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End of Regulatory Competition in European Company Law?

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The End of Regulatory Competition in European Company Law?

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Abstract

In this article, we analyze regulatory competition in company law in the European Union (EU). By examining the empirical evidence, we conclude that regulatory competition, which is triggered by legal arbitrage and the competitive pressure exerted by national lawmakers, has run out of steam in the EU. Unlike in the United States, both language barriers and double accounting obligations for branches have hampered entrepreneurs from engaging in legal arbitrage. As a result, a necessary precondition for horizontal regulatory competition is absent. Furthermore, vertical regulatory competition is not on the agenda of national legislators, as the Statute for a European Company is largely based on national company laws. Revising the national company law therefore improves the supranational competitor as well and destroys the incentives for national legislators to engage in vertical regulatory competition.

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1. Introduction

In regulatory competition, private or public lawmakers create new or change existing legal rules because other private or public lawmakers exert competitive pressure on them. Such competition can come from active private lawmakers, nation-states, regions, communities or even supranational organizations such as the European Union (EU). Furthermore, regulatory competition can arise in different ways. In Tiebout's (1965) original model, local lawmakers compete to attract legal entities by offering a specific package of goods in return for their tax paying. The competitive process is triggered in this framework by legal entities moving 'to the community whose local government best satisfies [their] set of preferences' (Tiebout 1965: 418). Applied to regulatory competition in company law, firms may choose a 'bundle' of laws by physically moving from one jurisdiction to another. Among other aspects, such a bundle may consist of a certain tax law, company law, labor law and bankruptcy law. Traditionally, regulators have engaged in this form of regulatory competition by attracting corporate headquarters or investments in production sites, to collect tax revenues or foster employment.

Regulatory competition can also evolve through a second form—namely, by 'unbundling' the legal rules subject to the competitive process (Heine/Kerber 2002; Behrens 2009; O'Hara/Ribstein 2009).[1] For example, a firm may decide to locate its company headquarters in Germany, adopt the company law of England and Wales, finance projects with bond indentures under the law of the Cayman Island and settle disputes in front of a Swiss court under the laws of Hong Kong. In this way, choice of law is independent of the company's headquarters and allows it to cherry-pick the rules most suitable for its business needs (Schön 2005: 337; Eidenmüller 2011: 739). Lawmakers who engage in this form of regulatory competition can specialize in a specific legal product and do not need to offer a bundle of laws to their consumers. In what follows, we focus on this second form of regulatory competition.

Whether regulatory competition in the form of unbundling is possible in a given jurisdiction depends on the applicable conflict-of-law rules (Eidenmüller 2004: 6). In principle, national legislators have two options for dealing with foreign companies; they can apply either the *real*

[1] The welfare implications of regulatory competition in the form of unbundling have been subject to a long-standing academic debate. Some scholars argue that regulatory competition leads to the implementation of optimal legal rules (race to the top); see Winter (1977), Fischel (1982) and Romano (1987). Others claim that regulatory competition results in the prevalence of those legal rules, which leads to the lowest standards of protection to relevant stakeholders (race to the bottom); see Cary (1974) and Bebchuk/Hamdani (2002). Sinn (1997, 2003) concludes that regulatory competition does not result in an efficient equilibrium, if government regulation is valuable in the first place (e.g., to overcome a market failure), and becomes subject to competition on a higher regulatory level.

seat theory (*siège réel*)[2] or the *incorporation theory*[3]. In times of the Treaty of Rome (1957), the real seat theory was the dominant conflict-of-law rule in the EU and made free choice of law in the form of unbundling impossible.[4] However, corporate mobility has been essential to establish the internal market, which constitutes one of the core objectives of the EU. Therefore, the European Court of Justice (ECJ) in a series of decisions had to interpret Art. 49, 54 TFEU (formerly Art. 43, 48 EC Treaty, and, before that, Art. 52, 58 EEC) with regard to cross-border mobility of European companies and largely abolished the real seat theory in the EU.[5]

Starting with *Daily Mail* (1988) and temporarily ending with *VALE* (2012), the current state of case law regarding cross-border company mobility in the EU can be summarized as follows: Regarding the immigration of foreign companies (inbound cases), the ECJ stated in its famous *Centrostrias*[6] that firms correctly registered under the law of a Member State (the so-called *home Member State*) had the right to transfer their company's *de facto* head office to another Member State (the so-called *host Member State*)[7]; this could be achieved without dissolving the original company. In other words, the original legal entity did not need to be liquidated in the home Member State before it could be reestablished as a new legal entity with a registered office in the host Member State. As a consequence of this case law, the host Member State must recognize the legal capacity of a company as such, which means that the foreign company does not need to meet the requirements for incorporation in the host Member State (e.g., minimum capital requirements).[8] Therefore, company founders can adopt a company law of their liking independent of their company's real seat, which allows for choice of law in the form of

2 According to the real seat theory, the applicable company law is determined by the location of the company's head office. The place of the head office is often considered the location of the 'company's central place of administration', the 'principal place of business', the 'main centre of operations', or the 'actual domicile.' To illustrate this doctrine, assume that a limited liability company established under Swiss law moves its real seat to another jurisdiction, for example, Germany. Following the real seat doctrine, the company must be dissolved and newly established under the law of the second jurisdiction (the host Member State). Germany, France, Austria and Belgium still follow this theory with respect to companies from outside the EU.

