Issuer Choice in Europe

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Abstract

Unlike the US, the European Union has a tradition of national securities laws significantly differing from each other. Regulatory idiosyncrasies largely remain today despite recent efforts aiming at more comprehensive harmonization. In addition, in important respects, the current conflict of laws rules contained in European Community securities laws bundle the choice of applicable securities laws with the issuer's registered office, while leaving some regulatory aspects to the law of the market where the issuer's securities are admitted to trading. Hence, to the extent that EU companies can choose their state of incorporation and trading location, they can also choose the applicable securities law among those in place in the 27 EU countries.

This article scrutinizes the policy implications of the conflict of laws rules EC securities regulation has chosen in two scenarios: the present one, in which obstacles to companies mobility across the EU still make regulatory arbitrage in practice unavailable, and a prospective one in which these obstacles are removed.

We consider the bundling of securities laws with the issuer's law of incorporation for conflict of laws purposes overall detrimental if corporate law arbitrage is unavailable. On the other hand, we argue that the impact of such rules is beneficial if companies can easily engange in company law arbitrage. Yet, we qualify our optimistic assessment by showing that bundling securities regulation and corporate law for conflict of laws purposes may have a negative impact on the dynamics of the market for corporate charters.

For the regulatory aspects that are governed by the law of the affected market (and specifically for securities law aspects of takeover regulation), we argue that already today issuer choice offers a broad variety of options and a separating equilibrium represents the likely outcome.

Keywords: securities laws, securities regulation, harmonization, conflict of laws, corporate law, corporate governance, regulatory competition, legal arbitrage, issuer choice, Financial Services Action Plan

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Table of Contents

I. INTRODUCTION

Regulatory competition is a salient feature of US federalism. The fifty States potentially serve as the rivalling jurisdictions' laboratories breeding constant legislative innovation.[1] The most vivid example of regulatory competition is the market for corporate charters.[2] Its contested impact on corporate law quality has sparked an intense and still lively academic debate at least since the 1970s.[3] The general contro-

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[1] The basic story was sketched out by Charles M Thiebout, 'A Pure Theory of Expenditures' (1956) 64 *J Pol Econ* 416, 419-20 (devising a model where jurisdiction compete for citizens through the provision of public goods); on the innovative potential of federal structures, see also Brian R Weingast, 'The Economic Role of Political Institutions: Market Preserving Federalism and Economic Development', (1995) 11 *JL Econ & Org* 1. On the underlying idea of competition as a discovery process see Friedrich A von Hayek, *New Studies in Philosophy, Politics, Economics and the History of Ideas* (The University of Chicago Press, Chicago 1979) 179 -190.

[2] Early accounts of the States' competition for corporate charters can be found in William C Cook, *A treatise on stock and stockholders, bonds, mortgages and general corporation law as applicable to railroad, banking, insurance* (3rd edn Callaghan and Co., Chicago 1894) 1604-5; Edward Q Keasby, 'New Jersey and the Great Corporations' (1899) 13 *Harv L Rev* 198, 201-2.

[3] For various facets of the complex debate see eg William L Cary, 'Federalism and Corporate Law: Reflections upon Delaware' (1974) 83 *Yale LJ* 663 (arguing that Delaware's dominance evidences a race for the bottom); Ralph K Winter, Jr., 'State Law, Shareholder Protection, and the Theory of the Corporation' (1977) 6 *J Legal Stud* 251 (maintaining that Delaware's responsiveness to the demands of incorporators makes for a race to the top); Roberta Romano, 'Law As a Product: Some Pieces of the Incorporation Puzzle' (1985) 1 *JL Econ & Org* 225 (arguing that Delaware dominates the market because it offers an attractive and flexible mix of corporate law rules and also provides a credible commitment that it will continue to supply that mix of rules in the future); Lucian A Bebchuk, 'Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law' (1992) 105 *Harv L Rev* 1435 (arguing that Delaware's dominance accounts for a pro-managerial tilt in US corporate law); Michael Klausner, 'Corporations, Corporate Law, and Network of Contracts' (1995) 81 *Va L Rev* 757, 842-47 (showing that Delaware benefits from positive network externalities like its extensive body of case law, its experienced administration and judiciary etc.); Robert Daines, 'Does Delaware Law Improve Firm Value?', (2001) 62 *J Fin Econ* 525 (finding that Delaware firms exhibit a higher valuation of 5 percent in terms of Tobin's *q*); Marcel Kahan and Ehud Kamar, 'The Myth of State Competition in Corporate Law', (2002) 55 *Stan L Rev* 679 (purporting

versy regarding regulatory competition's merits has more recently extended to other areas of regulation,[4] including the adjacent territory of securities regulation. Here, some scholars have argued in favour of issuer choice of disclosure regulation,[5] while others have advocated upholding a mandatory regime.[6] Whatever the merits of issuer

that political and economic barriers prevent States from mounting a serious competitive challenge to Delaware's monopoly); Mark J Roe, 'Delaware's Competition', (2003) 117 *Harv L Rev* 588 (arguing that Delaware's corporate law legislation and adjudictation was shaped by the permanent threat of Federal preemption); Oren Bar-Gill, Michal Barzuza and Lucian A Bebchuk, 'The Market for Corporate Law' (2006) 62 *J. Inst. & Theo. Econ.* 134 (devising a model that indicates that a dominant state has incentives to underprice its corporate law package and will favor managers' preferences).

[4] Other ambits of law where regulatory competition was recommended in light of the experience on the US market for incorporations include, among others, bankruptcy law (cf. *e.g.* David A Skeel, Jr., 'Lockups and Delaware Venue in Corporate Law and Bankruptcy' 68 *U Cin L Rev* (2000) 1243, 1270-79 (assenting social benefits from liberal bankruptcy venue rules similar to those achieved in charter competition); Lynn M LoPucki and Sara D Kalin, 'The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a "Race to the Bottom"', (2001) 54 *Vand L Rev* 231, 232-37 (arguing that contrary to charter competition forum shopping in US bankruptcy law represents a race to the bottom) as well as environmental law (see Richard L Revesz, 'Rehabilitating Interstate Competition: Rethinking the "Race-to-the-Bottom" Rationale for Federal Environmental Regulation', (1992) 67 *NYUL Rev* 1210 (advocating federalism in environmental law); Jonathan A Adler, 'Wetlands, Waterfowl, and the Menace of Mr. Wilson: Commerce Clause Jurisprudence and the Limits in Federal Wetland Regulation' (1999) 29 *Envtl L* 1, 44 (same); Daniel C Esty, 'Revitalizing Environmental Federalism', (1996) 95 *Mich L Rev* 570, 633-34 (claiming differences in the mode of operation of competitive forces on the market for incorporations and in environmental regulation).

[5] See eg Stephen J Choi and Andrew T Guzman, 'The Dangerous Extraterritoriality of American Securities Law' (1996) 17 *Nw J Int'l L & Bus* 207, 228-30 (advocating reduced extraterritoriality of US securities laws in order to allow for maximum regulatory choice of issuers); Stephen J Choi and Andrew T Guzman, 'Portable Reciprocity: Rethinking the International Reach of Securities Regulation' (1998) 71 *S Cal L Rev* 903, 941-45 (arguing for unrestricted mutual recognition of international disclosure regimes); Roberta Romano, 'Empowering Investors: A Market Approach to Securities Regulation' (1998) 107 *Yale LJ* 2359, 2362, 2418 (proposing that issuers be permitted to opt into both US States' and foreign nations disclosure regimes); Alan R Palmiter, 'Toward Disclosure Choice in Securities Offerings' [1999] *Col Bus L Rev* 1, 86-91 (restricting issuer choice to the selection of a primary market disclosure regime).

[6] Merritt B Fox, 'Securities Disclosure in a Globalizing Market: Who Should Regulate Whom? ' (1997) 95 *Mich L Rev* 2498, 2582-85 (recommending a "issuer nationality approach" which would apply the dis closure standards of the issuers' jurisdiction of incorporation mandatorily); James D Cox, 'Regulatory Duopoly in US Securities Markets' (1999) 99 *Colum L Rev* 1200, 1237-43 (arguing that sacrificing SEC authority as the sole regulator would reduce its weight in international standard setting and conjure up enforcement deficiencies which loom under a regime of issuer choice); Merritt B Fox, 'Retaining Mandatory Securities Disclosure: Why Issuer Choice is not Investor Empowerment' (1999) 85 *Va L Rev* 1335, 1345-56 (holding that the divergence between managers' private benefits and social benefits derived from disclosure rules will induce suboptimal outcomes under a regime of issuer choice); see also John C Coffee, Jr., 'Racing Towards the Top?: The Impact of

choice, a long-standing tradition of pre-emptive Federal legislation[7] makes any attempt to change the allocation of regulatory power between the federal government and the states a political non-starter. Similarly, as a practical matter issuer choice represents a rather remote policy option with regard to foreign securities.[8] This holds true even in the current scenario in which the two main US stock exchanges, the NYSE and the NASDAQ, have taken over foreign competitors and thus can offer some regulatory choice to their customers.[9] In fact, US ownership of foreign exchanges does not increase the options from an issuer's perspective: just like prior to the NYSE's and the NASDAQ's acquisitions, issuers can opt for foreign securities laws only by listing exclusively on Euronext or OMX, but are still prevented from listing on US exchanges without submitting to US securities regulation.

The European situation has traditionally looked quite differently. Until recently, regulatory competition in corporate law was basically ruled out, while, unlike the US, securities regulation has always been a matter for the Member States.

After the European Court of Justice (hereinafter: ECJ) rendered its now fa-

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Cross-Listings and Stock Market Competition on International Corporate Governance' (2002) 102 *Colum L Rev* 1757, 1827-29 (arguing for "exitless" competition, i.e. a regime where issuers cannot escape their home jurisdiction's regulation but opt into stricter standards by cross-listing their shares).

[7] Cf. Securities Act of 1933, 15 U.S.C. §§77a ff (2005); Securities Exchange Act of 1934, 15 U.S.C. §§78a ff (2005).

[8] To be sure, already today, reporting obligations under US securities laws contain many exemptions for foreign private issuers. See eg Rules and Regulations under the Securities Exchange Act of 1934, Rule 13a-16(b), 17 C.F.R. §240.13a-16(b) (2007); Form 6-K sub B, §17 C.F.R. §249.306 (2007) (exempting foreign private issuers from quarterly reporting obligations); Rule 13a-11(b), 17 C.F.R. §240.13-11(b) (2007) (no duty to file current reports of significant events for foreign private issuers). Yet, most of these exemptions do not permit issuer choice. Put briefly, US securities laws generally submit foreign private issuers to a less stringent regime compared to domestic issuers, but this regime is still mandatory. True issuer choice is only permitted within very narrow limits: foreign private issuers can choose to prepare their financial statements in accordance with US Generally Accepted Accounting Principles (GAAP) or can stick with their home country accounting methodology in which case they have to reconcile their financial statements with US GAAP. See Form 20-F, Items 17 and 18, 17 C.F.R. §240.220f (2007).

[9] See Chris Brummer, 'Stock Exchanges and the New Market for Securities Laws' Vanderbilt Law and Economics Working Paper 08-11 <http://ssrn.com/abstract=1014683> accessed 9 April 2008.

mous rulings in the *Centros*,[10] *Überseering*,[11] and *Inspire Art*[12] cases, which effectively prescribe mutual recognition of corporations established under the law of a Member State of the European Union (hereinafter: EU), regulatory competition is starting to gain ground in EU corporate law as well.[13]

At the same time, notwithstanding recent efforts at more pervasive and effective harmonization at the supranational level, national securities laws still vary considerably across the EU. Further, recent European Community (hereinafter: EC) directives have harmonized conflict of laws rules in securities laws, often linking the applicable securities law regime to a company's registered seat. As a consequence, and leaving aside the still relevant obstacles to reincorporations, in the EU there is now greater room for regulatory arbitrage[14] also in securities law.[15]

Scholars have scrutinized regulatory competition as a general alternative to

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[10] Case C-212/97 *Centros Ltd. v. Erhvervs- og Selskabsstyrelsen* [1999] ECR I-1459.

[11] Case C-208/00 *Überseering BV v. Nordic Construction Company Baumanagement GmbH* [2002] ECR I-9919.

[12] Case C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd.* [2003] ECR I-10155.

[13] See eg John Armour, 'Who Should Make Corporate Law? EC Legislation versus Regulatory Competition' in John Armour and Joseph A. McCahery (eds), *After Enron – Improving Corporate Law and Modernising Securities Regulation in Europe and the US* (Hart Publishing, Portland, 2006) 497.

[14] While we are aware that the term is sometimes used with a negative connotation to describe a race to the bottom-like outcome of issuer choice (see eg Amir N Licht, 'Regulatory Arbitrage for Real: International Securities Regulation in a World of Interacting Securities Markets' (1998) 38 *Va J Int'l L* 563, 567, 636; Ethiopis Tafara and Robert J Peterson, 'A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework' (2007) 48 *Harv Int'l LJ* 32, 52), we use it here in a neutral sense to describe issuers' choosing their securities law environment deliberately to obtain gains from regulation, whether because this allows insiders to extract higher rents to the detriment of outside investors or because, to the contrary, it better protects the latter and allows to reduce issuers' cost of capital. Further, it is worth clarifying that regulatory arbitrage is different from, and does not necessarily coexist with, regulatory competition, because issuers may engage in the former even in the absence of states' competition to attract them with a "better" regulatory environment. See generally Stephen Woolcock, 'Competition among Rules in the Single European Market' in William W Bratton and others (eds), *International Regulatory Competition and Coordination – Perspectives on Economic Regulation in Europe and the United States* (Clarendon Press, Oxford 1996) 289, 298.

[15] See also Eilís Ferran, *Building an EU Securities Market* (Cambridge University Press, Cambridge 2004) 56 (hinting at a conceivable connection between corporate mobility and securities law arbitrage).

comprehensive harmonization in the EU.[16] In particular, the prospects for a European race for incorporations and the policy implications of enhanced corporate mobility in the wake of the ECJ judgements have attracted extensive examination.[17] In this article we contribute to the debate on regulatory competition in securities and corporate law by analyzing recent EC securities legislation with regard to the legal arbitrage potentials it contains and the implications that issuers' choice of law decisions may entail.

Our article is structured as follows. We start by describing the core features of EC securities regulation. In light of this article's focused objective we confine our analysis to the current EU securities law framework which represents the implementation of the EU Commission's Financial Services Action Plan (hereinafter: FSAP)[18] (Part II). Next, we identify the relevant criteria under the conflict of laws rules contained in the FSAP implementing directives. To facilitate the appraisal of these rules we initially provide a brief survey of the European international private law rules which governed prior to the implementation of the FSAP. In our main analysis of the recently promulgated directives we show an important parallelism of conflict of laws

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[16] See eg Jeanne-May Sun and Jacques Pelkmans, 'Regulatory Competition in the Single Market' (1995)33 *J Common Mkt Stud* 67; Woolcock (n 14).

[17] Eg Klaus Heine and Wolfgang Kerber, 'European Corporate Laws, Regulatory Competition and Path Dependence' (2002) 13 *Eur J L & Econ* 47; Klaus Heine, 'Regulatory Competition between Company Laws in the European Union: the *Überseering*-Case' (2003) 38 *Interecon - Rev Eur Econ Pol'y* 102; Luca Enriques, 'EC Company Law and the Fears of a European Delaware', (2004) 15 *EBL Rev* 1259; Tobias H. Tröger, 'Choice of Jurisdiction in European Corporate Law – Perspectives of European Corporate Governance' (2005) 6 *EBOLR* 3; Martin Gelter, 'The Structure of Regulatory Competition in European Corporate Law', (2005) 5 *JCLS* 247; Christian Kirchner, Richard W Painter and Wulf A Kaal, 'Regulatory Competition in EU Corporate Law after Inspire Art: Unbundling Delaware's Product for Europe', (2005) 2 *ECFR* 159-206; Eva-Maria Kieninger, 'The Legal Framework of Regulatory Competition Based on Company Mobility: EU and US Compared', (2005) 6 *German LJ* 740; Luca Enriques and Martin Gelter, 'How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law' (2007) 81 *Tul L Rev* 577.

[18] Commission (EC), 'Financial Services: Implementing the Framework for Financial Markets: Action Plan' (Communication) COM (99) 232 final, 11 May 1999).

rules in EU corporate and securities laws:[19] with due exceptions, such rules apply identical criteria in both areas (Part III). Having thus established the basis, we assess the potential for issuer choice in European securities laws thereby distinguishing two scenarios: one in which the transfer of an existing company's registered office is materially impeded, the other where existing firms' can easily engage in company (and therefore securities law) arbitrage. We also scrutinize legal arbitrage implications where choice of law does not require the transfer of the issuer's registered office, to wit in the context of takeover regulation (Part IV). Finally, we conclude (Part V).

II. THE EC CAPITAL MARKET REGULATION FRAMEWORK

This part provides some background information to allow a reader unfamiliar with EC securities law to better gauge the potentials for legal arbitrage within the EU. After providing a few basic concepts of EC law which account for its still scattered and fragmentary nature, this Part briefly describes the EC achievements in the area of securities law harmonization, focusing on the most recent wave of EC measures.

A. EC Powers and Instruments of Securities Law Harmonization

The EC has the power to harmonize national securities laws of its Member States under the EC Treaty as a means to further an integrated common market.[20]

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[19] The relevance of the FSAP implementing directives stretches beyond EU Member States. They are also binding for the Member States of the European Economic Area (E.E.A.) and have to be incorporated into these jurisdictions' domestic law in accordance with the Agreement on The European Economic Area, , [1994] OJ L1/3 art 7. Terminologically, we do not explicitly refer to E.E.A. Member States in this article, although the substantive content of our deliberations extends to them as well.

[20] Consolidated Version of the Treaty Establishing the European Community, , [2006] OJ C321/37 [hereinafter EC Treaty] art 44(1). Although the procedure for the adoption of specific measures has changed over time, the European legislative was endowed with this competence since the Community's establishment, see Treaty Establishing the European Economic Community, (adopted 25 March 1957, , 298 UNTS 3) art 54(2). See generally Niamh Moloney, *EC Securities Regulation* (Oxford University Press, Oxford 2002) 5-10.

