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*How Does Corporate Mobility Affect Lawmaking?  
A Comparative Analysis*

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UNIVERSITEIT VAN AMSTERDAM  
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## Abstract

This paper examines the impact of increased corporate mobility on corporate lawmaking in the European Union (EU). More specifically, we seek an answer to a simple question: Has the increased mobility which arose from the implementation of the *Societas Europaea* (SE) and the path-breaking decisions of the European Court of Justice (ECJ) led to an outbreak of regulatory competition and the emergence of a Delaware-like member state in Europe? Two types of corporate mobility are distinguished: (1) the incorporation mobility of start up firms and (2) the reincorporation mobility of established firms. As to incorporation mobility, the *Centros* triad of cases makes it possible for start-up firms to incorporate in a foreign jurisdiction. Many entrepreneurs have taken advantage of this new freedom of establishment. However, recent data from Germany and The Netherlands indicate declining numbers of such foreign incorporations over time. Moreover, *Centros*-based incorporation mobility is a rather trivial phenomenon, economically speaking. The actors in question seek only to minimize costs of incorporation. National lawmakers have been responding, amending their statutes to lower these costs. But, because out of pocket cost minimization at the organization stage operates as only a secondary motivation of ‘choice-of-business-form’ decisions, there arise no competitive pressures that cause national legislatures to engage in thorough-going reform addressed to corporate governance more generally. As to reincorporation mobility, which concerns the migration of the statutory seat of a firm incorporated in one member state to another member state, the SE has opened the door, but not widely enough to serve as a catalyst for company law arbitrage. Reincorporation mobility is still far from generally available in the EU. As a result, competitive pressures do not yet motivate changes in the fundamental governance provisions of national corporate law regimes.

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# How Does Corporate Mobility Affect Lawmaking?

## A Comparative Analysis

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### 1. Introduction

It is increasingly argued that the European Court of Justice's (ECJ) line of cases starting with *Centros* could set in train the basis for competitive corporate lawmaking in Europe.<sup>1</sup> ECJ case law now provides two important pre-conditions for regulatory competition: mutual recognition and minimum standards. Today, start-up firms of all sizes can select a statutory seat anywhere in the European market without being hampered by severe constraints built into their home states' corporate law. Although the ECJ has not explicitly ruled the real seat doctrine, which ties a firm's state of incorporation to its administrative seat, contrary to community law, domestic courts now will normally apply the law of the state of formation to the corporate affairs – the relationships among the directors, officers, and shareholders – even if the corporation in question has no other business in that state. Under the ECJ case law, a member state could only impose its own stricter legal standards if it justified them as requirements essential to protect the general interest and applied them proportionally and on a non-discriminatory basis.<sup>2</sup> Incorporators of start-up firms have taken advantage of this new freedom of establishment, choosing to incorporate in member states offering more favourable conditions, in particular, the absence of minimum capital requirements. The United Kingdom has emerged as the situs of choice.

The suggestion follows that the United Kingdom, which recently overhauled its company law, could be well placed to establish itself as the leading state for European business

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1 See McCahery, J.A. and Vermeulen, E.P.M., *The Evolution of Closely Held Business Forms in Europe*, *Journal of Corporation Law*, vol. 26, 2001; Vermeulen, E.P.M., *The Evolution of Legal Business Forms in Europe and the United States*, The Hague: Kluwer Law International, 2003. See also a second wave of research: Armour, J., *Who Should Make Corporate Law? EC Legislation versus Regulatory Competition*, *Current Legal Problems*, vol. 48, 2005; Gelter, M., *The Structure of Regulatory Competition in European Corporate Law*, *Journal of Corporate Law Studies*, vol. 5, 2005.

2 See ECJ, Case C-212/97 *Centros Ltd and Erhvervs-og Selskabsstyrelsen* [1999] ECR I-1459, §34: 'it should be borne in mind that, according to the Court's case law, national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfil four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it.'

formations, like Delaware in the United States. The question thus arises as to whether and in what degree these developments in fact suffice to encourage lawmakers, whether in the UK or another member state, to engage in competitive lawmaking and to design policies that can lead to a more attractive regulatory environment in the area of corporate law. Unfortunately, the Delaware analogy holds out little immediate encouragement. The United States market for corporate charters was jump-started more than a century ago by a state seeking a yield of premium franchise taxes and chartering fees by attracting large existing corporations to a regulatory comfort zone that extended to antitrust as well as corporate governance. Delaware continues to work within this incentive framework, albeit playing only the corporate governance angle. As yet, the operative incentive framework cannot be replicated in Europe. The rulings in *Centros*, *Überseeing* and *Inspire Art* do not explicitly introduce the possibility of free choice for large existing firms that intend to reincorporate and migrate across borders.<sup>3</sup> And even if they did, charter fees and franchise taxes are not available to incentivize European member states to modernize and optimize their corporate law regimes.

If not franchise taxes and chartering fees, what might incent European national lawmakers to construct more responsive corporate legal regimes, and how might corporate mobility figure into such an incentive alignment? Delaware lawmakers have a secondary incentive stemming from demands and economic benefits emanating from the large professional services sector located in the state. There follows a second, weaker European analogy: Member state lawmakers can seek to provide legal rules and institutions that are attractive to both domestic and foreign firms if doing so benefits the professional services industry.<sup>4</sup> For this reason, it is argued that the introduction of the *Societas Europaea* (European Company, SE) Statute in 2001 and its subsequent implementation in October 2004 could give an important impetus to competitive lawmaking in Europe.<sup>5</sup> In effect, the SE created the first possibility for reincorporation without liquidation of the old entity and the formation of an entirely new vehicle. Because the internal governance structure of an SE continues to be governed largely by national legislation, the SE Statute could stimulate some regulatory arbitrage across the EU. So long as the firm in question was willing to move its seat, it could in theory decide to convert into an SE to avail itself of a more beneficial corporate law regime. It follows in theory that a jurisdiction could have incentives to provide those benefits. Such a highly developed corporate legal regime, characterized by responsiveness to the

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3 See Case C-208/00 *Überseeing BV and Nordic Construction Company Baumanagement (NCC)* [2002] ECR I-9919; Case C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd* [2003] ECR I-10155.

4 See Vermeulen, E.P.M., *The Evolution of Legal Business Forms in Europe and in the United States*, The Hague: Kluwer Law International, 2003; Armour, J., *Who Should Make Corporate Law? EC Legislation versus Regulatory Competition*, *Current Legal Problems*, vol. 48, 2005.

5 See Enriques, L., *Silence Is Golden: The European Company Statute as a Catalyst for Company Law Arbitrage*, *Journal of Corporate Law Studies*, vol. 4, 2004.

demands of management and capital, could import prestige to the jurisdiction's lawmakers and bring revenues to its legal intermediaries.

This scenario gets additional credibility from the recent adoption of the Directive on Cross-Border Mergers and the ECJ *Sevic*-case.<sup>6</sup> The Directive allows corporations to merge and restructure themselves across borders within the EU, and should enable firms to overcome some of the most important obstacles to free corporate mobility that exist due to differences in national corporate laws, thereby stimulating competitive lawmaking. The *Sevic*-case, in substance, indicates that medium-sized and large firms, which are most cost-sensitive, may undertake to relocate their seat based on the legal rules they prefer. As a practical matter, this is similar to the reason why larger companies could make use of the SE: it offers firms a legal form that allows them to better pursue their corporate objectives.

It is too early to conclude, absent accurate data on cross-border mergers, whether the Directive and the *Sevic*-case will lead to an increase in the reincorporation mobility and eventually more regulatory competition in Europe. Barriers remain, quite apart from the absence of affirmative national lawmaker incentives. First, residual frictions, such as tax barriers, continue to make European firms highly immobile and, hence, deter lawmakers from jumping on a chartering competition bandwagon. For instance, a member state may freely impose conditions to a firm wishing to transfer its administrative seat while retaining the corporate status under the law of the state of origin if its purpose is tax avoidance.<sup>7</sup> Second, the lack of a common history, culture and language further reduces the possibility of the emergence of US-style corporate mobility and lawmaking in the Europe.<sup>8</sup> Third, national lawmakers continue to resist encroachments on their corporate lawmaking discretion. National regimes long ago created barriers to corporate mobility to preserve their national lawmakers' autonomy. Continued preservation of national discretion has reinforced the barriers, despite the advent of the EU. Ultimately, it could be argued that so long as the member states retain a zone of discretion to deter the emigration of existing firms, the real seat doctrine has only been eradicated in part. If eradication is indeed the ECJ's ultimate goal, the job has not yet been completed.

Still, there have been recent signs of mobility-driven responsiveness among European lawmakers. The promulgation of a limited liability partnership in the United Kingdom and the

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6 See Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies, OJ 2005 L 310/1-9; Case C-411/03 *Sevic Systems AG* [2005] ECR I-10805

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

8 See Kirchner, C., Painter, R.W. and Kaal, W., *Regulatory Competition in EU Corporate Law after Inspire Art: Unbundling Delaware's Product for Europe*, *European Company and Financial Law Review*, vol. 2, 2005.

flexible *société par actions simplifiée* (SAS) in France both can be cited.<sup>9</sup> These, taken together with the joint phenomena of start-up migration to the UK and increasing numbers of large firm reincorporations under the SE statute, raise the question whether Europe approaches (or has indeed reached) a tipping point at which corporate mobility and responsiveness displace the preservation of national discretion as corporate law's motive force.

This paper analyzes the recent evolution of corporate mobility and corporate law in Europe to assess whether Europe has reached or approaches the tipping point. It concludes that it has not as yet done either. While corporate mobility has increased in dramatic ways, nothing points to the emergence of a Delaware-like 'European' state.

Section 2 explains and assesses the process by which European corporate law has evolved, tracing its development back to the establishment of the EU in 1957. This discussion shows that the member states have consistently attempted to block any intervention into their national corporate law legislation. Upon the inception of the European Union, most member states followed the real seat doctrine, foreclosing corporate mobility and limiting choice of situs. The creation of the European Union could have facilitated movement away from real seat,<sup>10</sup> but did not. Founding member states, such as France and West Germany, feared the consequences of an outbreak of a so-called 'race-to-the-bottom' in corporate law. This led to the introduction of top-down harmonization of national corporate law regimes. Under this strategy, the member states entered into a cooperative game in which the parties agreed, in exchange for political benefits or rents, to desist from opportunism after attaining Community membership. This cooperative agreement included another element: member states would only agree to the harmonization of the national corporate laws if this could be achieved without the alteration of the core components of their laws.<sup>11</sup> The member states' subsequent reluctance to adopt EU level corporate law confirmed and reinforced the zone of national legislative autonomy.

Section 3 turns to recent disruptions of the EU's corporate lawmaking pattern. Even as the EU has continued to pursue its harmonization strategy, policymakers within the Commission simultaneously have set out to design a more independent agenda on the basis of Article 308 (ex 235).<sup>12</sup> EU level business forms, such as the SE, have been introduced to stimulate cross-

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9 See McCahery, J.A. and Vermeulen, E.P.M., *Understanding (Un)incorporated Business Forms*, Amsterdam: Amsterdam Center for Corporate Finance, 2005.

10 The Treaty of Rome (1957) provided for the right of establishment for foreign corporations to establish branches in another member state, without being subject to more restrictive corporate law provisions of the host state.