3 According to the incorporation theory, the applicable company law is determined by the place of incorporation, i.e. the company's statutory seat. For example, the United Kingdom, Ireland, the Netherlands and Denmark follow this theory with respect to companies from any country.

4 The real seat theory was initially introduced to avoid losing firms to foreign jurisdictions, such as island jurisdictions or the Netherlands, see Charny (1991: 428); McCahery/Vermeulen (2005: 792). At the time of the Treaty of Rome, the Netherlands had abandoned the real seat theory in favor of the incorporation theory.

5 The ECJ rulings also apply to the Member States of the European Economic Area.

6 Decisions on the cases *Centros* (see Decision of 9 March in case C-212/97, *Centros Ltd.*, (1999) ECR I-1459), *Überseering* (see Decision of 5 November 2002 in case C-208/00, *Überseering BV*, (2002) ECR I-9919, para. 62) and *Inspire Art* (see Decision of 30 September 2003 in case C-167/01, *Inspire Art Ltd.*, (2003) ECR I-10155).

7 See *Table 1* top-left-hand corner.

8 See *Table 1* bottom-left-hand corner.

unbundling and, at the same time, paves the way for this form of regulatory competition. It is important to note though that the host Member State must apply the incorporation theory only with respect to foreign companies from other EU Member States, not with respect to companies from outside the EU.[9]

Furthermore, the Member State in which the company was founded still has the power to set requirements to prevent the emigration of firms under its national law (outbound case).[10] Since *Cartesio* (2008 – *obiter dictum*) and certainly since *VALE* (2012), already-existing companies can relocate by moving their statutory seat to another jurisdiction.[11] Although the transfer of the registered office necessarily leads to a conversion of the former company into a company governed by the law of another Member State, the former legal entity does not need to be dissolved. In general, legal scholars agree that such a transfer is now possible if the host Member State's national law allows the transfer for a national company.[12] Table 1 summarizes the current stand of case law regarding both inbound and outbound cases.

- Table 1 around here -

The remainder of this article is structured as follows: Section 2 provides an overview of legal arbitrage and regulatory competition among the EU Member States (horizontal regulatory competition). Section 3 moves the analysis to legal arbitrage and regulatory competition between the Member States and the supranational EU (vertical regulatory competition). Section

9 See e.g. the Bundesgerichtshof (German Federal Court of Justice), judgment of 5 March 2003, published e.g. in 56 NJW (2003, 1461); Servatius, in: Henssler/Strohn (eds.) (2014, recital 18); Moersdorf (2012: 1).

10 See decisions on the cases *Daily Mail* (Decision of 27 September 1988 in case C-81/87, *Daily Mail and General Trust plc,* (1988)), *Cartesio* (Decision of 16 December 2008 in case C-210/06, *Cartesio* (2008) ECR I – 9614) and *National Grid Indus* (Decision of 29 December 2011 in case C 371/10, *National Grid Indus* ECR I – 12273): According to these cases, the home Member State can require not only the registered office but also the head office of a legal entity under its national law to be located on its territory; otherwise, the company must be dissolved. The former § 4a II of the German Law on Limited Liability Companies, which also required the head office of a German limited liability company to be located in Germany, serves as an example in this regard.

11 See *Table 1* right-hand column.

12 The ECJ *obiter dictum* stated in *Cartesio* that the home Member State is not allowed to prohibit the transfer of a company's registered office because, in such a case, the corporation becomes subject to the national law of the host Member State, usurping the power of the home Member State (the same applies if a corporation is dissolved and newly established in another Member State). Regarding the right of the host Member State, the ECJ in the cases *SEVIC* (Decision of 13 December 2005 in case C 411/03, *SEVIC Systems AG* (2005) ECR I – 10805), pertaining to a cross-border merger, and *VALE* (Decision of 12 July 2012 in case C – 378/10, *VALE* (2012)), pertaining to a cross-border conversion, stated that if the host Member State allows its national companies to merge or convert, it must grant a foreign company the same right. Whether this also applies to cases in which the transfer of the registered office is not combined with the relocation of the statutory seat is highly disputed; see Moersdorf (2012: 638).

4 discusses two potential motives for lawmakers to engage in regulatory competition, which are distinct from the pressure stemming from legal arbitrage. Section 5 concludes.

