ANDRÁSSY UNIVERSITÄT BUDAPEST

ANDRÁSSY WORKING PAPER SERIES

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2013

Andrássy Working Paper Series No. 28

ISSN 1589-603X

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ISSN 1589-603X

Edited by the Professors and Readers of Andrássy Gyula University, Budapest.

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Martina Eckardt und Wolfgang Kerber

Abstract

Since the Centros decision of the European Court of Justice in 1999, the regime of corporate laws in Europe has evolved in a fundamental way. Although it is rather incomplete and imperfect, a two-level system of corporate laws has emerged. It is characterized by a considerable degree of free choice of law. This opens up the possibility of horizontal regulatory competition between the company laws of the Member States. With the draft regulation on the European Private Company (SPE) an additional legal form tailored to the needs of small and medium-sized enterprises (SMEs) is proposed. We analyse whether the introduction of such a supranational European legal form for limited liability companies can be recommended from the perspective of the economic theory of legal federalism. To this end we present a general theoretical framework for studying centralisation / harmonisation vs. decentralisation of legal rules and regulations in regard to company laws within the European Union. Our analysis of the empirical evidence on horizontal regulatory competition as well as on the advantages and problems of the introduction of such an additional legal form for SMEs shows clearly that it might render many benefits without considerable disadvantages when compared with the existing situation of only horizontal competition between the legal forms of the Member States.

Keywords: Company Law, Corporate Governance, Regulatory Competition, European Integration

JEL-Classification: F15, K22

1. Introduction

The 20.7 million small- and medium sized enterprises (SMEs) in the EU account for 99.8% of all the companies established in the EU, while employing 67% of the workforce and providing nearly 60% of the gross value added (Wymenga et al. 2012, 15). Not surprisingly so, also at the EU level SMEs are on the political agenda. The Small Business Act, implemented in 2008, identified a number of obstacles for SMEs and introduced an Action Plan, which was revised in 2012 (EU Commission 2008, 2012). One of the main issues was the introduction of the European Private Company (SPE: Societas Privata Europaea). It should complement the already existing supranational legal forms like the European Economic Interest Grouping (EEIG, introduced in 1985), the European Company (SE, introduced in 2001) and the European Cooperative Society (SCE, introduced in 2003) with a private limited liability company with an own legal personality.

The European Private Company (SPE) should be particularly tailored to the needs of SMEs for doing business internationally throughout the EU. About 40% of SMEs are involved in import, export or foreign direct investment (EU Commission 2010, 46). On average about 2% of all SMEs in the EU invest abroad, which amounts to around 500.000 enterprises (EU Commission 2010, 10). But due to their size, SMEs realize additional challenges when doing business abroad. However, the process of introducing the SPE has come to a stand-still. No agreement could be reached on a draft regulation of the SPE during the Hungarian Council Presidency in 2011, although most of the points of disagreement between the different actors involved had been successfully removed over the last years (for details see the papers in Hirte/Teichmann 2013 and especially Hommelhoff/Teichmann 2013). The EU Commission explicitly does not set a priority in completing the legislation of the SPE in the revised Action Plan, but wants to explore other possibilities for facilitating cross-border activities of SMEs (EU Commission 2012a, 12f.).

The question we focus on in this paper is whether the introduction of an additional European legal form for limited liability companies can be recommended from the perspective of the economic theory of legal federalism. To this end we analyse the current situation which, after the Centros jurisprudence of the ECJ in 1999, already allows for horizontal regulatory competition between national legal forms. Based upon these results, we ask what the advantages and problems of an additional legal form at the EU level will be. Our emphasis thus is less on a discussion of the specific pros and cons of the draft statute of the European Private Company.

It is on the more fundamental question whether introducing an additional European form of a limited liability company makes sense at all given that there is already a certain free choice of legal forms from different countries through the decisions of the ECJ in regard to the freedom of establishment.

Our paper is structured as follows: In section 2 we present a general theoretical framework for analysing the problem of centralisation / harmonisation vs. decentralisation of legal rules and regulations in regard to company laws within the European Union. This includes the possibilities of horizontal and vertical regulatory competition in a two-level legal system. This provides a clear framework for assessing the potential impact of this proposal. Section 3 analyses the results of empirical studies about the extent of horizontal regulatory competition which we already experience in regard to legal forms of limited liability companies within the EU. Based upon these results, section 4 analyses the possible benefits but also problems of the introduction of such an additional European legal form. Section 5 concludes.