The instruments at its hand are regulations and directives.[21] While EC regulations contain binding law directly applicable in each Member State, directives only prescribe the goals of harmonization but leave the form and method of their implementation to the Member States' discretion.[22]

The earliest steps toward securities law harmonization pointed towards a comprehensively harmonized, unitary European capital market under the supervision of a single supranational authority.[23] Yet, such ambitious plans were dropped after the UK joined the EC in favour of an approach which pursued a close integration of national securities markets but upheld their principal autonomy.[24] This was done through legislative measures targeting only certain aspects of capital market regulation that seemed particularly critical in approximating Member States securities laws, namely the conditions for admission to the primary market segment of stock exchanges,[25] the information to be published when such listing is sought,[26] the interim reporting duties of companies admitted to such listing,[27] the transparency requirements when significant shareholdings are assembled in listed companies,[28] the

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[21] EC Treaty, art 95.

[22] See EC Treaty, art 249. To be sure, often directives contain precise and detailed rules, which however Member States still have to translate into national law rules.

[23] Report of a Group of Experts Appointed by the EEC Commission, 'The Development of a European Capital Market' (Segré Report) (1966) <http://ec.europa.eu/economy_finance/emu_history/documentation/chapter1/19661130en382develeurocapitm_a.pdf>.

[24] For this change in policy goals see Richard M Buxbaum and Klaus J Hopt, *Legal Harmonization and the Business Enterprise* (Walter de Gruyter, Berlin 1988) 1-23, 280-83.

[25] Council Directive (EEC) 79/279 coordinating the conditions for the admission of securities to official stock exchange listing [1979] OJ L66/21.

[26] Council Directive (EEC) 80/390 coordinating the requirements for the drawing up, scrutiny and distribution of the listing particulars to be published for the admission of securities to official stock exchange listing [1980] OJ L100/1 [hereinafter Listing Particulars Directive].

[27] Council Directive (EEC) 82/121 on information to be published on a regular basis by companies the shares of which have been admitted to official stock-exchange listing [1982] OJ L48/26.

[28] Council Directive (EEC) 88/627 on the information to be published when a major holding in a listed company is acquired or disposed of [1988] OJ L348/62.

obligation to publish a prospectus when securities are offered to the public,[29] and the regulation of insider trading.[30] Most of this initial legislation was later consolidated into a single directive[31] and soon later largely superseded by more ambitious harmonization measures.

B. The FSAP and its Implementation.

To achieve a higher degree of financial markets integration, in 1999 the European Commission issued a plan to further and more effectively harmonize EU securities laws, the FSAP. The plan was complemented by a new structure in the legislative practice which relies on principal directives promulgated under the traditional, multi-institutional procedure[32] spelling out the central objects of the harmonizing measures but leaving the details to "level-2" directives devised by the Commission in order to speed up the regulatory process and ensure a higher degree of adaptability of EC provisions.[33] The FSAP was implemented in the first years of this decade through a number of legislative measures regulating or re-regulating financial services, securities markets, and corporate governance.[34] Among them are four core

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[29] Council Directive (EEC) 89/298 coordinating the requirements for the drawing-up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public [1989] OJ L124/8 [hereinafter Public Offerings Directive].

[30] Council Directive (EEC) 89/592 coordinating regulations on insider dealing [1989] OJ L334/30 [hereinafter Insider Trading Directive].

[31] Directive of the European Parliament and of the Council (EC) 2001/34 on admission of securities to official stock exchange listing and on the information to be published on those securities [2001] OJ L184/1 [hereinafter Consolidated Admission and Reporting Directive].

[32] The adoption of a directive requires the European Parliament and the Council to consent to the Commission's proposal. See EC Treaty, artt 95, 251.

[33] This regulatory practice draws on the recommendations of an expert group appointed by the European Commission. See The Committee of Wise Men, 'The Regulation of European Securities Markets: Final Report' (Lamfalussy Report) (2001) <http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf>; for a detailed description of the regulatory process see Ferran, (n 15) 61-84.

[34] See Luca Enriques and Matteo Gatti, 'Is There a Uniform EU Securities Law After the Financial Services Action Plan?' in Paul Krüger Andersen and Karsten Engsig Sørensen (eds), *Company Law and Finance* (Thomson, Copenhagen 2008) 167, 167-68.

components of the EC securities regulation framework, the Prospectus Directive,[35] the Takeover Bids Directive,[36] the Transparency Directive,[37] and the Market Abuse Directive.[38] Because our analysis later focuses on these legislative measures, we provide a brief overview of their contents here with particular regard to the arbitrage potentials they leave.

1. The Prospectus Directive. The Prospectus Directive and its implementing measures under the Lamfalussy architecture clearly mark a peak in the EC's regulation of mandatory disclosure for primary markets.[39] As a piece of legislation that aims at maximum harmonization in important respects, the EC prospectus regime leaves Member States with little maneuvering space with regard to the implementation of the Directive's substantive provisions.[40] Yet, despite the maximum harmonization approach, legal arbitrage with regard to primary market disclosure will continue to play a considerable role with regard to some substantive aspects that are still left to Member States, chief among them the liability regime for false statements in

[35] Directive of the European Parliament and of the Council (EC) 2003/71 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC [2003] OJ L345/64 [hereinafter Prospectus Directive].

[36] Directive of the European Parliament and of the Council (EC) 2004/25 on takeover bids [2004] OJ L142/12 [hereinafter Takeover Bids Directive].

[37] Directive of the European Parliament and of the Council (EC) 2004/109 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC [2004] OJ L390/38 [hereinafter Tansparency Directive].

[38] Directive of the European Parliament and of the Council (EC) 2003/6 on insider dealing and market manipulation (market abuse) [2003] OJ L96/16 [hereinafter Market Abuse Directive].

[39] Aligned with international disclosure standards (see International Organization of Securities Commissions, 'International Disclosure Standards for Cross-Border Offerings and Inititial Listings by Foreign Issuers' (1998) <http://iosco.org/library/pubdocs/pdf/IOSCOPD81.pdf> accessed 25 October 2007), prospectuses for any kind of security must contain detailed statements about the offered securities, the intended use of the proceeds, the nature and performance of the issuer's business as well as the identity of managers and large blockholders. For details see Prospectus Directive, art 5 and Annex I; Commission Regulation (EC) 809/2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements [2004] OJ L149/1 artt. 3-28,.

[40] For this assessment see Ferran (n 15) 143.

prospectuses.[41] Moreover, significant arbitrage potential follows from national variations in the uniform rules' administration and enforcement.

2. The Takeover Bids Directive. Leveling the playing field by harmonizing Member States' takeover laws has long been a goal for EC lawmakers.[42] Yet, with more ambitious attempts to achieve uniformity having fallen flat in Parliament,[43] the finally adopted version of the Directive leaves important aspects of takeover regulation for the Member States to determine at their discretion. Besides the threshold percentage which determines when a mandatory bid has to be made and its calculation,[44] it is particularly the optional character of the restrictions for the target's board in fending off hostile bids and of the break through-rule that suspends voting caps and transfer restrictions under certain conditions,[45] which allows for significant divergence of Member States' substantive law.[46] As a consequence, existing idiosyncrasies of pivotal parts of Member States' takeover laws still persist, retaining significant potential for legal arbitrage in the field.

3. The Transparency Directive. The Transparency Directive performs the same regulatory function for EU secondary markets that can be attributed to the Prospectus Directive with regard to the Community's primary markets, in a sense mirroring the division of labor familiar from the US Securities Act of 1933[47] and the Securities Exchange Act of 1934.[48] The cornerstones of the Directive's periodic information requirements are issuers' duties to publish annual financial reports[49] as well

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[41] See Enriques and Gatti, (n 34) 177-80 (detailing the various issues that the Prospectus Directive leaves to Member States).

[42] The Commission first announced its intention to propose a Directive in 1985. See European Commission, 'Completing the Internal Market: White Paper from the Commission to the European Council' COM (1985) 310 35, .

[43] On the reasons for this failure see Ferran, (n 15) 116-17.

[44] Takeover Bids Directive, art 5(3).

[45] Ibid, art. 9, 11 and 12.

[46] For a more comprehensive overview see Enriques and Gatti (n 34) 185-88.

[47] 15 U.S.C. §§77a ff (2005).

[48] 15 U.S.C. §§78a ff (2005).

[49] Transparency Directive, art 4.

as half-yearly interim financial reports,[50] and the obligations to disclose the acquisition and disposal of major shareholdings.[51] Yet, while the Prospectus Directive largely preempts Member States' idiosyncratic systems of primary market information, the Transparency Directive only puts up minimum standards which Member States may intensify.[52] Hence, differentiation among Member States with regard to the Transparency Directive's disclosure obligations is still possible. Moreover, private law liability for false or misleading statements, public enforcement of the directives disclosure obligations, and criminal sanctioning do not fall within the scope of the directives program of substantive harmonization.[53]

4. The Market Abuse Directive. The Market Abuse Directive[54] aims at policing manipulative and abusive practices which potentially can be deployed by corporate insiders as well as any other market agent. Hence, not only the prohibition of trading on inside information[55] and the ban on market manipulation[56] but also the preemptive obligation to immediately disclose, under certain conditions, inside information with relevance to the price of an issuer's financial instruments (so-called ad hoc disclosures)[57] represent prototypical market regulation. Although the Market Abuse Directive in principle allows Member States to promulgate stricter rules gov-

[50] Ibid, art 5.

[51] Ibid, art 9.

[52] The important facet of the pertinent rule is that it conforms to the home-state rule of the Transparency Directive's conflict of laws rules (cf 2.): only the home Member State, *i.e.* the jurisdiction whose substantive law principally governs, can tighten the ongoing disclosure requirements, while the host Member State has to recognize the incorporation domicile's standards without modification. See Transparency Directive, art 3.

[53] Enriques and Gatti (n 34) 183.

[54] Market Abuse Directive (n 37).

[55] Market Abuse Directive, artt 2-4.

[56] Market Abuse Directive, art 5.

[57] Market Abuse Directive, art 6. For the Directive's definition of inside information cf Market Abuse Directive, art 1(1) and Commission Directive (EC) 2003/124 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the definition and public disclosure of inside information and the definition of market manipulation, [2003] OJ L339/70 art 1.

erning their markets, EU implementing regulations[58] narrowed this leeway significantly and effectively rendered the EU framework a maximum harmonization regime. Yet again, national differences survive with regard to the liability regime governing infringements of the directive's proscriptions and its enforcement in general.[59]

C. Measuring the Room for Securities Law Arbitrage in the EU: A Tentative Assessment

Our brief survey indicates that, contrary to the US, securities regulation is still chiefly a matter of national law in the EU. In fact, despite ever more far-reaching efforts at harmonizing European capital market regulation that definitely have made national laws more similar, the still patchy and incomplete character of EC securities law and the fact that its private and public enforcement is almost purely a matter for the Member States mean that differences in national securities law regimes are still relevant.[60] In other words, unless private international law rules or other factors prevent it, the substantive law framework leaves plenty of scope for issuer choice. We now turn to conflict of laws rules to understand whether these are an obstacle to it.

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[58] For the implementation of the Market Abuse Directive see Commission Directive 2003/124/EC (n 59); Commission Directive (EC) 2003/125 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest [2003] OJ L339/73; Commission Directive (EC) 2004/72 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification of suspicious transactions [2004] OJ L162/70; Commission Regulation (EC) 2273/2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and stabilisation of financial instruments [2003] OJ L336/33.

[59] See Enriques and Gatti (n 34) 182.

[60] Obviously, this finding raises an important policy question we will not address here directly: whether EU policy-makers hit the right balance between promulgating mandatory securities law to correct market failures on the one hand and affording sufficient latitude for competitive forces to develop their beneficial functions on the other. Yet, our findings relating to prospective developments under the current legal framework are important as the starting point for a more general assessment which scrutinizes policy alternatives more categorically.

III. THE CONFLICT OF LAWS RULES IN THE FSAP-IMPLEMENTING MEASURES (AND THEIR PREDECESSORS)

This part describes the conflict of laws rules of the FSAP implementing directives. By introducing the relevant provisions we set the stage for our further analysis of the scope for issuer choice in the EU and the ensuing policy implications. First, however, we briefly review the international private law regime governing European cross-border securities transactions prior to the promulgation of the FSAP-regulatory framework and highlight the shortcomings of this regime. This will help us in the appraisal of the new rules in Part IV.

But why has EC securities law intervened in the field of conflict of laws rules to begin with? National conflict of laws rules in this area are typically a function of the public nature of securities laws that reflect a certain polity's conception of adequate capital market regulation.[61] Thus, absent coordination, jurisdictions traditionally follow the "affected market" principle, i.e. each of them applies its securities law to transactions having a territorial connection to it (*e.g.* offerings targeted to the state's residents, listings in one of the states' exchanges, and so forth). The implications for issuers engaging in cross-border transactions are straightforward: issuers are required to comply with a plurality of legal regimes, thus raising the costs of such cross-border activity (the multi-jurisdiction problem).[62] From a different angle, issuers from one Member State cannot conduct transactions in another Member State (*e.g.* offer securities to the public there) without subjecting themselves concurrently to this Member State's legal regime. In other words, issuers from one Member State wishing to tap another Member State's capital market have to "buy" the pertinent market's legal environment too (bundling problem), again with higher costs for such cross-border activity.

[61] For this public interest view of securities lawmaking, see eg Licht (n 14) 565.
[62] See eg Enriques and Gatti, (n 34) 170.

To the extent that private international law is an obstacle to the EC's goal of integrating European securities markets, it is easy to justify harmonized conflict of laws rules tackling the multi-jurisdiction and the bundling problems.

A. The Pre-FSAP Conflict of Laws Rules

Whether explicitly or implicitly, prior to the FSAP-implementing measures, conflict of laws rules with regard to European securities regulation followed the traditional affected market rule: the legal regime of the market being affected most eminently governed the pertinent conduct or transaction. Hence, in the context of exchange-traded securities, admission to a certain market in principle determined the applicability of the law of the Member State where the exchange was situated as well as its administration by that Member State's securities regulator.[63] As a consequence, the affected market rule could give rise to the multiple jurisdiction problem, i.e. multiple national laws would apply to any transaction conducted in more than one Member State (*e.g.* a pan-European IPO) or to issuers with multiple listings.

On the other hand, issuers wishing to escape their home Member State's securities laws could do so by seeking registration of their securities abroad. Of course, such an opt-out made it more difficult for issuers to still openly tap their domestic capital markets,[64] arguably the ones where security offerings promise the largest suc-

[63] For a manifestation of these largely unwritten rules see *e.g.*, Consolidated Admissions and Reporting Directive, artt 2(1), 3(1), 11(1), 105 (primary and secondary market disclosure obligations according to the law and administered by the competent authority of the Member State where admission to official listing occurred or is sought); on the implicit pre-FSAP conflict of laws rules see generally Stefan Grundmann, European Company Law (Intersentia, Antwerpen Oxford 2007) 385-89; Moloney (n 20) 100-102, 159, 160-61, 172, 767.

[64] See eg Consolidated Admission and Reporting Directive, art 37 (declaring applicable – for prospectus purposes – the law of the Member State of the registered office in case of simultaneous applications for official listing). The only conceivable way to offer securities admitted to official listing on the issuer's home market without becoming subject to the initial disclosure obligations of the law of the home Member State was under the Directive's safe-harbour provisions. However, these safe-harbours did not permit the public offering of equity securities. See Consolidated Admission and Reporting Directive, art 23. Hence, issuers wishing to avoid multi-jurisdiction problems were compelled to avoid official listing in their home Member State and could sell their securities to domestic

cess, due to higher investor recognition.[65]

Moreover, issuers in search of a suitable non-legal infrastructure, even if they were willing to limit themselves to transacting on one market only, had to submit to the selected market's securities regulation environment.

Hence, while pre-FSAP conflict of laws rules allowed for some legal arbitrage with regard to securities regulation under the affected market principle, they failed to address the multiple-jurisdiction and the bundling problems. Let us now describe the post-FSAP Directives' conflict of laws rules.

B. The Prospectus Directive

As a fundamental regulatory principle, administrative competence determines the applicable substantive law, relieving competent authorities of the burden to administer foreign law. Hence, as a general rule, the Prospectus Directive provides that public offerings and admissions to trading (i) are reviewed by the regulator of the Member State where the issuer has its registered office (home State[66]) and (ii) for matters covered by the Directive itself, are subject to the law of their home State,[67] no matter where the offering is conducted, that is, even if the offering is made abroad and no local investor is solicited.[68] However, this rule does not apply with respect to

investors only by making use of the Public Offerings Directive's exemptions. See n 115 and accompanying text.

[65] Cf. Robert C Merton, 'A Simple Model of Capital Market Equilibrium with Incomplete Information' (1987) 42 *J Fin* 483, 494 (showing that a firm's investor base is correlated to investors knowing about the security).

[66] Prospectus Directive, art 2(1)(m)(i).

[67] Prospectus Directive, art 21(1) requires Member States to concentrate the administrative powers conferred by the Directive in the hands of one competent authority (see also Prospectus Directive, recital 37). The designated administrative body has the competence to review the prospectus prior to its publication, Prospectus Directive, art. 13. This regulation of administrative competence implies the pertinent conflict of laws provision, as the competent authority is supposed to automatically apply its domestic law.

[68] The Prospectus Directive's predecessors were more lenient in this respect, see n 63. Issuers seeking multiple listings or conducting a plurality of offerings outside of the Member State of their registered office simultaneously could choose any of the competent authorities in the Member States where they developed their activities. Hence, the multiple jurisdiction problem was somewhat attenu-

offers of non-equity securities with a nominal value higher than Euro 1,000 and certain derivatives. In this case the issuer can choose to select among the law of its State of incorporation, of the place of listing or of the place where the offer is made to the public.[69] The "home State" of non-EU issuers of equity or low denomination debt is, on the other hand, the Member State in which the issuer (or the offeror or the person seeking admission to trading) first[70] makes an offer of such securities to the public or first applies for the admission of such securities to trading.[71]

It is also worth pointing out that the Prospectus Directive qualifies depositary receipts (DRs) as non-equity securities.[72] More importantly, the depositary institution – and not the issuer of the underlying shares – will be regarded as the issuer subject to the obligations laid out in the Directive.[73] As a consequence, with relative ease issuers can use DR-facilities for choice of law purposes: depositing shares with an institution registered in the designated Member State and having it offer the receipts to the market will lead to the application of the law on prospectuses and public offerings in force in the depositary's Member State.[74] Hence, a Danish issuer of

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ated in these cases. See Public Offerings Directive, art 20; Consolidated Admission and Reporting Directive, art 37. In contrast, the Listing Particulars Directive based administrative competence and the choice of applicable law solely on the location of the exchange to which admission was sought. See Listing Particulars Directive, art 24.