2. Horizontal Regulatory Competition

2.1. Legal Arbitrage

A necessary precondition for regulatory competition is the existence of 'legal arbitrage'.[13] Fleischer (2010: 229) describes this activity 'as a perfectly legal planning technique used to avoid taxes, accounting rules, securities disclosure, and other regulatory costs.' Legal entities engage in legal arbitrage by exploiting the gap between the substance of an economic transaction and the legal treatment of the very same transaction in different jurisdictions. Although legal arbitrage is a necessary precondition for regulatory competition, it is not a sufficient condition at the same time. Klöhn (2012: 290) rightly notes that the legislator also must have sufficient incentives to modify regulation based on the preferences of the consumers of the law. If the legislator is not aware of any possibility or is not allowed to change national regulation because of legal harmonization at the EU level, regulatory competition will not occur, despite legal entities engaging in legal arbitrage.

In company law, legal arbitrage often takes place when firms initially choose or later change their statutory seat. In the United States (US), large firms have traditionally migrated to Delaware. In one of the first empirical studies on regulatory competition, Romano (1985: 244) found that of the 653 firms changing their state of incorporation, 82 percent chose Delaware as their new statutory seat. In 2013, 65 percent of the *Fortune* 500 companies and 83 percent of all new US initial public offerings incorporated in Delaware (Bullock 2013). Romano (1993: 32) argues that the reasons for these reincorporations are twofold. First, firms minimize the legal cost of doing business by engaging in legal arbitrage. Second, firms also seek legal certainty and, thus, a state that retains its corporate law code.

Bebchuk and Hamdani (2002) provide evidence that firms that are not incorporated in Delaware are subject to a significant home-state bias. Although the majority of states are not successful in attracting companies from out of state, they succeed in retaining a large fraction of their companies at home. A good example is California, which attracts merely 0.2 percent of out-of-state firms but retains 22 percent of the local firms in state (Bebchuk/Cohen 2003). Analyzing

13 Fleischer (2010) also uses the terms 'regulatory gamesmanship' and 'regulatory arbitrage'.

more than 64,000 limited liability companies, Dammann and Schündeln (2012: 742) evidence that these companies are originally formed in the state in which their principal place of business is located but reincorporate if they grow beyond 1,000 or more employees. Furthermore, they find that companies most frequently migrate from states with low levels of minority shareholder protection, from home-states that offer low-quality courts and from states in which investors perceive a high risk of corporate veil piercing.

Unlike in the US, where firms have traditionally been allowed to reincorporate in any state, entrepreneurs from many EU Member States have been able to choose the company law of their liking, independent of their real seat, only since the landmark rulings of the ECJ in 1999, 2002 and 2003. Since then, legal arbitrage has mostly taken place through choice of law by entrepreneurs making an initial incorporation decision. As a consequence, the number of foreign companies incorporating in England had risen from 4,400 companies annually pre-*Centros* to more than 28,000 companies in the early post-*Centros* period (Becht et al., 2008). Becht et al. (2008) identify the direct and indirect costs of incorporation as the main drivers of legal arbitrage. According to their definition, direct costs are associated with the setup costs occurring at the time of registration (e.g., notary and certification costs, speed of incorporation), while indirect costs largely arise from the legal capital that firms must put up at incorporation, which may result in opportunity costs or additional financial constraints to the company.

From 2006 onward, however, the popularity of the English limited liability company steadily declined. While at the height of the legal arbitrage activities in Europe every fifth private limited liability company in Germany had used English company law, the figure dropped to slightly above 1 percent in 2011 (Ringe 2013: 250). This decline was partly due to the need for entrepreneurs to engage in round-trip incorporation—that is, setting up a shell company in England and then branching back to their respective home jurisdictions, to reap the benefits of English company law. In a field experiment, Becht et al. (2009) show that branching was costly and impractical in many European jurisdictions. Although incorporation agents reduced incorporation costs by standardizing the procedural steps, the hurdles of document translation and certification remained significant.

In the years following the *Centros* ruling, many entrepreneurs might have acted myopically, comparing only the minimum capital requirements as well as the setup costs and speed of establishing a firm across different jurisdictions. After incorporating, they then soon realized the higher costs of running an English limited liability company. The additional operating costs of running a company in a foreign jurisdiction can result from language barriers, certification and translation costs, costs for legal advice and double accounting obligations for the main company and the branch (Ringe 2013: 262). Moreover, the enforcement of reporting obligations in England is much stricter than in other European jurisdictions, and noncompliance can result in severe civil penalties, which for many foreign entrepreneurs might come as a surprise. As a result, of the 48,103 companies with head offices in Germany that incorporated in England between 2004 and 2011, 72 percent were dissolved or in default by February 2012 (Ringe 2013: 248).

