiFID will work only if regulators pull together and financial firms prepare. At the moment there is too little sign of either.").

58. *See* Marco Ventoruzzo, *Europe's Thirteenth Directive and U.S. Takeover Regulation: Regulatory Means and Political and Economic Ends*, 41 TEXAS INT'L L. J. 171 (2006). The long and somewhat tormented legislative history of this landmark piece of legislation shows how difficult it can be to achieve a common position on sensitive issues, such as the creation of a harmonized market for corporate control in Europe. It also suggests that harmonization can sometimes only be partial, and single Member States retain the power to adopt significantly different provisions, more or less takeover-friendly. An interesting historical perspective on the difficulties in the creation of a truly harmonized financial industry and market is offered by a paper that discusses the integration of the different regional Italian exchanges after the reunification of the divided country in 1862 and the introduction of a single currency. *See* Gianni Toniolo, Leandro Conte & Giovanni Vecchi, *Monetary Union, Institutions and Financial Markets Integration, Italy 1862-1905* (CEIS *Tor Vergata*, Research Paper Series, Vol. 6, No. 16, March 2003), *available at* http://ssrn.com/abstract=406120. The Authors argue how, in that situation, the creation of a single and unified financial market became possible only twenty-five years after the monetary union and after a truly uniform regulation of the financial industry has been achieved, an example from which

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In such a scenario, it is not surprising that some corporations, at least in particular circumstances, will strive to avoid subjection to different sets of rules for securities regulation and corporate laws. This creates a certain tension for forum shopping in corporate law. If the internal affairs of a corporation are subject to the rules of State X, while the applicable securities regulation, competent authorities and stock exchange are governed by State Y, there is a risk of incongruence, uncertainties and coordination costs. All of these may combine to discourage the development of a market for reincorporation in Europe. [59] This market for reincorporation, however, is again most relevant to larger publicly held corporations (or a corporation about to go public) than to smaller businesses not subject to securities regulations.

Finally, other compatibility problems might arise with respect to tax law, in particular the income tax. Some authors have pointed out that:

In the European market for corporate charters, double taxation is not an obstacle to corporate mobility either. The

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they derive some caution on the integration of financial markets in today's Europe. *See also* Birkmose, *supra* note 12, at 54 (arguing that because the Takeover directive allows for significant room for different regulatory solutions at the State level, "the existing harmonization will not be a significant deterrent to competition for incorporations.")

59. In this respect, the conclusion that "in the European market for corporate charters, the relevant provisions are unlikely to be a severe obstacle to corporate mobility because the Member States of the Community have traditionally shown comparatively little inclination to apply their registration and disclosure regimes to corporations that are not listed on local securities exchanges" seems too broad. Jens Dammann, *A New Approach to Corporate Choice of Law*, 38 VAND. J. TRANSNAT'L L. 51, 64 (2005). Consider, for instance, an Italian corporation dually listed in two different European countries: it might be subject – at least partially – to stock exchange rules of both the exchanges where it is listed. The fact that the internal affairs of the corporation are governed by the laws of one particular state, depending on the place of incorporation, might therefore not be neutral with respect to the application of part of financial markets regulation. Similarly, a corporation listed in State A, but with an important subsidiary listed in State B, might partially be subject to disclosure obligations and other substantive rules of State B, as the controlling shareholder of a listed corporation. Also, transactions between the two corporations – the controlling one and the controlled one – might be subject to different rules dealing with related-parties transactions in the two systems. Once again, the laws that govern the internal affairs of the controlling corporation might be more or less easily compatible with the applicable rules of state B.

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bilateral agreements between the Member States of the European Community to avoid double taxation typically follow the Model Double Taxation Convention on Income and Capital (MDTC) of the Organisation for Economic Co-operation and Development (OECD). As a result, corporations have little to fear from incorporating in another Member State.[60]

Even assuming away the possible, and even probable, coordination problems of these agreements, a similar argument presents some shortcomings. The first of these shortcomings is that avoidance of double taxation rarely is costless. At least some administrative expenses, or costs relating to dealing with different tax authorities, are probable. In addition, in several systems the earnings of the corporation, from which taxable income is derived, are determined by some corporate law rules, such as those governing financial statements. If a corporation is subject to the rules of state A in this respect, and to those of state B for taxation, some frictions and coordination problems might occur, resulting in additional expenses. This issue might, once again, influence the decision of reincorporating.

4. *The Role of the Lawyers*

In theory, in both the U.S. and in Europe, lawyers are licensed to offer legal advice and litigate only in one jurisdiction.[61] If we move from a more formalistic to a more substantive approach, however, several factors suggest that rigid state divisions are less rigorously observed in practice in the U.S. For example, given the absence of language barriers, the existence of standardized education, and the commonalities of bar admission standards across states,[62] as well as the similarities

60. Dammann, *supra* note 59, at 71.

61. LAWRENCE M. FRIEDMAN, LAW IN AMERICA: A SHORT HISTORY 12 (2002) ("[T]here is no such thing, really, as an 'American' lawyer; lawyers are licensed state by state. As far as New Hampshire is concerned, a member of the Vermont bar is just a layman who knows a lot about the law (though not necessarily New Hampshire law).").

62. In the U.S., most law schools courses, even if they offer insights on specific jurisdictions, are usually not state-specific. This holds true, in particular, for corporate law and business associations courses, which are generally taught without reference to only one specific jurisdiction. To the extent that there is one system whose cases and statutory rules are more often the object of research and teaching, it is Delaware's. Additional exposure to the spe-

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among state corporate laws, the reincorporation in Delaware of a business association that maintains its headquarters in New York is unlikely to lead to losss of clients for New York attorneys. On the other hand, it is much more likely that a Spanish attorney or legal counsel would be unable to continue to offer the same legal services to a client corporation that becomes subject to the laws of the U.K. Consequently, and again with some intentional simplification, it would not be surprising that –in good faith and independent from possible conflicts of interest – U.S. attorneys are less resistant than their European colleagues to the idea of reincorporation in another jurisdiction.[63]

Some authors disagree, and argue that this "lawyer resistance" argument "overlooks the transformation that has recently been effected in the European market for legal services." [64] Pointing to the growing international activity of major law firms operating on a multi-jurisdiction basis, some scholars observe that "[t]he 'lawyer hostility' problem is greatly reduced where the incumbent and the new adviser are both within the same firm."[65] They argue that any existing hostility tends to diminish over generations, as junior lawyers understand that it is necessary to be trained in, or exposed to, the legal systems more attractive for corporations.[66] While this trend is undoubtedly relevant, particularly as the European Union begins to facilitate cross-border attorney regulation, the differences among European countries are clearly in themselves a continuing hurdle. Legal education, access to the legal

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cific laws of a particular jurisdiction is often acquired after law school while preparing for the bar exam.

63. *See* Enriques, *EC Company Law*, *supra* note 20, at 1264. This argument might be true also for international law firms, whose national offices usually are, if not formally separate entities, at least distinct centers of profit, with the consequence that local attorneys will consider the potential loss of business, or additional costs, if the applicable corporate laws change and become the ones of a jurisdiction in which they are not licensed and with which they are not particularly familiar. According to Birkmose, *supra* note 12, at 57, "[n]aturally, the lawyers are interested in local incorporation, because it will benefit their business, and this may influence the advice they give."

64. Armour, *supra* note 19, at 27.

65. *Id.* at 28.

66. *See id.* at 28 n.108.

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profession, and organization of law firms, [67] all of which are compounded by language and cultural barriers, still seem profoundly different among Member States compared with the U.S. system. Moreover, these barriers are unlikely to disappear any time soon.

Consequently, the explanation for the different features of the European and the American markets for corporate charters, from a comparative perspective, must acknowledge higher lawyer resistance to regulatory arbitrage in corporate law in the Continent. To the extent that greater resistance exists in Europe, it is likely to affect in particular larger, already established corporations considering whether to reincorporate. In such situations there are extensive and ongoing relationships between the corporation and its attorneys, who are often influential lawyers in their own systems, as wellas significant forces internal to the corporation that might oppose change (for instance, in-house counsel who know the law of only one system). There are, in other words, more economic agents that have made a sunk investment through time, relationships, and so on, and therefore whose personal profitability would decrease as a result of a change in the applicable corporate laws.

5. *The Cost of Difference: Degrees of Separation*

For the reasons described above, some of the rules governing the internal affairs of a corporation are intuitively more relevant for bigger, and particularly publicly held, corporations than for smaller, closely held businesses. Just to give a few examples, consider how the more significant separation between ownership and control in the former type of corporation might complicate the issue of allocating power between shareholders and directors or managers. Also, consider how the issue of defensive measures available in a takeover context is irrelevant for a non-listed corporation, how some business transactions such as mergers or issuing of new shares are more

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67. As previously mentioned, in fact, even law firms having an international dimension are still often organized in such a way that the offices in different countries are separate centers of profit, and the single partners are largely remunerated on the basis of the result of their offices; similarly, the budgets of the single national units are determined proportionally to their economic results.

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common for larger businesses, or how the risk of derivative litigation is more threatening for these types of corporations.

This is not to say that these rules are not important to smaller business associations, or that litigation in these types of corporations is necessarily less likely or extensive. It is fair to say, however, that at least as perceived by those responsible for the decision to incorporate (or reincorporate), these elements receive closer scrutiny in larger, publicly traded corporations; if for no other reason, larger firms have more resources that can be dedicated to the evaluation of these differences.