[69] The rationale behind this rule of issuer choice may be seen in positive network externalities. Both London and Luxemburg emerged as the centers of bond and derivative issuance activities in the EU. As a consequence, local supervisory authorities could gain significant expertise in dealing with such issuances which would be inaccessible for foreign issuers if the administrative competence for the pertinent issuances was invariably tied to the issuer's Member State of incorporation. For a critical assessment see Ferran, (n 15) 174-75.

[70] After the deadline set forth in the Directive of December 31, 2003. Cf Prospectus Directive, artt 2 (1)(m)(ii), 32.

[71] Prospectus Directive, art. 2(1)(m)(ii)(iii).

[72] Prospectus Directive, recital 12.

[73] See Committee of European Securities Regulators (CESR), 'Frequently asked questions regarding Prospectuses: Common Positions agreed by CESR Members' (2007) (Ref. CESR/07-110), Question No. 30 <http://www.cesr-eu.org> accessed 25 October 2007.

[74] DRs should be treated as non-denomination securities covered exclusively by Prospectus Directive, art 2(1)(m)(i). Yet, our conclusion even holds if the underlying shares' par value – in case they have one – is considered as the DR's "denomination". If DRs thus have a "denomination" above Euro 1,000 the depositary institution will have the choice provided for in Prospectus Directive, art

shares can relatively easily opt for the UK regulation of primary markets by depositing shares with a UK depositary bank even if the receipts are to be offered only on Danish markets.

C. The Takeover Bids Directive

The Takeover Bids Directive contains two distinct conflict of laws provisions. This bifurcated approach tries to separate matters relating substantively to corporate law from those relating to securities regulation. It will only lead to a divergence in applicable law if the issuer does not maintain a listing in the Member State where it has its registered office.

On the one hand, certain significant matters in connection with the mandatory bid rule, namely the definition of control to be adopted as threshold for the mandatory bid and the safe-harbors and exemptions to the duty to make such bids shall be determined by the law of the Member State in which the target has its registered office.[75] In the same vein, the law of the target's State of incorporation shall apply with regard to the permissible defensive tactics in a takeover situation.[76]

On the other hand, for the transparency-related issues[77] and the procedural duties under the Takeover Bids Directive in general, as well as for the price at which mandatory bids must be made, the EC legislature identified the place of listing as the connecting factor: issuers and market participants are subject to the law of the State where securities are admitted to trading on a regulated market.[78]

2(1)(m)(ii). Hence, even if the DRs are to be offered on the equity markets situated in the Member State where the issuer of the underlying shares has its registered office, the applicability of the law of this Member State can still be avoided by choosing the home state accordingly.

[75] Takeover Bids Directive, artt 4(2)(e), 5(3).

[76] Takeover Bids Directive, art 4(2)(e).

[77] The information of the target's employees, however, is subject to the law of the Member State where the target has its registered office, Takeover Bids Directive, art 4(2)(e).

[78] Once again, the applicability of the pertinent Member States substantive law is a consequence of the competence of its administrative authority. See Takeover Bids Directive, art 4(2)(e) and Takeover Bids Directive, art 4(2)(a)-(c).

In case of tender offers for shares of a European company having multiple listings in Europe, the Takeover Bids Directive makes an offeror subject to the disclosure, procedural and price-related rules of the target company's home Member State if the shares are listed on the home market[79], while, in case shares are not listed on the target's home market, to the rules of the host Member State where the shares were first admitted to trading;[80] in case the multiple listings occurred simultaneously, companies may choose the competent authority on the first day of trading.[81]

D. Transparency Directive

The Transparency Directive contains conflict of laws principles similar to the Prospectus Directive's.[82] Following the allocation of administrative competence,[83] issuers are subject to the law of their home Member State, which for EU issuers of shares or of low denomination (*i.e.* less than Euro 1,000) debt securities is the State of incorporation.[84] For non-EU issuers of equity or low denomination debt securities, the "home State" is determined according to the principles set forth in the Prospectus Directive.[85] An issuer of high denomination debt securities admitted to trading on a EU regulated market is subject to the special regime familiar from the pertinent rules of the Prospectus Directive.[86]

[79] Takeover Bids Directive, art 4(2)(a) and (e).

[80] Takeover Bids Directive, art 4(2)(b) and (e).

[81] Takeover Bids Directive, art 4(2)(c) and (e).

[82] In fact, Transparency Directive, art 24(1) obliges Member States to designate the administrative authority competent under the Prospectus Directive as responsible body for carrying out the obligations provided for in the Transparency Directive and for ensuring that the provisions adopted pursuant to the Directive are applied.

[83] Cf. Transparency Directive, artt 19(1), 21(1).

[84] Transparency Directive, art 2(1)(i)(i), first indent.

[85] Therefore, it will be, at the choice of the issuer, the Member State in which it first made (after 31 December 2003) an offer of such securities to the public or first applied for the admission of such securities to trading. See Transparency Directive, art 2 (1)(i)(i), second indent; Prospectus Directive, art 2(1)(m)(iii).

[86] See Transparency Directive, art 2, (1)(i)(ii) which accords with Prospectus Directive, art 2(1)(m)(ii). For the reasons of this separate treatment of high-denomination debt see Ferran (n 15) 174 (identifying Europe's pre-eminent bond-markets' lobbying efforts as the driving force).

In light of the legal arbitrage potential associated with DR offerings,[87] it is important to note that it is the issuer of the underlying shares and not the depositary institution that is subject to the reporting duties under the Transparency Directive.[88] Hence, while opting into any Member States' disclosure system at the initial stage is greatly facilitated by the Prospectus Directive's treatment of DRs, legal arbitrage with regard to disclosure duties in the Transparency Directive typically requires an issuer to actually change its jurisdiction of incorporation.

E. Market Abuse Directive

As a consequence of the nature of the prohibitions and obligations mapped out by the Market Abuse Directive,[89] its conflict of laws rules follow a twofold territorial approach. The applicable law is determined either by the location of the regulated market to which the pertinent financial instruments are or are requested to be admitted[90] or by the location where the relevant action is carried out.[91] Hence, an issuer may have to comply with various Member States' regulations:[92] its actions with relevance under the Market Abuse Directive (*e.g.* its ad hoc disclosures under the Market Abuse Directive) will most likely emanate from the Member State where its headquarters are located, and hence be subject to that Member State's law.[93] But they will also be subject to the law of the Member State where the issuer's financial

[87] See B, text to n 77.

[88] Cf Transparency Directive, art 2(1)(d).

[89] See II.B.4, text to n 56.

[90] The competent authority of the Member State in which the regulated market is situated or operates can apply the national law implementing the Directive regardless of the location where the pertinent actions are carried out, Market Abuse Directive, art 10(a).

[91] Market Abuse Directive, art 10(b), resembling the classical *lex loci commissi delicti*, pays tribute to the fact that certain activities or failures to act can be tracked more efficiently by the competent authorities at the location of their occurrence.

[92] See Ferran (n 15) 199-200.

[93] Of course, a company may locate its office in charge of ad hoc disclosures in another Member State (e.g. the State of the exchange where securities are admitted to listing) and thus pick that Member State's law on such disclosures instead of the law of the place where its headquarters are located.

instruments are admitted to a regulated market. Thus, any cross-border divergence between headquarter and listing location will lead to the parallel application of different national securities laws. Obviously, this effect of the Market Abuse Directive's conflict of laws rules is further amplified where an issuer maintains multiple listings within the EU.[94]

F. Summary

To conclude, the applicable securities laws within the EU are typically determined by the issuer's registered office or, less frequently, the regulated market in which its securities are admitted to trading. With due qualifications, the deliberate choice of a specific Member State's law on (i) disclosure at the IPO stage, (ii) periodic disclosure and disclosure on major holdings later, (iii) mandatory bids (excluding their price) and (iv) on board obligations in a takeover situation requires a transfer of the issuer's registered office.[95] With regard to the traffic rules on takeovers and bid price specifications the choice of listing location governs.[96] Finally, the Market Abuse Directive represents somewhat of an outlier. Its territorial regime with two concurring connecting factors does not attribute immediate relevance to the issuer's registered office but instead to the location where its relevant actions are carried out, *i.e.*, in the case of ad hoc disclosure rules, its administrative seat (or the place where the office in charge of them is located). Given the burdens associated with a transfer of the latter,[97] it seems fair to assume that choice of law considerations regarding se-

[94] Eg car manufacturer Volkswagen AG has shares listed not only on Germany's exchanges but also in Luxemburg and London (as well as in New York, Tokyo and Zurich). See Volkswagen AG, Share Fact Sheet *available at* http://www.volkswagenag.com/vwag/vwcorp/content/en/investor_relations/share/share_fact_sheet.html (last visited October 25, 2007).

[95] Sections B, C, and D, above.

[96] Section C, above.

[97] Obviously, a significant loss of value impends where headquarters, key operations, employees etc. have to be moved. In the conflict of corporate laws setting, it is exactly this cost-factor which renders the real seat doctrine (*siège reel*) a powerful tool to push through legal and social val-

curities laws within the substantive scope of the Market Abuse Directive will not play a significant role as far as the second prong of the Directive's conflict of laws rule is concerned.[98] Issuers will simply have to learn to live with the additional application and enforcement of the relevant laws in effect where their administrative seat is located. On the other hand, insofar as the applicable law depends on the admission to listing in a Member State's regulated market,[99] choice of law for Market Abuse Directive purposes is just as easy as the selection of specific traffic rules under the Takeover Directive's conflict of laws rules, albeit without a comprehensive solution to the multi-jurisdiction problem in the former case. In other words, by listing in a regulated market of a given Member State, an issuer can opt into that Member State's supposedly more suitable Market Abuse regime, while concurrently retaining the (less appreciated) home country regulations. If the office in charge of ad hoc disclosure, however, is moved to the State of listing, then even the multi-jurisdiction problem can in part be solved.

Table 1 summarizes the conflict of laws rules in the FSAP securities law directives that we have previously described.

ues a polity deems indispensable. See Werner F Ebke, 'Centros – Some Realities and Some Mysteries' (2000) 48 *Am J Comp L* 623, 625; Roberta Romano, *The Genius of American Corporate Law*, (The AEI Press, Washington 1993) 132-33.

98 Market Abuse Directive, art 10(b).

99 Market Abuse Directive, art 10(a).

Table 1 – Conflict of Laws Rules in Securities Law Directives

Directive	***Conflict of Laws Rules***
Prospectus	Registered office Non-equity securities, debt with denomination higher than Euro 1,000: issuer's choice among State of registered office, State of the place of listing or State of the place where offer is made to the public Issuer's choice for multiple listings by non-EU issuers
Takeover Bids	Registered office for defenses, information to employees and rules defining when a bid is mandatory Listing for other issues, including price of mandatory bid, with only one system to apply in case of multiple listings (issuer's choice in case of simultaneous listings)
Transparency	Registered office Non-equity securities, debt with denomination higher than Euro 1,000: issuer's choice among State of registered office or States of the places of listing Issuer's choice for multiple listings by non-EU issuers
Market Abuse	Listing and place where the relevant actions are carried out.

If we couple these findings with our previous analysis showing that significant areas of securities regulation remain unharmonized even under the EC directives implementing the FSAP,[100] we can concur with commentators who have located the regulatory framework in the EU as somewhere in the middle between unimpeded regulatory competiton and comprehensive harmonization:[101] it exhibits in-

[100] Supra at II.

[101] With specific regard to securities regulation see Ferran (n 15) 54 (noting that from the European perspective, dividing "harmonization and regulatory competition into diametrically oppos-

deed potential for legal arbitrage above the common rules and standards stipulated in the capital market directives. We now move on to assess the FSAP choice of law framework.

IV. ISSUER CHOICE IN THE EU: AN ASSESSMENT

A. Determinants of issuer choice under FSAP implementing measures

As Part III has shown, the post-FSAP directives contain uniform choice of law rules, meaning that the ground-rules for competition are equal across the European Union, allowing for synchronized legal arbitrage decisions among Member States' securities laws. Hence, a principal objection that has been articulated with regard to the prospects for global competition in securities regulation, i.e. that regulatory competition depended pivotally on the existence of a uniform conflict of laws regime,[102] does not apply within the EU.

Leaving aside the Market Abuse Directive's reference to the law of the place where the relevant actions have been carried out, for certain aspects European securities laws make the application of a Member State's implementing regulations depend pivotally on the choice of the issuer's listing location, whereas in other respects the selection of the Member State of incorporation becomes critical.

Both factors, in turn, are already the outcome of issuers' choice. Such is the case of listing location, at least after stock exchanges started to admit foreign issuers to listing.[103] The same is true for the registered seat, so long as company law arbi-

ing camps seems rather wide of[f] the mark").

[102] See Frederick Tung, 'Lost in Translation: From U.S. Corporate Charter Competition to Issuer Choice in International Securities Regulation' (2005) 39 *Ga L Rev* 525, 562-81 (questioning that the US charter competition can serve as a model for international securities regulation, because a comparable consensus over uniform conflict of laws rules that would duplicate the internal affairs doctrine? the backbone of US charter competition? is unlikely to emerge in a global context).

[103] It was one of the rationales of the Community's first securities law harmonization meas-

trage becomes more easily available in a post-*Centros* world.[104]

As an important consequence, the respective choices do not only depend on securities law considerations. Opting for certain regulations by choosing a jurisdiction of incorporation buys the issuer a comprehensive package of securities and corporate law. On the other hand, executing a choice of securities law by seeking admission to a specific Member State's regulated market entails the complex non-legal consequences of having shares traded on that market (*e.g.* changes in liquidity, investor recognition etc.).

B. Bundling Securities Regulation with the Law of the Registered Seat

Bundling the applicable securities law regime to the incorporation State raises different issues, depending on how easy corporate law arbitrage is. It is still an open question whether in Europe regulatory arbitrage in corporate law is a real possibility not only for start-ups but also for existing companies, mainly in light of tax

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ures to facilitate the cross-border admission to stock exchange listing in order to "make for greater interpenetration of national securities markets" at a time where stock exchanges enjoyed legal or natural monopolies. See Council Directive 79/279/EEC (n 24). See also Guido A Ferrarini, 'The Regulation of Stock Exchanges: New Perspectives' (1999) 36 *CML Rev* 569, 572-74 (arguing that the Directive's detailed prescriptions are obsolete and that in an environment characterized by competition among exchanges like today's, European legislation pertaining to admission requirements should be limited to "high level principles" granting exchanges greater discretion in designing admission standards); Guido A Ferrarini, 'Pan-European Securities Markets: Policy Issues and Regulatory Responses' (2002) 3 *EBOLR* 249, 274 (same with regard to the Consolidated Admissions and Reporting Directive).

[104] The Court of Justice of the European Communities (ECJ) with its now famous *grands arrêts* established the preconditions for enhanced corporate law arbitrage by *de facto* proscribing those Member States' conflict of corporate laws rules which impeded incorporation of domestic companies under foreign law. See *Centros* (n 10); *Überseering* (n 11); *Inspire Art* (n 12). These judgments virtually impose a uniform State of incorporation rule in the EU and mandate mutual recognition of the Member States corporate forms. See eg Thomas Bachner, 'Freedom of Establishment for Companies: A Great Leap Forward' (2003) 62 *Cambridge LJ* 47, 49 (end of real seat doctrine); Kilian Baelz and Theresa Baldwin, 'The End of the Real Seat Theory (Sitztheorie): the European Court of Justice Decision in Überseering of 5 November 2002 and its Impact on German and European Company Law' (2003) 3 *German LJ* (same). For a more nuanced overview of the legal consequences of the ECJ holdings see Werner F Ebke, 'The European Conflict-of-Corporate-Laws Revolution: *Überseering*, *Inspire Art* and Beyond' (2005) 16 *EBL Rev* 9.

obstacles.[105] We consider here two scenarios: first, the present one in which regulatory arbitrage by listed companies is extremely rare due to existing obstacles, and, second, the scenario in which, thanks to the *Centros* doctrine, the adoption of the European Company Statute,[106] the Cross-Border Merger Directive,[107] the amendments to the related tax directive,[108] and possibly other future EC measures,[109] it is easy for listed companies to reincorporate across the EU. Note that the latter scenario is the one already applying to companies prior to their IPO: at this stage, it is easy for shareholders to agree to contribute their shareholdings to a holding company in another Member State and take that company public.[110]

1. With no company law arbitrage available. Assuming, first, that company law arbitrage is *not* a viable option (which appears to be the case for existing listed companies), bundling corporate and securities laws has a number of negative impli-

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[105] See William W Bratton, Joseph A McCahery and Erik MP Vermeulen, 'How Does Corporate Mobility Affect Lawmaking? A Comparative Analysis' ECGI Working Paper, 24-25 < http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1086667> accessed 2 April 2008.

[106] Council Regulation (EC) 2157/2001 on the Statute for a European company (SE) [2001] OJ L294/1. On the role of the European Company as a catalyst for company law arbitrage in Europe, see Luca Enriques, 'Silence is Golden: The European Company Statute as a Catalyst for Company Law Arbitrage', (2004) 4 *JCLS* 77.

[107] Directive of the European Parliament and of the Council (EC) 2005/56 on cross-border mergers of limited liability companies, [2005] OJ L310/1 [Cross-border Merger Directive]. A cross-border merger facilitates reincorporation of existing entities, as they can be merged into a shell corporation established under the law of the favoured jurisdiction. Shortly prior to the adoption of the Directive, the ECJ compelled Member States to permit cross-border mergers even under unharmonized national merger statutes. See Case C-411/03, *SEVIC Systems AG* [2005] ECR I-10805.