Nevertheless, differences in the substance of the law as well as uniform or similar languages across various jurisdictions still leave scope for legal arbitrage on the regional level. For example, the minimum capital requirement in Austria was initially reduced to EUR 10,000 but then raised to EUR 35,000 on March 1, 2014. Language barriers between Austrians and Germans are almost nonexistent. Austrian entrepreneurs could thus benefit from the lower minimum capital requirement of the German Unternehmergesellschaft (haftungsbeschränkt), which is available since November 1, 2008. However, according to the Austrian company register, only 41 Austrian firms have made use of this German company form so far, which casts doubt on whether regulatory competition will soon emerge even on the regional level.[14]

2.2. Regulatory Competition

By taking down the barriers to cross-border company mobility, the ECJ might have not only triggered legal arbitrage but also facilitated regulatory competition among the EU Member States. In what follows, we explore whether the aforementioned legal arbitrage activities forced legislators to reform their national company laws.

Since the ECJ's *Centros* decision in 1999, at least 10 major company law reforms have been implemented in nine EU Member States. Table 2 provides a brief summary of the changes made to facilitate the incorporation of private limited liability companies. The evidence shows that most legislators reduced the minimum capital requirement (see the reforms in France 2003, Hungary 2007, France 2008, Germany 2008, Poland 2008, Denmark 2010, Sweden 2010 and the Netherlands 2012). Numerous lawmakers even waived the minimum capital requirement to EUR 0 or EUR 1. Moreover, the reduction of the minimum capital requirement was in some cases accompanied by the introduction of a new company form (France 2008 and Germany

[14] We searched for the terms 'UG (haftungsbeschränkt)' and 'Unternehmergesellschaft' at http://www.firmenbuch.at (last accessed on August 1, 2014).

2008). Furthermore, lawmakers reduced the costs of setting up a company by waiving the notary requirement (Hungary 2007) or by allowing for electronic company registrations or document filings (France 2003, UK 2006 and Hungary 2007). Almost all reforms increased the speed of incorporation. As previous research has identified these factors as the main drivers of legal arbitrage (Becht et al. 2008), these company law reforms might be considered evidence that legislators reacted to the competitive pressure exerted by the English Limited.

- Table 2 around here -

A straightforward way to investigate whether lawmakers modified the national company law because domestic firms were engaging in legal arbitrage is to analyze the justifications of the new rules. Germany was one of the jurisdictions that experienced the largest drain of private limited liability companies and might have felt the strongest competitive pressure. When the *Gesetz zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen* (MoMiG – Law for the Modernization of the Private Limited Companies Act and to Combat its Abuse) was passed in 2008, the German Ministry of Justice (Bundesministerium der Justiz 2008) justified the reform in a press release, as follows:

> 'A core objective of the reform of the limited liability company is the easing and acceleration of the establishment of companies. The competitive disadvantage of the GmbH with regard to foreign company law forms like the English Limited have to be considered in this respect, because many Member States of the European Union have lower set up costs and minimum capital requirements.'
>
> ('Ein Kernanliegen der GmbH-Novelle ist die Erleichterung und Beschleunigung von Unternehmensgründungen. Hier werde häufig ein Wettbewerbsnachteil der GmbH gegenüber ausländischen Rechtsformen wie der englischen Limited gesehen, weil in vielen Mitgliedstaaten der Europäischen Union geringere Anforderungen an die Gründungsformalien und die Aufbringung des Mindeststammkapitals gestellt werden.')

According to the press release, the core objective of the MoMiG reform was to improve the attractiveness of the German private limited company in relation to the English Limited. The same holds for the French company law reform, which likewise sought to make the French limited liability company more attractive and competitive (Mortier 2008: 2233; Ringe 2013: 240). It can therefore be argued that the emergence of legal arbitrage provided sufficient incentives for legislators to render their company law more competitive in order to avoid losing the consumers of the national company law. Lawmakers thus engaged in what has come to be known as *defensive regulatory competition* (Klöhn 2012: 300; Ringe 2013: 244).

Nevertheless, Ringe (2013) questions whether these law reforms were successful as a measure to defend national company laws. His analysis reveals that the decline of the English Limited in Germany cannot be attributed to the reform of the MoMiG but began years before the company law reform was enacted. Apparently, not only did entrepreneurs engaging in legal arbitrage misjudge the potential value of a foreign company, but legislators also overestimated the impact of their company law reforms. In support of this, Hungary, which in 2007 had reduced the minimum capital from HUF 3,000,000 to HUF 500,000, increased the minimum capital requirement back to HUF 3,000,000 in March 2014.[15] One might therefore conclude that European legislators initially overreacted in their legislative undertakings and that the pressure from legal arbitrage was not as high as the numerous company law reforms suggest. Braun et al. (2013) argue, however, that this overreaction was not without merit, as it encouraged entrepreneurship more generally.

Until recently, there was little evidence that legislators have tried to attract foreign law consumers from other EU Member States by engaging in *offensive regulatory competition* (Klöhn 2012: 293). A small step in this direction was taken as part of the MoMiG reform. By abolishing the requirement for German companies to have head offices or places of business in Germany, § 4a GmbHG now allows a German limited liability company (UG or GmbH) to have its head office abroad. This change allowed foreign entrepreneurs to reap the benefits of German company law, without having their principal place of business in Germany. Use of the German private limited liability company abroad has been limited so far though.

