



FACULTY OF LAW
Lund University

Love Johnsson

EU's regulatory competition in the field of limited liability companies and the effects thereof

JURM02 Graduate Thesis

30 higher education credits

Supervisor: Michael Bogdan

Semester of graduation: Spring Semester 2017

Table of Content

Abbreviations	4
Summary	5
Sammanfattning	6
1. Introduction	
1.1 Background	8
1.2 Aims and research questions	8
1.3 Limitations	9
1.4 Structure	9
1.5 Method	10
2. The current legal situation	
2.1 Provisions	12
2.2 Article 54 TFEU - Equal treatment of natural and legal persons	12
2.2.1 Direct discrimination	12
2.2.2 Indirect discrimination	13
2.2.2.1 The Discrimination model or the Restriction formula	14
2.2.2.2 Justifications	15
2.3 Article 49 TFEU - Primary establishment	15
2.4 Article 49 TFEU - Secondary establishment	17
2.4.1 Equal treatment in matters of tax	19
2.4.2 Justified restrictions	19
3. Regulatory competition	
3.1 Theoretical background	21
3.2 Competitive federalism and reflexive harmonization	22
3.3 Delaware and the race to the bottom	22
3.3.1 The debate regarding the Delaware effect	24
3.3.2 Incentives to win the race	25
4. Regulatory competition in the EU	

4.1	Differences between the EU and the US	27
4.1.1	Historical differences	27
4.1.2	Lacking incentives	28
4.1.3	Closed vs. public corporations	30
4.1.4	Impediments on the European market	30
4.2	Brakes in the the EU legislation	32
4.2.1	Reversed discrimination and the Real seat doctrine	33
4.2.2	Mandatory requirements	33
4.3	Impact of the regulatory competition in the EU	34
4.3.1	The regulatory competition's effect on the incorporation patterns 1997-2006	34
4.3.2	National legal reforms and the effects thereof 2000-2011	35
4.3.3	The German legal reform as an example of defensive regulatory competition	36
5.	Analysis of the regulatory competition in the EU	
5.1	Causes behind the rising emigration from 2000 to 2006	38
5.2	The turning point in 2006 and subsequent law reforms	38
5.3	The migration and its bundled quality issues	39
5.4	Analysis of development	41
6.	Predictions about the future	
6.1	A small but steady migration	43
6.2	The abolishment of minimum capital requirement	44
6.3	A race towards what?	46
6.4	Brexit	47
6.4.1	Effects on companies already incorporated in the UK	48
6.4.1.1	Branches	49
6.4.1.2	Subsidiaries / Real seat issues	51
6.4.2	Restart of the regulatory competition	52
7.	Conclusions	55
	Bibliography	57

Abbreviations

Brexit	Exit of the UK from the EU
EU	European Union
EUR	Euro
ECJ	European Court of Justice
Member State	A member state of the European Union
SEK	Swedish Crown
Single market	The internal EU market
TEU	Treaty on the European Union
TFEU	Treaty on the Functioning of the European Union
The Treaty	Treaty on the Functioning of the European Union
The Treaties	Treaty on European Union, and the Treaty on the Functioning of the European Union
UK	United Kingdom
US	United States of America
USD	US Dollar

Summary

Regulatory competition is a competitive process through which the jurisdictions within a decentralized area develops and adapts to the market demands of that area. EU's Single market is such decentralized area in the field of company legislation. Any EU citizen may establish a company in any Member State and as a consequence a race between the different national jurisdictions in the EU can emerge, as the entrepreneurs in the EU are prone to choose the most attractive jurisdiction to incorporate in.

A regulatory competition in the field of limited liability companies does also take place in the US, and has done so since the early 19th century. Some academic legal writers claim that this regulatory competition has caused a sub-optimal development, while others claim that it resulted in a very efficient market. However, there are few lessons for the EU to learn from the US as the unique historical circumstances and substantially different market of the US makes the regulatory competition in US too different from the one in the EU for the two to really be comparable.

Until the mid-2000s, the UK was the most attractive jurisdiction and attracted a lot of incorporations, in both relative and absolute amounts, from all over the EU. However, in the mid-2000s it became apparent that the hidden costs and issues of being incorporated in a foreign jurisdiction were bigger than most entrepreneurs expected. A majority of all the migrating entrepreneurs dissolved their companies soon after the incorporation, and the migration started to decline until the point, in the 2010s, when it became almost negligible. The barriers of incorporating abroad were simply higher than the benefits, as there are big differences of language, legal traditions and other administrative duties in the various Member States and the benefits were only small and initial.

