Presentation by Gerard Hertig, Professor of Law, Swiss Institute of Technology

When we prepared this little introduction I asked whether I could challenge the European Court of justice (ECJ), the European Commission and our American friends all together. Klaus said yes but I had to stay within the allocated time frame, so here we go. In the recent cases mentioned by Eddy Wymeersch, the ECJ did not hesitate to take on Member states, showing courage at the time when the Commission was weak. This is in line with the EU tradition of the ECJ taking the lead when the Commission does not provide guidance.
It is true that one could argue that the ECJ did some posturing at no risk by not tackling two most fundamental issues, tax and codetermination. However, it would be wrong to say that we have a courageous ECJ for nothing. Actually we have a not so courageous ECJ for something. As far as new firms are concerned, it is now absolutely crystal clear that regulatory competition is on, with the UK taking the lead and France and Germany scrambling to try to fill the gap and not be left behind.

The situation more complex for established firms. The Daily Mail case has established that if you wanted to move your headquarters, you had to pay taxes on unrealised profits - which makes the move prohibitively expensive. But a recent case, the de Lasteyrie du Saillant case mentioned by Eddy, shows that the ECJ may well be prepared to reassess Daily Mail. The surprising thing, however, is that it is an individual, not an established firm that has tested the ECJ's appetite for challenging tax barriers to free movement. Similarly, the Centros, Überseering and Inspire Art cases mentioned earlier have all been originated by small, new firms. The question then becomes why it is small, new firms that have caused the regulatory environment to become more dynamic and why did larger, established firms undertake nothing in the past decade to challenge Daily Mail. My answer is: they remained passive because of trade-offs. Larger, established firms may succeed in getting Daily Mail reversed, but they realize that in tax matters there is a very unstable equilibrium. You have to consider the existence of jurisdictions that follow what is called the Irish model, and practice very low corporate tax rates. You have also to take into account the availability of transfer pricing possibilities, another very hot tax topic. So, if you are a major firm and you start manoeuvring to get the ECJ to reverse of Daily Mail, you could face retaliatory tax measures as well as a more general adjustment of the existing tax environment. In other words, you might win a bit but lose a lot. My conclusion thus is that we cannot expect major firms to challenge Daily Mail and give the ECJ an opportunity to show whether or not it is really courageous when it comes to striking down tax barriers.

Co-determination is the other larger/established issue that the ECJ has not tackled. Some empirical studies show that codetermination may not be as costly for firm as often argued. This means that it may not be as important a barrier to free choice as argued by some and that ECJ inaction is not that problematic. But it is clear that co-determination is such a hot political potato that, barrier to free choice or not, courageous ECJ or not, it is here to stay for the foreseeable future.

We thus seem left with a somewhat pessimistic tax and co-determination conclusions when it comes to freedom of choice for established firms. In reality, however, there is ground for optimism. Recent ECJ case law could provide a basis for regulatory competition for established firms too, provided the European Commission perceives that it provides an opportunity to eliminate remaining barriers by building upon the optional approach adopted for the Takeover Bids Directive.

This optional approach has been much decried, but is quite fascinating. In particular, it provides an opportunity to stop trying to pass multiple reforms, each comprising multiple provisions – which only compounds oppositions and distractions. By adopting a piecemeal opt-in approach, the European Commission would be able to focus on a small number of core procedural issues (substantive matters being generally better dealt with by judges) to satisfy the needs of those firms most unhappy with the current corporate law framework.

How can you implement such an opt-in programme? It is not that complicated and could even be of interest from an American perspective. We can start with the assumption that there are benefits in EU regulatory competition overall (as Colin just said), especially because we are not in market that is as mature as the US market. By adopting a piecemeal regulatory approach, the EU would depart from its practice of adopting overly detailed directives or recommendations, which probably bring more costs than benefits. It would propose the adoption of a couple of simple provisions that EU firms could opt in if they like them – or if there is market pressure for them to do so.

From a political economic perspective, the approach has the advantage of minimizing Member state resistance, allowing rapid progress. It would also circumvent tax and labour issues. Tax issues are here to stay, a point also made by Commissioner Bolkenstein in his recent comments about the Financial Services Action Plan. Co-determination issues are not necessarily that important, but if Germany wants to keep it, why not? In addition, opt-ins have the advantage that when a firm makes a choice in favour of EU provisions, there is no explanation to make. The "comply or explain" approach, which probably has more costs than benefits, is not applicable. You do not have to justify why you opt for EU law, at least for the time being – EU law is supposed to be superior to Member state law should a firm opt for it. In other words, the opt-in approach makes the reputation issue go away.

Conversely, if the EU opt-in provisions prove to be overly costly, nobody will choose them and there will be no social costs whatsoever. This is also why the opt-in approach could be an answer to the federalisation of corporate law that is taking place in the US. Following the scandals we have had, as Mark Roe has nicely shown in an article recently published in the Harvard Law Review, a transfer of powers from Member states to the SEC and other federal regulators. This constrains regulatory competition, which might or might not be positive in the US environment (there are many empirical studies on the subject, but nobody can be sure whether regulatory competition is good or bad). However, Marcel Kahan has just completed an empirical study that is very interesting from a European and opt-in perspective. He shows that regulatory competition debate has been framed in wrong terms. It should not be framed in takeover term, but rather focus on individual provisions, analysing whether they are good or bad - exactly what the opt-in approach is all about.

What our American friends might thus learn from us, for a change, it is that instead of having only mandatory rules at the SEC level, you could also have federal default provisions. That would definitely minimise compliance issues such as those currently discussed because of the implementation of the Sarbanes-Oxley Act (which, seen from the outside, often looks more like a box ticking exercise with a lot of paperwork to cover your backside, rather than being something that is efficient and provides value to the market). In other word, opt-ins could have the benefit of building investor confidence at lower cost.

Now, there is one caveat here. The situation in the US and the EU is potentially different in the sense that litigation is much more developed in the US. However, that should be a

temporary issue. One can argue that class actions and the like are coming to Europe and will develop here too. Therefore the litigation situation may become similar on both sides of the Atlantic, which is no necessarily to the detriment of European companies. Indeed, they may prefer facing collective actions in the EU, with the home court bias that is favouring domestic companies, than facing a collective action in the US where you generally are at a disadvantage as a non-US company fighting US investors.