Lawmakers might not engage intensely in offensive regulatory competition because they only have limited scope with regard to the legal products they can offer. In many fields, company law directives bring about a minimum harmonization of common standards. For example, the annual and consolidated accounts of companies with limited liability have been standardized.[16] Moreover, the Directive on Capital Maintenance requires that national legislators establish a minimum capital requirement of at least EUR 25,000 for public limited liability companies.[17]

15 See http://www.gtai.de/GTAI/Navigation/DE/Trade/Recht-Zoll/wirtschafts-und-steuerrecht,did=994914.html (last accessed August 1, 2014).

16 See Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings amending Directive 2006 /43/EC of the Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC.

17. See Art 6 (1) of Directive 2012/30 EU of the European Parliament and of the Council of 25 October 2012, which replaces Second Council Directive 77/91/EEC of 13 December 1976.

3. Vertical Regulatory Competition

3.1. Legal Arbitrage

When on October 8, 2004, Council Regulation (EC) No 2157/2001 on the Statute for a European Company (*Societas Europaea*, SE) became effective, the first supranational company form appeared on the stage of the legal world. As a result, legal arbitrage in company law was extended from the horizontal level to the vertical level for the first time. Although the SE Regulation fails to provide a complete company law statute and refers many material matters to national company law codes, it still leaves scope for legal arbitrage, making the SE slightly more attractive than some of its national contestants. Consequently, 2,052 SEs have been established as of January 1, 2014 (see Figure 1).

- Figure 1 around here -

In an early study on legal arbitrage regarding the SE, Hornuf (2012: 50) gathered a hand-collected data set on SE incorporations. The evidence showed that the new legal form was initially most frequently used in Germany. Moreover, many firms had adopted the SE to moderate the effect of mandatory codetermination or to establish a one-tier board structure if that was not feasible under the respective national public company law (Eidenmüller et al. 2009; Eidenmüller et al. 2012). Even today, SEs are formed more frequently in jurisdictions that have some form of mandatory codetermination at the board level (see Table 3). Finally, another reason for choosing the SE was the advantage of its cross-border mobility, which later became obsolete because of the implementation of Directive 2005/56/EC on cross-border mergers of limited liability companies (Eidenmüller et al. 2009) as well as the ECJ rulings in *Cartesio* (2008 – *obiter dictum*) and *VALE* (2012).

- Table 3 around here -

Today, most SEs are established in the Czech Republic. Eidenmüller and Lasák (2012) convincingly argue that the reason for this is the advantages the SE provides to Czech entrepreneurs with regard to legal arbitrage. Users of the SE can save on board compensation when choosing the supranational legal form rather than the national public limited liability company. While Czech company law only permits the two-tier board structure, the SE

Regulation allows for the one-tier board structure as well. Moreover, the SE Regulation does not mandate any minimum board size, while under Czech company law the management body of a public limited liability company must consist of at least three members (except if the company has only one shareholder). In a survey conducted by Eidenmüller and Lasák (2012), more than four of five Czech SE founders argued that the simplification of the board structure was the main reason to set up an SE. Many SE users, however, have also claimed that the image of the SE was a major motive to adopt this legal form (Eidenmüller/Lasák 2012: 242; European Commission 2012: recital 4.5).

If the supranational law of the SE was indeed superior to national company law codes, one would expect firm value to increase the moment the market learns about the prospective adoption of the new company law. After all, this might signal to entrepreneurs engaging in legal arbitrage that adopting the SE is welfare enhancing. However, whether incorporating under European law has a positive effect on firm value is a question that remains unanswered. If anything, the SE seems to have a positive impact on firm value, though research has not yet found this effect to be statistically significant (Eidenmüller et al. 2010; Lamp 2011).

3.2. Regulatory Competition

The EU pursued two major goals when introducing the SE. First, the European legislator wanted to establish a supranational legal form to realize the freedom of establishment of Art. 49, 54 TFEU. Second, the European legislator might have aimed to enrich regulatory competition by adding a vertical dimension (Schön 2005: 361; Klöhn 2012: 283).

For regulatory competition to take place on a vertical dimension, the supranational legal form must offer some exclusive features distinct from national company laws. As mentioned previously, the SE does not provide a real alternative to the national public company law, because it always has a national legal form as its basis.[18] Except for some specific features regulated by the SE Regulation, the national Member State's law applies. This explains why there is not one supranational legal form but 28 different SEs. With regard to the features of the SE not specifically covered by the SE Regulation, an improvement in the domestic company law will not provide a competitive advantage to national legislators. National company law reforms that aim to upgrade the public limited liability company will likewise improve the SE. This limits the incentives of national lawmaker to engage in regulatory competition.

[18] See opening clause, Art. 9 (1) (1) (c) SE Regulation.