2. A Two-Level System of Company Laws

Companies are characterized by one or more persons pooling their assets with the ultimate objective to gain a profit from joint production. This implies a common-pool problem. Decision-making rights and control mechanisms are necessary to coordinate the joint use of the pooled assets and the resulting profits (or losses). Asymmetric information and principal-agent problems between the company owners and its other stakeholders (like creditors, employees, management etc.) lead to moral hazard and adverse selection problems. Due to contingencies and general uncertainty, writing of complete contracts is prohibitively costly. Accordingly, company laws offer different legal forms with special property rights, decision-making rules and information and disclosure rights as well as competence rules to mitigate the resulting governance problems. Thus, it contributes to reducing agency and transaction costs of team production (Armour/Hansmann/Kraakman 2009, Eckardt 2012a).

By choosing a legal form, firms can choose between different sets of rules for their governance. Different legal forms (as, e.g., public limited liability companies, private limited liability companies etc.) offer appropriate solutions for different kinds of companies and their needs. Company laws can be described as a combination of a set of mandatory rules and facilitative law. Mandatory rules are necessary due to market failure problems and the need to

achieve further objectives. This is the regulatory dimension of company law rules. However, company law is primarily facilitative law. In that respect, company laws usually provide a broad legal scope for designing the constitutions of firms, but also offer a set of default rules for standard solutions. Within the EU, all Member States offer sets of different legal forms with a combination of mandatory rules and facilitative law. Due to different legal traditions there has been a wide variety of these national legal forms. This holds also true for the specific legal forms of private limited liability companies for SMEs we are dealing with in this article.

Although there is some consensus from an economic perspective about the most efficient legal solutions in regard to a number of issues, other questions have not found a satisfactory answer yet (Kraakman et al. 2009). This is complicated by the fact that in many jurisdictions, there are additional objectives pursued by company law other than only economic efficiency. The experience of serious failures in corporate governance shows that so far we do not know the optimal legal rules. Therefore, there is still a large need for finding better legal solutions for the governance of firms. Regulatory competition might be one mechanism contributing to that (Heine/Kerber 2002).

To analyse the advantages and disadvantages of an additional supranational European legal form for SMEs, we use the theoretical framework of legal federalism. It allows for legal rules on different levels of a multi-level system of jurisdictions. It analyses the optimal vertical allocation of regulatory and facilitative law within such a multi-tiered system of law from an economic perspective. In the following, we apply the framework of a two-level system of company laws for SMEs, i.e. that both the Member States and the EU can provide legal forms for SMEs. Competence rules are very important for such a two-level system of legal rules. They determine to what extent firms can choose between the company laws and the legal forms they provide within this two-level system (choice of law by firms), and how problems are solved in the case of conflicts between different company laws (jurisdictional issues). These rules are decisive for the working of the entire two-level system, because they decide on the possibility and extent of horizontal and vertical regulatory competition between different legal forms for SMEs.

The economic theory of legal federalism offers a number of criteria for assessing what the optimal degree of centralisation or decentralisation of legal rules should be (Van den Bergh 2000, Kerber 2008). (1) One group of criteria refers to different types of costs, like static

economies of scale, information and transaction costs, externalities, costs through inconsistencies of the legal order and through distortions of competition (barriers to trade), which usually tend to favour a centralized provision of legal rules. (2) Heterogeneity between Member States in regard to the problems that are solved by company laws as well as to different objectives (preferences) supports arguments for more decentralization. (3) Decentralised knowledge as well as the need for innovation and adaptability of company law solutions are important arguments for a decentralized provision and for experimentation with company laws. (4) Political economy problems (rent-seeking behaviour as well as high political transaction costs) provide arguments both for centralized and decentralized solutions. (5) Strong legal traditions with long established company law solutions in the Member States lead to powerful path dependence arguments and point to the necessity to take into account the historical status quo favouring the established decentralised legal forms. (6) Assessing the advantages and problems of possible regulatory competition processes, which might be triggered within a decentralised system, also provide essential information for deciding between centralized and decentralized solutions.

Regulatory competition in US corporate law provided the first important example of regulatory competition. It also triggered the first controversy whether regulatory competition entails rather beneficial or harmful results (Bebchuk 1992, Romano 1993). In the ensuing general discussion it turned out that on the one hand regulatory competition can lead to better regulations through enhancing efficiency, faster adaptation and more innovations of legal rules as well as less negative welfare effects through rent-seeking. However, these potential advantages can be counterbalanced by a number of negative effects. The most important ones are higher information and transaction costs as well as race-to-the-bottom problems, which might lead to a too low level of regulations, esp. in regard to the mandatory dimension of legal rules. Another problem is that a dynamic process of regulatory competition might not emerge at all, e.g. because of a lack of sufficient incentives for politicians or jurisdictions to engage in it. The overall result of both the theoretical and empirical research on regulatory competition is that it depends on the particular field of law and a number of specific circumstances whether on balance regulatory competition will have positive benefits or not (Sun/Pelkmans 1995, Heine 2003, Kerber 2008). An important additional insight is that the institutional framework under which regulatory competition takes place has a crucial influence on what kind of regulatory competition emerges and what it overall outcome is. Choice-

of-law and conflict-of-law rules as well as rules governing the mobility of firms are of utmost importance in this respect (Muir Watt 2003, Kerber 2008).