11 See Charny, D., *Competition among Jurisdictions in Formulating Corporate Law Rules: An American Perspective on the 'Race to the Bottom' in the European Communities*, Harvard International Law Journal, vol. 32, 1991.

12 Article 308 (ex 235) specifies two preconditions for unification: (1) action by the Community should prove necessary to attain, (2) the powers provided in the Treaty are insufficient. See Buxbaum,

border mobility while at the same time covering the creation and conversion of particular undertakings. In Section 3 we will analyze the impact of the introduction of the SE and assess whether its implementation has led to an increase in firm mobility and, consequently, induced member states to embark on a more innovative and ambitious lawmaking path.

Section 4 turns to the ECJ case law and start-up mobility. We will see that there is a significant pent-up demand to incorporate a start-up company in a low-cost formation jurisdiction. Marco Becht, Colin Mayer and Hannes Wagner investigated new company formations in the UK between 1997 and 2006, revealing that the number of ‘foreign’ private limited companies increased from 4,400 per year in the pre-*Centros* era to 28,000 post-*Centros*.<sup>13</sup> Moreover, they show that during this period 48,000 of the almost 120,000 ‘foreign’ private limited companies were located in Germany alone.<sup>14</sup> The increased mobility has created competitive pressures. Indeed, Germany, The Netherlands and, to a lesser extent, France have been driven to institute reforms to their corporate law and tax regimes not only to stem the flow of firms migrating to the United Kingdom, but also to gain establish reputations as competitive jurisdictions.<sup>15</sup> Section 4 offers a detailed analysis of the types of firms that decide to incorporate in the United Kingdom, showing a direct link to responsive lawmaking incentives. One of this paper’s arguments is that, based on data from Germany and The Netherlands, the volume of incorporation mobility resulting from the ECJ case law is declining. It is in any event rather trivial both as an economic proposition and as a lawmaking motivation. The impact of the ECJ’s decisions has so far only led to patching-up initiatives in most member states, influencing some jurisdictions – like Germany and The Netherlands – to eliminate or reduce minimum capital requirements for private companies and to focus on low-cost formation. There has been little or no sign of high-quality legislative or case law reform.

Section 5 concludes by arguing that while the new mobility has contributed to discreet modifications of company law among EU jurisdictions, the member states nevertheless continue to face little competition, competition that is objectively insufficient to alter people’s incentives and behavior and promote demands for new institutions. It is too early to draw hasty conclusions about the emergence of a European Delaware.

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R.M. and Hopt, K.J., *Legal Harmonization and the Business Enterprise, Corporate and Capital Market Law Harmonization Policy in Europe and the United States (Volume 4)*, Berlin - New York: Walter de Gruyter, 1988, p. 210-12.

13 See Becht, M., Mayer, C., and Wagner, H.F (2007), *Where Do Firms Incorporate?* ECGI Law Working Paper No.70/2006, August 2007.

14 See also Niemeier, W., *GmbH und Limited im Markt der Unternehmensrechtsträger*, *Zeitschrift für Wirtschaftsrecht*, vol. 27, 2006.

15 See *The Wall Street Journal* (by Martin D. and Alogna, F.G.), *New Delaware*, 20 December 2007.

## **2. EU Company Law Directives: The ‘Non-Competition’ Strategy**

Under the historic pattern of EU level corporate lawmaking national legislatures have had a virtual monopoly, supported by the twin pillars of the real seat doctrine in conflict of laws and national tax regimes. The real seat doctrine barred essential legal recognition to firms that attempt to relocate to another incorporation state. Of course, some member states choose not to follow the real seat doctrine. But even in those jurisdictions national regulators have for long attempted to restrain local entrepreneurs from incorporating elsewhere by restricting their reentry – reentering firms, termed ‘pseudo foreign corporations,’ have been forced to apply the core rules of the home member state. The real seat doctrine and restrictions on pseudo foreign corporations, taken together with exit taxes in cases where mobility was achieved by means of the physical relocation of the firm’s administrative seat, together constituted the foundations of a stable, long-run lawmaking equilibrium. Under the equilibrium a cooperative strategy dominated and no incentives could arise for member states to engage in competitive corporate lawmaking activity.

To look at the evolution of EU corporate law is to see that from the inception of the harmonization program in 1957 through the modernization period of the High Level Group of Company Law Experts, the EU has not been able to stimulate the right of establishment of pseudo-foreign companies. The harmonization program has not produced the coveted effect of limiting the barriers to corporate mobility. In fact, the emergence of a non-intervention approach in EU lawmaking has deterred member states both from dismantling costly legal barriers to reincorporation and from developing responsive measures aimed at encouraging corporate mobility. Let us look further into this to show how the harmonization program contributed to the non-competition strategy in the EU.

### **2.1 The First Generation of Company Law Directives**

Prior to the establishment of the EU, Europe amounted to a group of island jurisdictions, in which domestic lawmakers, each with different constituencies and political concerns, pursued their own policy agendas. Each jurisdictional island possessed an elite group of legislators, judges, regulatory agencies, professionals, and legal academics responsible for interpreting, preserving, and developing the law. They did so in conservative frameworks, undisturbed by and unresponsive to possible changes in the legal systems of surrounding islands. As jurisdictional islands, the states remained privileged to close their borders in response to exterior competitive threats. For example, in the 19<sup>th</sup> century, Belgium tried to play a non-cooperative corporate law game vis-à-vis France, encouraging French managers to change their jurisdictions of incorporation. France and other high cost jurisdictions responded to this

opportunistic initiative by introducing the real seat doctrine, which provides that the laws of the host state are apply if the actual center of the corporation's activities lies in the host state. This doctrine in effect closed their borders to corporate entry and exit.

It gets of course more difficult to keep the border closed when an island jurisdiction becomes part of a common market and national barriers to trade gradually dissipate. In such a market, corporate mobility is more likely to surface. At the same time, actions by a federal lawmaking body can help stimulate cross-border activities. The Treaty of Rome (1957) established the European common market, holding out just such possibilities. The Treaty was designed to encourage the creation of an integrated market by assuring the free movement of goods, services, people and capital. It provided foreign corporations the right to establish branches in another member state (host state) without being subject to more restrictive corporate law provisions. At that time, the real seat theory remained dominant. But, in 1957, many feared it was losing ground, the Netherlands having recently abandoned it. Furthermore, it looked like the Treaty could usher in a new era of corporate mobility. Provision 293 (ex 220) of the Treaty invited member states to enter into negotiations regarding the 1968 Brussels Convention on Mutual Recognition of Companies and Legal Entities, which would have abandoned the real seat in favour of the incorporation doctrine. But reaction was split. Some founding member states feared an outbreak of a so-called 'race-to-the-bottom.' They had learned important lessons about the effects of charter competition from the US experience.<sup>16</sup> Competition was seen to entail substantial losses for domestic interest groups. France in particular was concerned that the Netherlands, which had a more flexible corporation law code and was playing non-cooperatively on corporate tax matters,<sup>17</sup> would be able to attract a large number of pseudo-foreign companies.

Charter competition's opponents responded by using the lawmaking process, triggered by the Treaty and directed to elimination of disparities among the laws of EU member governments, to reduce potential benefits of competition. France and West Germany promoted top-down harmonization of national corporate laws as an EU agenda item. Existing members and new entrants went along, and the EU's mandatory corporate law Directives resulted. These sought to ensure compliance with a minimum level of regulation. With a common set of legal rules in each jurisdiction, no member state would have the zone of discretion needed to create law that attracted incorporations and hence no incentives to compete.

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16 See Charny, D., Competition among Jurisdictions in Formulating Corporate Law Rules: An American Perspective on the 'Race to the Bottom' in the European Communities, *Harvard International Law Journal*, vol. 32, 1991. See also McCahery J.A. and Vermeulen, E.P.M., The Evolution of Closely Held Business Forms in Europe, *Journal of Corporation Law*, vol. 26, 2001.

17 See Bratton, W.W. and McCahery, J.A., Tax Coordination and Tax Competition in the European Union: Evaluating the Code of Conduct on Business Taxation, *Common Market Law Review*, vol. 38, 2001.

This first generation of corporate law Directives restated the existing content of the member states' national laws. Mandates resulted, such as minimum capital requirements and disclosure rules. At the same time, the Directives made no attempt to expand the zone of mutual recognition of firms. Even as EU lawmakers justified the harmonization Directives as measures to protect creditors and shareholders, their lawmaking scheme maintained special interest outcomes that had been reached in the respective member states prior to the elimination of trade barriers.<sup>18</sup> Incumbent management, for example, had every reason to support provisions that limit dividend payments and share repurchases so as to obtain more leeway to reinvest firm's profits.

To sum up, the early member states played a cooperative game respecting corporate law. They in effect agreed to desist from non-cooperative corporate lawmaking in exchange for membership in the Community. They negotiated and enforced a political agreement that protected their national stock markets and domestic labor settlements. Still small in number, they were concerned with political stability as well as economic integration. They valued political payoffs yielded by stable corporation law more highly than the chance for enhanced economic welfare held out by corporate mobility and competitive experimentation.

## **2.2 Later Harmonization and the adoption of the Directive on cross-border mergers**

The second wave of corporate law Directives was arguably more flexible, granting states options in respect of compliance. The change reflected added diversity of legal regimes due to the admission of the United Kingdom and other new member states. At the same time, an optional approach only ensured that the Directives did not interfere with core elements of given member states' national settlements. The move to flexibility thus followed from the cooperative agreement. Rigidity and top-down mandate remained the dominant theme, however.

The rigid approach eventually showed its limitations. Harmonization of core areas of corporate law, like the structure and responsibility of the board of directors and cross-border mergers, proved slow and ineffective.<sup>19</sup> This was no surprise: the member states valued the autonomy of their national legal regimes. They had fundamental disagreements regarding important issues, such as board structures and employee participation, and so proved reluctant

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18 See Carney, W.J., *The Political Economy of Competition for Corporate Charters*, *Journal of Legal Studies*, vol. 26, 1997.

19 See Woolcock, S., *Competition among Rules in the Single European Market*, in W.W. Bratton, J.A. McCahery, S. Picciotto, and C. Scott (eds.), *International Regulatory Competition and Coordination, Perspectives on Economic Regulation in Europe and the United States*, Oxford: Clarendon Press, 1996, p. 289-321.

to implement the harmonized rules. There being no politically acceptable consensus, regular vetoes of directive proposals under Article 100 of the EC Treaty (now Article 94) followed.

In 1985, the ECJ and the European Commission's responded to calls for greater flexibility by adopting a 'new approach' to harmonization based on minimum harmonization and mutual recognition.<sup>20</sup> The following year, the Single European Act (SEA) attempted to resolve possible veto blockages at Council level by providing for a consultation procedure and qualified majority voting. A number of corporate law Directives were promulgated between 1968 and 1989, removing a wide range of discrepancies between the European member states' rules with respect to the protection of stakeholders.<sup>21</sup>

The EU reached another stage in the evolution of the harmonization program with the development of the subsidiarity principle, embraced by the member states in the 1992 Maastricht Treaty on the European Union.<sup>22</sup> The subsidiarity principle, embodied in Article 5 of the Treaty, concerns areas that are not within the exclusive competence of the European Union.<sup>23</sup> It commands the location of competence at the EU level or at the member state level, and, rather than listing the respective competencies, provides for an efficiency test to determine local decisions.<sup>24</sup>

The European Commission, building on the principles of subsidiarity and proportionality, has developed a new, more flexible type of Directive. The Commission articulated a new approach that moves away from the provision of minimum standards to a framework model. Even with the introduction of this new standard, the EU has enjoyed only limited success in the area of corporate law. The 2003 passage of a significantly weakened Directive on

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20 See Villiers, Ch., *European Company Law – Towards Democracy?*, Aldershot: Ashgate Dartmouth, 1998.