[108] Council Directive (EC) 2005/19 amending Directive 90/434/EEC 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States [2005] OJ L58/ 19.

[109] Currently, the Commission's efforts to propose a 14th Company Law Directive on the cross-border transfer of the registered office of limited companies have been put on hold but could be resumed once the impact of the recent ECJ -adjudication on the freedom of establishment can be assessed. See EC Commission, 'Impact assessment on the Directive on the cross-border transfer of registered office' <http://ec.europa.eu/internal_market/company/docs/shareholders/ia_transfer_122007_part1_en.pdf > accessed 4 July 2008.

[110] In May 2007 an otherwise Italian firm, D'Amico International Shipping SA, listed in the main Italian stock exchange as a (recently incorporated) Luxembourg holding company. See Consob, 'Relazione per l'anno 2006' 28 (2007).

cations. First of all, an issuer that, for whatever reasons, wants access exclusively to European capital markets other than its own will have to comply with its home securities laws and, for certain aspects, with its host ones, with an increase in transaction costs.[111] Second, the bundling of securities and corporate law holds issuers from "bad" securities law jurisdictions captive, preventing them from "opting up" for a better regime to signal their quality. Third, with captive issuers there will be fewer incentives for policymakers and securities regulators in "bad" securities law jurisdictions to improve on their regulatory environment.

Consider that under the pre-FSAP regime, an issuer Alfa from State A wishing to tap foreign EU capital markets was not doomed to incur the multiple jurisdiction problem:[112] by offering its securities exclusively in State B and by having its securities listed in a State B regulated market,[113] only State B securities regulation would apply to Alfa.[114] Further, State A investors were certainly not precluded from investing in Alfa shares: they could do so through intermediaries having remote access to State B's regulated market. If the domestic capital market was one Alfa wanted to tap while listing abroad, it could sell shares to domestic intermediaries in a

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[111] One can think of a listed company engaging in an offer to the public of newly issued shares. The law of the State of incorporation will apply to the prospectus approval, but the conduct of the offering will be subject mainly to the law of the host state.

[112] See n 63 above.

[113] Although some commentators have doubted that such a complete bypass of an issuer's home market represents a realistic scenario (see e.g. Howell E Jackson and Eric J Pan, 'Regulatory Competition in International Securities Markets: Evidence from Europe in 1999 – Part I' (2001) 56 *Bus Law* 653, 679), real-world examples of issuers from countries with small and underdeveloped capital markets exist. See Amir N Licht, 'Managerial Opportunism and Foreign Listing: Some Direct Evidence' (2001) 22 *U Pa J Int'l Econ L* 325, 336 (Israeli firms accessing US markets directly).

[114] See section III.A above. To be sure, art. 5 of the Insider Trading Directive constituted a conflict of laws rule which led to the simultaneous application of the securities laws both of the Member State where the traded security was listed and of the Member State where the dealing insider executed the transaction. See Klaus J. Hopt, 'The European Insider Dealing Directive', (1990) *CML Rev* 51, 78-89. Yet, this rule was still different from the one under the Market Abuse Directive, because the relevant prohibitions of the Insider Dealing Directive did not target issuers as such. The issuer-relevant aspects of the Market Abuse Directive, i.e. the ad-hoc disclosure obligations, entered European law only through the Consolidated Admissions and Reporting Directive (see Grundmann (n 63) 469), which followed the affected market rule. See supra n 63.

private placement and expect them to resell them to local investors, each of the intermediaries taking advantage of the "small number" exemption[115] and/or counting on reverse solicitations by local investors. Alternatively, it could even make an offer to the public at home, circumscribing the multiple jurisdiction problem to the initial public offering stage, after which, in the absence of any listing on a domestic exchange, the home country securities laws would stop applying.

The post-FSAP regime worsens the life of issuers like Alfa, which will typically be those in Member States with smaller and/or less well developed capital markets, *i.e.* those for which market integration matters the most. In fact, not only will they have to deal with their home state securities laws and competent authority for prospectus approval[116] and compliance with Transparency Directive disclosure obligations,[117] and therefore retain local legal counsel for these purposes, but they will also have to obtain advice from lawyers from the country where the public offer or the admission to trading takes place both to conduct the offer to the public or the admission to trading and to comply with the Market Abuse Directive's disclosure requirements (which incidentally start applying as soon as an application for listing is made).[118] Intuitively, the interaction between the local counsel and the host country investment bankers and lawyers will entail higher transaction costs.

[115] Public Offerings Directive, art 2(1)(b).

[116] Unless of course the home state authority transfers the prospectus approval to the host state authority. Note that there is no similar possibility of transferring powers relating to Transparency Directive disclosure obligations.

[117] Consider also that the home state competent authority for prospectus approval, once securities have been admitted to trading on a regulated market, pursuant to Prospectus Directive, art 21(4)(a) has the power to "require the issuer to disclose all material information which may have an effect on the assessment of the securities admitted to trading on regulated markets in order to ensure investor protection or the smooth operation of the market." In other words, it may interfere with the issuer's disclosure policies even beyond the Transparency Directive's boundaries.

[118] Cf III.E. above. The immediate applicability of the Market Abuse Directive's disclosure regime to issuers of securities with pending admission requests follows from the directive's definition of the 'financial instruments' it covers: the latter also encompasses securities for which an application for admission to trading on a regulated market has been made. See Market Abuse Directive, artt. 1(3) final indent, 6(1).

Further, if company law arbitrage is not easily available, bundling securities law with company law carries disadvantages for good quality issuers in States with "bad" regulators (i.e. those doing a bad job at policing securities laws violations).[119] With no escape, such issuers will find it harder to signal their quality by choosing another EU jurisdiction.[120] In fact, if public enforcement of securities regulation matters,[121] there will be no way for local issuers to "opt up" for a more effective supervi-

[119] Not to mention that it is far from clear that a local regulator would have enough incentives to properly monitor the activities of issuers having listing *and* security holders abroad (Ferran (n 15) 152 (pointing to the need of cooperative enforcement not easily feasible under the home state rule)); see also Iris H Y Chiu, 'Three Challenges Ahead for the New EU Securities Regulation Directives' (2006) 17 *EBL Rev* 121, 127 (exposing enforcement deficits looming under the home state rule). Clearly, the US experience suggests that cross-listings generally account for enforcement shortcomings even if the competent watchdog is the one of the host market. See Amir N Licht, 'Cross-Listing and Corporate Governance: Bonding or Avoiding' (2003) 4 *Chicago J Int'l L* 141 (identifying a "hands-off" policy at the SEC with regard to foreign issuers); Jordan Siegel, 'Can Foreign Firms Bond Themselves Effectively by Renting U.S. Securities Laws?' (2005) 75 *J Fin Econ* 319-59 (neither SEC nor private law enforcement significantly reduces cross-listing Mexican firm's ability to tunnel assets); Donald C Langevoort, 'Structuring Securities Regulation in the European Union: Lessons from the U.S. Experience' in Guido A Ferrarini and Eddy Wymeersch (eds), *Investor Protection in Europe – Corporate Law Making. The MiFID and Beyond* (Oxford University Press, Oxford 2006) 485, 496-501 (showing reasons for a "home bias" in SEC enforcement actions); but see also Coffee (n 6) 1794-96 (pointing to the deterring effect of high profile cases against foreign private issuers and the statistically distorting effect of silent settlements). Yet, even though host market regulators might perform worse with regard to foreign issuers compared to their enforcement activity vis-à-vis domestic issuers, their incentives to police misconduct that imperils investor confidence in their market are conceivably stronger than those of a competent authority whose home market is not affected at all. Hence, the risk of inadequate enforcement of the Prospectus and Transparency Directives provisions for issuers that do not tap domestic markets is higher under the home state rule.

[120] With the exception of an official listing thanks to the Consolidated Admission and Reporting Directive which still allows for non-discriminatory super-equivalent requirements. See Consolidated Admission and Reporting Directive, artt 8(1) and 8(2) as amended by Transparency Directive, art 32 (4). Yet, if the issuer simultaneously applies for admission of the pertinent securities to official listing in its home Member State, the law of this state, administered by the local competent authority will govern. See Consolidated Admission and Reporting Directive, art 37. Further, even in the case of an official listing, the prospectus will be approved by the home State, whose law will apply also on matters covered by the Transparency Directive.

[121] An assumption that, to be sure, a highly cited empirical work has questioned: see Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, 'What Works in Securities Laws?' (2006) 61 *J Fin* 1, 14-23 (presenting data suggesting that the development of stock markets is strongly related to private enforcement mechanisms sanctioning violations of comprehensive disclosure requirements whereas public enforcements impact is modest at best). But see Howell Jackson and Mark J Roe, 'Public and Private Enforcement of Securities Laws: Resource-Based Preliminary Evidence' (2008) Harvard Law School Working Paper, 15-25 <http://ssrn.com/abstract=1000086> accessed 12

sory authority from another Member State (other than with regard to matters covered by the Market Abuse Directive). To be sure, a limited way-out is offered by the Prospectus Directives' treatment of DRs: even captive issuers can make use of a foreign depositary facility and thus render applicable another jurisdiction's entire prospectus regime, including its public administration and enforcement, for the subsequent share offering.[122] Yet, this route provides the full scope of bonding opportunities only with regard to initial disclosure, whereas on-going Transparency Directive obligations are inescapably tied to the law of the issuer's home state.[123]

Of course, captive issuers still might take advantage of the bonding and signaling mechanisms that another country's market itself makes available, like hiring highly reputed gatekeepers (investment banks, audit firms, law firms) or listing on a given exchange.[124] Further, even without using a DR-facility, by publishing a prospectus in another Member State, they might incur civil prospectus liability according to the general private law rules of the host State[125] and hence be subject to its

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June 2008 (devising a public-enforcement variable based on regulators' staffing and budgets which suggests a correlation between stock market development and public enforcement intensity); John C Coffee, 'Law and the Market: The Impact of Enforcement' [2007] 156 *U Pa L Rev* 254-83 (arguing that the unique position of the US in the cross-listing market is due to a staggareing margin not only in private but also in public enforcement of securities laws). Even under the premise that private enforcement indeed is more effective to protect investor interests, depriving high-quality issuers of the opportunity to opt for a superior public enforcement environment cannot be totally neutral. This is all the more true, where the allegedly more effective tool (private enforcement) is de facto unavailable (see n 126 below and accompanying text).

122 See III.B above.

123 See III.D above.

124 For a survey of the empirical evidence on the signaling value of the described non-legal institutions see G. Andrew Karolyi, 'The World of Cross-Listings and Cross-Listings of the World: Challenging Conventional Wisdom' (2006) 10 *Rev Fin* 99, 121-26, 132-36.

125 The Directive does not harmonize Member States' substantive liability rules. This fact warrants the conclusion that it does not touch on conflict of laws rules in this respect either. See Enriques and Gatti (n 34) 181. The applicable rules of international private law will typically lead to the host state's liability rules and standards as the law of the location where investors incurred the relevant losses. See *e.g.* Commission (EC) 'Proposal for a Regulation of the European Parliament and the Council on the law applicable to non-contractual obligations ("Rome II") ' COM (2003) 427 final, 22 July 2003, art. 3(1).

private enforcement institutions.[126] Alternatively, they could take advantage of the bonding and signalling implications of listing in the US: hardly a good outcome in the perspective of European policymakers or a cheap exercise for European issuers, especially after the post-scandal reforms of US capital markets.[127]

Finally, if company law arbitrage is unavailable, regulators' incentives to improve on their supervisory practices (e.g. in terms of time taken to approve prospectuses,[128] paperwork required, flexibility as to financial innovation and regulatory issues not covered by directives, etc.) will be weaker, as they can only stem from the Committee of European Securities Regulators' (hereinafter: CESR) efforts to exercise some sort of peer pressure.[129] But one may doubt whether peer pressure itself can have any impact on "bad" regulators insulated from the threat of competition:[130] effectiveness of supervision and public enforcement are essentially a matter of politics and depend on adequate budgets, presence of qualified and motivated staff and several other socio-economic factors that cannot realistically be expected to be under CESR control, no matter how vigorous its action proves to be.[131]

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[126] Yet, even on Europe's currently most attractive market, private enforcement seems to play no significant role, Eilís Ferran, 'Cross-border Offers of Securities in the EU: The Standard Life Flotation' (2006) Cambridge University, Centre for Corporate and Commercial Law Working Paper, 17-22 (no successful cases under English law).

[127] For evidence of the vanishing attractiveness of US markets as cross-listing venues, see Tobias H Tröger, 'Corporate Governance in a Viable Market for Secondary Listings' (2007) *UPa J Bus Employ L* 89, 92-101.

[128] Cf Committee of European Securities Regulators (CESR), 'CESR's Report on the Supervisory Functioning of the Prospectus Directive and Regulation' (2007) (Ref. CESR/07-225) 31 http://www.cesr-eu.org/index.php?page=document_details&id=4665&from_id=40 accessed 25 October 2007 (reporting that the time period for prospectus approval varies among Member States).

[129] Cf Ferran (n 15) 151-52, 159 (noting that the rigidity of the home State rules "has potential adverse ramifications for the quality of issuer supervision across the EU because it gives national regulators a monopoly over their home issuers and thereby reduces the discipline of competition in that context too").

[130] Cf Frederick Tung, 'Passports, Private Choice, and Private Interests: Regulatory Competition and Cooperation in Corporate, Securities, and Bankruptcy Law' (2002) 3 *Chicago J Int'l L* 369, 380-86 (arguing that a territorial regime, even when complemented with a passport arrangement, will not exercise significant competitive pressure on regulators which aim at maximizing the number of firms and transactions under their purview as it ties issuers too strictly to home state regulators).

[131] For a skeptical view see Chiu (n 119) 128-32 (outlining the various obstacles CESR faces

To be sure, even without auspicious competition effects directly affecting the private interests of regulators and their dominant constituents – the essence of the public choice-oriented argument – European polities might push for improvements. In fact, the main Member States extensively amended their corporate laws even in the absence of competition for corporate charters in the last fifteen years or so.[132] The stimulus for the observed sweeping law reforms stemmed from the need, embraced at the highest political level, to ameliorate the position of domestic firms in the increasingly vigorous and global competition for investments.[133] It is easy to argue that the same holds true in the securities regulation framework:[134] the higher cost of capital issuers are exposed to when tied inescapably to an inefficient home state regulator represents another disadvantage in their competition for investment. Hence, if the political payoffs that accrue to the successful participants in the international competition for investments are high enough to outweigh the costs of overcoming opposition,[135] powerful political players will push for more efficient structures. However, the envisioned beneficial outcome and its precise dimension mainly depend on the specific distribution of power, the political dynamics, and the yields and costs of higher regulatory efficiency in each Member State. If these factors do not play out well, it might be the case that local issuers will keep on suffering from the higher

in its strive towards regulatory convergence which is dependent on national regulators' ungrudging cooperation). Generally, on the quintessential role of a (national) regulator, that "has the staff, skill, and budget to pursue complex securities disclosure cases" for the protection of investor interests, see Bernard S Black, 'The Legal and Institutional Preconditions for Strong Securities Markets' (2001) 48 *UCLA L Rev* 781, 790.

[132] See *e.g.* Luca Enriques and Paolo Volpin, 'Corporate Governance Reforms in Continental Europe' (2007) 21 *J Econ Persp* 117, 127-37 (describing corporate law reforms in Germany, France and Italy in the 1990s and the first half of the 2000s).

[133] Ehud Kamar, 'Beyond Competition for Incorporations', (2006) 94 *Geo LJ* 1725, 1730-43.

[134] In fact, many of the reform efforts Kamar (ibid) draws on to make his hypothesis relate to regulations conventionally classified as securities laws.

[135] Generally on the relevance of interest group opposition to investor-friendly law reforms, Lucian A Bebchuk and Mark J Roe, 'A theory of path dependence in corporate ownership and governance', in Jeffrey N Gordon and Mark J Roe (eds), *Convergence and Persistence in Corporate Governance* (Cambridge University Press, Cambridge 2004) 69, 82-88, 97-107.

costs arising from local regulators' sloppiness.

In any event, one important function that legal arbitrage may perform in a context of regulatory competition, i.e. of highlighting deficiencies in the law, will be unavailable in a scenario without corporate mobility. In other words, the new conflict of laws regime definitely does not help a reformer's agenda.

2. With corporate law arbitrage available. Assuming instead that corporate law arbitrage is easy not only for start-ups, but also for EU listed companies, the bundling of corporate and securities law implies that regulatory arbitrage will become possible in the securities law field as well.[136] In an environment in which the regulatory surplus to be gained by engaging in company law arbitrage is otherwise relatively small, at least for public companies,[137] reincorporations might become popular precisely for the purpose of picking a different securities regulation. Not only are securities regulations across the EU still far from uniform,[138] but, even more importantly, it makes a lot of difference whether the competent authority is an under-

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[136] Cf Alain Pietrancosta, 'The "Public Offering of Securities" Concept in the New Prospectus Directive' in *Investor Protection in Europe*, (n 119), 339, 344 (home seat criterion introduces a competitive aspect in the light of *Centros*); Ferran, (n 15) 154-55 (hypothesizing a flight to the jurisdictions with the best securities law environment).

[137] See Christian Kersting, 'Corporate Choice of Law – A Comparison of the United States and European Systems and a Proposal for a European Directive' (2002) 28 *Brooklyn J Int'l L* 1, 42 (noting firms' decreased desire to reincorporate in light of far-reaching uniformity of EU company laws); Enriques (n 17) 1268-69 (arguing that uniformity of corporate law leaves Member States less room for regulatory innovations to attract incorporations than New Jersey and Delaware had at the beginning of the US race); for a slightly different view leading to the same conclusion see Tröger (n 17) 36-41 (suggesting that although differences in Member States' corporate laws exist, no Delaware-like advantages from reincorporation will accrue due to ambiguities in choice of law decisions in a fully developed institutional environment with its resulting complementarities); Gelter (n 17) 251-52 (arguing that, unlike in the wake of the US race "no single issue that is only addressed by the law of one state is likely to become that important" in Europe).