Bearing in mind these assumptions, it is possible to underline another difference between the American and the European markets for corporate charters. Regulatory competition, in order to function properly, requires that the "available menus" of rules and legal institutions are "different enough" to create room for regulatory arbitrage. At the same time, however, the rules and the legal institutions should not be "so deeply different" that they cannot be compared, or can only be compared with great difficulty and costs. In other words, assuming it were possible to "rank" the depth of the differences among the competing jurisdictions, if the costs in terms of uncertainty of a change in the applicable corporate laws are excessive, they prevent the development of an effective market for rules. In other words, if the elements on which the different states compete to attract corporations cannot be clearly compared, the resulting information asymmetries might impugn the very existence of regulatory arbitrage.

This observation might have even more traction with respect to the information asymmetries suffered by creditors and investors, such as banks and bondholders. A sudden change in the applicable corporate laws might result in lower credit standards and a drop of the market price of the securities, at least in the short term, if the differences between the two systems are so broad that they impair the ability of the investors and other stakeholders to properly assess the different regulatory regimes.

In a system like the United States, it is relatively easy for corporate stakeholders to understand and assess the implications of a reincorporation. The similarities among the competing jurisdictions, combined with the absence of language barriers and the presence of cross-trained lawyers, allow for a

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more straightforward comparison of jurisdictions. In Europe, on the other hand, notwithstanding the growing harmonization of national corporate laws, the existing differences are still profound. These differences adversely affect the ability to properly assess the comparative advantages and disadvantages of the rules affecting the internal affairs of a corporation.

Remembering that these rules are ,for the above-mentioned reasons, often more relevant (or, more precisely, *perceived* as more relevant) in larger, publicly held corporations, we would expect less competition for reincorporation than for first incorporation in Europe due to the greater heterogeneity of the different legal systems.

6. *The Existence of a Dominant State and Network Externalities*

The very fact that a rule-based regulatory competition has not developed in Europe so far, and that, consequently, no truly dominant state has emerged, itself reduces the benefits connected to possible reincorporation in a different jurisdiction. Network externalities related to the simple fact that most corporations have chosen one particular system are however an important driver of regulatory competition. [68] Network externalities exist when the utility of one subject depends on the number of subjects that are in a similar situation. In a market context, for instance, positive network externalities exist when consumers attach a higher value to the product chosen by the majority of the other consumers, or by some specific consumers.[69]

Thus, when a sizable number of corporations comply with a given body of rules and doctrines, their compliance can make that body of rules and doctrines more attractive in the market for corporate charters. In fact, widespread adoption of one legal regime elevates the rules of that particular system to the state of "the standard" of the corporate world. The rules of

68. *See* Bar-Gill, Barzuza & Bebchuk, *supra* note 2, at 136.

69. *See* Michael L. Katz & Carl Shapiro, *Network Externalities, Competition, and Compatibility*, 75 AM. ECON. REV. 424, 424 (1985). Typical examples of network positive externalities can be found, for instance, in the software industry, where the very fact that one program is widespread among users makes it more appealing; an anecdotal example is the "QWERTY" keyboard. *See* Paul A. David, *Clio and the Economics of QWERTY*, 75 AM. ECON. REV. 332, 335 (1985).

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the dominant state become accepted by the financial industry, are better understood by institutional investors and creditors, facilitate mergers and acquisitions with other corporations (more likely to be subject to similar rules), and are more familiar to managers and directors that the corporation might want to hire in the future. [70]

These network effects are particularly alluring for larger public corporations, or for corporations that intend to grow through specific transactions and therefore consider reincorporating. The fact that a smaller, closely-held corporation is not active on national financial markets, and is relatively less likely to negotiate the issuance of securities with a major investment bank, renders network effects more crucial in the reincorporation market. For smaller, closely-held business associations whose founders have local connections with investors, clients, providers and other stakeholders, the network effects connected with the choice of where to incorporate are less important; these businesses are in fact more likely to look at the relative "costs" of incorporating in the different jurisdictions.

Despite the relative success of the U.K. in attracting some corporations, Europe cannot be considered a dominant corporate jurisdiction on the same scale as Delaware. As a result, network externalities are less important than the reincorporation market for larger, public corporations, at least if compared to the U.S. scenario. This phenomenon occurs independently from the causes of the existing lack of competition, and can be considered an inertia in the system that acts to limit the development of a market for rules.[71]

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70. Among the first works pointing out the network effects in the competition for corporate charters are: Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (Or "The Economics of Boilerplate")*, 83 VA. L. REV. 713 (1997); Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757 (1995). *See also* Brett H. McDonnell, *Getting Stuck Between Bottom and Top: State Competition for Corporate Charters in The Presence of Network Effects*, 31 HOFSTRA L. REV. 681, 681 (2003) (arguing that the existence of network effects might interfere with the adoption of optimal corporate laws, as it creates a disincentive for single regulators to improve the existing rules).

71. On the contrary, network effects can help the already dominant state to maintain its position even if it provides sub-optimal rules. *See* McDonnell, *supra* note 70, at 684-86 (critiquing race-to-the-top and race-to-the-bottom arguments).

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7. *Capture of Regulators and Corporate National Identity*

Regulatory capture, the phenomenon by which the members of an industry might exercise some control over their regulators and not necessarily involving illegal conduct, might also explain the existence of an active market for reincorporation in the U.S. in contrast to Europe.[72] If we compare Europe and the U.S., it seems intuitive to conclude that in the former system a large corporation or industry association able to implement an effective lobbying effort toward the legislature and the regulatory authorities will be more effective within its own national borders than in other states. For example, a corporation founded in Italy decades ago probably has already established significant connections with local policy makers, governmental agencies, and members of the judiciary. Given that it has thus significantly invested in the country, and furthermore if its most prominent shareholders or managers are citizens of that country, the corporation will be more influential in Italy with respect to corporate lawmaking than it will be in, for example, the Netherlands.[73]

In the United States, such relative strength of corporate influence in one state as compared to another is, on average, less dramatic. For a large publicly held corporation, it is, at least in comparison with the European situation, not so different to lobby in the state where real seat is as opposed to where the corporation is incorporated or at the federal level. Cultural, linguistic, economic, and political reasons support this claim.

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72. Extensive literature exists on regulatory capture. One of the seminal works is George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971). *See also* Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q. J. ECON. 371 (1983); William W. Bratton & Joseph A. McCahery, *Regulatory Competition, Regulatory Capture, and Corporate Self-Regulation*, 73 N.C. L. Rev. 1861 (1995) (providing an interesting study on the implications of regulatory capture for the proper functioning of the market for rules in corporate law); Michael E. Levine & Jennifer L. Forrence, *Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis*, 6 J. L. ECON. & ORG. 167, 174, 179 (1990); Richard A. Posner, *Economics, Politics, and the Reading of Statutes and the Constitution*, 49 U. CHI. L. REV. 263 (1982).

73. *See* Enriques, *EC Company Law*, *supra* note 20, at 1265 (characterizing this resistance to corporate mobility more as the consequence of opposition by political actors, lobbies (in particular, trade unions) and social groups).

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The intuition is that, in Europe, large corporations can deploy a meaningful lobbying effort more effectively where their headquarters are located, and therefore will be more willing to be subject to the laws of that system. This assumption is consistent with the idea that, in the European system, relatively more intense regulatory competition is expected with respect to smaller, closely-held firms. These firms, unable to exert influence on policy makers and regulators, might decide to incorporate in a state with which they have no significant contact but which offers less expensive incorporation, since these businesses are not concerned about losing non-existent influence over the local regulators.

In addition, at least for some firms with a strong "national identity," inertial forces might be generated by marketing and public relations issues. As one author has explained, "[t]he 'nationality' of a company is also a prized aspect of its corporate identity and one that will not be discarded lightly"; this author points to the case of Volkswagen deciding "against the development of a new plant in Portugal, in spite of much cheaper costs and a more flexible labor market, preferring to keep its business within Germany because, *inter alia,* it was felt there was something about the 'Germaness' of the Volkswagen brand." "Similarly," the same author reminds, "Ford has declined to move production of its Jaguar marquee to the USA, saying that Jaguar is a 'British brand.'"[74]

Surely, there is an obvious objection to such a "national identity" argument. In both of these cases, the issue was whether to move the physical plants where the products are manufactured. This scenario raises a completely different problem compared to the decision of whether to reincorporate in a different jurisdiction without moving the physical real seat of the corporation or relocating its plants. While this objection is obviously true, it cannot be denied that the very qualification of the corporation that produces certain goods or services as a "British", or "German", or "Italian" corporation is relevant to its image and its influence on the local

74. Maureen Johnson, *Does Europe Still Need a Fourteenth Company Law Directive?*, 3 HERTFORDSHIRE L. J. 18, 20 (2005).

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constituencies, including politicians, legislatures and regulators.[75]

8. *Choice of Law and Jurisdiction*

If a corporation has its real seat in state A, but is incorporated in state B without any particular connection to its territory, in the event of litigation, depending on the applicable rules either the courts of state A or state B might have jurisdiction. On both sides of the Atlantic, choice of law rules and jurisdiction rules might point at different legal systems. In order to assess this issue, a brief preliminary discussion of jurisdictional rules is necessary.

In the United States, a corporation is subject to jurisdiction in any state in which it has minimum contacts and in which the exercise of the state's authority comports with notions of fair play and substantial justice.[76] While, under this test, jurisdiction is always available in the corporation's place of incorporation and the place where it has its principal place of business, there may be several other jurisdictions where the corporation is "doing business" and thus subject to jurisdiction. The "doing business" standard allows a court to exercise jurisdiction for any cause of action, including claims relating to the internal affairs of the company. For example, a company incorporated in Delaware with its principle place of business in California but which advertises, sells substantial products, and places salespersons in Texas might be subject to jurisdiction in all three states.