21 The European Community has adopted an array of directives (First, Second, Third, Fourth, Sixth, Seventh, Eight, Eleventh, Twelfth, and the Securities Directives), which regulate disclosure and *ultra vires*, capital requirements of public corporations, mergers and divisions of public corporations, corporations' annual and consolidated accounts, the qualification of accountants, disclosure of branches, formation of single member corporations, admissions to stock exchange listing, public offers of listed and unlisted securities, acquisitions and sales of major holdings, and insider trading. See Edwards, V., *EC Company Law*, Oxford: Clarendon Press, 1999.

22 Besides constraining the Commission's role through the subsidiarity principle, the Maastricht Treaty also introduced the co-decision procedure. As a consequence, the European Union's decision-making structure closely resembles the constitutional form of democratic federalism in which central government policies are agreed to by a simple majority of elected representatives from lower-tier governments. See Inman, R.P. and Rubinfeld, D.L., *Rethinking Federalism*, *Journal of Economic Perspectives*, vol. 11, 1997.

23 Areas within the exclusive competence of the Union are subject to the proportionality test of Article 5 §3 of the Treaty, which provides that 'action by the Community shall not go beyond what is necessary to achieve objectives of the Treaty;' proportionality and subsidiarity both apply to nonexclusive areas.

24 First of all, it has to be determined whether there is a power under the Treaty to take action. The subsidiarity principle then determines whether and how the Community may act. It must be shown that the objectives of the proposed action cannot be sufficiently achieved by the member states. The finding must then justify the further conclusion that in view of the measure the objective can be better achieved at Community level. The proportionality test as defined in §3 of Article 5 still has to be satisfied.

Takeovers exemplifies the magnitude of the problem reflected in the persistence of deeply rooted conflict among the member states over the direction and pace of implementation of the Directives.

The Commission's current efforts to reform the regulatory framework for corporate law are largely inspired by recommendations made by a group of experts commissioned by the EU.<sup>25</sup> These measures were designed to simplify existing rules and improve freedom of choice between alternative forms of organization. The program looked toward reform at four levels. First, the Commission proposed to modernize corporate law by further harmonizing corporate disclosure, board structure, and director liability requirements, and by amending capital rules. Secondly, it planned to adopt rules facilitating corporate restructuring and mobility. Thirdly, it proposed the establishment of a permanent coordination structure, the European Corporate Governance Forum, to work along with member state agencies to sanction unfit directors. Fourthly, it proposed to strengthen the supervision of auditors and to adopt comprehensive rules on the conduct of audits. This initiative largely retraced the terrain covered by previous harmonization attempts and therefore its prospects for success were not too optimistic.

However, the High Level Group's call for an urgent submission of a revised Directive on cross-border mergers obviously bore fruit. On 15 December 2005, Directive 2005/56/EC entered into force. This Directive further facilitates the merger of corporations that have their statutory and business seat in one of the member states. Its provisions, which should be implemented in national corporation laws before 15 December 2007, apply to mergers where at least two corporations are governed by the laws of different member states. It took more than twenty years of negotiation before the EU legislature could obtain approval for the adoption of this Directive.<sup>26</sup> Since a cross-border merger results in the ceasing of the acquired and absorbed companies, a member state's corporation law could lose its application to the protection of national shareholders, creditors, employees and other stakeholders. Indeed, the adoption of the Directive on cross-border mergers could be viewed as a significant disturbance of the EU's non-competition strategy.

Still, the Directive does not allow merging firms to unlimitedly adopt a legal system that presents them with the most efficient governance structure and board composition. The strict principles and arrangements relating to employee participation – as set out in the Council Directive No 2001/86/EC of October 2001 with regard to the involvement of employees in the SE – apply when the corporation law of the absorbing company does not provide for at

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25 See Report of the High Level Group of Company Law Experts on A Modern Regulatory Framework for Company Law in Europe, Brussels, 4 November 2002.

26 A first draft of the Directive on cross-border mergers was presented in 1984 [COM(1984) 727 final, OJ 1985 C 23/11].

least the same employment participation regime as is applicable in one of the merging and disappearing companies. In order to ensure the working of the Directive on the involvement of employees, the merging companies must have an average of more than five hundred employees in the six months preceding the publication of the draft terms of the merger.

The Directive on cross-border mergers is largely based on the provisions of the SE Statute. It could be argued in this respect that EU Level initiative on business forms paved the way for more cross-border mobility. The next section will take a closer look at the emergence of the SE and its impact on corporate lawmaking in the EU.

### **3. The *Societas Europaea*: Challenging the ‘Non-Competition’ Strategy?**

#### **3.1 The SE: An Incomplete Lawmaking Product**

Historically, first generation EU lawmakers were convinced that an SE Statute could create an economic environment through which firms could reach their full development and more crucially to promote cooperation among firms located in different regions of the EU.<sup>27</sup> In line with the first harmonization Directives, the Commission initially aimed to create a uniform and comprehensive legislative proposal that served as a basis for a truly genuine European business form. This led to a first proposal in 1970. Since its approach would threaten the member states’ lawmaking autonomy, it came as no surprise that this proposal did not obtain the countries approval. It took until 1989 before the Commission published a new draft Statute. In order to expedite its adoption, it was decided to address the employee participation in a different Directive. A report – produced by a group of experts chaired by former Commission President Etienne Davignon – outlined a compromise solution regarding labour participation and opened the door for compromise legislation that resolved political difficulties, but only by referring extensively to the national corporation law of the member state where the SE would have its administrative seat.<sup>28</sup> The Council finally adopted the SE Statute in December 2000, and it entered into force in October 2004.

The SE Statute makes it possible for a firm to effect reincorporation from one member state to another by reorganizing as an SE and transferring the administrative seat. Under the Statute, legal persons may form an SE through (1) merger of two or more existing companies that are governed by the laws of at least two different member states (cross-border merger); (2) formation of a holding company promoted by public or private limited companies; (3)

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27 See Leleux P. Corporation Law in the United States and in the E.E.C., Some Comments on the Present Situation and the Future Prospects, *Common Market law Review*, vol. 6, 1968.

28 Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE) OJ L 294, 10/11/2001, 0001-21.

formation of a jointly held subsidiary; or (4) conversion of an existing public limited company.<sup>29</sup> Some governance matters are determined under the SE Statute. But most matters are determined by a *renvoi* to the national company law of the member state where the SE has its seat. However, the Statute explicitly allows firms to select a one-tier system in which the SE comprises a general meeting of shareholders and a board of directors. If the SE prefers to have a supervisory board that monitors the board of directors, the Statute provides for the implementation of a two-tier system.

Significantly, the Statute does open a door for a German *Aktiengesellschaft* (AG) to escape the strict German rules on labor codetermination, but not a basis for doing so based on a unilateral management decision. A special negotiation procedure for worker participation must be followed upon the creation of an SE.<sup>30</sup> The Directive distinguishes between information and consultation on the one hand and participation on the other hand. The employee representatives must in all cases be informed about material decisions and given the opportunity to influence the deliberation and decision-making process. In addition, where twenty five percent of the originating firm's employees have a right to participate in management, the employees' representatives must consent to the planned composition of the supervisory board (two-tier) or board of management (one-tier). Thus, a German AG whose unions agree to give up all or part of their supervisory board representation can reorganize as an SE with whatever governance structure agreed to by the unions. No movement of the administrative seat to another member state need occur.

The Statute holds out three advantages. First, it is the first piece of European level legislation that allows for cross-border mergers, making it relatively easy to relocate the administrative seat in another member state.<sup>31</sup> Secondly, the Statute holds out cost advantages for a firm not seeking to change its seat but seeking to consolidate operations in multiple member states. A firm, even if it plans no change of seat, can merge its various subsidiaries into the SE. The SE emerges as a unitary entity organized in one member state and operating branches in other states across the EU. The difference is that all companies in the group now follow a single body of corporate law. The recent conversion of Alliance AG into an SE suggests that firms do see cost advantages in operating under a single set of rules. Thirdly, the Statute makes it possible for a parent to merge out a minority shareholder interest in a

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29 See Art 2 and Title II of the Regulation.

30 Section II of the Regulation.

31 The registered office of an SE may be transferred to another member state. Such a transfer shall not result in the winding up of the SE or in the creation of a new legal person. Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE) OJ L 294, 10/11/2001, 0001-21. Art 8 paragraph 1.

subsidiary without having to take the potentially costly step of making a tender offer for the minority shares.<sup>32</sup>

Despite its advantages and encouragement of corporate mobility, many question whether usage of the SE makes any sense in practice. Practitioners express skepticism about EU level legislative measures and point at the lack of statutory guidance respecting incorporation and operation as an SE. They view this European business form as compromise legislation that offers a rigid and unattractive choice for firms to structure their internal affairs.<sup>33</sup> Even as the Statute holds out a path around obstacles surrounding the cross-border reincorporation process, the path nevertheless is much too narrow to lead to undisturbed choice of situs of incorporation. For instance, start-up firms cannot establish an SE *ex novo* or *ex nihilo*.<sup>34</sup> What is more, the provisions set forth in the Directive on Involvement of Employees detail the level of employee involvement in the formation and operation of an SE and, as a result, decrease rather than increase the SE's attractiveness.<sup>35</sup> In particular, the need to enter into negotiations with employee representatives creates a bottleneck. Lastly, the absence of a specific tax regime, particularly with regard to cross-border seat transfers, is likely to be a significant impediment to the use of the SE.

To date (December 2007) more than hundred SEs have been incorporated – of which one has already been liquidated and two others converted into limited companies residing on the Cayman Islands. The resulting pattern of usage lets us draw some preliminary conclusions about the SE's role in stimulating corporate mobility.

### **3.2 The SE: A Vehicle for Company Law Arbitrage?**

Only one hundred and eight SEs have been formed and corporate law forum shopping has not been a salient motivation. Although numbers of new SEs have steadily increased quarter by quarter since the form's introduction in October 2004 (see *Figure 1*) overall numbers, whether quarterly or in aggregate, remain small. This suggests that the Commission's efforts to find an attractive alternative for firms seeking to pursue cross-border activities or migration strategies have been wasted.

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32 Allianz bought out minority shares of RAS, an Italian insurer, in connection with its conversion to SE status. See Financial Times (by P. Jenkins & T. Buck), Corporate Governance: Why European Companies May See Benefits in a Company Statute with Fewer Limitations, 11 October 2005.

33 See McCahery, J.A. and Vermeulen, E.P.M., Does the European Company Prevent the 'Delaware-effect'?, European Law Journal, vol. 11, 2005.

34 The significant amount of minimum capital that is required to form an SE is yet another dissuasive element in the SE Statute. The minimum capital requirement of €120.000 would certainly prevent start-up firms to opt for this EU-level business form. See section 4 of the Council Regulation (EC) No. 2157/2001 of 8 October 2001 on the Statute for a European company (SE), OJ 2001 L 294/1-21.