The desire to escape from codetermination requirements in Germany (and other countries providing from them) is in theory a strong driver of corporate law arbitrage. Yet, so long as reincorporations can only take place via cross-border mergers or via the European Company Statute, only by negotiating with labour can codetermination rights be diluted in the process (see Cross-border Merger Directive, art. 16; Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees, [2001] OJ L 294/22).

[138] Part II above.

funded securities regulator from a country with no tradition in capital market regulation or the skilfully designed authority with a long record of regulating one of the world's most vibrant financial centers.[139] Similarly, it is quite one thing if securities regulation advice is in the hands of a very small circle of local lawyers who are the only ones familiar with the national language, it is quite another if one can choose from a number of top international law firms competing to assist you.

With regulatory arbitrage in corporate law easily available, issuer choice will become a reality in the EU. So the first question to ask is: will Member States start competing in the market for securities laws? And if this will be the case, the next query of course is: will the outcome of such competition be a race to the top, a race to the bottom, or neither of them? In order to address these questions in the European context, we briefly discuss Member States' incentives to respond to issuers' demands before we survey the literature debating issuer choice's merits and assess it from a European viewpoint.

a. Incentives to compete. So, to begin with, do regulators have sufficient incentives to engage in competition at all?[140] Even if doubts may be warranted that EU regulators have any real appetite for increased market shares garnered by national exchanges and trading platforms,[141] with political elites becoming more and more

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[139] Cf Ferran (n 15) 219.

[140] For skeptic assessments cf Cox (n 6) 1232-33 (questioning that the number of potential competitors would suffice for a race); Tung (n 102) 587-616 (arguing that established capital market countries lack the incentives to offer popular securities laws while smaller countries lack the means to provide attractive regulation).

[141] But see William E Decker, 'The Attractions of the U.S. Securities Markets to Foreign Issuers and the Alternative Methods of Accessing the U.S. Markets: From the Issuer's Perspective' (1994) 17 *Fordham Int'l LJ* 10, 22-23 (purporting that the SEC has been hospitable with regard to US exchanges' interest to attract international secondary-listings). The recently promulgated alleviations for foreign private issuers seeking escape from continuous reporting duties under the Securities Exchange Act of 1934 can also be seen as an instance where the SEC was at least not averse to business interests of US exchanges. See Securities and Exchange Commission (SEC) 'Termination of Foreign Private Issuer's Registration of a Class of Securities under Section 12(g) and Duty to File Reports under Section 13(a) or 15(d) of the Securities Exchange Act of 1934' (2007) Securities Exchange Act Release No. 34-55540, 72 Fed. Reg. 16,934. If issuers indeed were chilled from tapping US capital

aware of the essential role viable capital markets play in fostering economic prosperity, there should be sufficient incentives to at least retain the critical mass of issuers on domestic markets to secure sufficient depth and liquidity, institutional infrastructure etc.[142]

To be sure, it is precisely the post-FSAP directives' conflict of laws regime that seems to dissolve the link between a polity's interest in establishing and maintaining deep and liquid capital markets and its securities laws. By pointing to the law of the home state, the new conflict of laws-regime allows issuers—to a significant extent—to choose their listing location without switching to the regulatory framework of a potential host Member State (supra III). As a flipside, if issuers opt for a foreign Member State's securities laws, they can do so without altering their choice of listing location. Hence, Member States with unattractive securities laws might not worry too much about issuer choice. They might even welcome it as a cheap way of piggy-backing on a foreign Member States regulatory framework, as long as the choice of securities laws will not be accompanied by a relocation of listing venue that would weaken domestic capital markets. Of course, some welfare losses will occur even then, as the demand for legal advice from domestic securities lawyers will fall. Similarly, political downsides may result from the domestic regulator's decreascing relevance.

However, it is pivotal in this context that Member States cannot be entirely sure to maintain their position in the listing market once the securities laws of another Member State emerge as more attractive ones. Typically, not only the applicable parts of the host market's public securities laws (supra III.F) but also its stock

markets by the cumbersome process of SEC deregistration (see ibid at 16934-5), their absence from US markets did not so much constrain US investors' ability to acquire the pertinent securities through their brokers with remote-access to foreign markets (cf. *e.g*. Choi and Guzman, 'The Dangerous Extraterritoriality', (n 5) 221) as deprive US exchanges and market intermediaries of valuable business.

[142] Cf Ehud Kamar (n 133) 1730-43 (arguing that competition for investments is the driving force behind corporate and securities law reforms in Europe).

exchange listing rules as well as the regulations promulgated by its self-regulatory bodies are matched to fit with the relevant parts of the domestic legal system. Hence, an issuer that compartmentalizes the applicable legal framework by separating its home Member State from its listing location will most likely experience transaction costs as a result of a inherent multi-jurisdiction problem. At the margin, it may well choose to list in a home State exchange to avoid them.

Moreover, a market's legal and its non-legal institutions are typically intertwined in a way that also creates complementarities. Disclosure standards are an intuitive example: analysts, institutional investors etc. will be more inclined and better equipped to evaluate information that is presented according to the familiar standards prescribed by the law governing domestic issuers. Hence, reaping benefits from a market's non-legal informational environment depends partly on the legal framework governing an issuer's disclosure obligations.[143] From an issuer's perspective, choosing a home Member State different from the listing location potentially entails losses also with regard to these complementarities.

To avoid these losses and the multi-jurisdiction-related transaction costs, at the margin issuers attracted by another jursidiction's better company and securities law might find it convenient even to list on a regulated market there.

To sum up, the competitiveness of Member States with less effective/efficient securities laws would thus weaken. If the regulatory surplus from legal arbitrage for issuers proves sufficiently large, as we suggest, we will see in securities regulation as well at least what one of us, with regard to developments in corporate

[143] See e.g. Oren Fuerst, 'A Theoretical Analysis of The Investor Protection Regulations Argument for Global Listing of Stock' (1998) Working Paper, <http://ssrn.com/abstract=139599> accessed 9 April 2008 (devising a model to show how the US capital market's informational environment is coupled with strict disclosure standards under US securities laws); Mark T. Bradshaw, Brian J. Bushee and Gregory S. Miller, 'Accounting Choice, Home Bias and U.S. Investment in Non-U.S. Firms', (2004) 42 *J Acct Res* 795 (showing that greater conformity of foreign issuers' financial reports to US GAAP standards attracts a higher fraction of share ownership by US institutional investors).

law, termed "defensive regulatory competition."[144] Hence, it is not a thought experiment remote from reality if we explore now whether such competition will drag regulatory quality up or down in the European context.

b. The issuer choice debate. Our assessment of the impact of regulatory competition in European securities laws can dwell on the extensive debate regarding issuer choice's merits.

The optimistic view assumes that issuers are typically in search of a regulatory regime that best serves investor interests, because such a regime will reduce the risk premiums investors charge and hence will lower issuers' cost of capital. As a consequence, a race to the top will ensue, ultimately leading to socially desirable institutional arrangements.[145] As a variation on the theme of an upward trajectory, others argue that the outcome of regulatory competition would be a separating equilibrium:[146] in this view, the survival of high-quality and lower-quality legal regimes represents a result, brought about by deliberate issuer choice, which enhances social welfare. Lower-quality legal regimes persist, typically as the law of regional exchanges catering to purely domestic issuers, because some firms have financing needs that do not warrant the costs of compliance with high-quality securities laws governing the world's principal exchanges.

Conversely, putting the emphasis on conceivable market failures makes the effect of regulatory competition look rather murky, with a race to the bottom repre-

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[144] Enriques (n 17) 1273. See also n 210 below.

[145] Roberta Romano (n 5) 2383-88 (invoking evidence from the competition for corporate charter in the US to validate her thesis); Roberta Romano, 'The Need for Competition in International Securities Regulation', (2001) 2 *Theo Inq L* 387, 390, 493 (same); Steven Huddart, John S. Hughes and Markus K. Brunnermeier, 'Disclosure Requirements and Stock Exchange Listing Choice in an International Context' (1999) 26 *J Acct & Econ* 237, 260 (exchanges' incentives to maximize trading volume will induce them to raise reporting requirements because trading concentrates on markets with high disclosure standards).

[146] Stephen J Choi and Andrew T Guzman, 'National Laws, International Money: Regulation In A Global Capital Market' (1997) 65 *Fordham L Rev* 1855, 1876-79; Stephen J Choi and Andrew T Guzman, 'The Dangerous Extraterritoriality of American Securities Law' (n 5) 223, 227; John C Coffee (n 6) 1814-17.

senting the plausible worst-case scenario. Incentives to opt for suboptimal securities laws are conceivable because managers or large blockholders (those effectively exercising issuer choice) fully bear the costs of high-quality securities laws, but have to share its benefits with outside investors. Hence, they will either opt for incrementally lower quality regulation or constantly lobby for diminished standards, as long as investors are unable to detect and punish such rent-seeking.[147]

The direction of the potential race depends crucially on investors' ability to appraise the merits and deficits of specific securities regulations correctly.[148] Only under this condition will informed investors be in a position to charge "bad law"-adjusted risk premiums and make issuers fully internalize the heightened threat of expropriation for securities holders in an inferior legal environment.

Clearly, the conditions necessary to warrant a perfectly accurate assessment of any particular securities law regime will never be present in reality, and certainly not with regard to each and every retail investor. Yet, the empirical literature suggests that changes in an issuer's institutional environment are reflected in share prices, with no compelling evidence indicating that the relevant valuations are systematically biased.[149] These findings warrant the conclusion that markets are gener-

[147] Merritt B Fox, 'Securities Disclosure in a Globalizing Market: Who Should Regulate Whom?' (n 6) 2626-27 (arguing that political pressure will induce regulators to reduce disclosure standards to garner trading volume); James D Cox (n 6) 1233-36 (same); Merritt B Fox, 'Retaining Mandatory Securities Disclosure: Why Issuer Choice is not Investor Empowerment' (n 6) 1410 (purporting that issuers would "choose a regime requiring a level of disclosure well below what is socially optimal for it"); Robert Bloomfield and Maureen O'Hara, 'Can Transparent Markets Survive?' (2000) 55 *J Fin Econ* 425, 448-452 (showing a preference of influential market participants for reduced transparency, because low transparency dealers are capable of outperforming more transparent competitors).

[148] Cf Joel P Trachtman, 'Regulatory Competition and Regulatory Jurisdiction in International Securities Regulation', in Daniel C Esty and Damien Gerardin (eds) *Regulatory Competition and Economic Integration* (2001) 289, 293-94 (pointing out that if the conditions for informed investor choice are met there is a need for regulation at all); Cox, (n 6) 1234 (demanding clear evidence for investor's ability to assess securities law regimes).

[149] Darius P Miller, 'The Market Reaction to International Cross-Listings: Evidence from Depositary Receipts' (1999) 51 *J Fin Econ* 103-23 (finding higher positive abnormal returns for US exchange cross-listings compared to private placements or OTC-offerings); Craig Doidge, G Andrew

ally capable of assessing accurately the securities law regime a specific issuer is subject to. Although one can be skeptical with regard to even sophisticated investors' ability to precisely gauge the merits of a complex set of securities laws, there is reason to believe that investors' general assessment of specific securities laws, mainly based on their overall reputation, is correct. As a consequence, legal arbitrage decisions should generally be reflected in share prices, making opportunistic choices of controlling insiders less likely.

Still, with regard to issuer choice in Europe, a conceivable caveat might be raised: the empirical studies we relied on earlier to justify our position only present evidence for US-investors' ability to impound changes in an issuer's regulatory environment adequately in securities prices. Yet, capital markets' informational efficiency depends pivotally on the pertinent institutional environment,[150] thus casting doubts on premature analogies to the US example if Europe's case was in fact different. Obviously, not each and every EU capital market has an informational infrastructure comparable to the one characterizing US capital markets, where an unrivaled number of market makers, financial intermediaries, analysts, institutional investors and other sophisticated agents provide for the closest real world example of an efficient capital market. At least for UK markets—arguably quite akin to their US counterparts—evidence suggests that investors impound changes in the regulatory

Karolyi and René M Stulz, 'Why Are Foreign Firms that Are Listed in the U.S. Worth More?', (2004) 71 *J Fin Econ* 205-238 (approximately 16 percent valuation premium in terms of Tobin's *q* for the year 1997 in a worldwide sample of 712 issuers cross-listing in the US relative to a global benchmark sample of 4078 publicly traded firms); Craig Doidge, G. Andrew Karolyi and René M. Stulz, 'Has New York Become Less Competitive in Global Markets? Evaluating Foreign Listing Choices over Time' (2007) Ohio State University, Dice Center Working Paper No. 2007-9, 31-32 <http://ssrn.com/abstract=982193> accessed 25 October 2007 (finding a persistent premium for US cross-listings in terms of Tobin's *q* of 17.4 percent for the period between 1990 and 2001 and of 14.3 percent between 2002 and 2005). For further evidence from bond indenture and corporate charter contexts, see Romano, Empowering Investors (n 5) 2367. See also n 167 and accompanying text.

[150] For this assessment see *eg* Ronald J. Gilson and Reinier Kraakman, 'The Mechanisms of Market Efficiency Twenty Years Later: The Hindsight Bias' 28 *J Corp L* 715, 737 (2003). See also Karolyi (n. 124) 121-26 (reviewing the literature relating US-cross listing decisions to the associated improvements in the firms' informational environment).

environment in share prices.[151]

More generally, even without plunging into the details of asset pricing and its relation to market microstructure,[152] one can plausibly assume that securities prices in Europe will by and large correctly reflect issuers' regulatory environment. The reason for this assumption follows from the quintessentially public nature of the pertinent information, its independence from individual firms' specifics and its long-lived character. In fact, these observations make the pricing of securities laws according to their reputation an exercise that can be peformed with sufficient accuracy even on less developed markets. First, it is reasonable to suppose that the overall reputation of a jurisdiction's securities laws, of their administration and their enforcement are widely known to local as well as foreign market participants. Even where some firms receive special treatment under otherwise uniform securities laws (e.g. national champions being treated with velvet gloves), this fact should be also be known to market partecipants. Second, changes in the relevant determinants, like law reform or shifts in existing laws' administration and enforcement, do not come rapidly and arbitrage decisions cannot be implemented overnight either. This fact makes the speed of price adjustment a subordinate concern.[153] Finally, the increasingly in-

[151] See FSA 'A Review of the Listing Regime' Discussion Paper 08/1 Annex 2 <http://www.fsa.gov.uk/pubs/discussion/dp08_01.pdf> accessed 4 July 2008 (showing positive cumulative abnormal returns if issuers transfer from less stringently regulated AIM to the LSE's main market and negative cumulative abnormal returns for the move the other way round). Older studies indicate, however, that the informational environment on London's markets is still less efficient than that in the US, see H Kent Baker, John R Nofsinger and Daniel G Weaver 'International Cross-Listing and Visibility' (2002) 37 *J Fin & Quantitative Anal* 495.

[152] See generally Ananth Madhavan, 'Market Micro Structure: A survey' 3 *J Fin Mkts* 205, 242-44 (2000).

[153] In essence, improvements in price discovery as a consequence of changes in an issuer's informational environment lead to faster and more accurate adjustments of prices with regard to firm specific information. See e.g. Mark H. Lang, Karl V. Lins & Darius P. Miller, 'ADRs, Analysts and Accuracy: Does Cross-Listing in the United States Improve A Firm's Information Environment and Increase Market Value?', 41 *J Acct Res* 317, 331 (2003) (using a sample of 235 US listed foreign stocks relative to a benchmark of 4,859 equities from 28 countries to show higher accuracy of analysts' forecasts); Young K Park and Kee H Chung, 'Foreign and Local Institutional Ownership and the Speed of Price Adjustments', 34 *J Bus Fin & Acct* 1569 (2007) (showing that the speed of price

ternational investor base even in less developed markets[154] has incrementally introduced globally-operating institutional investors' sophistication to these markets, particularly that of specialized funds.[155] In sum, these considerations warrant the conclusion that even though at least some EU securities markets certainly lag behind with regard to informational efficiency when compared to their US counterparts, these differences do not pivotally hinder investors' ability to price various regulatory frameworks in accordance with their overall quality. Hence, it is indeed well-founded to assume that opportunistic legal arbitrage decisions will trigger proportionate valuation discounts for the issuers involved.

c. Issuer choice in the EU: race to the bottom or separating equilibrium? Against this backdrop, should we expect a race to the bottom, once regulatory arbitrage in company law, and thus securities law, becomes available?

i. Distorting impact of non-legal institutions? An initial concern centers upon conceivable distortions issuer choice in Europe would face. Certain markets today exhibit a degree of maturity and development which will give them a tremendous head-start in any race. Particularly from an investor's perspective, the historical disparities with regard to market depth, liquidity etc. might easily even out any detrimental effects from worse legal institutions.[156]

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adjustment to firm specific information is positively correlated to (foreign) institutional ownership in South Korea).

[154] At the end of 2005 foreign investors owned 33% (weighted average) of the value of listed shares in Europe, the simple average being even higher (39%) as a result of the low foreign investor base in two important markets (Germany and Italy). With the notable exception of Slovenia, particularly Eastern Europe's emerging markets exhibit foreign ownership figures well above average, with Hungary taking the lead with a staggering 77.7% of foreign share-holdings. See Federation of European Securities Exchanges (FESE), 'Share Ownership Structure in Europe' (2007) 9-10 <http://www.fese.eu/_lib/files/FESE%20Share%20Ownership%20Structure%20in%20Europe%202006.pdf> accessed 26 June 2008.

[155] See *eg* Bernard S. Black, Hasung Jang & Woochan Kim, 'Does Corporate Governance Predict Firms' Market Values? Evidence from Korea', 22 *JL Econ & Org* 366, 403 (2006) (showing that the presence of international investors on the Korean stock market leads to share pricing that arguably reflects differing governance practices even within a single market).