Nonetheless, several Member States did reform their company legislations due to the perceived pressure of regulatory competition and the reforms caused a minor, but not insignificant, increase in incorporations. However, the Member States that did not reform their legislations to become more attractive did not do noticeably worse than the Member States that did reform, something that indicates that the de facto pressure from regulatory competition is quite low. Even though the de facto pressure is low, the possibility in itself for the entrepreneurs to migrate forces the national legislators to stay up to date. Because if a national company law becomes obsolete and unattractive to the point that the barriers of incorporating abroad are less burdensome than to stay, then the entrepreneurs in that jurisdiction will start to migrate.

Today a form of balanced, low intensive and defensive regulatory competition has been reached in the EU. Some writers are worried that the exit of UK from the EU ("Brexit") will cause an intensification of the regulatory competition. That is however unlikely to happen in the opinion of this writer. A mass-exodus of the companies incorporated in UK by EU entrepreneurs is likely to take place, as these entrepreneurs want to keep their business

within the Single market. However, this is most likely only a temporary effect on the migratory flows, there is no reason for entrepreneurs in the other Member States to start to migrate because of Brexit, as it will not substantially change the competitive situation since there are several attractive alternatives to the UK jurisdiction nowadays.

Sammanfattning

Konkurrens mellan regelverk är en process som uppstår ifall det inom en decentraliserad zon finns flera olika jurisdiktioner för en potentiell användare att välja mellan. Det logiska valet för en användare torde vara att välja det mest attraktiva regelverket. EU:s inre marknad skapar därför en konkurrens mellan medlemsstaternas nationella jurisdiktioner eftersom varje EU invånare har rätt att etablera bolag eller filial varsomhelst inom EU.

EU:s inre marknad är inte den enda zonen inom vilken bolagsrättslig konkurrens förekommer. I USA finns också en sådan konkurrens, som till skillnad från EU:s har pågått under en lång tid. Det har flitigt diskuterats i den akademiska litteraturen huruvida konkurrensen i USA har resulterat i en urholkning av bolagsrätten, en slags tävling där delstaterna försöker övertrumfa varandra för att skapa den mest attraktiva jurisdiktionen, men gör så på bekostnad av andra viktiga intressen så som för aktieägarnas inflytande, borgenärs trygghet etc., eller om konkurrensen snarare har resulterat i en synnerligen effektiv och väl lämpad bolagsrätt. Hur det än är så visar det sig vid närmare granskning att den amerikanska marknaden är så väsensskild från den europeiska att det är omöjligt att dra några detaljerade lärdomar från den.

Fram tills mitten av 2000-talet var Storbritannien den jurisdiktion inom EU som ansågs vara den mest attraktiva. Något som resulterade i att många EU-invånare från andra länder valde att etablera bolag i Storbritannien. Men någon gång under mitten av 2000-talet blev det uppenbart att det inte var så lönsamt som många först hade trott att etablera bolag i Storbritannien, det fanns många dolda kostnader och oväntade problem för de entreprenörer som migrerat eftersom de inte kände till det lokala rättssystemet, de administrativa kraven osv. En majoritet av alla de som etablerat sig i Storbritannien upplöste därför sina företag mycket snart. När det blev allmänt känt hur mycket svårare det var att etablera sig i en obekant jurisdiktion och att fördelarna samtidigt var förhållandevis små så blev det allt ovanligare att etablera sitt företag i en utländsk jurisdiktion. Under 2010-talet var migrationen inom EU nästan försumbar.

Trots detta så reformerade flera medlemsstater sin bolagsrätt med motiveringen att det skulle göra dem mer konkurrensfärdiga på den inre marknaden, något som också orsakade en svag, men noterbar, ökning av etablerandet av nya bolag. Dock så är det intressant att notera att de medlemsstater som valde att inte reformera sin bolagsrätt inte hade nämnvärt annorlunda utveckling än de medlemsstater som valde att reformera, vilket indikerar att trycket från konkurrensen faktiskt inte är så högt. Men bara möjligheten för

entreprenörerna att välja och etablera sig utomlands skapar åtminstone ett visst tryck och garanterar en miniminivå av konkurrensmässighet på hela den inre marknaden. Om en jurisdiktion skulle bli så oattraktiv att nackdelarna med att etablera sig utomlands är färre än stanna i sin hemjurisdiktion så kommer detta i så fall att orsaka en massmigration ifrån jurisdiktionen i fråga.