To complicate things, if the case is filed in state court, it can be removed to federal court if the case is either based on a

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75. *See* Christian Kirchner et al., *Regulatory Competition in EU Corporate Law after* Inspire Art: *Unbundling Delaware's Product for Europe* 13 (Univ. of Ill. Col. of Law, Law & Economics Working Paper No. 17, 2004), *available at* http://ssrn.com/abstract=617681 ("[T]here may be reputational and emotional factors as well stemming from the national identity of a corporation registered and having its seat in a given Member State. These factors are very likely to have a larger weight in Europe than in the United States, and they are especially important for the 'old economies' in Europe which have a long tradition of national corporate law.").

76. *See* Int'l Shoe Co. v. Washington, 326 U.S. 310, 316 (1945). *See also* Burnham v. Superior Court, 495 U.S. 604, 618-19 (1990) (jurisdiction based on minimum contacts is analogous to physical presence and physical presence alone constitutes due process).

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federal question, such as a suit by shareholders for securities fraud, or if there is diversity of citizenship. Citizenship of a corporation includes both where it is incorporated and where it has its principal place of business. In the previous example, the case could thus only be removed to a federal court on diversity grounds if none of the plaintiffs were from either Delaware or California.

Just because it is possible to exercise jurisdiction over the parties in a particular judicial district, however, does not necessarily imply that that is the proper venue for the lawsuit. Once jurisdiction is established, either a plaintiff or a defendant can move to transfer the case to a place where there is such proper venue. Venue is determined by looking to where all defendants reside,[77] where the substantial part of the acts or omissions giving rise to the suit occurred, or, if neither of these is applicable, where any single defendant is subject to jurisdiction. Given that a defendant is deemed to "reside" wherever he or it is subject to personal jurisdiction, this provision is not frequently a basis for transferring a case. However, there is also a separate provision that grants courts the discretionary power to transfer a case to another federal forum in which venue is proper, based on the convenience of parties and witnesses and in the interest of justice. [78] Under this provision, if a plaintiff sues a corporation in Texas, but the witnesses and documents are all in California, the court may transfer the case to California. These same provisions apply when the company is a large publicly held company and when there is a class action suit.

The European situation is also quite complicated, and litigation might easily occur in a state different from the one in which the corporation is incorporated and whose laws must therefore be applied. First of all, according to Article 2(1) of the Council Regulation 44/2001 of 22 December 2000 on Ju-

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77. See the general federal venue statute, 28 U.S.C. § 1391(c) (2000 & Supp. 2003) (defining corporate residence for venue purposes as follows: "a corporation shall be deemed to reside in any judicial district in which it is subject to personal jurisdiction at the time the action is commenced").

78. *See* 9 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 4385 (perm. ed. 2006). Specifically, 28 U.S.C. § 1404(a) (2000) provides that, "For the convenience of parties and witnesses, in the interest of justice, a district court may transfer any civil action to any other district or division where it might have been brought."

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risdiction and the Recognition of Enforcement of Judgments in Civil and Commercial Matters,[79] the general forum is in the state where the person is domiciled: "persons domiciled in a Member State shall, whatever their nationality, be sued in the courts of that Member State." As for corporations, Article 60(1) provides that the domicile is in the state where it has its: "(a) statutory seat, or (b) central administration, or (c) principal place of business." These fora are alternative, with the consequence that a corporation might easily be sued in a state different from the one where it is incorporated and the judges might be required to apply a foreign corporate statute and case law.

In addition, Article 22(2) of the Regulation provides for mandatory jurisdiction in the Member State where the corporation "has its seat," for cases raising certain issues such as "the validity of the constitution, the nullity or the dissolution of companies" and, most importantly because it is a common issue raised in corporate litigation in Europe, "the validity of the decisions of their organs." Needless to say, the seat state might differ from the state of incorporation whose laws shall be applied.

In addition, depending on the type of litigation, in particular on whether the plaintiff is bringing an action in contract (as might be the case for a bondholder suing the corporation) or in tort (e.g., when a shareholder or an investor sues the directors that caused a direct damage that is not the consequence of a damage suffered by the corporation – like under art. 2395 of the Italian Civil Code), other forums might come into play, such as "the place where the harmful event occurred or may occur" (Article 5(3) of the Regulation). Finally, at least for certain subject matters, although the law in this area is very unsettled, the parties to a suit might agree to a different jurisdiction through a forum selection clause (Article 23(1) of the Regulation).[80]

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79. 2001 O.J. (L 12) 3.

80. For a comprehensive overview of the Regulation, see Franco Mosconi & Cristina Campiglio, DIRITTO INTERNAZIONALE PRIVATO E PROCESSUALE: PARTE GENERALE E CONTRATTI (3d ed. 2004), 32 ff.; Sergio M. Carbone, IL NUOVO SPAZIO GIUDIZIARIO EUROPEO DALLA CONVENZIONE DI BRUXELLES AL REGOLAMENTO CE 44/2001 (2002).

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Also, in Europe, if a corporation shops around for substantive corporate laws, jurisdiction and choice of law might not overlap. As a matter of fact, especially if the corporation has its real seat in a state different from the one where it is incorporated, they are likely to be different.[81] A business incorporated in the U.K., for instance, and subject to U.K. corporate laws might be sued or sue in the state where its real seat is located, depending on the applicable rules on jurisdiction. The judges of the latter state would, in this case, have to apply the relevant foreign substantive rules.[82]

The above analysis shows that in both the U.S. and Europe, it is possible that the internal affairs of the corporation may be litigated in the state of incorporation, the state of the real seat, or, in some situations, a third state. This fact demands consideration of the relative advantages and disadvantages of litigating in a forum different from the one in which the corporation has its real seat or one whose substantive laws must be applied, as well as the possible effects on regulatory competition of such forum-shopping.

Different authors have expressed opposite views on the desirability of litigating in the state of incorporation versus the seat state.[83] Litigating where a state is incorporated may carry

81. *Cf.* Dammann, *supra* note 5, at 495 ("As a general matter, Article 23(1) of this regulation allows the parties to choose a forum state by mutual agreement. However, with regard to a corporation's internal affairs, Article 22(2) contains an important exception to that general rule. Provided that the Member States apply the state of incorporation doctrine, certain internal matters—including the dissolution of the corporation and the validity of the decisions of its organs—must be litigated in the state of incorporation") (citations omitted).

82. *See, e.g.*, Kieninger, *supra* note 13, at 747 ("German courts have unanimously abandoned the real seat theory and have applied the law of the place where the foreign company is incorporated."). For a description of how reincorporation is executed in the U.S., see *supra* note 25.

83. According to one author, "[S]mall and medium-sized businesses will often want to avoid litigating their internal affairs in the state of incorporation." Dammann, *supra* note 5, at 494. Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1099 (2000). Other scholars point out the advantages of litigating in the state whose substantive laws will apply. ("The manner in which Delaware courts maintain an aggressive lawmaking agenda, focus on articulation of principles to govern future standards, and freely adjust previously announced principles based on policy considerations, resembles the legislative process. At the same time, the standards based muddiness of Delaware law

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with it the advantage of a specialized judiciary (especially if the state of incorporation "invested" in corporate law) and judges familiar with the applicable substantive rules and existing precedents. Litigation in a state where the corporation has no connections besides its incorporation, however, can also be more expensive, and the forum might be perceived, although perhaps wrongly, as less friendly.

The opposite situation, in which litigation occurs in the state of the real seat with the court applying foreign law, presents the inverse problem. In that case, there might be costs related to the lack of familiarity of the local judges with the substantive rules, but other transactions costs might be lower for the litigants.

Jurisdiction is often extremely difficult to predict *ex ante*, but it is also important to recognize that it is extremely difficult to make any general and conclusive statement on the relative advantages and disadvantages of the different possible combinations of jurisdiction and applicable laws, therefore limiting the utility of forum selection clauses to the extent that they are permissible. There are simply too many heterogeneous and conflicting elements in play.

To understand this idea, we should start from the few existing certainties in this area. In the U.S., the statutes, regulations and precedents of a given state are relatively easy to access for judges from different states, but the same is not true in Europe. In support of this conclusion, consider the most self-evident elements, such as language barriers and the different function of legal precedents in civil law and common law systems.[84] In other words, it would be much more difficult for an

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retains a degree of ex post review for which courts are well suited. In addition, Delaware's extensive reliance on judicial lawmaking offers several advantages over the legislative process, including greater and more balanced access to the lawmaking process, increased political independence, and enhanced decision-making transparency . . . . The peculiar role of the Delaware courts may provide greater explanatory power for Delaware's success in attracting corporate charters than previously identified theories."). On the role of the judiciary in determining the "effectiveness" of the governing corporate laws, see generally Luca Enriques, DO CORPORATE LAW JUDGES MATTER? SOME EVIDENCE FROM MILAN, 3 EUR. BUS. ORG. L. REV. 765 (2002).

84. A seminal and rich comparative analysis of the value of precedents can be found in INTERPRETING PRECEDENTS: A COMPARATIVE STUDY (D. Neil MacCormick & Robert S. Summers eds., 1997). For an analysis of the peculiar case of Louisiana, a common law jurisdiction where the judiciary applies

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Italian judge to understand and apply English corporate law than for a Californian judge to apply Delaware law. For similar reasons, the costs to litigate in a foreign jurisdiction for a European corporation that, for example, has its seat in Portugal but is incorporated in the Netherlands with no other connections to the Netherlands are likely to be higher than the costs faced by a corporation located in California with respect to litigation in Delaware.