35 See Council Directive 2001/86/EC [2001] OJ L294/22.

But the numbers also can be read positively. Even if the Commission's new business form has not encouraged forum shopping, it is being used in increasing numbers. Now, with an average of approximately eight SE being incorporated per quarter, critics must acknowledge that there is demand for a EU-level business form designed to facilitate cross-border movement. Moreover, if we take into account the SE's time-consuming formation procedures and legal advisors' unfamiliarity with it,<sup>36</sup> the small numbers come as no surprise. Indeed, in an environment in which differences in culture and legal traditions abound, the SE should already be considered successful since it not only enables more cross-border mergers and activities, but also offers firms across jurisdictions a cost-effective means of pursuing inter-jurisdictional strategies.

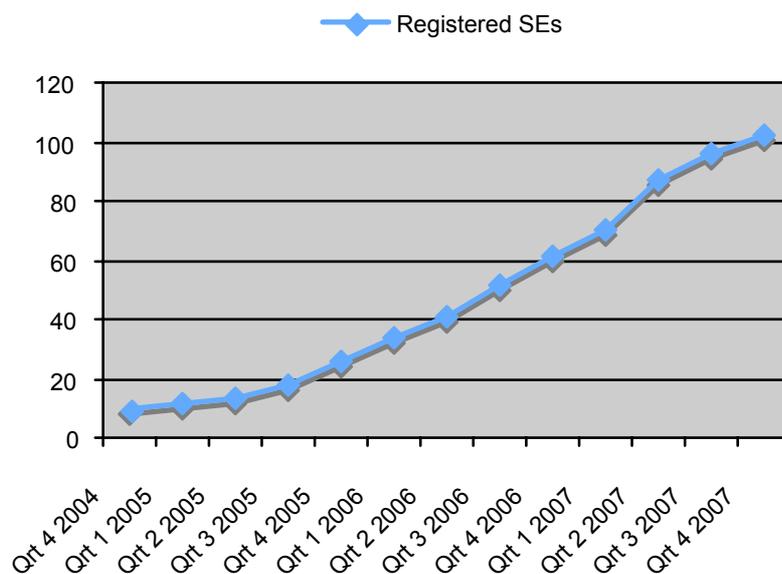
In order to give a more complete picture of the effect of the SE on corporate mobility, we will categorize the main determinants of SE formations. If we look at the available data, we can draw some interesting, although not surprising, conclusions. Firstly, it appears that the benefits of establishing an SE outweigh its considerable formation costs mainly in jurisdictions with widespread participation rights... For instance, German BASF AG estimated a cost of €5,000,000 to convert to an SE. This amount includes the costs of compliance with the necessary legal and accounting requirements as well as registration and disclosure costs.<sup>37</sup> The fact that more than 75% of the SEs are established – and have their administrative seat – in countries with strict regulations, particularly in the area of formation and employee participation (see *Table 1*), indicates that there are important reasons other than cross-border benefits that make it cost-effective to go through the cumbersome formation requirements. There is evidence that firms interested in contemplating the establishment of an SE may also be attracted to the positive advantages of the SE's flexible governance structure and the its mechanisms protecting shareholder participation rights.

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36 A feasibility study of a European Statute for SMEs (financed by the European Commission) shows that business practice, especially in the area of small and medium-sized enterprises, is not familiar with the possibility of forming an SE. 91.3% were not familiar with this EU level business form. See AETS, *Etude de faisabilite d'un statut européen de la PME*, July 2005.

37 See Conversion Documentation, Conversion of BASF Aktiengesellschaft into a European Company (Societas Europaea, SE) with the company name BASF SE.

Figure 1: Total number of SEs registered (October 2004 to December 2007)<sup>38</sup>



Source: Adapted from information available at [www.worker-participation.eu/european\\_company](http://www.worker-participation.eu/european_company)

Table 1: The relation between participation rights and number of registered SEs

<b>Countries with widespread participation rights at board level</b>	
Germany	42 SEs <sup>39</sup> registered
Finland	1 SE registered
Hungary	2 SEs registered
Luxembourg	4 SEs registered
The Netherlands	9 SEs <sup>40</sup> registered
Norway	3 SEs registered
Austria	9 SEs registered
Slovakia	2 SEs registered
Sweden	5 SEs registered
Czech Republic	5 SEs registered
<b>Countries with limited or no participation rights at board level</b>	
Belgium	6 SEs registered
Cyprus	2 SE registered
Estonia	2 SE registered
France	7 SEs registered
Latvia	3 SEs registered
Liechtenstein	2 SE registered
The UK	4 SEs registered

Source: Adapted from information available at [www.worker-participation.eu/european\\_company](http://www.worker-participation.eu/european_company)

While the SE allows firms voluntarily to adopt the corporation law of a more flexible and liberal jurisdiction by changing their administrative seats, firms tend not to do so for practical

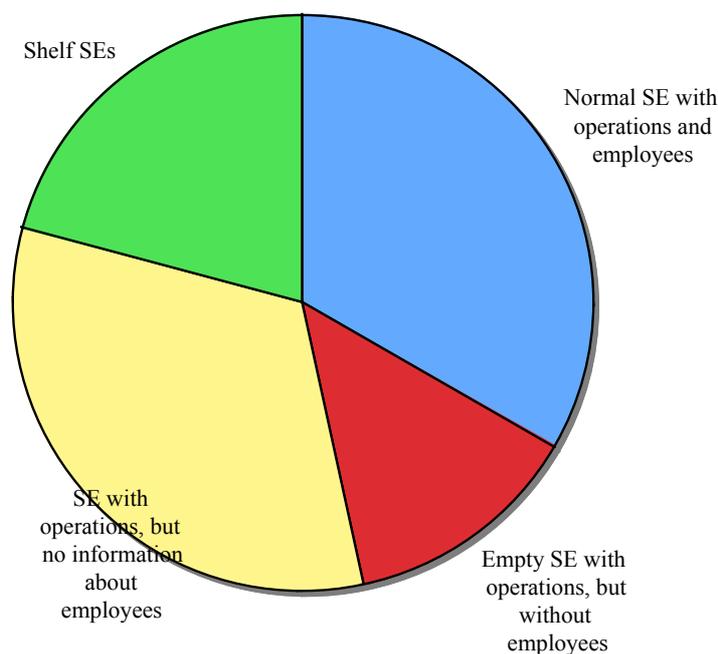
<sup>38</sup> This figure depicts the information available on 102 registered SEs.

<sup>39</sup> One SE was liquidated.

<sup>40</sup> Two SEs were converted to private limited companies residing on the Cayman Islands.

and psychological reasons. If we only take the ‘normal’ SEs with operations and employees into account, we see that more than 65% of the SEs is formed by the conversion of national corporations that had one or more subsidiaries in other member states (see *Figure 2*). Instead of stimulating reincorporation mobility, the SE competes with national business forms, such as for instance the *Aktiengesellschaft* in Germany. The following business cases exemplify the advantages of the SE.

*Figure 2: SEs per category*



*Source: adapted from information available at [www.worker-participation.eu/european\\_company](http://www.worker-participation.eu/european_company)<sup>41</sup>*

In August 2006, MAN B&W Diesel AG, a German market leader in the world of two- and four-stroke engines,<sup>42</sup> converted to an SE. Significantly, it was the first German company that successfully concluded an agreement with the employee representatives of different European business divisions. Even though Augsburg remained the administrative and statutory seat of MAN Diesel SE, the conversion offered the possibility to deviate from the rigid co-determination provisions that apply to the German AG by reducing the number of supervisory board members from twelve to ten as well as giving its supervisory board (*Aufsichtsrat*) a more international composition (through reducing the influence of German workers).<sup>43</sup> The

<sup>41</sup> Almost 50% of the operating SEs are concentrated in the financial sector.

<sup>42</sup> See [www.manbw.com](http://www.manbw.com).

<sup>43</sup> This explains the specificity of the SE and its virtual absence in jurisdiction without stringent participation rights. For German companies, the SE could be a relatively quick and efficient means to

intended conversions by Fresenius AG, a German Healthcare company, and BASF AG indicate that this is the prime motivator for German companies to switch to an SE. Both companies attempt to involve all European employees in the appointment procedure of the members of the supervisory board.<sup>44</sup>

Other companies in strict regulation jurisdictions, such as Germany and Austria, go a step further and take the opportunity to choose a one-tier board structure. A recent example is Mensch und Maschine Software SE, a high-tech company that focuses on Computer Aided Design and Manufacturing (CAD/CAM) solutions. This German-based firm converted into an SE adopting the one-tier system because it is the preferable corporate governance structure for listed high-tech companies in which management holds a significant number of the outstanding shares. A single tier board makes prompt and flexible decision-making possible. This is viewed as a substantive benefit for firms that operate in a fast-growing and ever-changing business environment and may explain why the majority of the ‘normal’ SEs opted into the one-tier system offered by the SE Statute.

Finally, we note that almost 20% of the set of SEs have been established as ready-made shelf companies. A shelf company can be a convenient option when firms promptly require an EU-level business form without going through the complex and costly formation requirements. Like we will see with post-*Centros* start-ups, here too ‘registration agents’ play an important role in promoting new practice developments. For instance, the German Foratis AG, which according to its website is a market leader in shelf companies,<sup>45</sup> offers SEs for a purchase price of €132,000. With such an SE, buyers acquire a EU-level entity with a share capital of €120,000. Because many of the SEs that are offered off the shelf by this agent are structured as a one-tier board, it could indeed be concluded that corporate governance rather than mobility considerations are responsible for the appearance of a niche market for shelf SEs.<sup>46</sup> The fact that Foratis AG focuses on the German market reinforces the conclusion that

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transform their board structure to meet international standards, whereas for other firms it constitutes a burdensome and costly alternative.

44 See Financial Times (by G. Wiesmann en I. Simensen), German blue chips ponder switch to SE format, 12 April 2007; Financial Times (by R. Milne), Porsche’s designs on VW lead it to steer to a different company structure, 12 April 2007; Financial Times (by I. Simensen en G. Wiesmann), Unions weakened on supervisory board, 12 April 2007; Financial Times (by R. Hönighaus en I. Simensen), Allianz plans to raise €3.5bn in German property sale, 4 May 2007.

45 See [www.foratis.com](http://www.foratis.com).

46 It follows from the available data that two companies purchased a shelf SE at Foratis AG: (1) Atrium Erste Europäische VV SE was renamed into Convergence CT SE in January 2006 and (2) Donata Holding SE was before the acquisition called Atrium Fünfte Europäische VV SE. Both companies have a one-tier board structure. In the first months of 2006, Foratis registered four new SEs. Atrium Achte Europäische VV SE and Atrium Neunte Europäische VV SE were registered in April 2006. Atrium Dritte Europäische VV SE and Atrium Vierte Europäische VV SE were established in March and February 2006 respectively. In October 2007, Atrium Elfte Europäische VV SE and Atrium Zehnte Europäische VV SE were incorporated.

the SE is generally viewed as an additional ‘national’ business form which, besides the international allure, holds out advantages mainly in the area of corporate governance.