Three main types of the allocation of regulatory powers can be derived from the empirical experience with two-level regulatory systems like the European Union as well as from theoretical analysis. To some extent these pure types can be combined and mixed, leading to hybrid forms. In the following, we present both kinds in regard to company law and discuss their main characteristics.

Full harmonisation or perfect centralisation (type 1) of company laws is the simplest form. It implies that only one uniform set of legal forms for firms exists for all Member States in the EU. SMEs would not be able to choose between different legal forms of private limited liability companies from different Member States. However, they would be able to use the same legal form throughout the whole EU. In addition to that, the same mandatory rules would apply to all SMEs within the EU. In this way any regulatory competition would be eliminated. An analysis based on the theory of legal federalism would show a number of advantages, but also large problems in comparison to more decentralised solutions. Harmonisation has been the dominant form in a number of other legal fields in the EU, e.g., in large parts of consumer law. In respect to company laws, however, a full harmonisation or centralisation approach seems to be very unrealistic for the foreseeable future due to the large variety in existing company laws.

A *pure decentralisation approach without direct regulatory competition* (type 2) is one of the opposite types. SMEs would only be able to choose from company laws at the Member State level, while at the same time, however, they have to establish according to the company law of that Member State where they are doing business. If a firm wants to be recognized as a legal entity in another Member State, it has to establish there in one of its legal forms. This means (1) that a firm cannot migrate with its legal form to another Member State, and (2) that there is no direct freedom of choice of company laws between Member States. Therefore, there is no direct regulatory competition between these company laws. Since, however, investors are free to choose in which Member States they want to establish their firm (mobility of capital) and do business, there is still some indirect regulatory competition between different company laws through locational (i.e. interjurisdictional) competition. In this case investors can only choose between a whole package of public goods, regulations, and taxes by choosing between different locations. Accordingly, the competitive pressure in regard to the specific

company law, e.g., for SMEs, is very weak. In respect to other fields of regulation, this solution is well-known in the EU as the principle of the country of destination. In company law, this conflict-of-laws rule is the traditional 'real seat theory' rule, which was prevalent in the EU until the Centros decision of the ECJ in 1999. In this decision (and the ensuing jurisprudence) the ECJ decided that the real seat theory is not compatible with the freedom of establishment in the EU. It therefore replaced this conflicts-of-law rule with the so-called 'incorporation theory' in a similar way as the country of destination principle (host country rule) was replaced by the country of origin principle (home country rule) by the Cassis de Dijon jurisprudence since the end of the 1970s (for a more nuanced account of the complex legal situation in the EU in regard to corporate law, see Schaper 2012).

Accordingly, a *pure decentralisation approach combined with free choice of law and direct regulatory competition* (type 3) is the other opposite type compared to a full harmonisation approach. Here, too, only the Member States offer legal forms with limited liability for SMEs. But the firms can choose freely between these national company laws. This implies (1) the freedom to choose between all national company laws when starting a business, and also (2) the possibility to do business with the legal form of one Member State throughout the whole EU as well as to migrate with an already established legal form to other Member States. In its pure theoretical form, this implies that all legal forms with limited liability for SMEs compete directly with each other in the EU. The replacement of the real seat theory by the incorporation theory in the EU through the jurisprudence of the ECJ can be interpreted as a transition in the direction to this third main approach of pure decentralisation with free choice of law and direct regulatory competition. This form is – to a large extent – practised in the U.S., where only the states offer company laws, while firms can choose between these company laws without being restricted where they do business within the United States. In the U.S., empirical research in regard to competition between company laws tends to emphasize the advantages of regulatory competition. The evidence found does not support race-to-the-bottom concerns (Romano 1998). Nevertheless, this type of allocation of regulatory powers has raised concerns also in the EU as to whether the ensuing process of regulatory competition between the company laws from the Member States might lead to race-to-the-bottom problems.

In addition to these pure types of the allocation of regulatory powers in a two-level system of legal rules, there exist also hybrid forms. They are combinations of the three pure types discussed so far.