In light of this intuitive consideration, it appears clear that with respect to this factor, regulatory competition is not likely to be as intense in Europe as in the U.S., especially for those corporations that either anticipate possible litigation or base their choice of applicable laws on the availability of a judiciary with the ability to apply the chosen rules efficiently and correctly. This acts as another factor helping to explain why in Europe there is less rule-based competition and more cost-based competition. In fact, the elements discussed above might be even less significant for a small, closely held corporation incorporating in a given state mainly to take advantage of the lower incorporation costs rather than considerations related to potential shareholders' lawsuits.

IV. SUPPLY-SIDE DRIVERS OF REGULATORY COMPETITION

The different types of regulatory competition that presently exist in the U.S. and Europe also depend on the different incentives the individual states have to enact a body of rules, as well as maintain legal institutions, that are capable of attracting corporations. In this respect, it can be observed in general terms that European States have fewer incentives to compete in the market for corporate charters than do U.S. states.

1. *Franchise Taxes*

Franchise taxes similar to those levied in the U.S., which constitute one of the major incentives for "Delaware-style" reg-

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a body of civil law rules rooted in the French civil law tradition, see Mary Garvey Algero, *The Sources of Law and the Value of Precedents: A Comparative and Empirical Study of a Civil Law State in a Common Law Nation*, 65 LA. L. REV. 775 (2005). Algero also provides a brief but clear discussion of the value of precedents in some civil law systems (e.g., France, Italy and Spain).

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ulatory competition, are not permissible in Europe. Articles 2(1) and 10 of Directive 69/335/EEC of July 17, 1969 prohibit single Member States from imposing a "tax for the mere fact of incorporation in a certain state."[85] Additionally, some authors point out that case law interpreting these provisions also prohibits states from circumventing the principle through means such as "registration fees that exceed the real cost [of registration]."[86]

Franchise taxes in the U.S., particularly in Delaware, act as a proxy for the capitalization of the corporation and the number of shares issued. As this variable is obviously larger for big, publicly held corporations, it is reasonable that regulatory competition in the U.S. focuses in particular on reincorporation of such established and economically larger corporations.

This difference also helps to explain why a cost-based regulatory competition prevails in Europe for incorporation of small businesses. European States are relatively less interested in attracting corporations deciding where to incorporate or reincorporate on the basis of an analytical examination of the applicable corporate laws and the overall judicial attitude toward corporations. As a result, from a fiscal point of view, these States are less dependent than Delaware on reincorporation of large corporations. Different corporate regimes in Europe are, therefore, more the consequence of different judgments of the policy makers with respect to the most efficient and desirable rules for their constituencies rather than the product of efforts to lure corporate decision-makers to a certain jurisdiction.

It is also worth noting that, according to some research, franchise taxes and other fiscal revenues can be an adequate and meaningful incentive for a state willing to engage in regulatory competition only if the tax revenues connected to the

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85. Kieninger, *supra* note 13, at 766. *See also* Becht, Mayer & Wagner, *supra* note 14, at 6; Birkmose, *supra* note 12, at 60-61; Enriques, *EC Company Law*, *supra* note 20, at 1271.

86. *See* Kieninger, *supra* note 13, at 766. *See also* Kamar, *supra* note 59, at 1744-45 (contending that even if franchise taxes would be permissible in Europe, the lower level of market capitalization might render this type of revenue an insufficient incentive for effective regulatory competition. Despite the fact that this revenue could potentially be significant for some of the smallest member states, these states lack adequate legal infrastructures to attract companies that can generate such revenue.).

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"incorporation business" reach a relevant threshold of the state budget. That threshold must exceed the costs connected with the implementation and maintenance of a competitive legal environment.[87] This condition is usually met, clearly enough, only by states that are relatively small, with a limited number of inhabitants and lack of other major sources of income.

As correctly observed by one scholar, in larger states the need to take into account the position of minority shareholders, employees, investors and creditors, the largest part of the electorate, *vis-à-vis* the relatively minor benefits that might derive from regulatory competition, affects the willingness of the legislature and the policy makers to engage in a regulatory action aimed primarily at the interests of foreign corporate-decision makers (managers, directors or controlling shareholders) who decide whether and where to reincorporate.[88]

2. *The Market for Legal Services and the Efficiency of the Legal System*

Obviously, franchise taxes are not the only element on which regulators compete. On the one hand, the ability of a jurisdiction to attract a large number of incorporations might have a significant effect on the local market for legal services. Lawyers, institutions of legal education, and other professionals specializing in business law and related fields might greatly benefit and create a thriving network effect. The above-mentioned persons and institutions not only represent an important industry in absolute economic terms, but also are a social group particularly influential with the legislatures and policy makers.[89]

In addition, a strong system of business law, regarded as efficient and respective of minorities' rights, is also in itself a

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87. Delaware obtains more than 15 percent of its tax revenues from franchise taxes despite having few local corporations. *See* Romano, *supra* note 9, at 2388.

88. *See* Kieninger, *supra* note 13, at 758-59. In light of this, it is not surprising that some of the states in Europe that seem more concerned with regulatory competition, like the Netherlands or Liechtenstein, fit into this description. Liechtenstein, however, is a strange example because the country only recently adopted the incorporation theory. *See id.* at 759.

89. *See* Armour, *supra* note 19, at 31 (citing additional supporting sources).

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goal of the policy makers, as it enhances the economic strength of the country and results in increased influence for its politicians, regulators, practicing lawyers and academics. It can be expected, therefore, that some form of competition, or room for regulatory arbitrage, results among the Member State almost automatically as an indirect consequence of the goalsand activities of the individual legislatures.

While these elements might drive regulatory competition somewhat, they do not seem sufficient to generate a U.S.-style system focused on luring the reincorporation of listed corporations, at least in the short-run.

V. CONSTRAINTS TO FREE CHOICE OF LAW

In economic terms, we have so far considered the incentives for the "producers" and (some of) the "consumers" of corporate law with respect to regulatory arbitrage. It is now necessary to turn back to the "balance constraints" that limit the possible options. These are comprised of mandatory rules that make it impossible, or at least difficult, to engage in forum shopping.

1. *State of Incorporation and Real Seat Principles*

"Place of incorporation" and "real seat" are two different choice-of-law rules that might be used to determine the substantive corporate law that governs the internal affairs of a business association. Countries follow these different systems in varying forms and degrees. As mentioned in the introductory paragraph, common law systems such as the U.S. and the U.K. tend to follow the place of incorporation approach. In continental Europe, the approaches of civil law systems are more variegated. Some countries, such as Germany and France, follow the real seat method. Other countries, such as Denmark, the Netherlands, Italy and Switzerland, follow the incorporation theory.

Extensive scholarship now exists on the real seat and the incorporation principles. It is, therefore, sufficient to simply

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point out their meanings and possible implications.[90] Under the real-seat approach, a business association is subject to the rules of the country where its real seat is physically located. Of course, the real seat can be defined in different ways, such as the center of the administration (the "headquarters") of the corporation, the place where the directors are located (which might be a way to define the headquarters), or the place where the "majority" of the business activities are conducted. The incorporation rule, on the contrary, holds that the applicable corporate laws are those of the country in which the "registered seat" is located, often meaning the place in which the incorporation process has been completed, and independent from the physical location of corporate assets, activities, administrative functions or corporate bodies.

The principles and historical origins underlying these two rules are easy to grasp. The incorporation approach developed in the colonial period in order to allow British corporations to operate solely abroad while still remaining subject to a body of laws with which they were familiar.[91] The real seat approach, on the other hand, might be considered the expression of a protectionist policy, as it forces a corporation doing business in a given jurisdiction to incorporate there and to be subject, at least to some extent, to local laws. The underlying idea, of the real seat approach is that the state that has the better incentive to efficiently regulate the internal affairs of a corporation is the one in which that corporation has its primary seat.[92]

A common misconception is that the incorporation principle implies the corporation's freedom of movement and therefore creates a market for rules. On the contrary, incorporation states might actually limit the ability of their national corporations to emigrate and change the applicable corporate laws. This was the practice of England, for instance, in the *Daily Mail* case, in which the European Court of Justice upheld British tax laws limiting the ability of a corporation to change

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90. *See supra* notes 5, 8-10, & 13. *See also* Hanne Søndergaard Birkmose, *A Market for Company Incorporations in the European Union? –Is Überseering the Beginning of the End?*, 13 TUL. J. INT'L & COMP. L. 55, 65-71 (2005).

91. *See* TITO BALLARINO & ANDREA BONOMI, DIRITTO INTERNAZIONALE PRIVATO 344 (2d ed. 1996).

92. *Id.* at 344.

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domicile, deeming those rules compatible with the freedom of establishment principle of the European Treaty.[93]

On the other hand, an incorporation state might, at least in theory, provide for pseudo-foreign corporation statutes that impose the application of some internal rules on corporations either incorporated elsewhere or subject to the rules of a foreign jurisdiction, when those corporations are doing business in their territory. The aforementioned § 2115 of the California Corporation Code is one such example.[94] This was also the case of the Dutch law on formally foreign corporations of December 17, 1997; this law's legitimacy *vis-à-vis* the European Treaty was the central issue of the *Inspire Art* case that will be briefly discussed later[95] In this respect, it is correct to state that the incorporation principle is a condition necessary, but not sufficient, for the development of a free market for corporate charters.