Three years after the introduction of the SE we can accordingly draw some tentative conclusions about this EU-level initiative. As we have shown above, the legislation has not resulted in the hoped-for increase of reincorporation mobility. Nonetheless we can foresee a trend that companies which are located in the new member states of the EU will value the European label of the SE more than companies in other member states.<sup>47</sup> In fact, because firms in most of the new member states are perceived to lack credible enforcement mechanisms and high quality governance institutions, corporate lawyers in recent years have urged Eastern European firms to use the SE, for example, to facilitate entry into foreign markets, to protect investors and creditors more effectively, and increase the efficiency in enforcing contracts. On the other hand, even though the SE is tailored for larger companies, a more widespread use of the SE does not seem to entail the migration of the administrative and statutory seat to another member state due to substantial legal and cultural barriers. On balance, the experience with the SE suggest that it is now widely acceptable for managements to use the SE to streamline internal governance structures and to protect minority shareholders from their exposure to opportunism by non-shareholder constituencies.

This is an important development to be sure, but not one that significantly enhances mobility. The next section will determine the prospects for the emergence of competition in the context of smaller and private companies and explore whether the competitive pressures, which have arisen in the post-*Centros* era, could stimulate the demand for modern and innovative lawmaking by national legislatures.

#### **4. ECJ Case Law: Challenging the ‘Non-Competition’ Strategy?**

##### **4.1 The ‘Incorporation Mobility’ Case Law**

Recent research suggests that corporate mobility is a prerequisite for regulatory competition among member states and can significantly affect the level of experimentation and the quality of institutional arrangements. In the United States, corporate mobility is seen as a unitary phenomenon – any corporation can select its jurisdiction of incorporation at any point in its life cycle so long as its managers and shareholders agree on the choice. In Europe, corporate mobility is a more complicated notion that makes a fundamental distinction between incorporation of start-up firms and reincorporation of existing firms. As for the first type of

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<sup>47</sup> See for similar conclusions AETS, *Etude de faisabilité d’un statut européen de la PME*, July 2005. An unnoted, but equally important, development is the leading role played by registration agents in the market for shelf-SEs.

corporate mobility, the post-*Centros* decisions have made it possible for an entrepreneur in member state A, even if this is a classical real seat jurisdiction, to incorporate a start up company in member state B and later establish a branch containing all of the assets and activities of the business in state A. Even if the establishment in state B serves the purpose of avoiding state A's rigid corporate law rules, such as minimum capital requirements, the organizers normally obtain full recognition in state A without application of any of its corporate law.

The *Centros*-case is an example of this scenario. *Centros* involved Danish nationals who, seeking to evade Danish minimum capital requirements, organized a close corporation in the United Kingdom. Then, seeking to establish the actual business in Denmark, the organizers sought Denmark's permission to register a branch. This permission was refused, and the ECJ decided that so doing was contrary to the freedom of establishment under Articles 43 and 48 of the Treaty. Denmark, like the UK, follows the theory of incorporation. The firm's primary establishment – its legal status as a corporation – was accordingly beyond dispute in Danish courts. The case solely concerned the 'secondary establishment' of a branch by an English private company in Denmark. Secondary establishment alludes to the setting up of agencies, branches or subsidiaries. The ECJ expanded the scope of the term 'branch', reducing the difference between primary and secondary establishment to a minimum and ruling that it was contrary to the Treaty for Denmark to refuse to register a branch of a firm organized as a private limited company in the United Kingdom solely to evade the application of Denmark's minimum capital requirements.<sup>48</sup> To be sure, this new constitutionally-mandated permission has limits. Under the *Cassis de Dijon* decision,<sup>49</sup> the Court does allow Treaty freedoms to be restricted when justified by the public interest, applying a multistep rule of reason test. But the ECJ rejected the Danish justification for minimum capital. Creditors of closely held firms, said the Court, could look to other protections than minimum capital requirements, and governments seeking to protect creditors could adopt measures less burdensome on fundamental freedoms.<sup>50</sup>

*Centros* did not involve a country of origin holding to the real seat doctrine, and thus did not explicitly rule the real seat doctrine contrary to community law. Nevertheless the

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48 See Ebke, W.F., *Centros – Some Realities and Some Mysteries*, *American Journal of Comparative Law*, vol. 48, 2000, p. 961-986.

49 Case 120/78 (*Rewe Zentrale AG v. Bundesmonopolverwaltung für Branntwein*), [1979] ECR 649.

50 At the time of the *Centros*-decision, most member states viewed minimum capital requirements as essential to obtaining limited liability protection. However, these requirements do not pass the four factor test. See *Centros* §34: '[I]t should be borne in mind that, according to the Court's case law, national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty must fulfill four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary to attain it.'

judgment has important implications for corporate migration. The English private company in the case had been incorporated by Danes who at all times lacked any intention to conduct operations in the UK. Read broadly, the case shows that actors can situate their incorporations in countries offering internal processes and legal regimes that lower their costs regardless of where the firm's assets, employees and investors are located.<sup>51</sup> But the case also holds out possible limits on the privilege extended, leaving open the parameters of the principle of mutual recognition. In a future case where a member state imposes higher minimum standards as a condition for recognition, said the ECJ in *Centros*, such measures must be proportional and non-discriminatory.<sup>52</sup> It still remains to be seen which minimum standards will prove proportional and non-discriminatory, in particular minimum standards protecting stakeholders other than creditors.

The ECJ continued along the *Centros* path in *Überseering*, opening the door to transfer of the real seat. The case holds that where a firm incorporated in member state B, in which it has its initial registered office, is deemed to have moved its actual centre of administration to state A, Articles 43 and 48 preclude state A from applying its law so as to deny the capacity to bring legal proceedings before its national courts.<sup>53</sup> As in *Centros*, refusal to recognize a firm's corporate status was held to be a disproportionate sanction for the mere transfer of the real seat. It could be argued that strictly speaking, the *Überseering*-judgment does not cover the incorporation process by a newly established firm in a member state different from its actual place of business. However, since the existing corporation did not move its statutory seat – and thus kept its corporate nationality – this case is considered to be a further clarification of *Centros* and not a different type of corporate mobility.

Both *Centros* and *Überseering* left open questions respecting the scope of a member state's privilege to apply national law to pseudo foreign companies. *Inspire Art* answered some of these questions, extending the rule beyond recognition and standing to cover application of a member state's broader system of corporate law. *Inspire Art* involved a Dutch enterprise organized in the UK solely for the purposes of avoiding stringent rules of Dutch company law. The organizers registered a branch in the *Handelregister* of the Chamber of Commerce in Amsterdam, but refused to register as a pseudo-foreign company. Two

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51 This trend is far from new. In *Segers* (case 79/85 *Segers v Bedrijfsvereniging voor Bank- en Verzekeringswezen, Groothandel en Vrije Beroepen* [1986] ECR 2375), the court already decided that under Article 43 (ex 52) a Dutch sole proprietor could incorporate in England, because setting up a Dutch close corporation took considerably longer – even if he intended to continue to operate wholly in the Netherlands.

52 See *Centros* §§31-38.

53 The ECJ rejected German case law principles under which a Dutch corporation was denied legal entity status and, consequently, the right to bring an action in a German court. The ECJ took the view that since member states defer negotiating the mutual recognition of firms under Article 293, the denial to the Dutch corporation of the procedural right to bring an action fails to comply with Articles 43 and 48 of the Treaty.

questions went to the ECJ: (1) whether Articles 43 and 48 preclude the Netherlands from setting additional demands such as those found in Articles 2-5 of the *Wet op de formeel buitenlandse vennootschappen* (WFBV-Dutch law on pseudo-foreign companies); and (2) whether, if the provisions in the WFBV are found to be incompatible with European law, Article 46 must be interpreted so that Articles 43 and 48 do not preclude the Netherlands from applying rules such as those set forth in the WFBV, on grounds of creditor protection.

The ECJ held that Article 1 of the WFBV, which required Inspire Art to register as a pseudo-foreign company, was contrary to Article 2 of the Eleventh Council Directive, which does not allow member states to impose disclosure requirements in addition to those provided by the Directive. In terms of the second issue, the Court referred to its earlier judgments and ruled that it was immaterial for the applicability of the freedom of establishment that a company, established in a certain member state, carries out its operations in another member state. Moreover, the ECJ held that the minimum capital requirements for pseudo-foreign companies mandated by the WFBV were in violation of the freedom of establishment, as they were not justified by the exception of Article 46 or any other requirement in the general interest.

Summing up, *Centros* introduced constitutionally mandated mutual recognition and constitutional review of minimum standards. It implied, contrary to the real seat doctrine, that incorporation in one member state cannot be called into question in another simply because the firm's central administration is not located in its state of incorporation. *Überseering* carries the line of reasoning to a transfer of real seat context. *Inspire Art* extends the ruling from mandated access to judicial process to substantive corporate law more broadly.

#### **4.2 The 'Reincorporation Mobility' Case Law**

The triad of ECJ decisions does not cover reincorporation. To see the distinction, consider the following scenario: Company X, incorporated in member state A wishes to reincorporate in member state B. To this end, company X plans to organize a shell company X1 in state B and then merge company X into the shell. Company X will retain its administrative headquarters in State A and remain resident there for tax purposes. The company law of neither state A nor state B includes provisions that facilitate a merger of a company formed thereunder with a company formed under the laws of another state.

The lack of corporate law provisions to facilitate company X's planned transaction was the rule rather than exception in the EU. Mergers of this kind were only possible in a small number of member states, specifically, Greece, Italy, Portugal, and Luxembourg. The other member states lacked this enabling legislation. National policymakers, content to follow old patterns, have opened few doors to facilitate cross-border combinations. Absent statutory

recognition of the merger, company X literally must transfer its assets and liabilities to a new entity in state B, liquidating itself in state A prior to the transfer.

A robust freedom of establishment arguably should cover this type of cross-border merger. The ECJ takes a step in this direction in its decision in respect of the merger between the Security Vision Concept SA and Sevic Systems AG. The case concerns a sale of all assets by a Luxembourg firm to a German firm in exchange for the German corporation's common stock. The parties structured the transaction so that the Luxembourg transferor liquidated after the asset transfer. German corporate law recognized such mergers 'by dissolution without liquidation' only among domestic firms, and the German register of companies refused the registration of the merger. The ECJ held the refusal violates Articles 43 and 48 of the Treaty, citing cost savings and brushing aside concerns like fiscal supervision and protection of creditors and minority shareholders.

Note that the merger in the *Sevic*-case did not traverse the law of the transferor state, Luxembourg. The scenario we described above accordingly is not covered in all particulars – company X needs the right to exit state A's corporate law regime in addition to recognition of the merger in state B while keeping its headquarters in state A. *Sevic*, however, covers a merger that results in both the transfer of the statutory seat and the real seat. Exit from state A becomes complete only if state A recognizes the state B incorporation of an entity with a local administrative seat. State A's real seat doctrine could thus remain as an independent barrier.