Minimum harmonisation constitutes an important group of such a hybrid form. At the central level minimum rules are established, which all legal rules and regulations on the Member State level have to fulfil. Beyond these minimum rules Member States are allowed to enact rules with higher regulatory standards. In regard to company laws, this would imply that the EU would enact certain minimum standards in regard to company law rules. If the standards of the minimum rules are very high, then this solution is very close to full harmonisation, whereas very low minimum standards render such a solution very similar to a pure decentralisation approach. Such a minimum harmonisation with the possibility of stricter national standards can come in two variants. In a first variant, the regulated entities have to comply with the stricter domestic regulations, i.e. this is a combination of harmonisation (type 1) with decentralisation according to the host country principle (type 2). This would imply that the Member State can enforce its higher national standards within its territory, because in regard to these rules no direct competition takes place. However, there is also a second variant, which we can observe in other regulatory fields in the EU (like, e.g., product regulation). In this case Member States can enact higher regulatory standards in their national laws than the EU minimum rules. But due to the application of the home country rule, only domestic firms have to comply with these higher regulatory standards, whereas firms from other Member States need only comply with their home country rules. This leads to direct regulatory competition and does not allow the respective Member State to enforce its higher standards within its own territory. This second variant of minimum harmonisation is therefore a combination of harmonisation (type 1) with decentralisation with free choice of law and direct regulatory competition (type 3).

Partial harmonisation is another hybrid form of harmonisation and decentralisation, in which one part of the relevant legal rules for corporate governance are harmonised, while other parts are left to the national legislators. This might be an appropriate solution, if there are serious concerns about race-to-the-bottom problems in regard to specific aspects of company law without eliminating direct regulatory competition in regard to all other rules of the respective legal form. Hybrid forms resulting from a *mixture of the two types of pure decentralisation with and without free choice of law* (type 2 and type 3) are also possible: For example, in general, firms might be free to choose between different legal forms with limited liability from different Member States and use them within the entire EU. But in respect to certain issues, as, e.g., co-determination, they have to comply with the domestic rules of the host country. Then, in regard to most aspects of company law, direct competition among the legal forms

from different Member States is possible, however, with the exception of certain explicitly defined issues. Other complex hybrid forms might be *mixtures of all three main types*: One part of company law rules might be harmonised (type 1), another part might be under direct competition through free choice of law (type 3), and whereas some governance issues require compliance with the specific domestic rules of the host country (type 2).

So far, however, we have not taken into account the additional possibility of *choosing between company laws at the EU level and at the Member State level*, leading to the possibility of vertical regulatory competition. The proposal of the SPE aims at such a solution. In addition to the 27 private limited liability company statutes of the Member States, firms would be able to choose the SPE as an additional European option and use it within the entire EU. In its pure form without rules about minimum and partial harmonisation, the provision of such a European legal form is primarily only the provision of a 28th legal form that competes with all the other national legal forms. However, other examples of additional European options for legal rules (as, e.g., optional European contract law rules) have shown that a European provision of optional legal rules might lead to special advantages, but also to specific problems, which can differ considerably from those of a pure horizontal regulatory competition. Especially important here are path dependency problems and dangers of a monopolisation of the European solution in the long run (in regard to vertical regulatory competition in corporate law see Röpke/Heine 2005).

Based upon such a theoretical framework of a two-level system of company laws in the EU, the above mentioned economic assessment criteria from the theory of legal federalism could be used for analysing which of these different types and hybrid forms are optimal from an economic perspective, both in regard to the extent of centralisation or decentralisation and to the extent and form of regulatory competition. The experience with other fields of law shows that sophisticated combinations of centralised and decentralised rules, with a perhaps limited degree of direct regulatory competition, might be a particularly promising solution for dealing with the manifold trade-offs between the advantages and problems of (de)centralisation and regulatory competition (see, e.g., Kerber/Grundmann 2006, in regard to the optional European contract law). In this paper we do not carry out such a complex analysis in regard to limited liability company law, although this would lead to valuable insights. In the following, we only analyse what the advantages and problems of the introduction of a 28th legal form for limited

liability companies for SMEs are compared to the current legal situation in which SMEs can already choose between the different legal forms of the member states.

3. Horizontal Regulatory Competition between Limited Liability Company Laws in the EU: What Do we Know Empirically?

This section presents the available empirical knowledge about the extent and intensity of the already existing horizontal regulatory competition between the 27 different legal forms for private limited liability companies of the Member States. Since the transition from the real seat theory to the incorporation theory through the Centros jurisprudence of the ECJ, free choice of different legal forms and therefore direct regulatory competition is at least legally possible. The crucial question, however, is whether this has led to a process of horizontal regulatory competition – independent from the question of its benefits or problems. In that respect, it has to be analysed to what extent SMEs with their specific problems respond to differences between the legal forms of different Member States, and whether Member States have incentives to compete for incorporations of companies by modifying their legal forms.