[156] Where institutional factors and network externalities figure in regulatory arbitrage, they

Why forgo the benefits of one of the world's deepest and most liquid capital markets with mature non-legal institutions only to be better protected from expropriation under the laws governing a tiny, illiquid market where no sophisticated investment banks, analysts etc. accompany market transactions? Why not submit to a legal regime although it appropriates rents to certain constituents as long as the pertinent jursdiction's non-legal institutions offer sizeable advantages that outweigh the detriments and thus put it in a Delaware-like position?[157] Yet, such problems are effectively attenuated by the post-FSAP conflict of laws-regime. By tying applicable law in important respects to the issuer's registered office instead of its trading venue, European conflict of securities laws rules disentangle legal and non-legal institutions and thus create a basis for largely undistorted regulatory competition.[158] Under such rules, with the qualifications highlighted in Part III, issuers may choose their securities law by registering the company in State Alpha that ideally fulfils their legal demands and simultaneously benefit from State Beta's superior non-legal infrastructure

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are apt to lead to socially suboptimal outcomes. The advantages unrelated to substantive law's content give providers of regulation the leeway to cater to rent-seeking interests of those in control of the arbitrage decision. Those making choices can seek private benefits as long as deviations from optimal solutions are surpassed by advantages resulting from informal institutions or positive network externalities. See Bar-Gill, Barzuza and Bebchuk, (n. 3) 145, 149-50 (showing that a dominant state in the competition for corporate charters has incentives to cater to managers' interests and that shareholders are willing to acquiesce to a suboptimal incorporation decision as long as they reap an overall benefit from it). Structurally, the outcome in securities law arbitrage could be distorted by a bundling of legal and non-legal determinants similar to the one that, as some argue, impedes the US race for corporate charters today. See Klausner, (n 3), at 842-847 (arguing that Delaware's preponderance in the charter-market is due to its extensive body of case law, its experienced administrative and judicial system etc.); Lucian A Bebchuk and Assaf Hamdani, 'Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters', (2002) 112 *Yale LJ* 553, 585-95 (holding that due to network externalities and prior investments in its institutional framework Delaware is largely protected from potential challengers by significant entrance barriers). See also Licht (n 14) 609-35 (arguing that the bundling of various legal rules alone renders accurate pricing difficult).

[157] See Jonathan R. Macey and Geoffrey P. Miller, 'Toward an Interest-Group Theory of Delaware Corporate Law', 65 *Tex L Rev* 469 (1987) (arguing that Delaware's dominant position in the US incorporation market allows it to devise a corporate law that benefits the State's bar as a powerful interest group); Bar-Gill, Barzuza and Bebchuk, (n. 3) (same with regard to rents for managers).

[158] Undistorted issuer choice is thus the flipside of the FSAP-directives' solution to the bundling problem which occurred under the traditional European conflict of securities laws rules. See above III.A.

by having equities traded on its deep and liquid markets, where the best intermediaries offer their services etc. Equally important, the post-FSAP regime also induces those jurisdictions to participate in regulatory competition, whose securities markets today have an edge over their competitors with regard to their non-legal infrastructure. On the one hand, their trumps do not win the trick with regard to issuer choice of regulatory environment as the non-legal advantages are largely irrelevant in the decision process thanks to the applicable conflict of laws regime. On the other hand, as described above (supra 2.a), losing in the regulatory sphere also imperils the dominant position of the securities market itself, giving a jurisdiction sufficient incentives to maintain attractive laws and administration/enforcement.

ii. Emergence of a separating equilibrium. For the time being, there seems to be at best only anecdotal evidence that the highest-quality markets (and their regulators) have lowered the applicable rules to compete with other jurisdictions.[159]

The UK experience is a case in point. Continuous and well-considered amendments of the British law governing capital markets rather tightened than slackened issuers' obligations.[160] Alongside these developments, the London Stock Exchange has become an increasingly attractive trading venue for international issuers in recent years.[161] To be sure, we are not suggesting here that the regulatory regime governing UK markets is as stringent as that applying to issuers at other suc-

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[159] See Bloomfield and O'Hara (n 147) 426 (reporting that the London Stock Exchange (LSE) successfully lured away trading volume from the Paris Bourse when it allowed large block trades to remain unreported for several days, a success that ultimately compelled the Paris Bourse to adopt the LSE rules). Yet, the generally conclusive empirical evidence produced to validate the basic propositions of the legal bonding hypothesis articulated in the finance and legal literature (n 167 below) vindicates at least some issuers' alleged strive for better securities laws and hence is apt to thwart the notion of a general race to the bottom.

[160] Most notably, the post-Enron reforms in the UK have been hailed for rectifying existing drawbacks but were largely free of panic-driven overreaction. See Paul Davies, 'Enron and Corporate Governance Reform in the UK and the European Community' in Klaus J. Hopt and others (eds), *Corporate Governance in Context Corporations, States, and Markets in Europe, Japan, and the US* (Oxford University Press, Oxford 2005) 163, 190.

[161] For a survey of the empirical evidence on the LSE's incremental attractiveness see Tröger (n 127) 92-110.

cessful trading venues, most notably the one issuers become subject to by tapping the US securities market.[162] The pivotal aspect for our analysis is that the success of UK markets cannot be attributed to a relaxation of regulatory standards, at least vis-à-vis other EU jurisdictions. Quite the contrary, the UK today once again contemplates tightening its rules, particularly those applying to companies listed on the Alternative Investment Market (AIM).[163]

On the other hand, the palpable differences in regulatory austerity and enforcement rigor that distinguish successful UK and US markets[164] pose a test to our investor appreciation hypothesis: if investors are indeed capable of evaluating the overall quality of securities laws correctly, they should price UK and US regulation attaching to cross-listing issuers differently. And in fact they do, as a recent empirical study measuring cross-listing premiums for foreign issuers on both markets suggests.[165] In light of this, a plausible scenario in a world with more freedom to engage in regulatory arbitrage is one in which issuers divide into three groups.[166]

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[162] Several studies have pointed to the fact that UK securities regulation for various reasons takes a smoother stance vis-à-vis foreign issuers. See eg Coffee, Jr. (n 121) 239 n 20 (maintaining that pivotal parts of UK capital market regulation do not apply to foreign issuers); Doidge, Karolyi and Stulz (n 149) 9-10 (same); Tröger (n 127) 127-167 (comparing UK and US securities laws applying to foreign issuers and finding that UK regulation offers more latitude to overseas companies and is less rigidly enforced).

[163] The new AIM rulebook introduced in February 2007 has increased transparency requirements for listed companies and tougher standards for nominated advisors, i.e. persons guiding the would-be AIM issuer through the admission process and responsible for the issuer's compliance with market regulations thereafter. For details of the amendments see London Stock Exchange plc., 'AIM Notice 27 (Feb 20, 2007)' (2007) <http://www.londonstockexchange.com/NR/rdonlyres/EEB85E9E-6592-46E0-9880-0A142618ABEA/0/AIMNotice27.pdf> accessed 25 October 2007.

[164] It is interesting to note that although US exchanges are no longer enjoying a position in the cross-listing market as predominant as during the 90s, the NYSE, the NASDAQ or the AMEX still attracted a considerable number of newly cross-listing issuers over the last couple of years parallel to the UK's increased attractiveness, Tröger (n 127) 101-10. For a similar assessment of continuous success of US equity markets see Karolyi (n 124) 110.

[165] Doidge, Karolyi and Stulz (n 149) 30-33 (finding persistent premiums for US cross-listings but none for UK secondary listings).

[166] See also Choi and Guzman (n 146) 1876-79 (identifying two groups of issuers – in short, the good and the bad ones – demanding for securities law regimes of different quality); Coffee (n 6) 1814-17.

A first group would comprise high-quality issuers, *i.e.* those ready to comply with strict rules and to deal with tough regulators, if that is the price to pay to get access to cheaper capital: in this category fall several national champions from many countries, which, during the 1980s and the 1990s, listed on the New York Stock Exchange, and self-confident emerging businesses that joined the NASDAQ to reap the benefits of the deep and liquid US market and, according to some, of bonding to a high-level investor protection system.[167]

A second, large group would comprise local issuers, *i.e.* those for which domestic markets would constitute the only option in practice. This will be the case for both mid- and small-size "good natured" issuers, raising an amount of capital too low to justify the cost of listing abroad, and large, average-quality issuers that are afraid of enhanced investor protection (*e.g.* because the founding family wants to continue to extract its moderate amount of private benefits) or simply content with the money they have raised at the IPO stage and not even considering the idea of

[167] The bonding hypothesis suggests that, besides the liquidity effects of tapping deeper and more liquid capital markets, it is mainly the corporate governance related changes in an issuer's environment that drive cross-listing decisions. By decreasing the chances to expropriate investors ex post, firms can lower their costs of capital because market participants will charge lower risk premiums. For the earliest articulations of the bonding-hypothesis see René M Stulz, 'Globalization, Corporate Finance, and the Cost of Capital', (1999) 12 *J Applied Corp Fin* 8-25; John C Coffee, 'The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications' (1999) 93 *Nw U L Rev* 641, 683-91; for empirical assessments see William A Reese, Jr. and Michael S Weisbach, 'Protection of minority shareholder insterests, cross-listings in the United States, and subsequent equity offerings' (2002) 66 *J Fin Econ* 65, 80-104 (finding issuers from jurisdictions with – according to the LaPorta et al. index – weak investor protection to be more likely to cross-list in the United States and conducting equity offerings after cross-listing significantly more frequently, the latter findings being even more conclusive for issuers whose home jurisdictions offered poor protection of minority shareholders); but compare Licht (n 119) 160-61 (arguing that the Reese and Weisbach findings in fact suggest that foreign issuers try to avoid stringent US securities regulation because their subsequent equity offerings are conducted primarily on their home markets); see also n 149 above. For a recent explanation of cross-listings which departs completely from the functionalist, cost of capital-oriented approaches see Jordan I Siegel, Amir N Licht Shalom H Schwartz, 'Egalitarianism and International Investment' (2007) Working Paper <http:// ssrn.com/abstract=899082> accessed 25 October 2007 (devising a measure for societies' attitudes towards egalitarian ideals, i.e. their disapproval of the abuse of economic and political power, and finding it more robustly related to cross-national investment flows of equity than comparable indicators of competing explanations).

raising new equity on the market.

Finally, a third group would comprise "rogue issuers," *i.e.* those keen on exploiting weaknesses and loopholes in the jurisdictions with the most lenient securities regulation.

While unquestionably no Member State will deliberately cater to the interests of rogue issuers,[168] EU members will rationally vary with regard to the incentives spurring their legislatory efforts in designing securities laws. Depending on the number and relative importance of high-quality issuers in the Member States, the pressure to constantly improve the regulatory framework will vary. Moreover, under the post-FSAP choice of law rules, high-quality issuers can opt into adequate regulation by reincorporating abroad. Together with the fact that they can piggy-back on foreign markets' non-legal institutions by seeking admission to exchanges abroad,[169] this will further reduce the pressure on national regulators to improve their securities laws. Hence, some Member States find themselves in a position where it is rational to cater mainly to the demands of local issuers, and some might even consider it dispensable to autonomously improve their capital market regulations at all. As a consequence, within the band sketched out by the EU's harmonizing measures, we would have good, average and bad quality securities laws across the EU, serving the interests of different types of issuers and catering to investors with diverging attitudes toward the risk of expropriation.

Is this a dreadful scenario? Definitely so, if one covets the ideal of an integrated, high-standard single EU securities market deserving investors' unreserved

[168] However, the strong terminology is apt to distract from the variations within the set of rogue issuers, which comprises cold-blooded fraudsters who operate deliberately outside the borders of legality as well as less hardboiled agents that aim at relatively slight overstatements of their represented value as permitted under lax securities laws. The latter kind of opportunism is at least tacitly tolerated by regulators that make do with more lenient disclosure regimes.

[169] Besides the market's depth and liquidity, pivotal factors in this respect are *e.g.* the presence of reputed investment banks and other gatekeepers, the close following by sophisticated analysts, an overall good informational environment, and the presence of actively monitoring institutional in-

and undiscriminating confidence and allowing issuers from any EU jurisdiction to reduce their cost of capital uniformly.

This ideal, however, is unattainable in the real world and, so long as the EC plays a role in the regulation of securities markets, the above scenario appears to be almost the best one can get.

First of all, EU securities regulation cannot ensure uniformity in the level of investor protection under the current institutional framework. Even a comprehensive set of EC rules would not be enough as long as enforcement is decentralized and national underenforcement hard to detect and punish. A possible way out would require the political consensus among 27 EU Member States to go significantly beyond the current state of legislatory competence at the EC level. It is unlikely for such a consensus to emerge in the near future. Unpredictable political horse-trading aside, for such a far-reaching sacrifice of sovereignity to occur, the case for it has to be compelling. Yet, the rationale for centralized enforcement at the EC level is ambiguous at least: it is difficult to tell whether centralization would indeed make EU capital markets more efficient. Despite plausible positive network effects, a US SEC-like, single European regulator would potentially suffer from diseconomies of scale and could exhibit an increased tendency to abuse its EU-wide monopoly power in the form of over-regulation.[170] Moreover, on a global scale, the lower number of competitors could even facilitate reaching tacit anticompetitive conformity with the SEC.[171] With no pretence to decide the multi-faceted controversy here, suffice it to

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vestors. Cf also n 124 above and accompanying text.

[170] Cf Jonathan R Macey, 'Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty' (1994) 15 *Cardozo L Rev* 909, 914 (delineating bureaucracies' incentives to overregulate). For a far more favourable assessment of SEC-style regulators see Robert A Prentice, 'The Inevitability of a Strong SEC' (2006) 91 *Cornell L Rev* 775 (arguing that a strong-SEC model best facilitates capital market development and economic growth). See also Merritt B. Fox, 'Optimal Regulatory Areas for Securities Disclosure' (2003) 81 *Wash University L Q* 1017, 1041-2 (highlighting the lack of accountability of a hypothetical EC bureaucracy in charge of operating a Community-wide securities law regime).

[171] Obviously, we are not suggesting the appearance of open cartelization but a general ten-

say that advocates of centralized enforcement do not have all the arguments on their side, which makes it unlikely that they will overcome the well-organized opposition against such a significant expansion of EC powers any time soon. Hence, for the time being, EU-wide uniformity in administration and enforcement of securities laws will remain out of reach.

Further, a reduction in the cost of capital should be easier and quicker to attain if issuers can immediately choose the most efficient EU securities regulation at relatively low cost than if they have to rely on evolving investor confidence as a long term outcome of the cumbersome efforts for uniformity.

Finally, as to investor confidence, why assume that markets are unable to distinguish among good-quality, average and bad quality securities law regimes, price securities accordingly and therefore avoid systematic investor expropriation?[172] Empirical evidence indeed supports the conclusion that in general markets reflect the merits of a specific legal framework accurately.[173] Issuer choice and the ensuing separating equilibrium should leave investor confidence in the overall efficiency of European capital markets unscathed.

If all that sounds Panglossian, consider the alternatives: with harmonization necessarily imperfect, one could think of bundling securities law with the real seat,

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dency to substitute informal coordination for regulatory competition. That the SEC and CESR have during recent years intensified and institutionalized their dialogue on various regulatory issues can be seen as evidence of this. See Securities and Exchange Commission (SEC), 'SEC and CESR Set Out the Shape of Future Collaboration' (2004) press release No. 2004-75 <http://www.sec.gov/news/press/2004-75.htm> accessed 25 October 2007.

[172] See Romano, 'Empowering Investors' (n 5) 2367-68; Choi and Guzman, 'Portable Reciprocity' (n 5) 942.

[173] See n 149 above and accompanying text. To be sure, one of us has argued elsewhere that capital markets are unable to translate specific securities laws' merits or shortcomings into precisely metered premiums or discounts if the jurisdictions involved both represent high-quality suppliers. See Tröger (n 127) 165-67 (comparing US and UK markets and finding a palpable difference reflected in share prices only with regard to enforcement levels). This, however, is not inconsistent with the argument advanced here which rests on the far less ambitious assumption that market participants are capable of correctly reflecting the overall reputation of significantly diverse regulatory environments in share prices.

as Professor Merritt Fox has suggested.[174] But, quite apart from the proposal's own merits,[175] this connecting factor would not rule out the possibility that certain jurisdictions continue to provide weak investor protection. In fact, this conflict of laws rule would not significantly alter Member States' incentives in securities lawmaking outlined above. Further, it would strip high-quality issuers of the opportunity to opt for better securities laws.

Admittedly, at the margin, with national champions deprived of the possibility of an easy European opt-in, some Member States might deem it worthwhile to provide better securities laws at an earlier stage than they would have in a scenario where their existing high-quality issuers had the opportunity to escape inferior domestic securities laws lightly. Yet, this conceivable long-term social benefit arguably does not offset the immediate individual disadvantage an inescapable home State rule would entail.

Other connecting factors, like the place where most of the securities have been sold or where they have first been admitted to trading would be very easy to manipulate, thereby opening the same opportunities for securities law arbitrage existing under the current regime. The only real alternative to the current framework would be to abandon the idea of mutual recognition altogether and leave Member States free to regulate transactions with a sufficiently close connection to their territory, or in other words, since at this point harmonization would be harder to justify, dismantle existing EC securities regulation altogether or limit its future contents to

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[174] Fox, 'Securities Disclosure in a Globalizing Market' (n 147) 2506, 2628 (proposing to apply US securities laws "only to those issuers that have their economic center of gravity in the United States" as behaviour of these issuers most affects social welfare in the US).