Furthermore, even if both states A and B enacted facilitating corporate law, other reincorporation costs could render company X immobile. Reorganizing under a foreign corporate law statute often triggers taxes on hidden reserves, effectively restricting the demand for firms to opt into different national governance systems. If the tax burden exceeds the expected cost savings held out by the alternative legal regime, migration has no point even if there is a complete and consistent set of harmonization Directives in place. Indeed, the still current ECJ decision in *Daily Mail* on hidden reserves will do little to stimulate demand for reincorporation. Interestingly, the ECJ has treated the issue of the permissibility of exit taxes in the context of the transfer of residence by an individual, self-employed person. In *Lasteyrie du Saillant*,<sup>54</sup> the ECJ prohibited discriminatory taxation of an exiting taxpayer. Mr. de Lasteyrie left France in 1998 to settle in Belgium, transferring both his professional practice and tax residence. At that time, he held securities that exceeded 25% of the profits of a company subject to corporation tax in France, securities whose market value exceeded their acquisition price. The Code Général des Impôts includes a provision that prescribes a levy of income taxes on such differences in value of securities when a French resident leaves the country. The plaintiff challenged this provision and the case was referred to the ECJ, which

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<sup>54</sup> See Case C-9/02 Hughes de Lasteyrie du Saillant v. Ministerie de l'Economie, des Finances et de l'Industrie [2004] ECR I-2409.

held that the legislation in question impeded the exercise of free establishment. The Court reasoned that the rule was discriminatory because taxpayers who transfer their residence abroad are taxed on latent increases in value, while taxpayers remaining in France are taxed only on increase in value after they have actually realized such gains. Thus, *Lasteyrie du Saillant* provides that exit taxes cannot hinder the exercise of the free establishment exercised by a natural person and that exit tax regimes must comply with the criteria established in *Centros*.<sup>55</sup>

Clearly the case is important because it challenges the discretion of member states to use of exit taxes on the basis of freedom of establishment, if only in relation to individual taxpayers. But the ECJ in *Lasteyrie du Saillant* distinguished between natural persons and corporate residents and therefore left untouched its judgment in *Daily Mail*. It is difficult to assess whether the ECJ will extend its freedom of establishment jurisprudence to legislation hindering corporate emigration, such as seat transfers and mergers. Nonetheless some tax professionals are aware that the current exit charge rules in a number of member states could be vulnerable to ECJ challenge.

In this light, it is worth noting that there is a referral Case pending that could credibly challenge the imposition of exit taxes in respect of reincorporation.<sup>56</sup> The Court of Appeal Szeged (Hungary) seeks, among other things, to answer to the following three questions. Firstly, what is the applicable law, if a company, organized under the corporate law of member state and entered in its commercial register, wishes to transfer its seat to another member state? Secondly, can such a company transfer its registered office under articles 43 and 48 of the Treaty without the obligation to pay various exit charges? Thirdly, is it possible to subject such a transfer to conditions and approvals by either the state of incorporation or by the host member state?

In this case, *Cartesio*, a Hungarian legal entity, requested the Court of Registration to register the transfer of its registered office to Italy. *Cartesio* wishes to remain registered in Hungary. The Court rejected this request holding that *Cartesio* should follow the Hungarian corporate law procedures. If the ECJ confirms this view, *Cartesio* must first be dissolved and liquidated and then again be incorporated in Italy. The new Italian company must register as a branch in Hungary. The questions in this case could give the ECJ an opportunity to clarify its position on both the statutory seat transfers (which entails the application of a different legal regime) and de facto seat transfers (which do not affect the applicable corporation law).

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<sup>55</sup> See the four-factor test described in footnote 17.

<sup>56</sup> See Case C-210/06 OJ C 165 of 15 July 2006 – *Cartesio*.

Following the development of the ECJ's new jurisprudence, the court may well extend the decision in *Lasteyrie du Saillant* to legal entities.<sup>57</sup>

### 4.3 The Practical Impact of the ECJ Case Law

As we have seen, the ECJ decisions in *Centros*, *Überseering* and *Inspire Art* only recently set in train the basis for the migration of new firms to more favourable jurisdictions. The resulting improvement of incorporation mobility at a minimum allows the development of some arbitrage with respect to minimum capital rules. Europe's minimum capital requirements require firms to hold on their books accounts often in excess €8,000. These capital maintenance mandates constrain the repurchase of issued shares, the reduction of capital, and the issuance of new shares. They also have the effect of limiting the access of wealth-constrained entrepreneurs to the corporate form, and at the margin reduce the number of start-up businesses. As a consequence, the demand for low-cost company law vehicles unhindered by capital maintenance requirements is relatively high across the EU. One would expect that the jurisdictions without minimum capital requirements are likely to attract more registrations of start-up companies. This finding is corroborated by the Germany Government's official data collection body (see *Table 2*). Germany is the absolute leader in post-*Centros* outflows and the UK, with its private limited company form, is the overwhelming favorite host jurisdiction..

*Table 2: Ratio of new incorporations GmbH – Limited (Private Company UK)*

	01/2005	02/2005	03/2005	04/2005	05/2005	06/20056	07/2005	08/2005
GmbH	3115	3113	3216	3018	2675	3056	2637	2666
Limited	357	359	403	429	399	426	381	441

*Source: Deutscher Bundestag (BT) – Drucksache 16/283 – 16.12.2005 – Auswirkungen und Probleme der Private Limited Companies in Deutschland.*

The Netherlands is a distant second in terms of new incorporations of UK private limited companies with their activities in the Netherlands. *Figure 3* shows the increasing popularity of the UK private limited company in the Netherlands. This analysis is based on the January 1997 through June 2007 Chamber of Commerce Registry, which surveys all of the private limited companies that were established in the Netherlands in a particular year and are still registered in July 2007. The *Figure* distinguishes between the annual total of Dutch UK private limited company incorporations and the number of such firms still economically

<sup>57</sup> See Hopt, K., Concluding Remarks 1st ECFR Symposium in Milan, 2006, *European Company and Financial Law Review*, vol. 4, 2007 (arguing that the ECJ should 'issue a clear statement that it is doing away with the specter of Daily Mail, maybe when it decides the recent Hungarian referral case').

active as of 1 July 2007. The firm's short active lives emerges as a key point.<sup>58</sup> If we compare our findings with the 2003-2006 post-*Centros* data collected by Becht, Mayer and Wagner, we can observe that the rate of dissolution of these 'Dutch' Limiteds is relatively high. From the more than 6,000 'Dutch' private limited companies were registered in that period, only approximately 2,000 were still registered at the Chamber of Commerce on 1 July 2007.<sup>59</sup> (This data also includes branches from UK companies, but most of these companies have either Dutch names or a majority of directors that reside in the Netherlands making them 'Dutch' private limited companies.)

The numbers look slightly stronger if we restrict our focus to the data for 2006 and the first six months of 2007. This shows that more than 60% of the 'Dutch' private limited companies remain active.<sup>60</sup> 'Active' does not necessarily mean large -- our analysis also indicates that the economically active private limited companies are actually very small firms, with more than 75% employing at least one person. Amongst the economically active companies, the most popular sectors employing the UK private limited companies in the Netherlands are: wholesalers (20%), service providers (19%), retail companies (10%) construction and transport firms (10%) and IT and software (9%).

The low survival rate follows from the characteristics common to the start-ups that find foreign incorporation attractive. European firms incorporating in the UK are mostly 'round-trippers'.<sup>61</sup> There are several reasons for this. Firstly, empirical evidence indicates that lower costs are a main factor inducing especially small companies to incorporate in the UK. Economic work shows that in the pre-*Centros* era, forming a private company is rather expensive, as a percentage of GNI per capita, and involves many long and complex formalities in most member states.<sup>62</sup> Secondly, the reason the UK is attractive is that it often takes some days rather than several weeks to actually establish a company. Thirdly, registration agents in continental Europe advertise and vigorously promote the UK as a major destination for small companies. It is common for agents to lure entrepreneurs by offering to create a company within 24 hours for insignificant sums. Given terms such as these,

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58 The Netherlands considers a company as 'economically active' if it employs at least one person for at least 15 hours per week.

59 In Germany, we see a similar trend: the evidence shows that about 50% of 'German' Limiteds fail already after one year, and more than 90% are dissolved after two years of trading. See Niemeier, W, Die "Mini GmbH" (UG) trotz Marktweende bei der Limited?, Zeitschrift for Wirtschaftsrecht (ZIP), vol. 28, August 2007.

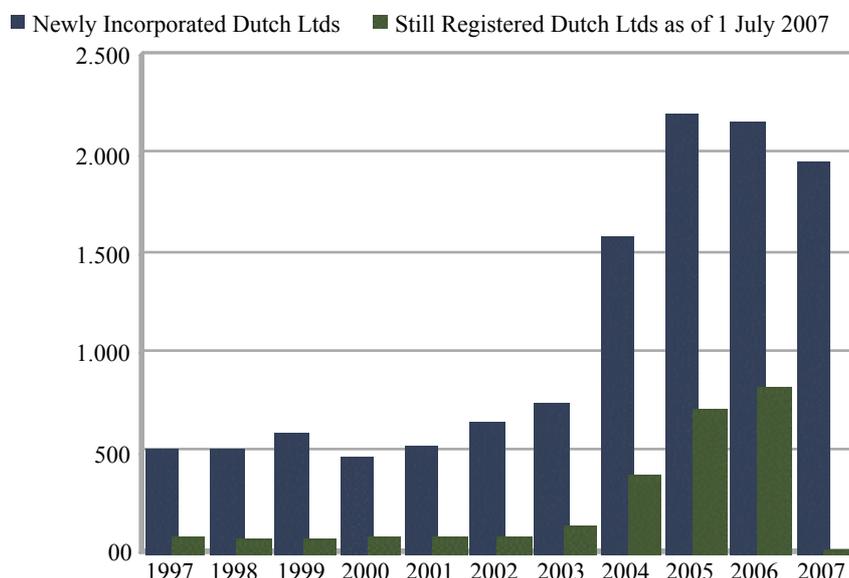
60 In Germany, just more than half of the private limited companies register their trading activities in Germany. See Niemeier, W, Die "Mini GmbH" (UG) trotz Marktweende bei der Limited?, Zeitschrift for Wirtschaftsrecht (ZIP), vol. 28, August 2007.

61 See Becht, M., Mayer, C., and Wagner, H.F (2006), Where Do Firms Incorporate? ECGI Law Working Paper No.70/2006, August 2007.

62 See Djankov, S., La Porta, R, Lopez-de-Silanes, F., Shleifer, A., The Regulation of Entry, The Quarterly Journal of Economics, vol. 117, 2002.

incorporation need not necessarily presuppose an actual business. It should not be surprising that the survival rate of ‘foreign’ private limited companies, is extraordinarily low.<sup>63</sup>

Figure 3: Registered Private Limited Companies in the Netherlands established in 1997-2007 and still registered in July 2007



Source: Data from the Dutch Chamber of Commerce. The total number of private limited companies is extrapolated from the registration between 1 January 2007 – 30 June 2007; Becht, M., Mayer, C. en Wagner, H.F., *Where Do Firms Incorporate?*, ECGI Working Paper No. 70/2006, August 2007.