Kirchner/Painter/Kaal (2005) discuss different direct and indirect costs on the side of companies which might decrease the potential for horizontal regulatory competition in the EU. The main types are mobility costs, switching costs and transaction costs. Costs resulting from different, i.e. unfamiliar legal and adjudication systems as well as costs resulting from the need to establish under a foreign language are seen as additional factors potentially decreasing the working of horizontal regulatory competition (see also Armour 2005, Bratton/McCahery/Vermeulen 2009, Gelter 2008, Kieninger 2004, Klöhn 2012). This holds in particular when it comes to SMEs which are characterized by a general shortage of managerial resources and which are rather limited in their potential to exploit scale economies. In addition to the costs of setting up a company under a foreign legal system, also the on-going costs of complying with a Member State's regulatory regime have to be taken into account (Becht/Mayer/Wagner 2008).

For a fully effective process of regulatory competition, it is also necessary that the Member States strive to offer new or improved forms of company laws, i.e. at least some Member States must have incentives to modify their legal forms in order to attract additional companies to establish under their rules. Franchise taxes paid by the companies to the respective

state of incorporation and successful lobbying by local lawyers specialized in corporate law are discussed as the main factors in the US (Bratton/McCahery/Vermeulen 2009, Gelter 2008, Kieninger 2004, Klöhn 2012). However, in the EU such franchise taxes are prohibited and so far there is no empirical evidence on the lobbying impact of law firms specialized in company law. Nevertheless, we also observe in the EU a number of reforms of the national private limited liability company laws over the last years, which might be motivated by concerns about the international competitiveness of the respective company law (see Teichmann 2010 in regard to reforms of the German *GmbH*). Accordingly, for the time being it is an open question as to what exactly motivates Member States to modify their legal forms so as to attract both start-ups and companies incorporated under a 'foreign' legal form to establish under their company law regime.

However, even if no dynamics are triggered on the supply side, it would suffice if companies respond to the existing differences in legal form among Member States. By a pure selection effect the average quality of the legal forms in use in the EU would improve. If all SMEs choose those legal forms which they deem best for them through free choice of law, the 'market shares' of the superior legal forms would increase and those of inferiors ones be reduced. In addition to that, through the combination of legal forms from different Member States, new hybrid forms of private company laws can emerge, leading to the innovation of hitherto not existing legal forms. One prominent example is the *Limited & Co. KG* as a new combination of the British *Private Company Limited by Shares* with the German *Kommanditgesellschaft (KG)* as an alternative legal form to the well-known German *GmbH & Co. KG*. The result is a new hybrid form, which is different from both the German and the English form (for a detailed analysis of its benefits and problems see Schaper 2012, pp. 268 - 303). Such inventions of new legal forms through the combination of several already existing national forms is one possible outcome of horizontal regulatory competition by pure choice through firms, which does require any active competition by the Member States.

However, there is some evidence that Member States indeed compete for companies to establish under their company law. e.g., in regard to minimum capital requirements. This is shown by the manifold differences as well as changes of the minimum shares required (MSR) for private limited liability companies within the EU (for details and additional references see Eckardt 2012b). In 2011 the average MSR was 7,000 € with the median 3,000 €. However, in five countries only 1 € has to be paid as MSR, while the highest MSR is 35,000 €. Since 2003

MSR have been reduced in 10 Member States. In some – like Austria – such a reform is on the political agenda. In addition, some countries have introduced additional legal forms for start-ups. For example, in 2009 Germany introduced the *Unternehmergesellschaft* with a 1 € MSR to supplement the *GmbH*, the German private limited liability company as a low-cost alternative for start-ups (Teichmann 2010).

There is descriptive evidence for Germany that companies indeed react to cost differences resulting from differences in MSR when deciding in what member state to establish. The MSR in Germany are 25,000 €, while the British MSR and the German *Unternehmergesellschaft* MRS are only 1 € (Eckardt 2012b). According to data from the German business register (*Gewerberegister*) from 2005 to 2012, on average 4,700 companies registered each year as a British private company limited by shares in Germany, with a maximum of 8,643 in 2006. With the introduction of the German *Unternehmergesellschaft* the number of newly registered British private companies limited by shares dropped significantly by 38% from 2008 to 2009, with a further decreasing tendency. Compared to that, the *Unternehmergesellschaft* proves to be a success. In 2012 only 1,496 companies registered newly as *British private companies limited by shares*, which is only about one third of its average between 2005 and 2012. In contrast to that, 15,344 companies newly registered as an *Unternehmergesellschaft*, which amounts to 17% of all companies newly registered as a *GmbH* (for more details see Eckardt 2012c). Bratton/McCahery/Vermeulen (2009) provide similar evidence also for the Netherlands, where companies react to the relatively high MSR of 18,000 € in a similar way.