[175] For critical assessments see Choi and Guzman, 'Portable Reciprocity', (n 5) 948-50 (arguing that Fox's "issuer-nationality" model undermines international capital mobility and cancels regulatory competition completely); Romano, 'Empowering Investors', (n 5) 2408-09 (arguing that welfare gains resulting from rather minor improvements in an issuer's legal environment would be foregone if opting for better law required physical and human capital to be moved). Romano (n. 145) 29- (arguing that an inescapable regulatory monopoly cannot be justified, because contrary to Fox's reasoning no interfirm externalities of information would give rise to incentives to deviate from socially

uniform conflict of laws rules.

iii. Race to the bottom-concerns revisited: the particular situation of the UK. Even if general race to the bottom-concerns under the post-FSAP choice of securities law regime are unfounded, a UK peculiarity might reanimate them in a narrower context. The legal framework governing issuers on the London Stock Exchange provides the institutional preconditions for a separating equilibrium to emerge not only on the integrated EU capital market but also within the UK market itself. The UK Listing Authority's regulation allows overseas issuers to seek a secondary listing on the LSE's main market for their equity securities. Such secondary listing largely exempts non-UK issuers from the more stringent rules applying to those issuers with a primary listing.[176] As a consequence, overseas issuers can tap UK capital markets without incurring significant regulatory burdens. The post-FSAP conflict of law regime changes the landscape for EU issuers listing in London. The disclosure obligations under the Prospectus Directive and the Transparency Directive follow from the law of the (overseas) home state, thus bringing about an inevitable multiple jurisdiction problem.[177] To be sure, for those overseas issuers that maintain a listing on their home jurisdiction's capital market in addition to their London listing, the multiple jurisdiction-problem actually is mitigated under the post-FSAP regime: prior to the implementation of the new conflict of laws rules, they had to comply with both, their home and host market's initial and ongoing disclosure regulations.[178] However, at least for those EU issuers that bypass their home markets and go directly to the City,[179] the new framework raises the costs of a London listing by adding the home state compliance costs. Although it is hard to tell how serious this problem would be,

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optimal disclosure and no 'race to the bottom' concerns are warranted).

[176] See FSA, Listing Rules, Rule 14. For the wide (optional) exemptions see particularly Rule 14.2.6.

[177] See already supra IV.A.2.a.

[178] Supra III.A.

[179] For the (dubious) real-world significance of such a scenario see already n 113.

supposing for the sake of argument that it would be sizeable, these overseas issuers could have incentives to forestall the multiple jurisdiction problem by simply reincorporating as an English plc. Yet, as a consequence they would loose the option to entertain a secondary listing.[180] Hence, to avoid the multiple jurisdiction-problem these issuers would have to submit to the significantly tougher securities laws that apply to UK issuers. As a consequence, they might choose to pursue another route to avoid the multiple jurisdiction problem: they might instead delist in London and relist at home, thus disrupting the LSE's success in the cross-listing market. Considering the reaction that Wall Street's perceived backslide triggered in the US,[181] it is not inconceivable that this will ultimately lead to a watering-down of UK rules for domestic issuers. Thus, a downward drag at least with regard to UK regulatory standards would be introduced. Yet, it should not be overlooked that the City's recent success is largely attributable to the upswing of its AIM,[182] a market segment that has been established deliberately outside the scope of the post-FSAP directives.[183] Hence, a large fraction of non-UK issuers is unaffected by the regulatory changes anyway. More importantly, the UK does not at all resemble Bill Cary's famous

[180] The option under Rule 14 of the Listing Rules hinges upon the status of the issuer as an overseas company, see Rule 14.1.1. The latter is defined in the Listing Rules Glossary as a "company incorporated outside the United Kingdom".

[181] To regain competitiveness the Committee on Capital Markets Regulation, endorsed by the US Secretary of the Treasury recommend deregulating US securities laws in several ways. See Committee on Capital Markets Regulation, Interim Report <http://www.capmktsreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf> accessed 4 July 2008; and Committee on Capital Markets Regulation, The Competitive Position of the U.S. Public Equity Market <http://www.capmktsreg.org/pdfs/The_Competitive_Position_of_the_US_Public_Equity_Market.pdf > accessed 4 July 2008.

[182] See Tröger (n 127) 109 Figure 6.

[183] Except for the Prospectus Directive which applies to any public offering of securities regardless of the forum where they are conducted (Prospectus Directive, art. 1(1)), the FSAP-implementing directives apply to securities admitted to trading on a "regulated market" (see Transparency Directive, art. 1(1); Takeover Bid Directive, art. 1(1); Market Abuse Directive, art. 9). The AIM is not a regulated market in terms of EU securities directives, see Annotated presentation of regulated markets and national provisions implementing relevant requirements of ISD (93/22/EEC), [2007] OJ C 38/5.

'pygmy'[184] that could be expected to custom tailor its domestic securities laws in order to promote and foster the international trade of its exchanges. Instead, it is more realistic that the UK will take a much broader stance regarding public policy goals. In fact, there is increasing evidence that UK regulators struggle hard to respond swiftly to any perceived laxity of the legal regime governing the City's markets.[185] Most importantly, the FSA has recently affirmed that contemplated reforms will not alter the basic structure of the markets under its authority, which will continue to divide into a high quality segment that tops EC standards and a second tier that requires only EC presets.[186] As a consequence, race to the bottom scenarios seem highly unlikely.

iv. Deterioration of EU securities laws in the absence of credible commitment devices? If race-to-the-bottom concerns under the current system are misplaced, another possibly more serious problem arises in the new framework. With the regulatory arbitrage option open both at the IPO stage and once a company is listed, effectively no firm would be making a credible commitment to any (high-quality) securities law for indefinite time in the future. Yet, according to a leading US scholar, the ultimate function of securities law is precisely to facilitate such a credible commitment, in particular for IPO firms and foreign issuers seeking to tap more liquid markets.[187] In other words, if firms were free to engage in midstream reincorporations,

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[184] Cary (n 3) 701 (arguing that tiny Delaware is a pygmy that has come to dominate the US incorporation market by catering exclusively to specific interest groups desires). For a recent analysis of Delaware's unique political situation see Mark J Roe 'Delaware's Politics' (2005) 118 *Harv L Rev* 2491.

[185] See already n 163. See also the FSA's recent contemplations regarding increased disclosure of contracts for difference (CfD) < http://www.fsa.gov.uk/pubs/cp/cp07_20_update.pdf> accessed 4 July 2008;

[186] See FSA 'A Review of the Listing Regime' Discussion Paper 08/1 33-44 <http://www.fsa.gov.uk/pubs/discussion/dp08_01.pdf> accessed 4 July 2008.

[187] Edward B Rock, 'Securities Regulation as Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure' (2002) 23 *Cardozo L Rev* 675, 684-91 (explaining the – until very recently – extremely restrictive rules governing the exit of foreign private issuers from the system of continuous disclosure under US securities laws as a credible commitment device). Although some backfiring consequences of the traditional US system may weaken Professor Rock's explanation with regard to

there is a chance that some will opportunistically make an IPO in a high-quality jurisdiction only to run to a sloppy one after taking the money.

This scenario looks less theoretical than one may initially think. Consider that such opportunistic midstream reincorporations can be driven by the goal of making the company takeover-proof, a corporate law matter that plays a primary role in incorporation choices at the IPO stage in the US[188] As the Takeover Directive's art. 9 leaves Member States enough latitude to custom-tailor their takeover regulation to fall somewhere in between mandating board-passivity and permitting just-say-no-defense strategies,[189] it is well conceivable that considerations similar to those observed in the US will drive some reincorporation choices in Europe..

Even worse, markets will anticipate that issuers may reincorporate in lower-quality jurisdictions and will discount the securities for the potential opportunism.[190] With no device available to facilitate an ex ante credible commitment to high investor protection standards, even truly domestic issuers would thus be unable to take full advantage of their home country good-quality securities law.

Interestingly, that issuers may have "second thoughts" on the applicable securities law and may thus reincorporate to change it is a possibility that EC securities

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the US (cf Securities and Exchange Commission (SEC), 'Termination of a Foreign Private Issuer's Registration of a Class of Securities under Section 12(g) and Duty to File Reports under Section 13(a) or 15(d) of the Securities Exchange Act of 1934 – Reproposed Rule' (2006) Securities Exchange Act Release No. 34-55005, 72 F.R. 1384, 1391 (reporting that quite many foreign private issuers terminated ADR facilities as a preparatory measure in order to escape the disclosure duties under the Securities Exchange Act of 1934 and thereby triggered materially detrimental consequences for US investors)), Rock's fundamental insights remain valid.

[188] On protection from takeovers as a powerful force in the market for corporate law, see Lucian A Bebchuk and Allen Ferrell, 'Federalism and Corporate Law: The Race to Protect Managers from Takeovers' (1999) 99 *Col L Rev* 1168, 1172-77 (outlining the importance of manager's preference for takeover protection in incorporation decisions); Lucian A Bebchuk and Alma Cohen, 'Firms' Decisions Where to Incorporate' (2003) 46 *J L & Econ* 383, 404-11 (presenting empirical evidence from the 1990s).

[189] On Member States' leeway in defining the rules for takeover contests see Matteo Gatti, 'Optionality Arrangements and Reciprocity in the European Takeover Directive' (2006) 6 *EBOLR* 440, 564-68.

[190] See Roberta Romano, *The Advantage of Competitive Federalism for Securities Regulation*

regulation almost completely ignores,[191] perhaps because the FSAP directives' drafters had not envisaged the possibility of post-*Centros* company law arbitrage. Even more severely, it appears that the conflict of laws rules in the FSAP directives themselves would prevent Member States from imposing their securities laws to issuers that have reincorporated elsewhere; at the same time, the possibility of cross-border mergers established under EC law[192] enjoins Member States from impeding reincorporations outright; and freedom of establishment sets tight limits on any attempts Member States may undertake in order to hamper corporate mobility indirectly.[193] Note also that the typical safeguards Member States rely on to counter post-IPO opportunism in the form of evading stringent securities laws the issuer originally pledged to comply with, i.e. restrictions on delisting,[194] are pretty worthless in this context. To facilitate a change in applicable law under the Transparency Directive's continuous disclosure requirements or the pertinent parts of the Takeover Directive, opportunistic issuers can, without turning a hair, maintain their listing on any Member State's regulated market because the conflict of laws rules depend on the issuer's registered office.[195]

As a consequence, the quality of securities regulation across the EU could inexorably fall, because its costs would not be justified any more. Yet, the take-the-money-and-run kind of opportunistic strategy outlined above is only available for prototypical rogue issuers that do not intend to approach capital markets again, at least not in the short or medium term. Investors would certainly red-flag any issuer

(The AEI Press, Washington 2002)127-28.

[191] A provision very weakly addressing the issue is the Transparency Directive's one providing that third countries issuers' choice of a given Member State as their home State "shall remain valid for at least three years unless its securities are no longer admitted to trading on any regulated market in the Community" (Transparency Directive, art 2(1)(i)(ii)).

[192] See n 107.

[193] Consolidated Version of the Treaty Establishing the European Community (n 19), artt 43, 48. On the freedom of establishment's consequences for reincorporation restrictions see Tröger (n 17) 51-56.

[194] For details see n 204.

once it reincorporated opportunistically. The rise in the firm's future costs of capital[196] such reputational damage would entail will arguably chill long-term oriented issuers from pursuing such strategies in the first place, *i.e.* high-quality and domestic issuers are deterred from this conduct ex ante by market sanctions.

The reliance on these costs of capital effects seems more plausible in the European context than skeptics about the merits of regulatory competition regard it in the US market for corporate charters.[197] According to Lucian Bebchuk, managers can use Delaware's unique institutional advantages and network externalities (*i.e.* its elaborate body of case law, its experienced and efficient administration and judiciary) to camouflage the opportunistic streak of their reincorporation decision.[198] In the EU securities law context, if an issuer reincorporated opportunistically to capitalize on less stringent securities laws, no provider of lower quality regulation in the EU appears to be able to offer comparable positive network externalities to conceal the true character of the pertinent choice of jurisdiction.

Even if it is true that meaningful market sanctions are apt to deter repeat players from opportunistic reincorporations, one-shot players, *i.e.* the typical rogue-issuers, are—by definition—immune to purely reputational losses. As a consequence, EU securities laws provide no guidance for investors when it comes to identifying rogue issuers: while stringent securities laws that are inescapable ex post deter entrance by rogue issuers, no such effect is warranted where ex post opportunism is possible in principle. If the lobster-trap metaphor in its strongest form did capture the core function of securities regulation,[199] the current EC conflict of laws frame-

[195] See III.B.2; III.C.2.

[196] Even if investors will generally charge a risk-premium from spotless issuers adjusted to the overall probability of ex post opportunism, issuers with an opportunistic record will have to live with an additional charge.

[197] See especially Bebchuk, (n 3) 1458-84 (outlining controllers' ability to exploit informational asymmetries at the IPO stage in the US).

[198] See also n 156 above.

[199] See n 187 above.

work could make securities regulation worthless, once company law arbitrage becomes easily available. In the worst case scenario, investors who could not discriminate between rogue and innocuous issuers would lose confidence in the markets and refrain from investing in equity shares altogether.[200]

Yet, in light of recent experience, the fears of a total deterioration of investor protection standards in Europe seem unwarranted. The legal safeguards intended to impede ex post opportunistic choices of securities laws are actually no less stringent than those that pursued the same goal prior to the promulgation of the FSAP implementing directives. In fact, despite the absence of a lobster-trap kind of regulation, European exchanges went through a significant upswing recently, at least one of them becoming a serious competitor of US exchanges.[201] More precisely, European issuers traditionally can cease to comply with high-quality, secondary market securities laws simply by delisting their securities.[202] Clearly, a comparable option was always unavailable under US securities laws where the termination of the exchange listing has no immediate influence on the pivotal registration of the securities with the SEC.[203] Despite this, investors did not perceive EU exchanges as lemon markets. The reason for this persistent investor confidence is that high-quality jurisdictions indeed had safeguards in place at all times that were apt to prevent the easy execution of opportunistic choice of law decisions.

While they were certainly less incisive than the US-style lobster trap, these pre-FSAP protections relied on shareholder consent prior to the execution of delist-

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[200] As a result of the informational asymmetry, capital markets not offering a signaling device would represent a prototypical market for lemons. See generally George A Akerlof, 'The Market for Lemons: Quality Uncertainty and the Market Mechanism' (1970) 84 *QJ Econ* 488.

[201] Cf Tröger (n 127) 119-20 and 130-32.

[202] See eg Consolidated Admission and Reporting Directive, art 2(1); Takeover Bids Directive, art 1(1); Transparency Directive, art 1(1) (all requiring the securities to be admitted to official listing or a regulated market).

[203] Cf Rules and Regulations under the Securities Exchange Act of 1934, Rule 12g-2 (2006) 17 C.F.R. 240.12g-2.

ing schemes.[204] In essence, they resemble or are even less restrictive than those that will make reincorporations rather cumbersome under the new choice of securities law regime.

A reincorporation will typically be completed through a cross-border merger, which requires not only shareholder consent but also compliance with several other preconditions designed to protect, among others, minority shareholders.[205] Delistings and reincorporations offer only alternative routes for rogue issuers to achieve their opportunistic ends. Hence, it is unlikely that introducing another, at least similarly rocky road towards an opportunistic escape from stringent securities laws will lead to a melt-down of EU capital market regulation. While it is unlikely that deep and liquid securities markets will develop in the absence of special mandatory legal institutions,[206] it is probably sufficient to complement non-legal safeguards with some legal hooks, like supermajority requirements, to shut the lobster-trap effectively.[207]

Moreover, the alternative of walling in issuers once they have made their

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[204] See e.g. UK Listing Authority, Listing Rules 5.2.5(2) (requiring approval by 75% of the shareholder votes cast in a general meeting); Bundesgerichtshof [BGH] [Federal Court of Justice] Nov 25, 2002, 153 Entscheidungen des Bundesgerichtshofs in Zivilsachen [BGHZ] 47 (53-59) (F.R.G.) (requiring simple majority shareholder consent in a general meeting and establishing a shareholder appraisal right).

[205] See Cross-border Merger Directive, art. 5-9 (mandating shareholder approval on the basis of a detailed document containing the terms of the transaction, a management report and an independent expert report). Importantly, the Directive only provides a framework of minimum standards, allowing Member States to retain stricter requirements set by domestic merger statutes. See eg Companies Act 2006, 2006, c.46, § 907 (Eng.) (supermajority of 75% in value, of each class of members of each of the merging companies, present and voting either in person or by proxy at a meeting); Umwandlungsgesetz [UmwG] [Merger Statute], Oct 28, 1994, BGBl. I at 3210, last amended by Gesetz, April 19, 2007, BGBl. I at 542, §§ 13, 50, 65 (F.R.G.) (supermajority of 75% of the votes cast in shareholder meeting for each class of shares).

[206] Eg Black, (n 131) 789-99; Andrei Shleifer and Daniel Wolfenzon, 'Investor Protection and Equity Markets' (2002) 66 *J Fin Econ* 3; for empirical evidence see La Porta, Lopez-de-Silanes and Shleifer (n 121); for a critique of the La Porta et al.'s methodology see Mathias M Siems, 'What Does Not Work in Comparing Securities Laws: A Critique on La Porta et al.'s Methodology' [2005] *Int'l Company & Com L Rev* 300.

[207] See also Romano, 'The Need for Competition' (n 145) 411-14 (arguing that management self-interest complemented with shareholder approval requirements will prevent a good deal of midstream opportunism).

choice comes at a cost too, because it eliminates the upside of issuer choice – the opportunity for high-quality issuers to opt for another provider of even better regulations later down the road, in case such a provider should emerge. Put pointedly, meeting the race to the bottom concerns also deletes the prospects of a race for the top. If one accepts that market forces, reputational mechanisms and legal safeguards enable issuers to commit to high-quality standards,[208] albeit less tightly than inescapable mandatory law would, the question becomes a quantitative one: will the losses caused by less credible bonding be offset by the gains associated with "better law" opt-in opportunities? It should be recalled that opportunistic reincorporations in our context require rogue issuers to submit to good securities laws and other efficient non-legal institutions of investor protection at the initial stage in order to allow for noteworthy arbitrage gains. If so, however, the chances that effective gatekeepers,[209] analysts, lawyers, and underwriters can detect these issuers' malevolent intentions are as high as it gets. This, together with the additional safeguards established through common standards in the EU's harmonizing measures, results in an institutional framework which makes it a maintainable policy choice to accept the remaining losses due to issuer midstream opportunism. In sum, allowing for issuer choice within the EU and its groundwork of harmonizing directives should enable market participants to fetch most of the benefits of securities law arbitrage without incurring exceeding costs.

d. Towards a more vibrant EU market for company law? The bundling of company and securities law for conflict of laws purposes may have important consequences also for the dynamics of the market for corporate law itself. Let us not forget

[208] On the possibility and significance of reputational bonding on international capital markets see Siegel (n 119); Larry E Ribstein, 'Cross-Listing and Regulatory Competition', (2005) 1 *Rev L & Econ* 97, 112-13.