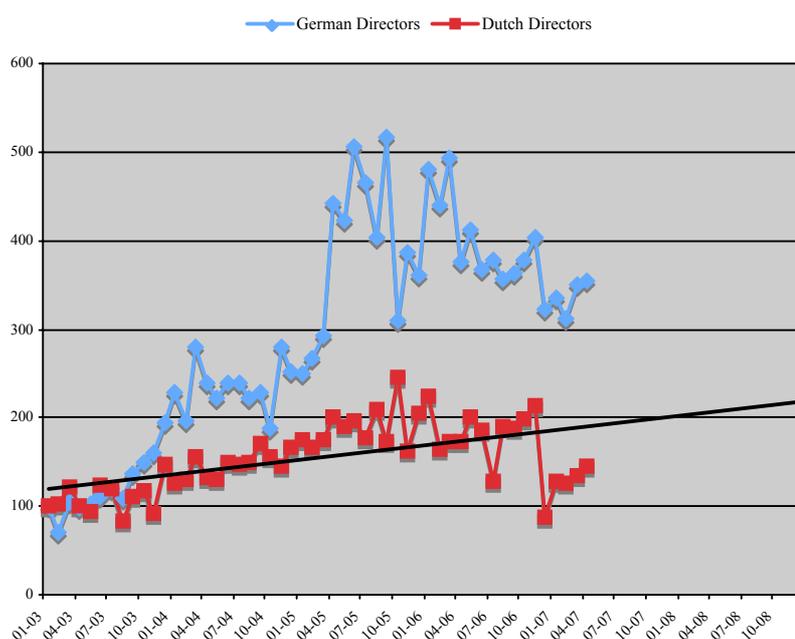
Meanwhile, the terms of foreign incorporation have not turned out to be quite as easy as some of these entrepreneurs at first believed. The practice reveals that foreign corporate law regimes hold out significant disadvantages to some small businesses. When a German company employs a UK private limited company, it might face more costs than initially expected due to the different business environment.<sup>64</sup> Together the costs include: the loss of personal privacy, loss of competitive position, direct compliance costs, and administrative costs. Surprisingly, smaller firms in Germany rarely meet their disclosure obligations under the fourth and seventh EU Directives on the annual accounts and consolidated accounts of limited liability entities. From the small firm perspective, they would prefer to pay a fine

<sup>63</sup> See footnote 60.

<sup>64</sup> The costs for creating a British limited for a foreign company are not excessive. For example, the German registration company Go Ahead offers a UK limited for € 260. However, there are some additional costs that users of the UK private limited company tend to discount or overlook. For instance, VAT registrations, opening a bank account, domain and website charges are not included. Also, there are major legal costs associated with the translation and legalization of the incorporation documents. See Robert Drury, ‘The EPC Versus the Private Limited Company’, presented at the 5th European Company Law and Corporate Governance Conference, Berlin, 28 June 2007 ([www.bdi.eu/company-law-conference2007/](http://www.bdi.eu/company-law-conference2007/)).

rather than reveal information that could be used against them by competitors.<sup>65</sup> In the UK, in contrast, small businesses tend to make their financial disclosures in a timely and accurate manner. Registration agents predict that German companies will adapt to UK business practices. The first wave of directors of ‘German’ private limited companies were not adequately informed of their personal responsibility for filing of annual returns and accounts under UK criminal law or did not take seriously the criminal charges which could be brought against them. However, research conducted by Companies House shows that the compliance rates have improved significantly.<sup>66</sup> In 2007, the main prosecution warning letter was translated into German and forwarded to home addresses of directors of ‘German’ private limited companies. There is little doubt that this initiative has been a resounding success resulting in higher compliance rates. To succeed, it was especially important that Companies House avoided, during the post-*Centros* period, taking steps to prosecute non-UK resident directors.

Figure 4: Trends in the number of appointments of German and Dutch directors in UK private limited companies (January 2003=100)



Source: The Dutch trend is adapted from information available at Companies House (UK). The German trend is adapted from Niemeier, W., *Die "Mini-GmbH" (UG) trotz Marktwende bei der Limited?*, *Zeitschrift für Wirtschaftsrecht (ZIP)*, vol. 28, August 2007.

65 See also the Financial Times (by Hugh Williamson), *Germany's love of the 'Limited'*, 3 October 2006.

66 Correspondence of 13 July 2007 with Thomas Smith, Director of Communications of Companies House (on file with the authors).

These compliance problems may be contributing to a fall off in activity with UK limited by German and Dutch small businesses. *Figure 4* tracks numbers of German and Dutch directors appointed to UK private limited company boards since January 2003. The figure shows the number of directors appointed in private limited companies who are nationals of Germany and the Netherlands, including the number of such directors in a UK branch or companies that have a majority of British nationals as directors. From this data, we assume that the number of real UK private limited companies is relatively constant. Hence, the noticeable differences that we observe in *Figure 4* are due to the changes in total number of ‘German’ and ‘Dutch’ private limited companies respectively. The figure shows an explicit upward trend at the outset of the post-*Centros* period, a trend that probably reflects pent-up demand for a low cost vehicle. The leveling trend in the number of German and Dutch directors since the last first months of 2006 is accordingly unsurprising, but still could follow from multiple causes.

Other countries show an even more pointed downward trend in the usage of the UK limited by their small businesses. Here post-*Centros* corporate law reform emerges as the primary cause of the decreasing usage. Lawmakers who view small company migration to the UK private limited company as a problem calling for a solution have a ready expedient. All they need do is replicate the UK template and the UK vehicle’s competitive cost advantage is undermined. Incorporation mobility occurs in large volume only to the extent that migration to the host state holds out economic rents for the businesses in question and their agents. Sometimes those rent advantages can be eliminated by home lawmakers.

*Table 3: The correlation between the increased use of the limited and formation requirements*

Country	Pre- <i>Centros</i> (1997-1999)	Post- <i>Centros</i> (2003-2006)	Relative increase	Minimum capital (required paid-in capital)	Costs (€)	Duration (days)
Germany	2,009	43,181	21.5	25,000 (12,500)	1,000	24
Austria	240	3,141	13.1	35,000 (17,500)	2,000	30
Denmark	446	2,291	5.1	16,800 (16,800)	6,175 (- August 2003)	23 (- August 2003)
Netherlands	1,590	6,652	4.1	18,000 (18,000)	2,000	10
Belgium	914	1,841	2.0	18,550 (6,200)	1,500	30

*Source: Adapted from Niemeier, W., GmbH und Limited im Markt der Unternehmensrechtsträger, Zeitschrift für Wirtschaftsrecht (ZIP), vol. 27, 2006; Becht, M., Mayer, C. en Wagner, H.F., Where Do Firms Incorporate?, ECGI Working Paper No. 70/2006, August 2007; www.doingbusiness.org.*

Consider the case of Denmark, where lawmakers modified their private company law to fast track (from two to three week to two to three hours) their formation procedures but without altering in effect the minimum capital requirements. As a result, there was a 25%

drop in the use of the limited in Denmark, that is from the 1,401 Post-*Centros* ‘Danish’ private limited companies only 344 were established in 2004 and 2005 (see *Table 3*).

Other countries have made different adjustments. For instance, France lowered its minimum capital requirement to €1 in 2003. In Germany, it is proposed to reduce the minimum capital from €25,000 to €10,000.<sup>67</sup> In The Netherlands, despite the relatively low number of firms attracted to the UK legal regime (see *Table 3*), the challenge posed by the private limited company has nevertheless triggered a new legislative proposal.<sup>68</sup> This measure would make it easier and less costly to establish a Dutch private company, the BV, by abolishing the €18,000 minimum capital and simplifying the formation procedures and the drafting of the articles of association. Although the Dutch simplification proposals face both theoretical and practical problems, the legislation has the clear virtue that it may be adequate to reduce the outflows to pre-*Centros* levels. The next section outlines the legal responses in Germany and The Netherlands in greater detail.

#### **4.4 Responsive (Not Competitive) Lawmaking in Germany and The Netherlands**

The above discussion highlights a crucial point about incorporation mobility in the EU. For the most part, it is only the smallest start-up firms are considering the adoption of a British limited – those which are more responsive to features of corporation law that lower out of pocket costs than to the features of corporation law that deal with internal governance structures. There results a clear cut incentive for lawmakers to reduce or eliminate minimum capital requirements and provide simpler formation rules, but not much more.

The incorporation mobility resulting from the ECJ case law is accordingly rather less significant as a mechanism for stimulating competitive lawmaking than proponents had predicted. Since the out of pocket costs of incorporation are not the most important factor in ‘choice-of-business-form’ decisions, viewed in aggregate, it is difficult to locate sufficient incentives for national legislatures to engage in meaningful regulatory competition.<sup>69</sup> Member state policymakers will stay in the existing incentive framework in which they occasionally upgrade an existing corporate form without undertaking fundamental changes to the core elements or introducing innovations that would enable firms to adopt the most effective

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67 See Seibert, U., *Close Corporations – Reforming Private Company Law: European and International Perspectives*, *European Business Organization Law Review*, vol. 8, 2007.

68 See Van Duuren, T.P., Portengen, H.J., Vermeulen E.P.M. and Bier, B., *De vereenvoudigde BV, Preadvies van de Vereniging ‘Handelsrecht’ 2006*, Deventer: Kluwer.

69 Scholars have made a similar point for the US. See Ayres, I., *Judging Close Corporations in the Age of Statutes*, *Washington University Law Quarterly*, vol. 70, 1992; Bratton, W.W. and McCahery, J.A., *The Equilibrium Content of Corporate Federalism*, *Wake Forest Law Review*, vol. 41, 2006.

governance structures.<sup>70</sup> Such legal upgrades do look toward provision of easy to use corporate vehicles that supply lawyers and firms with familiar provisions that are ‘tried and tested’. Such reforms rarely introduce more than a few needed alterations, making it easy for practitioners and business parties to adjust to the changes, changes unlikely to touch the core components of the legal tradition and its legitimating features.

These statutory upgrades do not entail a high level of difficulty for enacting lawmakers. Even so, some recent corporate law reform initiatives have proved costly and time-consuming, much more so than would have been the case with high stakes competition as the underlying motivation.<sup>71</sup> This is evidenced by: (1) the difficulty in the design of acceptable upgrades; and (2) the reluctance of lawmakers to agree and quickly implement the proposed changes. It seems that economic and political pressures have not built up sufficiently to force through legislative action that would involve substantial costs to incumbent groups.

In Germany, for example, the current upgrade process began with a proposal to change the private company (*Gesellschaft mit beschränkter Haftung*, GmbH) to (1) reduce the minimum capital requirement from EUR 25,000 to EUR 1, (2) transplant of the British wrongful trading rule,<sup>72</sup> and (3) give firms the option to choose a single layer member-managed GmbH. The German legislature had a two-phased reform in mind. First, a compromise proposal would have lowered the capital requirement from EUR 25,000 to EUR 10,000; subsequently, a more fundamental reform would have further adjusted the GmbH legislation to the social and economic changes. However, due to the change in government after the federal election in September 2005, the proposed reform path has not seen the light of day. Major reforms that involve deviations from the current rules on the preservation of the share capital and the notarial deed requirement for the transfer of the shares were unlikely to find support in the near future. The point here is that not only have reform groups failed to overcome the system’s barriers, but they have also failed effectively to alter society’s perceptions about the need for legislative change in this field. Reforms motivated by the desire to lend the GmbH a more flexible and lower cost structure do not appear to have the traction to overcome legislative stasis.

But the increasing popularity of the UK Limited does continue to focus German attention on corporate law reform. A new proposal to introduce a modernized GmbH was published on 29 May 2006. The proposed act – *Gesetzes zur Modernisierung des GmbH-Rechts und zur*

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70 See McCahery, J.A., Vermeulen, E.P.M., Hisatake, M. and Saito, J., Traditional and Innovative Approaches to Legal Reform: The ‘New Company Law’, *European Business Organization Law Review*, vol. 8, 2007.

71 In this respect, it is worth noting that Delaware’s legislature strives to maintain legislative pre-eminence by periodically amending its corporate laws. See McCahery, J.A. and Vermeulen, E.P.M., *Corporate Governance of Non-Listed Companies*, Oxford: Oxford University Press, forthcoming 2008.