Nevertheless, the SE Regulation provides some exclusive features vis-à-vis national public limited companies. For example, entrepreneurs can exploit the SE to establish a one-tier board structure, which might not be feasible under the domestic company law regime.[19] In addition, the SE requires that management and employees negotiate the terms of worker representation. Although innovative arrangements can be agreed on, employees can also insist on preserving the level of board representation that existed before SE incorporation. Note that even if board-level representation remains untouched, the SE is not subject to size thresholds with regard to enhanced codetermination on the national level.[20] National Member States' legislators may thus improve their company law to equal the supranational law in the fields in which the SE leaves scope for legal arbitrage. However, beyond these specific features of the SE, incentives to improve the national company law are rather limited. Here again, national legislators might only engage in defensive regulatory competition.

Apart from the SE features that provide opportunities for legal arbitrage, in some respects the SE causes additional costs to users. The most prominent example is the minimum capital requirement of EUR 120,000.[21] In this regard, national legislators might indeed improve their company law by reducing the minimum capital requirement for the public limited liability company and thus decrease the opportunity costs of using the national company law form.[22] Moreover, national company law forms might have an advantage over the SE, precisely because they do not require negotiations for worker representation. This is particularly relevant for affiliated firms of corporate groups, which tend to employ only high-level management officials. However, abolishing compulsory negotiations for worker representation does not allow for regulatory competition, as these negotiations are generally absent in national company law.

Conversely, the EU itself might want to engage in regulatory competition by improving its supranational legal form. Thus, innovations may come from a reform of the SE Regulation itself. The original SE Regulation contained a revision clause that required the European Commission to evaluate the original SE Regulation five years after its implementation and to propose amendments when appropriate. According to the Action Plan drafted in response to the

19 Under the two-tier board structure, the board is composed of members of the supervisory board and members of the management board, whereas under a one-tier board structure, the board is made up of one administrative organ, see Art. 43 (1) (1) SE Regulation.

20 Council Directive 2001/86/EC supplementing the SE with regard to employee involvement.

21 See Art. 4 (2) SE Regulation.

22 As mentioned previously, according to Art. 6 (1) of Directive 2012/30 EU, the minimum capital of a public limited company should not be less than EUR 25,000.

revision clause, the European Commission (2012) stated that '*the expected benefits of a revision, in terms of simplification and improvement* […] *would not outweigh the potential challenges* […], *the Commission does not plan to revise them in short term.'* In 2008, the European Commission made another attempt to engage in regulatory competition proposing a European private limited liability company (*Societas Privata Europaea*, SPE). The proposal faced fierce opposition by national legislators and has so far not been approved by the Council of the European Union. Thus, neither the EU nor national regulators seem eager to engage in vertical regulatory competition in the near future.

4. Other Incentives for Lawmakers to Engage in Regulatory Competition

4.1. Charter Fees

As a necessary precondition for regulatory competition, legal arbitrage activities are almost absent in the EU. The question therefore is whether national legislators have other incentives to engage in regulatory competition.

One of the main objectives for US lawmakers to engage in regulatory competition and to create new company law rules is the ability to raise charter fees (Kieninger 2002: 177). In 2013, Delaware collected 24 percent of its total tax revenues through business entity taxes and fees as well as Delaware Uniform Commercial Code fees (Bullock 2013). In Europe, however, the collection of charter fees is generally prohibited, and as a consequence, direct financial incentives to engage in regulatory competition are almost nonexistent.[23] An exception to this rule is the small state Liechtenstein, which can collect charter fees within the European Economic Area (EEA) (Kieninger 2002: 186; Klöhn, 2012: 292). Because Liechtenstein is a member of the EEA agreement, which generally excludes council directives regarding harmonization measures of direct or indirect taxes, the issuance of charter fees is legally possible.[24] Liechtenstein charges a one-off incorporation fee as well as an annual 'special capital duty' in the amount of 1/1000 of the net assets (minimum CHF 1,000) for 'domiciliary companies'. Domiciliary companies have their registered office in Liechtenstein, though their head offices are located in another EEA Member State. However, it seems that there is not

[23] See Art. 5, 7 Council Directive 2008/7/EC of 12 February 2008 regarding indirect taxes on the raising of capital, which replaces Art. 2 I, 4, 10 lit. a) Second Council Directive 69/335/EEC of 17 July 1969.

[24] See Art. 40 and annex of the agreement on the EEA.

enough demand for Liechtenstein’s company law to put any competitive pressure on the EU Member States.

4.2. Legal Services Exports

Legal scholars have repeatedly argued that lawmakers have an incentive to engage in regulatory competition to promote the domestic legal services industry (Eidenmüller 2011: 713; Gabor 2013, 97; Ringe 2013, 244). After all, lawyers, tax advisers and accountants contribute to the gross domestic product (GDP) of a country and pay taxes. Whether national legislators consider these service activities attractive enough to engage in regulatory competition is questionable though.