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93. Case 81/87, Regina v. H.M. Treasury & Comm'rs of Inland Revenue *ex parte* Daily Mail & Gen. Trust Plc, 1998 E.C.R. 5483. The case involved a British holding company incorporated as a private limited company under British law wanted to transfer its domicile to the Netherlands in order to avoid British capital gains when selling a securities portfolio. *See id.* at 5485-86. The British tax authority denied the necessary authorization for change of domicile and the corporation filed a complaint with the European Court of Justice, alleging that corporations should enjoy the same freedom of changing domicile granted by the European Treaty to individuals. The court ruled, however, that corporations are legal entities whose creation and existence depends on the laws of the single Member States, and that notwithstanding the general equation between individual and legal entities as for freedom of establishment, British law requiring the authorization was compatible with the Treaty. *See id.* at 5496. It is important to point out that in this case applicable corporate laws would have not changed because of the different location of the domicile. Since the U.K. in fact follows the principle of incorporation, Daily Mail would have remained subject to British law. The case, however, suggests that limitations that affect the ability of a corporation to change its applicable corporate laws, provided for by the "home state" that the corporation intends to abandon, might be legitimate.

94. *See supra* note 5.

95. Another example of a similar statutory rule might be Article 25 of the Italian statute on International Private Law. According to this statute, a corporation is regulated by the laws of the state of incorporation, but Italian law would apply if the seat of the corporation is located in Italy, or if the main corporate purpose is located in Italy. International Private Law, No. 218, art. 25 (1995) (It.). This rule, as will be discussed, might be considered incompatible with the European Union Treaty.

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On the other hand, real seat states hinder regulatory competition. If not in a very peculiar situation, a corporation simply cannot, from an economic and practical standpoint, move around its "seat," however it might be defined, in order to be subject to the "best" corporate laws.[96] In light of all the different elements that determine where the physical corporate seat should be located (type of activity, availability of raw materials, cost of labor, existence of apt infrastructures, and other substantive areas of the law such as taxation), corporate laws are not a top priority. The costs of a change of seat driven by corporate laws would often exceed its benefits. Real seat states, therefore, strongly discourage a national corporation from "emigrating" in the sense of opting out of local corporate laws.

In addition, the real seat principle inhibits "immigration" of corporations incorporated abroad into a state that adopts it. The reason is that if a foreign corporation moves its real seat to a real seat state, while remaining subject to the laws of a different state, the state of destination might either not recognize the business association as a legal subject with the standing to sue or be sued (we might define this approach "strong real seat" per the *Überseering* case), or recognize it but "downgrade" it to a *de facto* corporation, and thus regulate it similarly to a general partnership and hold all the shareholders unlimitedly liable for the obligations of the corporation ("weak real seat").[97]

96. The firm cannot simply move its seat, unless the firm is so "small" and has such limited investments that it can easily relocate. This is consistent with the underlying idea of this article that in Europe there is more regulatory arbitrage affecting smaller business associations than in the U.S.

97. Surely enough, real seat states that recognize the existence and status of a corporation incorporated in a different jurisdiction also can, and often do, provide for pseudo-foreign corporation rules, mandating the application of national rules. For instance, they could do this with a corporation that does business primarily within the territory of the state. It should also be noted that the consequences of the move of the real seat, from the point of view of the state of departure, are obviously different depending on whether the incorporation principle or the real seat principle is followed. In the first instance, the rules of the home state should still apply, creating a conflict of law with the applicable rules of the real seat state of destination. However, if the departure state is another real seat state, the applicable rules might overlap and conflict, or the departure state might provide for special rules applying to the leaving corporation, from winding up to withdrawal (appraisal) rights for its shareholders. The result is dependant on how the real seat is defined.

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It's obvious that the consequences of such an approach are extremely disruptive and make it impossible, as a practical matter, for a corporation to separate its real seat from the place of incorporation. As a result, it would be difficult for it to operate primarily in one country, while subject to the laws of a different system with which it might have no contact but the registered office.

2. *Corporate Mobility and the European Court of Justice*

As noted in the introduction, three groundbreaking cases decided by the European Court of Justice between 1999 and 2003 have interpreted the freedom of establishment principles of the European Treaty (Articles 43 ff.) in a way that might enhance regulatory competition in corporate law.[98] In *Centros*,[99] two Danish citizens, probably motivated by the desire to avoid Denmark's mandated minimum capital requirement, incorporated a private limited mail-box company in the U.K. No business activities were conducted in England. The address of a friend of the shareholders was indicated as the corporate seat, and all activities of *Centros* were centered in Denmark. The company was, however, subject to British law, since England is an incorporation state. The company applied to the competent Danish office in order to register a secondary seat there. The registration was denied, notwithstanding the fact that Denmark also follows the incorporation principle. The grounds for the refusal were that incorporation in the U.K. was only designed to circumvent the application of Danish law, the company had no real connection with the country of incorporation, and Centros was not trying to establish a secondary seat but rather establishing its only actual seat. According to the Danish authorities, this scheme would have created a potential prejudice for creditors, in particular by eluding the minimum legal capital required by Danish law, a law significantly stricter than the correspondent British rule.

98. While numerous analyses of these decisions have been published, see sources cited *supra* note 13, one of the most lucid and concise discussions of the meanings and consequences of *Centros, Überseering* and *Inspire Art*, is offered by Portale, *supra* note 15, at 125 ff., on whose observations the present paragraph builds.

99. Case C-212/97, Centros Ltd v. Erhvervs-og Selskabsstyrelsen, 1999 E.C.R. I-1459, 1999 2 C.M.L.R. 551 (1999).

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The denial of the registration of Centro's secondary seat was successfully challenged in the European Court of Justice based on an allegation that it was contrary to the principle of freedom of establishment provided by then Articles 52 and 58 of the European Treaty. The Luxembourg Court upheld this interpretation, affirming the principle that a corporation duly incorporated under the laws of a Member State could not be banned from establishing and registering a secondary seat in another Member State, even if the laws of the former differ from the laws of the latter. [100]

The European judges, however, in a somewhat ambiguous manner, also asserted that, notwithstanding the decision in the case, Member States could adopt

"any appropriate measure for preventing or penalizing fraud, either in relation to the company itself, if need be in cooperation with the Member State in which it was formed, or in relation to its members, where it has been established that they are in fact attempting, by means of the formation of the company, to evade their obligations towards private or public creditors established on the territory of a Member State concerned."[101]

The second landmark decision is *Überseering*, which was published three years later in 2002.[102] *Überseering* was a Dutch corporation, incorporated and registered in the Netherlands, an incorporation state. *Überseering* sued on breach of contract grounds in Germany a German limited liability corporation, *Nordic Constructions GmbH*. The German judges dismissed the claim, reasoning that the plaintiff corporation lacked standing to sue. This conclusion was reached by applying the real seat principle provided by German law; because all the shares of *Überseering* had been bought prior to the lawsuit by two German citizens residing in Germany, the seat of the corporation

100. It should be remembered, in this respect, that the setting up of a secondary seat of a corporation incorporated in one Member State in a second has been partially harmonized by Council Directive 89/666, 1989 O.J. (L 395) 1 (EEC). There is, therefore, a common European framework that regulates the so-called secondary right of establishment. *See* Lombardo, *supra* note 13, at 366.

101. Case C-212/97, Centros Ltd v. Erhvervs-og Selskabsstyrelsen, 1999 E.C.R. I-1459, 1999 2 C.M.L.R. 551 (1999).

102. Case C-208/00, Überseering BV v. Nordic Constr. Co. Baumanagement GmbH, 2002 E.C.R. I-9919. *See* Birkmose, *supra* note 90, at 83-84.

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was ruled to be located in the German territory. As a result, the German judiciary found German law would apply and determine the legal status of the firm. Since *Überseering* had never undergone incorporation in Germany, the German judges further reasoned that the corporation did not have legal capacity and was unable to sue. [103]

Once again, the European Court of Justice, to which the corporation had appealed, decided that the solution reached by the German judiciary was incompatible with European law The Court of Justice held that the corporation was duly incorporated in the Netherlands, and thus Germany could not deny its existence and legal capacity to apply local law. Therefore, the laws of the state of incorporation would control and prevail in case of conflict.[104]

Inspire Art is, like *Centros*, a case involving the right to establish a secondary seat; *Inspire Act* added an important piece to the puzzle however. [105] Decided in 2003, this third ruling concerns a corporation incorporated in the U.K. but not performing any activity in the state. The sole director of *Inspire Art* resided in the Netherlands, and the corporation intended to register a secondary seat in the Netherlands, which also follows the incorporation theory. A 1997 Dutch statute, [106] however, provided that pseudo-foreign corporations, incorporated abroad but lacking meaningful connections with the Netherlands, would have to comply with some internal corporate rules when doing business in the Netherlands, in particular with respect to minimum legal capital and directors' liability. The European Court of Justice held that these provisions violated the freedom of establishment, as they would force a British corporation to comply with local rules that – consistent with *Centros* – were deemed not necessary to prevent fraud and

103. It is easy to point out, in this respect, how the consequences of the real seat approach might be detrimental not only to the shareholders or the subjects responsible for the corporate decision, but also to third parties or minority shareholders. This is an effect that seems to conflict with the very goal of the real seat approach to protect these parties.

104. Portale, *supra* note 15, at 126 n.53.

105. Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd, 2003 O.J. (C 275) 16.