In addition to reductions in MSR over the last years, Member States have also been concerned with reducing other costs resulting from their legal forms as well as administrative procedures for start-ups. Between 2007 and 2012 the overall costs of starting a new business changed in 16 of the 27 Member States. They declined by 27 % from an average of 485 € to 353 €. Over the same period, the time required for performing all the necessary administrative tasks of establishing a company (i.e. of setting up a new legal entity) declined by 52% from 11 to 5 days on average. This is due to reforms undertaken by 15 of the 27 Member States (own calculations according to EU Commission 2007, 2012b). These reforms might be motivated at least in part through the Small Business Act (EU Commission 2008).

There is also first econometric evidence available confirming these descriptive findings. Becht/Mayer/Wagner (2008) analyse whether the ECJ's decisions on freedom of establishment for companies indeed led to a migration of companies to Member States with lower

costs of establishing. They use a data set of all limited liability companies newly established in the UK between 1997 and 2005, based on the UK central business register. With the information available, they distinguish between domestic Limiteds and non-domestic Limiteds, the latter being companies which are established under UK company law as British Limiteds, but are intended to have their principal place of business outside the UK. As a proxy for classifying such non-domestic Limiteds, they use the state of residence of a company's directors. In this way they get a sample of 2.14 million limited liability companies, with 78,000 non-domestic firms established between 1997 and 2005 in the UK. One third of these are German Limited companies, that is, they have directors residing in Germany. By applying difference-in-difference tests they find that after the ECJ's Centros decision there was a significantly stronger inflow of establishments from other EU Member States than from non-EU Member States in the UK. Besides, there is a significantly higher number of establishments from EU Member States with high costs of setting up a business, particularly in respect to MSR. Thus, according to Becht/Mayer/Wagner (2008) horizontal regulatory competition is working in the EU.

The studies by Hornuf (2012) and Braun et al. (2013) confirm these results. They also use a difference-in-difference approach for analysing the causal impact resulting from reforms in statutory laws concerning minimum share requirements. These studies take into account reforms in France, Germany, Hungary, Poland and Spain between 2003 and 2008. Applying the same methodology as Becht/Mayer/Wagner (2008) they find that a reduction in minimum share requirements leads to a significant increase in new establishments in the respective country.

Econometric studies for the US confirm the findings that the cost of establishment matters. By using OLS, Häusermann (2011) finds that differences in establishment fees between US states significantly affect the popularity of the number of limited liability companies found in a state. His study uses state level data from 2004 to 2009. In addition, there is some, however not uniform evidence that differences in substantive law and in adjudication also play a role for SMEs where to establish, as it is the case for publicly held companies (Dammann/Schündeln 2008, 2010; Kobayashi/Ribstein 2011). Gevurtz (2012) analyses the motives a company has for choosing a state for establishing different from its principal business location. By performing a qualitative analysis based on 50 interviews with private attorneys, he finds that Delaware is chosen due to its superior legal infrastructure and because it has ad-

vantages in the eyes of majority owners or managers of limited liability companies. Furthermore, there is some evidence that horizontal regulatory competition for private limited liability companies does not lead to a dominant market share for a single state in the US, which is in contrast to the findings for publicly held companies (Gelter 2008, Kahan/Kamar 2001, 2002/2003; Manesh 2011).

Despite the still very few empirical studies and the need for much more research, a preliminary assessment of the empirical evidence about horizontal regulatory competition in regard to limited liability company laws for SMEs within Europe shows that different costs of establishment matter to SMEs. Besides, a considerable number of firms seem to use the possibilities of free choice of law. Obviously, Member States also engage in regulatory competition by modifying and improving their legal forms. This holds although their incentives are much more unclear since there are no direct pecuniary incentives, like franchise fees in the US. However, so far we cannot assume that already a dynamic and smoothly working regime of horizontal regulatory competition between the national legal forms does exist. There are still serious legal problems as well as considerable (migration) costs due to the differences in languages and national legal systems.[1]

4. The European Private Company (SPE) as an Additional Option: Advantages and Problems

According to the draft statute of the EU Commission, the European Private Company (SPE) is a new legal form for a private limited liability company with a legal personality (EU Council 2011). SMEs within the EU could choose it in addition to the already existing 27 national legal forms for private companies. It is especially targeted to SMEs to promote them doing business internationally. According to the literature on the internationalization of SMEs and on the economics of corporate law, the following aspects are important for an internationalization-friendly legal form for SMEs (see Eckardt 2012c with additional references). It should be (1) inexpensive, requiring few resources for establishment and for meeting its regular tax and accounting obligations. Besides, it should (2) provide secure ownership rights, including