72 The wrongful trading regulation requires directors to monitor the firm’s health and, if necessary, to take some remedial or preventive measures that prevent their firms from sliding into insolvency.

*Bekämpfung von Missbräuchen* (MoMiG) is built on three main functions of the GmbH law:<sup>73</sup> (1) The incorporation of a GmbH should be fast, cheap and simple, (2) the new GmbH should offer a transparent shareholder structure, and (3) creditors should be better protected against illicit exploitation and rent seeking strategies of the owners of a GmbH. The reform measures serve to simplify the registration system, making a fast and electronic registration with the Chamber of Commerce possible for GmbHs. The availability of a public shareholders' list at the Chamber of Commerce emphasizes the importance of the electronic registration as such an up-to-date list should help prevent the acquisition of the company from non-shareholders. It is the intention of the new Act to consider only registered persons as shareholders. In order to make the GmbH an attractive product, the new Act proposes to abolish the requirement that the registered office of a firm is located in the same country as its corporate seat. Surprisingly, however, the upgraded GmbH would still require a minimum capital of €10,000 (see *Table 4*). Finally, as a trade-off for the reduction of the minimum capital requirement, the Government proposes to increase the managing director's liability in the event of the firm's insolvency.

Given this proposal, it seems that Germany's legislature seeks to secure the popularity of the GmbH by enacting a compromise legislation that mainly focuses on the relations of shareholders and managers to persons dealing with the GmbH. However, on 23 May 2007, the German Government submitted a revised version of the MoMiG Act to the Parliament. This provides smaller firms with the possibility of incorporating as a variant of the GmbH without minimum capital, but with the legal requirement to save profits until a minimum level of minimum capital has been reached (the *Unternehmergeellschaft*). Moreover, it makes it possible for the founders of small firms with a maximum of three shareholders simply to sign the model articles of association – which will be attached to the corporate statute – and have the signatures legalized. This procedure will streamline and expedite the incorporation process as it will dispose of the need for a notarial deed in the event of a small business setting up a company.<sup>74</sup> Down the road, these measures will certainly have similar effects on the use of the private limited company as the fast track registration system in Denmark, but is unlikely that these changes will give Germany a 'Delaware' status.

*Table 4: Legal Characteristics 'new' GmbH (Germany)*

Characteristic	GmbH (revised)
Legal Personality	Yes
Management	At least one managing director

<sup>73</sup> See Seibert, U., *Close Corporations – Reforming Private Company Law: European and International Perspectives*, *European Business Organization Law Review* 8 (2006): 83-92.

<sup>74</sup> The increased incorporation mobility arguably puts some pressure on the formal use of lawyers as notaries in the incorporation process. That is not to say that their function is outdated in the modern business world. Much will depend on the value-added content of the services they provide.

Formation	Articles of Incorporation + notarial deed + registration at the Registry of Commerce + audit by the Local Court + publishing in a legal gazette
Autonomy of Articles of Incorporation	Small firms with a maximum of three shareholders can use the model articles of association ( <i>Mustergesellschaftsvertrag</i> ) without the need for a notarial deed. Some provisions are only valid if they are included in the Articles. Agreements and resolutions with effect for the future or that lack the agreement of all shareholders are null and void or voidable
Notarization of Articles of Incorporation	The Articles must be recorded in a notarial deed, otherwise the Articles are null and void
Fiduciary Duties	The notarial deed is not needed when the model articles of association are used Statutory shareholder's right to information/case law duty of good faith and loyalty
Financial Rights	Shareholders have a right to share profits in proportion of their investment
Transferable Interests	No public offerings allowed; a transfer of shares requires a notarial deed in order for the transfer to be valid
Continuity of Life	Yes
Limited Liability	Yes, minimum capital requirement of EUR 10,000
Financial Statements	It is possible in the new proposal to establish a <i>Unternehmergeellschaft</i> without without the minimum capital, but with the requirement to save profits until a minimum level of minimum capital has been reached Mandatory disclosure
Taxation	Corporate taxation
Linkage	Management structure of public corporation ( <i>Aktiengesellschaft</i> , AG)

The Netherlands is considering a private company law (*Besloten Vennootschap*, BV) reform that seeks to foster efficient tailoring and gap-filling by business parties involved in resolving complex issues in closely held business relationships, ranging from problems of collective action to free-riding, shirking, private information, and opportunism. It endeavours to encourage entrepreneurship and innovation by making the BV better accessible and more flexible. More importantly, the Dutch legislature introduces new legal measures that serve to minimize the three specific agency problems inherent in the governance structure of non-listed companies. The first agency problem that the Dutch proposal addresses involves the conflict between the company and its third parties, such as creditors and employees. In this context, it is proposed to eliminate the minimum capital requirements and capital maintenance rules and replace them with an expanded directors' liability for unlawful payment of dividends or unlawful stock purchase or redemption. Under the new corporate law regime, board members may be jointly and severally liable towards the company if a proposed dividend or stock purchase or redemption does not meet the liquidation test – which means that directors must check and verify that the company will still be able to pay its debts at the time of the dividend payment or stock redemption. Shareholders can only be called upon to return any payments received if they acted in bad faith and the company faced bankruptcy within one year after the unlawful payment of dividend or unlawful stock redemption.

The ‘new’ BV also attempts to mitigate the parties’ vulnerability to a second agency problem, which involves the conflict between the shareholders and the directors. A modernized corporate law regime allows parties freely to contract into an optimal decision-making arrangement. The Dutch bill explicitly states that general meeting of shareholders may give instructions to the board of directors regarding the general lines of the financial, social, and economic policies. In order to give full effect to the parties’ intentions, companies may furthermore issue shares without voting powers or dividend rights attached to them. These shares may be categorized in different and separate classes, with, if the articles of association so permit, each class being entitled to appoint and remove at least one director.

The need to introduce ‘contractual’ flexibility also offers a solution to a third agency problem between the controlling shareholders and the minority shareholders. The power to appoint its own directors is without any doubt a key strategy for the minority to protect themselves from opportunistic behaviour and expropriation on the part of the controlling shareholder. Yet, in a non-listed company that is identified by a relatively small numbers of shareholders, no ready market for the corporate stock, and substantial majority shareholder participation in management, direction and operation of the firm, minority shareholders could be locked into a very unpleasant investment, which leaves them basically unprotected and vulnerable to oppression. In this view, ex post enforcement can serve to protect minority investors in non-listed companies. To be sure, the Dutch Civil Code already provides for an exit/buy-out remedy that shareholders could use as a last resort if other softer mechanisms proved to be insufficient. Any shareholder may require the other shareholders to acquire his or her shares if his or her rights are prejudiced by the conduct of these shareholders. However, this statutory exit right is a very costly and time-consuming legal procedure. It also involves complicated valuation issues since the fair value of interests is likely to be non-verifiable in conflict situations.

By proposing to streamline the buy-out and valuation procedure and creating the possibility of temporary injunctions, the Dutch legislature promotes the efficiency and simplification of corporate law. It is questionable, however, whether these changes are fundamental enough to attract foreign companies or prevent domestic firms from migrating to other jurisdictions.

The BV, even as thus amended, will not be as user-friendly as alternative regimes. As is depicted in *Table 5*, the relationship between the shareholders themselves and the board of directors is governed mainly by the articles of association under Dutch corporate law. The Dutch Civil Code expressly requires that firms disclose essential information in the articles, such as the capital structure, the company’s objectives and the deviations from the statutory

default rules.<sup>75</sup> In addition, the incorporation formalities suffer from a range of technicalities, which limits the ease of start-up firms' access to the Dutch private company form. The formation rules require also that a notarial deed be drawn up by a lawyer who is specializes in incorporations. Moreover, the deed of incorporation, which contains the comprehensive set of articles of association, must be filed and made public with the Dutch commercial registry. Obviously, Dutch lawmakers have neatly side-stepped the question whether the notarial deed should be liberalized to improve chances of implementing legislation that will facilitate the competitiveness of the BV.

Table 5: Legal Characteristics of the 'new' BV (The Netherlands)

Characteristic	<i>Besloten Vennootschap</i> (revised)
Legal Personality	Yes
Management	At least one managing director
Formation	Articles of Incorporation + notarial deed + filing with the Dutch Chamber of Commerce
Autonomy of Articles of Incorporation	In general, deviations from the statutory provisions are valid if they are included in the Articles. Shareholders agreements are allowed, but in the case of a conflict, the articles of association arguably trump the terms set forth in the agreement
Notarization of Articles of Incorporation	The Articles must be recorded in a notarial deed
Fiduciary Duties	Statutory shareholder's right to information/case law duty of good faith and loyalty
Financial Rights	Shareholders have a right to share profits in proportion of their investment
Transferable Interests	No public offerings allowed; a transfer of shares requires a notarial deed in order for the transfer to be valid
Continuity of Life	Yes
Limited Liability	Yes, no minimum capital requirements, but expanded directors' liability
Financial Statements	Mandatory disclosure
Taxation	Corporate taxation
Linkage	Management structure of public corporation – statutory separation between ownership and control

## 5. Conclusion

This paper has addressed European legislative responses to increased corporate mobility arising from the implementation of the SE and from European Court of Justice decisions according freedom of establishment in foreign member states to start-up firms.

The SE has not triggered significant corporate movement and so has not prompted any national level regulatory adjustments. Switching to the SE is expensive and its future benefits are uncertain. We have seen that there is a limited set of cases in which the SE can help firms overcome inefficiencies resulting from rigid and mandatory rules in national corporation

<sup>75</sup> Among other things, the system of voting, supervision, and regulations concerning the conduct of the shareholders general meeting.

forms. Companies in jurisdictions, such as Germany, with widespread employee participation rights have incentives to incur the cost to convert to the SE. However, aside from such express benefits in certain jurisdictions, the SE will not spark off a more competitive lawmaking approach. The SE's rules are not designed for the needs of a wide range of companies and, while it opens a door to migration through movement of the administrative seat, it does not free firms to choose corporate law based on nominal contacts. .

ECJ case law, on the other hand, set in train the transformation of the private company form into a more flexible, all purpose vehicle. Rigid formalities and capital maintenance rules had locked the evolution of company law in a certain path, and so thwarted the emergence of more flexible legislation. Increased mobility has removed some of the blocks and opened up opportunities for reform-minded lawmakers. But the scope of these reforms remains narrow because the competitive pressures stem only from the desire to minimize the out of pocket costs of incorporation on the part of a subset of small entrepreneurs.

Mobility is still largely constrained by member state discretion. Even though the ECJ has reduced the scope of the real seat doctrine and its barriers to the freedom of establishment, the Court has not effectively eliminated it. ECJ case law, for instance, does not explicitly resolve matters involving a domestic company wishing to exit its state of incorporation. This paper has documented the serious obstacles preventing an outbreak of mobility, including the absence of a reincorporation procedure and exit taxes that continue to block freedom of establishment and restrict cross-border mobility. It appears to be up to the ECJ to remove the remaining obstacles to cross-border mobility as it follows through on its new line of reasoning in subsequent cases. Such a follow-on thread of ECJ interventionism certainly would make domestic lawmakers more responsive. They already have reacted to the loss of small start-ups and certainly would adjust their regulatory and fiscal strategies to avoid losing large, existing domestic firms. Whether a European Delaware also would be in offing is another, more speculative question. All one can say is that Europe's present constitutional dispensation hold out conditions that replicate the incentives that drive US charter competition.

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