106. Portale, *supra* note 15, at 126, n.53; Lombardo, *supra* note 13, at 364.

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protect creditors or, more precisely, did not pass the four-stage *Gebhard* test.[107]

While the jurisprudence of the European Court clearly creates room for regulatory competition, its decisions are far from a grant of complete freedom of movement to European corporations. Strictly interpreted, in fact, these cases only state two principles. Firstly, a corporation incorporated in a state that follows the incorporation theory can register a *secondary seat*[108] in another state and operate in its territory without being subject to local rules that might impugn its freedom of establishment (*Centros* and *Inspre Art*). The only permissible limits on this freedom, according to Article 46 of the European Treaty, are the grounds of "public policy, public security or public health," when these limits meet the *Gebhard* test of: (a) applied in a non-discriminatory manner; (b) justified by public interest; (c) capable of attaining their object: and (d) proportionate.[109] Secondly, it is contrary to freedom of establishment for a state, following the real seat doctrine, to deny legal capacity to a corporation incorporated abroad, or to requalify the corporate type, on the basis that the real seat has been transferred within its territory but the corporation has not been incorporated according to its laws (*Überseering*).[110]

It remains unsettled, however, whether and to what extent a state can prevent its national corporations from reincorporating abroad, or otherwise change the applicable corporate laws, without winding up the existing corporation (with the cost and the tax consequences that this might imply) and in-

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107. *See* Case C-55/94, Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, 1995 E.C.R. I-4165, I-4166.

108. The fact that the Courts' case law deals with the right to establish a secondary seat, and not a primary one, should not be overlooked. *See* Johnson, *supra* note 74, at 27 ("Case law, it would seem, has little to offer to the problems of primary establishment, dealing . . . with the concept of secondary establishment of a company validly incorporated in another member state. Arguments that the ECJ has signaled the death of the real seat doctrine in *Centros* may also be premature . . . .").

109. It is worth noticing that, according to the Luxembourg judges in the cited opinions, these conditions are not met, in particular, by the provision of a minimum legal capital, considering that the corporate creditors are sufficiently protected by the rules concerning legal publicity and disclosure of financial statements.

110. As observed by Portale, *supra* note 15, at 131.

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corporating anew in the state of destination.[111] On the contrary, the precedent of *Daily Mail* seems to suggest that similar limitations, at least with respect to tax law, are permissible.[112] In addition, notwithstanding *Überseering* and *Inspire Art*, the issue of whether, and to what extent, a foreign corporation might be deemed subject to some mandatory rules of a host state where it performs its activity remains unresolved.[113]

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111. Gildea, *supra* at note 13, at 260 (observing that "the *Überseering* court interprets the freedom of establishment as giving a company the right to move to a new state, but not to emigrate from its home state"). *See* also Lombardo, *supra* note 13, at 371; Portale, *supra* note 15, at n.57. It is interesting to point out that the U.K., a jurisdiction which is presently attracting many new corporations, does not allow complete freedom of movement between its two national legal systems (England and Wales, on the one hand, and Scotland, on the other). The Department of Trade and Industry, however, is proposing to enable corporate jurisdictional migration between England and Wales and Scotland. *See* DEPARTMENT OF TRADE AND INDUSTRY, COMPANY LAW REFORM 48 (2005), *available at* http://www.dti.gov.uk/consultations/page13957.html (arguing for the desirability of allowing "a company registered in Great Britain either to migrate to a jurisdiction other than Great Britain (including another EEA State, or a third country).").

112. *See* Armour, *supra* note 19, at 16 (arguing that the *Daily Mail* precedent will be bypassed by the European legislation which grants corporations the freedom to relocate); Federico Maria Mucciarelli, *The Transfer of the Registered Office and Forum-Shopping in International Insolvency Cases: An Important Decision from Italy*, 4 EUR. COMPANY & FIN. L. REV. 512, 517 n.18 (2005). *See also* Case C-9/82, Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie, 2004 E.C.R. I-2409 (striking down French exit taxes in respect to natural persons as being contrary to freedom of establishment). On this decision, see Gilbert Parleani, *Relocation and Taxation: the European Court of Justice Disallows the French Rule of Direct Taxation of Unrealised Gains*, 3 EUR. COMPANY & FIN. L. REV. 379 (2004). A similar principle might be extended to corporations.

113. Although prior to the *Inspire Art* decision, Gildea pointed out that:

[T]he court requires that a 'real seat' host state recognize a European foreign company in its territory. But, the court does not specify whether the host state must apply internal affairs law from the state of registration. Thus, it is still unclear how far the host state must go in recognizing the legal personality of the company or whether current case law, taken as a whole, sufficiently requires member states to apply the law of a corporation's place of registration.

Gildea, *supra* at note 13, at 285 (internal citation omitted). In addition, it is interesting to point out that, according to Birkmose, *supra* note 90, at 91, even after *Überseering*, "[i]t is still not clear whether the duty of recognition in relation to primary establishment also applies when a company has no connection with the Community other than having its registered office in a state of incorporation within the Community." Also, similar questions, left open

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In the light of these precedents, it is necessary to conclude that presently in Europe, a corporation should be allowed to incorporate in a state with which the firm has no relevant connection while doing business exclusively in a different jurisdiction, in particular through a secondary seat duly registered in the second state. More doubts arise with respect to the possible reincorporation of an already established corporation, whose state of incorporation might prevent emigration, or which might encounter mandatory rules of the state of destination that conflict with those of the state whose laws govern its internal affairs. This scenario is perfectly compatible with the observable empirical evidence and the stronger development in Europe versus the United States of what we have defined a cost-based market for charters.

3. *Possible Evolutions: The European Company*

Legislative landmark innovations at the EU level, either recently enacted or forthcoming, might significantly alter the above scenario, creating favorable conditions not only for increased regulatory competition for incorporation of small-sized corporations, but also for re-incorporation of larger, established ones. One of these innovations is the *Societas Europaea*, or *SA*, a new type of corporation designed to favor integration among European corporate law systems and corporate mobility across the borders of the different Member States.[114] The project to develop a harmonized corporate form in Europe dates back four decades, but only recently has a

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by the European Court of Justice and correctly pointed out by this author, suggest that the exact meaning and scope of freedom of movement of corporations in Europe is not settled yet.

114. Council Regulation 2157/2001, 2001 O.J. (L 294) 1 (EC); Council Directive 2001/86, 2001 O.J. (L 294) 22 (EC). *See generally* Sakari Helminen, *The European Company – "SE"*, 3 TURKU L. J. 19 (2001) (a brief but complete overview of the new institution). *See also* Françoise Blanquet, *European Company Statute (SE)*, in CORPORATE BUSINESS FORMS IN EUROPE. A COMPENDIUM OF PUBLIC AND PRIVATE LIMITED COMPANIES IN EUROPE (Frank Dornseifer ed., 2005); Udo C. Braendle & Juergen Noll, The Societas Europaea – A Step Towards Convergence of Corporate Governance Systems? (Apr. 15, 2005) (unpublished manuscript) (discussing regulation of the SE in Austria and the U.K.), *available at* http://ssrn.com/abstract=704881; Enriques, *supra* note 44 (arguing that the SE might be an attractive vehicle for corporate law shopping in the EU); Stefano Lombardo & Piero Pasotti, *The 'Societas Europaea': A Network Economics Approach*, 1 EUR. COMPANY & FIN. L. REV. 169

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compromise been reached. The particular structure of the regulation of the SE, and the legislative technique followed in this regulation, reflect that compromise. This type of company is not entirely regulated by European law. Rather the European legislation follows a so-called "*renvoi*" technique, regulating directly only certain issues: the formation of the company; the company seat; the governance model, which can either be a two-tier, German-like system, or a one-tier one; and the co-determination of employees. As for issues not conclusively dealt with by European law, the laws of the state where the registered office and the real seat (the "head office") of the corporation are located control.

An SE can be formed only in one of four ways: through merger of corporations governed by the laws of different Member States, through creation of a subsidiary or a holding corporation of an existing corporation, or through transformation of an existing corporation. In order to form an SE, however, the corporations participating in the transaction must present an element of internationality and, in particular, either be subject to the laws of two different Member States or have had a subsidiary governed by the laws of a different Member State.[115]

(2004), *available at* http://ssrn.com/abstract=493422; Véronique Magnier, *La société européenne en question*, 93 REV. CRIT. DROIT INT. PRIV. 555 (2004).

115. 1. Public limited-liability companies such as referred to in Annex I, formed under the law of a Member State, with registered offices and head offices within the Community may form an SE by means of a merger provided that at least two of them are governed by the law of different Member States.

2. Public and private limited-liability companies such as referred to in Annex II, formed under the law of a Member State, with registered offices and head offices within the Community may promote the formation of a holding SE provided that each of at least two of them:

(a) is governed by the law of a different Member State, or

(b) has for at least two years had a subsidiary company governed by the law of another Member State or a branch situated in another Member State.

3. Companies and firms within the meaning of the second paragraph of Article 48 of the Treaty and other legal bodies governed by public or private law, formed under the law of a Member State, with registered offices and head offices within the Community may form a subsidiary SE by subscribing for its shares, provided that each of at least two of them:

(a) is governed by the law of a different Member State, or

(b) has for at least two years had a subsidiary company governed by the law of another Member State or a branch situated in another Member State.