[209] See T Chemmanur and P Fulghieri, 'Investment bank reputation, information production, and financial intermediation', (1994) 49 *J Fin* 57-79 (analyzing incentives of investment banks and underwriters to perform their certifying function efficiently).

that today some regulatory arbitrage is *already* taking place in Europe. A high number of German small and medium firms are in fact flocking to the UK to take advantage of the lower incorporation costs for private limited liability companies.[210] At least some of the German "GmbH Limited" founded these days will be among tomorrow's IPO companies. Once they are organized under English law, these firms might avoid an offer to the public and admission to trading on a German market, to take advantage of the UK market and avoid remaining double jurisdiction problems altogether. Alternatively, they may just go public in Germany as an English plc or convert to a German stock company for that purpose. To be sure, offering shares to the public for the first time represents a stage in a firm's history where its dominant decision-makers have to reconsider and adjust the organizational framework governing the firm's operations anyway, making reincorporation more plausible.[211] But, transforming an English Ltd. into a plc. should work more smoothly than converting it into a German stock company.[212] Clearly, the thus created path dependency is amplified if sticking to English corporate law liberates the firm from reconciling its organizational law with foreign securities regulations in the future. On the other hand, at least for some firms the advantages of tapping German stock markets will outweigh the costs associated with either incurring limited multiple jurisdiction prob-

[210] M Becht, C Mayer and HF Wagner, 'Where Do Firms Incorporate?' (2006) Centre for Economic Policy Research (CEPR) Research Paper No. 5875 <http://ssrn.com/abstract=953820> accessed 25 October 2007 (naming minimum capital requirements and delays in registration as main determinants for the observed outpour). As predicted (see Tröger (n 17) 50; Gelter (n 17) 263) affected Member States respond by amending their corporate law, in order to rectify the deficits exposed by corporate migration. See the recent amendments to the German Private Limited Liability Company Statute (Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen [Act Modernizing the Law of Private Limited Liablity Companies and Combating Abuses] <http://www.bmj.bund.de/momig> accessed 4 July 2008). Similar legislatory action has occurred much swiftlier in France. See Loi No. 03-721 du 1 aout 2003, [2003] JO 13449. In corporate law, defensive regulatory competition is well under way.

[211] It is exactly this moment in which US corporations feel the most intense stimulus to reincorporate. See (n 188).

[212] A secure way to accomplish the latter would be to merge the English limited into a German shell-stock company, hardly a transaction cost-saving endeavor.

lems[213] or with conducting a cumbersome cross-border merger. It should not be overlooked that if our German "GmbH Limited" does business exclusively or mainly in Germany, the prospects for success of a UK IPO are questionable.[214] The latter finding lends attractiveness to share offerings in Germany despite the associated costs. In sum, the proper place where to conduct a share offering can only be decided on a case-by-case basis. However, as an outcome, the bundling of company and securities laws will have a negative impact on the German securities industry or at least, if the offer is nonetheless made (also) in Germany, on its securities law one. With time, this should raise the stakes of having attractive company laws, *i.e.* provide further incentives for defensive regulatory competition in the field of corporate law.

Further, there can be few doubts that the main candidate to the position of a European Delaware – if any such exists at all – is the UK itself.[215] With securities regulation tied to company law, (re)incorporating in the UK will become even more attractive: in fact, as already hinted,[216] this choice lowers the securities law-related costs for issuers that wish to list on a British market. Further, if there are synergies between a country's corporate and securities laws or, in other words, if each of them

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[213] A prominent example for a firm that has its center of operations in Germany but went public on the Frankfurt Securities Exchange (and its electronic trading platform XETRA) as an English company is Air Berlin plc, a rapidly expanding no-frills airline. See Air Berlin plc, 'Annual Report 2007' 43 <http://ir.airberlin.com/saveas.php?filepath=_files/en/&file=080410_AB_AnnualReport2007_247.pdf> accessed 4 July 2008.

[214] Empirical evidence indicates a relation between investors' familiarity with an issuer's product or service and the outcome of share offerings. See S Sarkissian and M Schill, 'The Overseas Listing Decision: New Evidence of Proximity Preference' (2004) 17 *Rev Fin Stud* 769-809 (finding the success of cross-listings to depend significantly on the connection between the home and host state's product markets and attributing this finding to the importance of investor familiarity).

[215] See John Armour, 'Who Should Make Corporate Law?' (n 13) 510-18. Even before *Centros*, see Brian R Cheffins, *Company Law: Theory, Structure and Operation* (Clarendon Press, Oxford 1997) 426-430. The UK would resume a position it already occupied during the second half of the nineteenth century. See Elvin R Latty, 'Pseudo-Foreign Corporations' (1955) 65 *Yale LJ* 137, 166 n130.

[216] See supra text accompanying n 116-118.

"works better" when applied together with the other than with that of another jurisdiction,[217] bundling the two will allow issuers to take advantage of such synergies.[218] Finally, reincorporating in the UK is the most straightforward way to associate with its "good-quality securities regulatory supervisory regime."[219]

If bundling reinforces the dominant player's position in the market, then, no matter what view one takes on regulatory competition in corporate law, the outcome may be negative for its dynamics: for opponents of regulatory competition, the fact that a European Delaware would become even more attractive is obviously bad. On the other hand, a regulatory competition supporter, at least at first glance, would not be fond of a market in which, willy-nilly, the EC legislature has favored one jurisdiction by raising the entry costs for potential competitors. In fact, entering the market for corporate law itself requires an investment by the relevant jurisdiction, especially if a well-established corporate law supplier exists.[220] The investment needed to be attractive to the listed companies segment will be higher, because the relevant jurisdiction will have to make its securities regulation attractive as well. And this may not

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[217] See Reinhard H Schmidt and Gerald Spindler, 'Path Dependence, Corporate Governance and Complementarity' (2002) 5 *Int'l Fin* 311 (formalizing complementarities between corporate law and neighboring fields of law).

[218] See Roberta Romano, *The Advantage of Competitive Federalism* (n 170) 123, for some examples of synergies between corporate and securities laws, that would stem from adopting the incorporations state approach as the conflict of laws criterion for securities law (better integration of fiduciary and disclosure duties; a single set of rules for hostile bids and shareholder meetings; lower litigation costs). See also Ribstein (n 208) 115-16 (discussing the additional bonds a US incorporation creates, *e.g*. shareholder governance powers in board election, significant transactions etc., adjudication by reputed US courts, protection in takeover situations). With regard to the UK in particular, it is important to note that many institutions frequently regarded as critical for investor protection originated from and thus are sometimes still located in company law, making them unavailable to issuers merely listing their shares on a UK regulated market but retaining their registered office abroad. See Tröger (n 127) 148-49, 153-54 (showing that the strict disclosure duties with regard to significant holdings and the takeover regulation of the City Code until very recently required a UK incorporation as a prerequisite of their application).

[219] Ferran (n 15) 155.

[220] To gauge the potential magnitude, it should be recalled that leading US scholars have argued that Delaware today is in a position to successfully chill potential competitors by artificially raising entry costs. See Marcel Kahan and Ehud Kamar, 'The Myth of State Competition in Corporate Law' (2002) 55 *Stan L Rev* 679; Lucian A Bebchuk and Assaf Hamdani (n 150) 553.

even be enough, because the UK will still retain the advantages of a deep, liquid and efficient capital market, which might make listing in the real seat country irrelevant, so that the costs of dealing with two jurisdictions under the post-FSAP framework will not have to be incurred. The same will not be true for the majority of other Member States and especially, with one exception to which we will turn immediately, for smaller countries, i.e. the least unlikely candidates to compete in the market for corporate law.

Yet, it should not be overlooked that regulatory competition need not be stirred by the goal of increasing a jurisdiction's market share alone. It can also occur in a defensive form that aims more modestly at preserving the current status quo. If the purpose of enhancing one's own legal system is only to counter domestic agents' incentives to move to a more attractive jurisdiction, the costs of entering and participating in the race are considerably lower. Instead of having to become materially more attractive than the competitors to justify the costs of switching the legal regime, jurisdictions only have to make sure that they do not become too unappealing. Member States which have not engaged in a defensive race for corporate charters so far might do so once the UK is additionally favored in such a competition. In this scenario the post-FSAP bundling of corporate and securities laws might actually have a desirable stimulating effect.

Of course, the evidence suggests that defensive regulatory competition was well under way even prior to the implementation of the new conflict of securities law rules.[221] However, it does not hurt to fast-track the race, so long as an additional advantage for the already predominant player does not adversely affect also defensive regulatory competition. Clearly, if the competitive edge of the UK increases, disfavored Member States will have to jump higher even if their goal is only to defend their current position. The tipping point is reached once those who found it worth-

[221] See supra n 210.

while to engage in defensive regulatory competition with the UK as to corporate law alone find it excessively hard to stem the tide with corporate law bundled to securities laws. When this is the case, bundling negatively affects the dynamics of defensive regulatory competition as well. Although it is too early to rely on conclusive evidence in this respect, it can be observed that important Member States did not decelerate their efforts to improve their corporate law recently.[222] This suggests that incentives have not tilted yet, leaving defensive regulatory competition intact.

One may speculate whether the new conflict of laws rules might have an impact on Luxembourg, which is often dubbed as a potential European Delaware[223] and which also happens to have one of the most vibrant capital markets in the world. Like the UK, Luxembourg may become more attractive as the incorporation State for EU issuers wishing to list their securities on its exchange. One might even speculate that the link between issuer choice and company law might finally prompt Luxembourg actively to seek for reincorporations from other Member States, because a more attractive corporate law would make Luxembourg's securities markets even more attractive than they are already.

It is highly doubtful, however, whether Luxembourg's sleepy attitude toward the market for corporate law[224] is going to change: apart from any possible corporate law-specific reasons why Luxembourg is likely to remain passive,[225] it is Luxembourg securities market's specialization that makes this scenario unlikely: Luxem-

[222] For evidence from Germany see Ulrich Noack and Dirk Zetzsche 'Germany's Corporate and Financial Law 2007: (Getting) Ready for Competition' CBC Research Paper <http://ssrn.com/abstract=986357> accessed 4 July 2008.

[223] Jens C Dammann, 'Freedom of Choice in European Corporate Law' (2004) 29 *Yale J Int'l L* 477, 528-30; Gérard Hertig and Joseph A McCahery, 'Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts of Regulatory Competition', (2004) 3 *EBOLR* 179, 187; even before the *Centros* line of cases, see Alfred F Conard, 'The European Alternative to Uniformity in Corporation Laws' (1991) 89 *Mich L Rev* 2150, 2194.

[224] See Kamar (n 133) 1752 (noting that, even after *Centros* Luxembourg "has done nothing to signal an intention to comp ete for incorporations.").

[225] Ibid (pointing to the alleged bad quality of Luxemburg's corporate law, the unfamiliarity of lawyers outside the country with its corporate statutes and deterring language barriers).

bourg is a leading market for mutual funds (Undertakings of Collective Investments, or UCIs) and debt securities.[226] The former are out of the scope of the post-FSAP legislative directives considered in this article.[227] As to the latter, if the post-FSAP regulatory framework substantially raised the cost of listing debt on the Luxembourg exchange for EU issuers, they might simply incorporate a Luxembourg vehicle, let it issue the debt securities, act as guarantor and use the proceeds via an intra-group loan: they would not need to reincorporate the parent company itself in Luxembourg.

C. Bundling the Securities Law Aspects of Takeovers with Listing

An interesting exception to the registered seat criterion can be found in the Takeover Bids Directive: the Directive makes an offeror subject to the disclosure, procedural and price-related rules of the target company's home Member State if the shares are listed in a home market, while, in case shares are not listed on a home market, to the rules of the host Member State where the shares were first admitted to trading; in case the dual listing occurred simultaneously, companies may elect the competent authority and therefore the applicable law.[228] In the last case, the securities law aspects of takeover law are bundled only with the few host state rules applying to an EU issuer from another State, *i.e.* with the Market Abuse Directive's requirements.[229] In other words, it basically allows for the cherry picking of one coun-

[226] The bond turnover observed in 2006 at the Luxembourg Exchange was Euro 1,291.7 million compared to Euro 187.3 million in equity. Significantly, trading in UCIs largely takes place outside Luxembourg's exchange. Luxembourg's UCIs in 2006 held net-assets of Euro 1,844.9 billion but total UCI-turnover on Luxembourg's exchange amounted to Euro 21.3 million only. Source: Bourse de Luxembourg Factbook 2006, Statistics, pp. 64-65; 73-74 <http://www.bourse.lu/application;JSESSIONID_BDL=HghJwCmKTJv83hkBtTm2DSrn10LGQpR54NJ9H12Qbv9GkXbSm92g!-1075562651!-1154818722?_flowId=PageStatiqueFlow&content=services/statistiques/Statistiques.jsp> accessed 25 October 2007.

[227] Prospectus Directive, art 1(2)(a); Takeover Bids Directive, art 1(2); Transparency Directive, art 1(2) all define UCIs as falling outside the scope of their regulations.

[228] Cf Takeover Bids Directive, art 4(2) and III.C.2. above.

[229] III.E.2.

try's securities law on takeovers.[230]

Suppose that a given jurisdiction ("A") decided to enact a very friendly regulation on on-going disclosure, mainly deferring to other Member States' laws when an issuer is also listed elsewhere, in terms of compliance procedures and so on. The costs of Market Abuse Directive compliance in A would hence be low. Suppose also that A chose to impose highly demanding securities law rules for takeovers. An EU company wishing to go public and particularly averse to the risk of a hostile takeover might decide simultaneously to list in A and, say, in Luxembourg and choose A's anti-bidder regime to protect against hostile bids. To be sure, if it comes to hostile takeovers the more daunting shark repellents will be those involving board activity, the latitude for the latter being invariably tied to the law of the registered office.[231] Yet, given the proclivity of managers to insulate their firms from takeover threats as effectively as possible,[232] it is conceivable that some issuers will fetch any opportunity to impede takeover attempts, particularly if the chance to do so is cheap.

Conversely, another jurisdiction ("B") may supply a regime that does not adequately protect minority shareholders in the event of a friendly sale of control potentially triggering the Directive's mandatory bid requirement. For instance, B may allow for a *de facto* unequal treatment of shareholders,[233] a low level of bidder disclosure, discounts on the mandatory bid price etc., catering to companies (typically those controlled by a dominant shareholder that does not face dilution of her control

[230] See Mathias M Siems, 'The Rules on Conflict of Laws in the European Takeover Directive' (2004) 1 *ECFR* 458.

[231] Takeover Bids Directive, art 4(2)(e); see III.B.2 above.

[232] Cf n 188.

[233] Takeover Bids Directive, art 3(1)(a) stipulates shareholder equality in control transactions as the overarching principle for Member States' implementing measures. Yet, by leaving acquirers greater latitude in determining the price of a mandatory bid, shaping disclosure requirements less ambitiously etc. a great deal of subsurface inequality can persist. Compare L Enriques, 'The Mandatory Bid Rule in the Takeover Directive: Harmonization Without Foundation?', (2004) 1 *ECFR* 445-46 (arguing that the Directive fails to harmonize mandatory bid rules across the EU by granting Member States too much freedom to de facto make the mandatory bid never applicable, whether in law or *de facto*).

stake) that anticipate a friendly sale of control or a squeeze-out bid by the dominant share holder later on.

As an outcome, already today, no matter how difficult company law arbitrage is, issuer choice is available with respect to important takeover law issues. Even here, provided that countries are sufficiently differentiated in their treatment of such aspects, separating equilibria are likely, with some companies choosing very bad jurisdiction in terms of minority shareholder protection, and others choosing the ones that make life the hardest for hostile bidders.

V. CONCLUSION

We explored the prospects of legal arbitrage in European securities regulation following the implementation of post-FSAP EU securities law measures. Although European lawmakers have made considerable efforts to harmonize capital market regulation, we identified significant latitude for Member States to retain national idiosyncrasies in securities laws. Legal arbitrage considerations are still of considerable relevance with regard to the regime of private liability for false statements in disclosure documents, the public administration and enforcement of securities laws in general, and less densely harmonized takeover law.

Furthermore, we showed that the conflict of laws rules contained in the FSAP-implementing directives with regard to initial and continuous disclosure obligations as well as takeover defenses bundle the choice of applicable securities laws with the issuer's registered office. On the other hand, disclosure duties and traffic rules accompanying public tender offers as well as ad hoc disclosure obligations are governed by the law of the market where the issuer's securities are admitted to trading.

We have deemed it to be too early for a conclusive assessment of whether corporate migration will be a realistic scenario for existing companies in Europe and hence have scrutinized the prospects of issuer choice in two scenarios.

While the home state rule generally serves to disentangle choice of law considerations from non-legal determinants such as market development, depth, and liquidity, it also creates so far unknown multi-jurisdiction problems where issuers face considerable barriers to a transfer of their registered office. Moreover, where corporate law arbitrage is unavailable, the home state rule strips issuers of the opportunity to signal their high quality by opting into a better securities law regime and exempts national regulators from competitive pressure working to improve their practice.

If future developments should render the transfer of an existing company's seat a viable option thereby facilitating issuer choice, we predict that Europe will not see a race to the bottom. The EU will rather end up with a separating equilibrium offering socially beneficial choice of law opportunities for different types of issuers. Concerns that the quality of securities regulation in the EU would inevitably fall because issuer choice would thwart credible long-term commitments to high standard regulation are unwarranted because legal and non-legal institutions sufficiently prevent midstream opportunism.

Bundling corporate and securities laws potentially stimulates defensive regulatory competition in corporate law because jurisdictions that lose incorporations at early stages are confronted with path dependence if they attempt to recoup them later down the road. Yet, as any path dependence favors the status quo, it also threatens the dynamics of the market for corporate charter. Hence, at the margin the home state rule reinforces the UK's dominant position in the market for newly founded businesses. This is all the more true as we do not expect any other jurisdiction actively to compete with the UK.

With regard to the aspects of takeover law that are governed by the affected market rule, we show that already today issuer choice offers a broad variety of options. Once again, we expect a separating equilibrium to be the outcome.

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