For legal services to be worth promoting, not only must they contribute to the GDP, but legal services also must create more value than any other activity that could be pursued instead. Whether national legislators should promote activities other than those of incorporation agents is a matter beyond the scope of this article. However, many economic activities can create more economic value—for example, one might only think of the entrepreneurial initiatives in the US Silicon Valley, which in some cases have a much broader impact on the overall economy. National legislator could thus easily conclude that it is better to promote such entrepreneurial initiatives rather than the domestic legal industry.

Moreover, in general, the promotion of product or service exports might not be advisable from a macroeconomic perspective, because an active trade balance comes along with capital outflows (Sinn 2005: 179). Unlike in the US, legal service providers in Europe may not operate under the same currency as their consumers. Consider, for example, a Spanish entrepreneur who wants to incorporate an English limited liability company with the help of an English incorporation agent. It is important to note that the monetary base in England does not change as a result of such activity. Because the Spanish entrepreneur must pay the incorporation agent in British pounds, the Bank of England must exchange euros for British pounds. If the Bank of England does not want to hold non-interest-bearing euros, it might change the euros back into Spanish debt securities. While these debt securities again might pay an interest to the Bank of England, they might in principle also default. It is thus unclear whether England benefits from the export of its legal services and whether the export of legal services provides an incentive to engage in regulatory competition.[25]

5. Conclusion

In this article, we analyze which route regulatory competition in Europe might take in the future. With regard to horizontal regulatory competition, we found that legal arbitrage had initially taken place but has recently come to an end. This development may be because entrepreneurs were initially myopic with regard to the merits of legal arbitrage and underestimated the costs of running a company under foreign law. Unlike in the US, enthusiasm for legal arbitrage was dampened in Europe because of language barriers and double accounting obligations, which make such activities costly endeavors. Moreover, after company law reforms had lowered the minimum capital requirement in the home jurisdiction, entrepreneurs no longer needed to switch to foreign company laws.

Horizontal regulatory competition, which is triggered by legal arbitrage activities and the pressure stemming from company law reforms of other legislators, has run its course in the EU. Although language barriers with regard to English company law were initially too high, Portuguese or Polish company laws do not seem to be serious contestants. Therefore, legal arbitrage no longer forces national legislators to restrain domestic companies from reincorporation. On the regional level, on which the transaction costs of using a foreign company law might be lower because of uniform or similar languages, not much legal arbitrage has taken place so far, and regulators also do not engage in active regulatory competition. Vertical regulatory competition is not on the agenda of national legislators, as the SE Regulation is largely based on national company laws. In addition, direct and indirect financial incentives are absent in the EU; thus, the necessary preconditions for regulatory competition are missing in Europe. Without a doubt, company law reforms will take place in the future. However, such regulatory changes may no longer be attributed to legal arbitrage and the competitive pressure exerted by foreign legislators. Lawmakers might still compete for the sake of reputation of national company laws, which could eventually lead to 'regulatory competition' in the form of yardstick competition.

25 Within the Economic and Monetary Union legal service exports might likewise result in undesirable imbalances of the TARGET2 accounts (Sinn 2012).

In summary, this article set out to provide an overview of legal arbitrage and regulatory competition in Europe. The goal was not to analyze any normative implication of legal arbitrage or regulatory competition. However, if regulatory competition leads to a race to the bottom, the European legislator does not have much to worry about right now. In contrast, if regulatory competition in company law is welfare enhancing, the European legislator might currently give away some regulatory opportunities.

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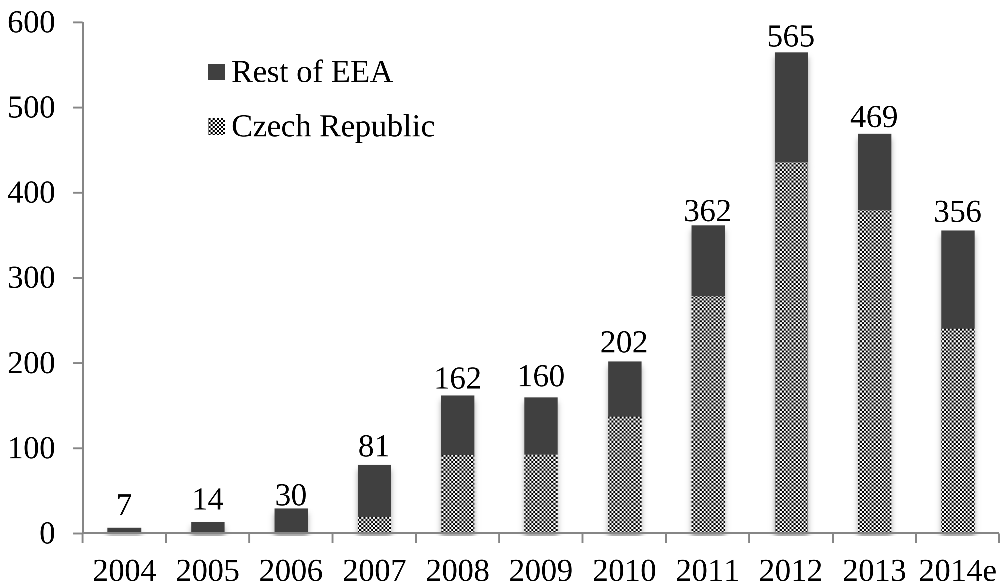
Annex

Figure 1. SE Incorporations from 2004 to 2014e



Source: www.worker-participation.eu; 2014 estimate based on authors' own calculations.