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The SE must be established as a public-limited liability company and have a minimum legal capital of 120,000 euro. The registered office and the head office must be located in the same state, which suggests that the SE opted for the real seat approach.[116] Once formed, the SE can move its registered office and real seat to a different jurisdiction without winding-up and being re-incorporated, which according to some might facilitate shopping for corporate laws. Although a provocative theoretical analysis that argues the contrary, [117] and some prominent examples of adoption of the SE form,[118] the SE does not seem destined to become a particularly widespread corporate structure. Moreover, it is not likely to represent an effective vehicle for regulatory arbitrage in corporate law, especially after the enactment of the Cross-border Merger Directive and the possible introduction of the Fourteenth Directive on the transferability of the corporation's registered office. There are several reasons for this conclusion, which appear to be consistent with the limited existing empirical evidence.[119] On the one hand, rules concerning employee participation in the governance of the corporation, mandatory in case of adop-

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4. A public limited-liability company, formed under the law of a Member State, which has its registered office and head office within the Community may be transformed into an SE if for at least two years it has had a subsidiary company governed by the law of another Member State.

Council Regulation 2057/2001, 2001 O.J. (L 294) 1 (EC).

116. *See* Lombardo & Pasotti, *supra* note 114, at 5.

117. *See* Enriques, *supra* note 44.

118. One such prominent example is the merger of the Italian listed insurance company RAS holding with its controlled German corporation Allianz AG, with the resulting corporation being a SE. The merger will be completed in the Fall of 2006. *See* Press Release, RAS Holding & Allianz, Allianz-RAS Holding Merger Registered Today: Allianz SE Becomes Effective (Oct. 13, 2006), *available at* http://www.ras.it/rasit/en/vpo/ufficio_stampa/comunicati_stampa/documenti_allegati/2006/13102006_AllianzRas.pdf. The choice of establishing a SE, in this particular case, might also have been justified by the difficulties posed by German corporate law, prior to implementation of the Tenth Directive on Cross-border mergers, to the completion of a cross-border merger. *See infra* note 124. The SE might, therefore, have been a way to achieve this result without the more complex and expensive corporate transactions that were followed, for instance, in the well-known Daimler/Chrysler merger. *See* Siems, *supra* note 16, at 182-83.

119. Julie Tenenbaum, *The European Company*, BWB Commercial Law Update (Spring 2005), http://www.bateswells.co.uk/newsletters/Commercial%20Law%20Update%20-%20Spring%202005.pdf.pdf (reporting that as of Spring 2005, only one SE had been incorporated in the U.K).

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tion of this form, might represent a serious disincentive in those countries in which co-determination is opposed, including most significantly the U.K. More generally, the "patchwork" regulatory structure of this company, a centaur of European common rules and local applicable laws, might impose coordination costs and raise uncertainties.

Some authors suggest, interestingly enough, that the use of the *renvoi* technique solves some of the problems surrounding the fact that no body of precedents on the SE exist. These arguments are based on the idea that judges will be able to rely on national law – and, therefore, the existing case-law – for all the issues not directly regulated by European law.[120] While this might be the case comparing the existing regulation of the SE to a theoretical, all-inclusive regulation that has not been provided for, the reality is that the SE competes with the adoption of the already existing, well-established, types of corporate forms in the different systems. Even accepting this argument, however, the legal uncertainties concerning the SE would be, by definition, more significant than the ones regarding other, "national" types of corporations. In addition, it is also worth noting that since the SE is subject to the regulations imposed on a public limited liability company, its use might be discouraged by smaller firms preferring the private limited liability company form.[121]

As for use of the SE as a vehicle for corporate migration, once again several doubts can be cast. Until the recent Directive on Cross-border mergers, which will be discussed hereinafter, doubts concerning the merger of corporations of two different Member States would have affected also mergers designed to establish a SE. However, the enactment of the cross-border merger Directive might now render relatively less appealing the creation of the SE as a tool for changing the applicable laws, as two national corporations can now more easily merge directly.[122]

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120. *See* Enriques, *supra* note 44, at 10-11.

121. According to Helminen, *supra* note 114, at 45, "it is not easy to be optimistic of the future success of the [European Company], mainly because the 'access' to the SE has been made too difficult for small and medium-sized companies."

122. Also, the change of applicable corporate laws for an already established SE is somewhat unclear. On the one hand, as suggest before, the SE seems to follow the real seat approach, and the European legislature pro-

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In light of these observations, notwithstanding the fact that an agreement on the SE has been reached, an old, but quite basic, question cannot be completely disregarded. "What is it that the European Company has intended and able to achieve that a national company cannot accomplish?"[123]

4. *Cross-border Mergers and the Proposed Directive on Transfers of the Registered Office*

As previously described, reincorporation is usually achieved in the U.S. through a merger in which the existing corporation wishing to emigrate is incorporated in a new empty-shell corporation of the chosen state of destination. Traditionally, notwithstanding harmonization of corporate laws at the European level, a similar mechanism was not available in most European countries.[124] The recent Tenth Directive

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vides that relocation of the seat (which should result in a change of law) is possible without winding-up the corporation. This suggests that the SE can engage in some forum shopping while maintaining its legal personality. It is, however, exposed to the costs and problems related to the change of the physical seat of the corporation, which discourages regulatory arbitrage. In addition, as pointed out by Lombardo, *supra* note 13, at n.96, the European Regulation is very ambiguous. In fact, Article 8, paragraph 14, states that: "The laws of a Member State may provide that, as regards SEs registered in that Member State, the transfer of a registered office which would result in a change of the law applicable shall not take effect if any of that Member State's competent authorities opposes it within the two-month period referred to in paragraph 6. Such opposition may be based only on grounds of public interest." Council Regulation 2157/2001, art. 8, 2001 O.J. (L 294) 1, 5 (EC). This rule appears to allow a change of seat *without* a change of applicable laws. Independent from the solution given to this interpretation problem, these very uncertainties might adversely affect the diffusion of the SE.

123. F. A. Mann, *The European Company*, 19 INT'L & COMP. L. Q. 468, 477 (1970).

124. The principle, however, was challenged by the European Court of Justice in another landmark decision regarding freedom of movement within the E.U., the so-called *Sevic* case. *See* Case C-411/03, SEVIC Sys. AG v. Amtsgericht Neuwid (December 13, 2005), *available at*, http://europa.eu.int/eurlex/lex/LexUriServ/LexUriServ.do?uri=CELEX:62003J0411:EN:HTML; Clemens Philipp Schindler, *Cross-Border Mergers in Europe – Company Law is Catching Up! – Commentary on the ECJ's Decision in SEVIC Systems AG*, 3 EUR. COMPANY & FIN. L. REV. 109 (2006); Peter Kindler, *Le fusioni nel diritto tedesco: la sentenza Sevic della Corte di giustizia e l'attuazione della direttiva 2005/56CE in Germania* (for a very clear analysis of the German regulation of cross-border mergers before and after the decision and the Tenth directive). As reported by Siems, *supra* note 16, at 170, until the enactment of the Tenth

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on Cross-border mergers,[125] however, removes most of the limitations on these types of transactions. The directive identifies the applicable law and provides for criteria to resolve possible conflicts of laws, as well as specific rules designed to facilitate intra-European mergers.

As several scholars have noted, the directive will undoubtedly boost regulatory arbitrage, or at least facilitate the process of an existing corporation reincorporating in a different jurisdiction through a mechanism similar to the one followed in the U.S.[126] The extent and speed of this process, however, is still open to question. For instance, on the delicate and heavily-politicized issue of co-determination and employee representation on the board of directors, the directive reached a compromise that, while sensible from a theoretical standpoint, might affect the practicability of mergers between countries following different approaches. It is beyond the scope of this Article to analyze the complicated rules provided by the directive on this issue,[127] but following a regulatory solution model experimented with the SE; the mergers directive ensures the possibility that employees of a corporation subject to co-determination rules may maintain their right to participate in the governance of the corporation should the corporation result-

Directive on Cross-border Mergers, in Germany, Austria and the Nordic Countries, a cross-border merger was practically impossible (the German *Umwandlungsgesetz*, for instance, is only applicable when the corporations involved in the merger have their domicile in Germany); in countries like Belgium and the Netherlands, the absence of specific rules raised extensive doubts as for the lawfulness of a cross-border merger, and both substantive and procedural issues; finally, in other countries (France, Spain, Italy), cross-border mergers were generally considered admissible, but still extensive doubts existed on rules applicable to these transactions. The uncertainties discouraged significantly the flourishing of a truly intra-European merger activity. International mergers, surely enough, would still occur; consider, for instance, the Daimler/Chrysler merger, but the procedures followed to overcome possible pitfalls of national laws were significantly more expensive and complicated than a simple, direct merger. For a discussion of the Daimler/Chrysler merger, see generally *id.* at 182.

125. Council Directive 2005/56, *supra* note 16.

126. *See, e.g.*, Armour, *supra* note 19, at 15-16 (pointing out how the Tenth and Fourteenth Directives will allow emigration, therefore removing the barriers to regulatory competition placed by the *Daily Mail* doctrine for established corporations). *See also* Siems, *supra* note 16, at 179 (reaching similar conclusions).

127. Council Directive 2005/56, *supra* note 16, at art. 16.

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ing from the merger not be subject to any similar rule. This solution might affect cross-border mergers, in particular between companies of those systems that, so far, have proven more open to regulatory competition, namely Germany and the U.K. Consistent with the thesis of this article, it has been pointed out that, because of the co-determination rules "[t]he market for re-incorporation will. . . remain less open than the market for first incorporations."[128]

While the European legislation on mergers lifts most of the veils that have so far formally prevented these operations, some of the nontrivial substantive reasons that discourage an intra-European merger, especially for an established publicly-held corporation, still exist. The very differences among substantive corporate rules of individual national systems, such as shareholders' rights (including appraisal rights in case of merger), classes of shares, and determination of the exchange ratio, might render these operations, quite complicated, expensive and uncertain, at least for the next few years.