[1] For general assessments of (the possibility) of regulatory competition in Europe see, e.g., Heine/Kerber (2002), Kirchner/Painter/Kaal (2005), Bratton/McCahery/Vermeulen (2009), Schaper (2012), Klöhn (2012).

limited liability so as not to endanger the parent company by doing business internationally. In addition, it should also provide secure property rights for creditors so as to reduce problems of getting access to outside finance and to lower extra risk charges. Furthermore, it should (3) reduce principal-agent problems due to information asymmetries. This holds for business partners, customers, and foreign authorities to whom the company statute should provide clear information about the company thus increasing trust. In addition, (4) information and consultation costs for SMEs about legal and administrative questions should be low, which requires a not too complex legal form. And finally, (5) competence rules should exist so that it can be decided easily and at low costs whether EU, the home or the host country legal rules apply in a particular case.

The SPE draft regulation comprises 48 articles, which are grouped in ten chapters with three annexes (EU Council 2011). Its structure follows the life cycle of a company, stating property rights, decision-making rights, information rights as well as competence rules for the main stakeholders, i.e. for owners, management, employees, creditors and the public. Eckardt (2012c) finds that the proposed SPE statute is well suited to fulfill the criteria stated above as an internationalization friendly legal form for SMEs, although there might be some complications in regard to co-determination issues. All in all, the SPE is a not too complex legal form: On the one hand, it gives the owners broad scope for individual and flexible regulation of the articles of association. On the other hand, it contains a number of competence rules, where it states when the legal rule of the country of establishment have to be applied. But in contrast to the European Public Company (SE), the SPE draft regulation limits the subjects thus addressed very strongly. This increases legal certainty, which is a prerequisite for its successful implementation (for a detailed discussion on specific issues of the SPE see the papers presented in Hirte/Teichmann 2013).

To analyse the potential advantages and problems of such an additional legal form in comparison to the current situation, we apply the assessment criteria from the economic theory of legal federalism from section 2. The proposed statute of the SPE does not imply any kind of minimum or partial harmonisation of the already existing national legal forms for private limited liability companies. As before, SMEs would be able to choose any of the 27 national legal forms. Therefore, it is not easy to argue why the introduction of an additional option might have any negative effects at all. Rather any additional option should always have some positive effects, because for a certain group of SMEs the new legal form might provide better cor-

porate law rules for solving their specific governance problems. However, the SPE is more than an additional option: The specific advantages of the SPE as a legal form especially designed for doing business simultaneously in several Member States of the EU will have a lot of specific advantages for those SMEs with a clear internationalization strategy. Since it can be used easily throughout the EU and will be well-known as the only European legal form in all Member States, the SPE will lead to a reduction of information and transaction costs for establishing firms and doing business in the entire EU. Economies of scale and scope in regard to setting up companies as well as in regard to the costs associated with their regular duties can be realized. Reputation effects might also be very important for SMEs from Member States with otherwise less familiar or less trusted legal forms. Both the cost advantages mentioned above and these reputation effects, which reduce costs for the trading partners of SMEs in the legal form of the SPE, imply lower barriers of entry within the EU and therefore easier market access. In that respect, the introduction of the SPE as an additional new legal form might fill a specific, so far unfulfilled market demand. This is also positive in regard to the assessment criteria heterogeneity as well as innovation and adaptability. Therefore, we can expect additional benefits from regulatory competition by the introduction of the SPE (see also Hommelhoff/Teichmann 2013, 13-15).

What kind of problems might arise with the introduction of this additional legal form? There might be problems due to path dependency effects (see Heine/Kerber 2002 in regard to path dependency effects in corporate law). In the law and economics literature, it is a well-known fact that the quality of new laws depends on the extent of their application and adjudication. Therefore, a lot of experience with the SPE and a large number of court decisions are necessary, before the new legal form achieves the same level of precision and legal quality as the limited liability company laws already well-established in the Member States. Thus, a critical-mass problem emerges, which results from dynamic economies of scale. If the SPE is not used by a minimum number of firms, then it might never become sufficiently competitive in terms of legal quality. As a consequence, the SPE might fail in the market of legal forms for SMEs. But also such a result would not worsen the situation compared to the current one. However, also the opposite kind of problem might arise in the long run: The SPE might become so successful that it will be the dominant legal form for SMEs in the EU. As a result, most other national limited liability legal forms for SMEs and thus regulatory competition would be eliminated. Both these types of problems are well-known and discussed in regard to other fields of law, in which optional European legal rules have been suggested (as, e.g., Eu-

ropean contract law; Kerber/Grundmann 2006). Whereas the critical mass problem might become relevant, it is less likely that the SPE would get the dominant legal form for SMEs in the EU. Since most SMEs are doing business only on domestic markets, it can be assumed that they would still use the national legal forms. In any case, it might be important for safeguarding regulatory competition that – also in the long run – Member States retain the right to introduce new legal forms.