Table 1. Current State of European Case Law with Regard to Cross-Border Mobility of Companies

	transfer of the head office	**transfer of the registered office**
Outbound Cases	Daily Mail (1998)	
	Cartesio (2008)	Cartesio (2008 – *obiter dictum*)
	National Grid Indus (2011)	
Home Member State	Power to determine the right to transfer while maintaining the original legal personality	Not allowed to reject this possibility (at least if there is the possibility for national companies)
Inbound Cases	**transfer of the head office**	**transfer of the registered office**
	Centros (1999)	SEVIC (2005)
	Überseering (2002)	VALE (2012)
	Inspire Art (2003)	
Host Member State	Duty to recognize the foreign legal capacity as such (apply incorporation theory)	Duty to treat equally with own national companies (principle of nondiscrimination)

Table 2. Company Law Reforms in Europe Facilitating Private Limited Liability Company Incorporations

Country	Effective Date	New Start-up Company Type	Reduction of Minimum Capital	Content of Reforms
Spain	2 June 2003	Yes	No	- New company type *Sociedad Limitada Nueva Empresa* (SLNE) (special form of the traditional *Sociedad de Responsalbilidad Limitada* (SL/SRL) - Registration within 48 hours after filing
France	5 August 2003	No	Yes	- Minimum capital of the *Société à Responsabilité Limitée* (SARL) reduced from EUR 7,500 to EUR 1 - Electronic filing of incorporation documents - Registration within 24 hours after filing - Formalities of incorporation reduced (even applications for registration via the Internet became possible)
UK	2006 (implementation) different effective dates	No	No	- Electronic fillings with the Registrar of Companies - Extension of the reach of the English system of director's disqualification to cover directors disqualified abroad - Introduction of a ban on sole 'corporate directors' under English law
Hungary	1 September 2007	No	Yes	- Minimum capital reduced from HUF 3,000,000 to HUF 500,000 - Electronic filing of incorporation documents - Registration within 15 days or two days, if standard articles of incorporations are used - Formalities of incorporation reduced (no notary required but a lawyer)
France	4 August 2008	Yes	Yes	- New company type *Société par Actions Simplifée* (SAS) (legal form between *Société à Responsabilité Limitée* (SARL) and *Société Anonyme* (SA) - Minimum capital waived from EUR 37,000 to EUR 0

Country	Effective Date	New Start-up Company Type	Reduction of Minimum Capital	Content of Reforms
Germany	1 November 2008	Yes	Yes	- New company type *Unternehmergesellschaft (haftungsbeschränkt)* (integrated into the existing GmbH statute) - Minimum capital reduced from EUR 25,000 to EUR 1 - No need to consult a public notary to obtain model articles of association for standard setups
Poland	8 January 2009	No	Yes	- Minimum capital reduced from PLN 50,000 to PLN 5,000
Denmark	1 March 2010	No	Yes	- Minimum capital reduced from DKK 125,000 to DKK 80,000 - Modernization and simplification of the overall regulation - Time for notification of formation reduced from eight weeks to two weeks from the date of execution
Sweden	1 April 2010	No	Yes	- Minimum capital reduced from SEK 100,000 to SEK 50,000
Netherlands	1 October 2012	No	Yes	- Minimum capital waived from EUR 18,000 to EUR 0 - More options in articles of associations to depart from the provisions of law, such as voting rights, board member appointment and shareholder resolution - Incorporation procedure within a couple of days (entire procedure one to two days)

Source: Partly adapted from Braun et al. (2013), Ringe (2013); www.doingbusiness.org.

Table 3. SE Incorporations in Countries with and without Codetermination as of May 1, 2014

Country Codetermination	**SEs**	**Country No codetermination**	**SEs**
Austria	19	Belgium	10
Czech Republic	1,506	Bulgaria	0
Denmark	3	Cyprus	14
Finland	1	Estonia	6
Germany	295	France	23
Hungary	5	Greece	0
Luxembourg	27	Ireland	10
Netherlands	33	Iceland	0
Norway	4	Italy	2
Rumania	0	Latvia	4
Slovakia	93	Liechtenstein	6
Slovenia	0	Lithuania	2
Sweden	5	Malta	5
		Poland	3
		Portugal	1
		Spain	3
		United Kingdom	61
Average	**153**		**9**
Without Czech Republic	**40**		

Source: www.worker-participation.eu.

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