An alternative and even easier way to change the applicable corporate laws would be a transfer of the registered office. This transfer would facilitate corporate transactions by which a corporation subject to the laws of Member State X (independent of whether it follows the real seat or the incorporation approach), is free to "opt-out" of the applicable national laws and to "opt-in" to the rules of a different European jurisdiction without having to wind-up (and therefore be possibly subject to taxation) and re-incorporate. It is, in other words, a choice-of-law rule allowing national corporations to select the governing substantive rules without engaging in either a merger or creating a SE, provided that the decision is adopted according with applicable governance rules, which might, for instance, provide for an appraisal right for dissenting shareholders.

The few Member States that seem to allow this option usually require reciprocity, or that the transfer of the registered office is possible under the laws of the state of destination. [129]

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128. Siems, *supra* note 16, at 179.

129. For an interesting analysis of how the registered office of a corporation can be transferred under Italian law (in particular, with respect to a case in which an Italian corporation transferred its office to Luxemburg), see Mucciarelli, *supra* note 112, at 519-24 (describing analytically the conditions

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The proposed Fourteenth Directive, concerning the transferability of the registered office within the Union, might obviously provide a very relevant contribution to competition among jurisdictions in Europe.[130] This piece of legislation, however, in addition to raising several delicate political problems, might be subject to limitations similar to those regarding the Cross-Border Mergers Directive

It is also worth noting that the Proposed Directive in its present state does not seem to address all the issues that limit the development of a free market for corporate charters. For instance, Article 2 defines the registered office differently for incorporation states and seat states. With seat states, the registered office is "the place where the company has its central administration and is registered." Even if Article 3 provides, rather ambiguously, that "Member States shall take all measures necessary to allow a company to transfer its registered office to another Member State," it appears that a corporation physically located and incorporated in a real seat jurisdiction might still need to re-locate its headquarters in order to change the applicable corporate laws.

On top of that, Article 10, paragraph 2, provides that "A Member State might refuse to register a company in accordance with paragraph 1 where the company's central administration is not situated in that Member State." As pointed out by one author, a similar provision "puts up potentially huge barriers for a company wishing to make a transition which the directive is designed to allow with the least possible fuss."[131]

Finally, cross-border transactions in Europe might still raise delicate tax issues adversely affecting their popularity, notwithstanding existing harmonization, recent case-law, and possible legislative reforms on this issue.[132] This is not the case, for instance, with merger of corporation of different States in the U.S., according to § 368(a)(1)(A) and (F) of the

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under which it is possible under Italian law to transfer the registered office, and change applicable laws).

130. *See* Armour, *supra* note 19, at 15-16.

131. *Id.* at 39.

132. For an overview of the tax law problems related to seat transfer in Europe and cross-border mergers see CARLO GARBARINO, MANUALE DI TASSAZIONE INTERNAZIONALE chs. 4 & 15 (2005); Arvind Ashta, *The Taxation of Mergers Directive (90/434/EEC)*, 3 CAHIER DU CEREN 2 (2003), *available at* http://ssrn.com/abstract=929392.

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Internal Revenue Code, according to which a statutory merger and a change of place of organization are neutral from a tax law point of view.[133]

VI.
REGULATORY COMPETITION IN EUROPE AND IN THE U.S.: IMPLICATIONS OF THE TWO DIFFERENT MARKETS

The above analysis illustrates some of the elements accounting for the different types of regulatory competitions in corporate law occurring in the U.S. and in Europe. The features of the European market for rules in this field, to the extent that one exists, are profoundly different from the ones shaping American corporate law, and do not depend entirely on the relative lesser freedom of movement due to the adoption of the real seat principle in many European States.

The most evident effect of these differences is that the rule-based reincorporation movement that distinguishes the U.S. system, is not nearly as relevant in Europe. The type of corporate mobility that Europe is witnessing affects a different "segment" of the incorporation market, namely small or medium, and usually closely held, corporations that are in search of a less costly jurisdiction allowing a quick and inexpensive incorporation. Obviously an indirect effect of this development is that corporations that incorporate in a state that requires, for instance, a significantly lower legal capital, will also be subject to some extent to the applicable internal affairs rule provided for in the jurisdiction of incorporation. In other words, the "cost-based" regulatory competition occurring in Europe also forces a change in the most widely applied corporate laws. But the different drivers, and effects, of this type of

133. *See generally* Matthew B. Krasner, *Liquidation/Reincorporation after the Tax Reform Act of 1986*, 24 WILLAMETTE L. REV. 885 (1988). Additionally, as Stephen Land points out, with respect to section 368 of the Internal Revenue Code" The rules governing tax-free reorganizations, like kind exchanges, involuntary conversions, and installment sales all permit taxpayers to postpone the day of tax reckoning beyond the date of a realization event. These provisions generally are intended to mitigate the somewhat arbitrary consequences that a strict application of the realization requirement would entail. Their effect, however, is to magnify the distortions of income measurement that the realization requirement creates. Stephen B. Land, *Defeating Deferral: A Proposal for Retroactive Taxation*, 52 TAX L. REV. 45, 52-53 (1996).

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corporate mobility should not be underestimated. This type of market for rules is not mimicking the U.S. market.

The rationale underlying the above analysis is partially but powerfully confirmed by another very interesting example, which has to date been somehow overlooked in the scholarly debate on regulatory competition in corporate law. A recent study shows that in Canada, notwithstanding some similarities with the U.S. system, in particular the existence of jurisdictions that might compete to attract corporations, little reincorporation occurs in different provinces as compared to the process in the United States.[134] Interestingly enough, but perhaps not surprisingly, the causes of this lesser rule-based competition for reincorporation identified by the authors of the cited work, partially overlap – *mutatis mutandis* – with those pointed out in this study as possible explanations of the peculiar features of the European market for rules in corporate law.[135]

In the preceding pages we have considered three major elements affecting charter competition in Europe: limitations to mobility (part V), incentives of national legislatures and pol-

134. *See* Douglas J. Cumming & Jeffrey G. MacIntosh, *The Rationales Underlying Reincorporation and Implications for Canadian Corporations*, 22 INT'L REV. L. & ECON. 277 (2002). *See also* Ronald J. Daniels, *Should Provinces Compete? The Case for a Competitive Corporate Law Market*, 36 MCGILL L. J. 130 (1991) (discussing regulatory competition in Canada).

135. *See* Cumming & MacIntosh, *supra* note 134, at 281-82 (listing the elements to help explain the limited regulatory competition occurring in Canada: (a) securities regulation is within provincial jurisdiction, and there are different securities authorities in each province; (b) no Canadian province depends significantly on franchise tax or similar revenues related to incorporation; (c) lawyers are qualified to practice only in one jurisdiction, and even if there are large law firms operating in the entire national territory, offices in different provinces are usually separate profit centers; (d) there are no provinces in which Canadian judges specialize in corporate law; (e) the Supreme Court of Canada reviews decisions of the courts of all the provinces, therefore – differently form the U.S. – there is not one province that can develop a unique and particularly attractive body of case law; (f) precedents from other provinces are often used as persuasive authority, therefore reducing the differences among the different jurisdictions.) It shall be noted that points from (a) to (c) might apply also to the European situation; point (d) would apply only to some European jurisdictions; while points (e) and (f), which suggest an excess of harmonization that renders shopping around for different rules useless, is not applicable to European corporate laws, in particular with respect to closely held corporations (harmonization is more significant for publicly held corporations, for instance with respect to the regulation of legal capital).

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icy makers (part IV), and demand-side drivers for businesses deciding to incorporate or reincorporate (part III). Comparing these elements with the current U.S. situation, the following conclusions can be drawn:

While greater freedom in choice of law is certainly possible as a consequence of both the jurisprudence of the European Court of Justice and recent European legislation (including, in particular, new rules on cross-border mergers), this freedom is still far from complete. Significant uncertainties still limit corporate emigration, and most of the new European instruments that might increase freedom of movement (such as the SE) still pose some delicate coordination problems that limit their effectiveness;

European States, while not indifferent to their ability to attract incorporations, lack incentives similar to the those of Delaware and other U.S. States driving them to attract a large share of the "charter business."

Most importantly, in Europe, several elements affect regulatory competition from the point of view of the corporation. These elements create the pre-conditions for a "cost-based" competition affecting smaller, closely held businesses deciding to incorporate for the first time. The features of European corporate laws, and other substantive areas of the law in Europe, are presently not particularly favorable for the type of "rule-based" competition that developed in the U.S., which affects larger corporations considering to reincorporate (often publicly held or about to go public). Specifically, these features include the different rules concerning minimum legal capital, the greater differences among European States as to incorporation procedures, securities regulations, lawyers' resistance, lack of a dominant state comparable to Delaware, regulators' capture, and the rules on jurisdiction.

These differences between the European and the U.S. situation are clearly evolving, and even a casual look at contemporary European legal history suggests that the sun is setting on them. They are vanishing, and probably – or one might say, hopefully – at an ever increasing rate. At certain latitudes, however, the sunset can be particularly long, and a true "rule-based" competition in Europe similar to the American one

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does not seem to be as visible on the horizon as several commentators have assumed.*

* Journal of Law & Business Editor's Note: due to the high volume of foreign language source citation in this Article, the Journal was unable to obtain English language translations of many of the Italian language sources cited within. As a result, we have not independently verified the accuracy of these citations. However, after consultation with the Author, the Journal is confident that the protocols of legal citation have been abided for these sources and fully stands behind the citations included in the Article.

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