Another concern is that regulatory competition might lead to race-to-the-bottom problems. Such problems can only emerge from the mandatory part of the new legal form, not from its – much more important – facilitative part. However, a small risk of race-to-the-bottom problems does already exist with respect to the current horizontal regulatory competition between the legal forms of different Member States. The introduction of the SPE as an additional option would not increase it significantly, although it cannot be excluded that some mandatory rules of the SPE might lead to lower standards than the regulatory standards of the limited liability company laws prescribed in some Member States. An already existing solution to this problem is that in regard to certain governance issues the national legal systems require the application of the host country rule. Although we would have, in general, free choice of law – and thus direct regulatory competition – between all legal forms available, there would be exceptions in regard to certain issues which would still be solved by applying the domestic (host country) rules (as regards employee participation rights or the restructuring, winding-up and nullity of a SPE, see EU Council 2011). Therefore, well-designed competence rules could take account for such race-to-the bottom problems.

However, these problems hint to a more general difficulty. Company laws always work within the context of a number of other sets of legal rules (as, e.g., tax law, accounting and auditing rules, securities law). Since many of these complementary laws are not harmonized within the EU, there might always be difficult interface problems, if legal rules from different Member States are combined, either as legal forms from other Member States or the SPE. This might lead to legal inconsistencies and thus to conflicts – resulting in manifold cost problems. However, with free choice of law these kinds of problems already exist in the current situation. The introduction of the SPE will not increase them. On the contrary, a wide diffusion of the SPE throughout the EU might lead to more standardized interface solutions and therefore contributing to reduce such interface problems. A more critical problem in regard to the consistency of the resulting company law might emerge because all legal questions in regard to

the SPE have to be adjudicated by national courts. The absence of an integrated European court system might lead to different decisions about the SPE in different Member States. This would endanger the development of a uniform jurisprudence in regard to the SPE and question the advantages of a uniform European legal form for SMEs. Solving this problem might be crucial for the success of the SPE in the long run.

5. Conclusions

Since the Centros decision of the European Court of Justice in 1999, the regime of corporate laws in Europe has evolved in a fundamental way. Although it is rather incomplete and imperfect, a two-level system of corporate laws has emerged. It is going to replace the national corporate law regimes of those Member States which have been dominated by the 'real seat theory'. This two-level system is characterized by a considerable degree of free choice of law. This opens up the possibility of horizontal regulatory competition between the company laws of the Member States. An important additional development is the introduction of new legal forms at the EU level, as the European Corporation (SE) and the European Cooperative Society (SCE), which can be chosen in addition to the national legal forms. Since these legal forms considerably refer to national company law rules, they provide only to a small extent a real alternative to the national legal forms as, e.g., the German *Aktiengesellschaft*. In that respect, there is skepticism about the degree of vertical competition in regard to these supranational legal forms. In contrast to this, the proposal in regard to the European Private Company (SPE), which does not entail much reference to national rules, would allow for much more vertical competition between such a European legal form and the national ones (Schaper 2012, 165-167).

Our analysis of the advantages and problems of the introduction of such an additional legal form for SMEs shows clearly that it might render many benefits without considerable disadvantages when compared with the existing situation of only horizontal competition between the legal forms of the Member States. The summary of the empirical studies about the current state of horizontal regulatory competition in section 3 confirms that firms do indeed respond to cost differences resulting from different legal forms by migrating to Member States with less 'expensive' legal forms. Moreover, Member States react to such movements by modifying and improving their legal forms, too. Therefore horizontal regulatory competition in regard to limited liability company law seems to be working already. However, its extent and intensity

seems to be still rather weak. The introduction of an additional European legal form for SMEs, as the SPE, can be expected to reduce information and transaction costs and spur further regulatory competition. As a result, its advantages of more efficiency and innovation can be reaped. The risks associated with such an additional legal form, as, e.g., in regard to race-to-the-bottom problems, seem to be rather small or even negligible. The strongest concerns refer to the problem that the SPE, as any new legal form, has to overcome a critical-mass problem in form of a minimum number of applications, and solve the various difficulties of its matching the many complementary legal rules of the different national legal systems. This includes in particularly its uniform adjudication by the national court systems.

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