Idag har en balanserad, lågintensiv och defensiv konkurrensmässig situation uppstått på den inre marknaden, men vissa författare är oroliga att detta kommer ändras och att konkurrensen riskerar att än en gång bli mycket intensiv när Storbritannien lämnar EU. Denna författaren menar dock att en sådan utveckling är orealistisk. Nog för många entreprenörer etablerade i Storbritannien kommer att välja att etablera sig i en annan jurisdiktion inom EU, men detta är enbart en temporär effekt och kommer inte resultera i att substantiella mängder av entreprenörer från andra jurisdiktioner än Storbritannien kommer att börja migrera. Den balanserade konkurrensmässiga situationen kommer inte ändras nämnvärt av att Storbritannien lämnar EU eftersom det idag finns flera fullgoda och jämbördigt attraktiva alternativ till Storbritannien för en entreprenör som vill etablera sig utomlands för att undvika en betungande bolagsrätt i sitt hemland.

1. Introduction

1.1 Background

As a consequence of the four freedoms provided by the Treaties a European single market (hereinafter referred to as “Single market”) is created where each and every EU citizen is entitled to freely conduct business throughout the whole Single market and can do so by establishing a branch, an agency or a subsidiary. That is the so called freedom of establishment and as a by-product of this freedom comes competition between the Member States’ jurisdictions in the field of company law. If someone is free to choose where to incorporate one’s company, the choice tends to be, at least theoretically and assumed that the entrepreneur in question is rational, to incorporate under the most suitable legislation for the specific intended business activities. As a consequence of this free mobility for companies, certain jurisdictions might gain more incorporations at the expense of other jurisdictions. If the jurisdictions on the losing end want to avoid falling behind their more successful adversaries, these losing jurisdictions must change their legislation to become more attractive for the entrepreneurs. This phenomenon has in the literature been called regulatory competition. There is no doubt that regulatory competition is a solution that might be advantageous in perspective of the individual, but at the same time the question arises regarding how regulatory competition affects the system itself over time, and whether or not it is a beneficial and desirable development for the system and society.

1.2 Aims and research questions

The first aim of this work is to present a description of regulatory competition as a phenomenon and as a system in the EU. Secondly, an investigation will be made in what potential benefits as well as draw-backs regulatory competition might have as a system. The third aim of this thesis is to investigate what actual effects and trends the regulatory competition in the EU has caused on the national corporate legislations of the Member States and the incorporation patterns of the entrepreneurs. Finally, some predictions about the future will be made, where focus especially will be on the potential effects upon the regulatory competition caused by the exit from the EU by the UK, the so called “Brexit”.

To achieve the aims of this thesis the following research questions will be posed:

- What is regulatory competition?
- What are the potential benefits and draw-backs of regulatory competition?
- What impact has the European regulatory competition had so far?
- What effect might Brexit have on the regulatory competition?

1.3 Limitations

First of all, within the scope of this work whenever a reference is made to “regulatory competition”, this will refer to regulatory competition within the field of corporate law and for incorporation of limited liability companies, unless otherwise is explicitly stated. Cross-border mergers will be excluded from this scope as they concern already pre-existing companies.

Secondly, the European Company Statute¹ could be of some importance for the topic as it introduces a new type of limited liability company from the EU itself, *Societas Europaea*, that offers an alternative to the limited liability companies offered by the various national legislations. However, the amount of incorporated *Societas Europaea* has so far been relatively low, only a few thousand incorporations in total have been made as of 2014, according to the European Trade Union Institute.²

Furthermore, it is highly unlikely that the EU would participate and drive, at least actively, the regulatory competition through the *Societas Europaea*.³

Consequently, this writer has decided to leave the *Societas Europaea* out of the scope of this work as it is not likely to influence the regulatory competition to any greater extent.

1.4 Structure

As a start chapter 2 will present the relevant provisions of the Treaty on the Functioning of the European Union (hereinafter referred to as “TFEU”) along with case-law that clarifies the meaning of such relevant provisions. Wherever needed, literature will be used to fill in the gaps and further clarify.

In chapter 3 the theoretical background to regulatory competition as a phenomenon will be presented. In this chapter the main focus will be on the regulatory competition in the US and on the debate in the American legal literature regarding the effects, benefits and draw-backs the regulatory competition have had in the US. The US poses a good example of one type of regulatory competition and might be a good example of the prolonged effects thereof. Chapter 3 will primarily present the opinion expressed in the legal literature. The purpose of this chapter is also to investigate what possible advantages and risks for the European system that its regulatory competition might give rise to.

¹ Regulation (EC) No 2157/2001 on the Statute for a European company (SE).

² <http://www.worker-participation.eu/European-Company-SE/Facts-Figures/Archive-of-SE-facts-figures2> accessed June 14, 2017.

³ Martin Gelter: *The structure of regulatory competition in European corporate law* in *Journal of Corporate Law Studies*, Vol. 5, No. 2 (2005), pp. 247-284.

Chapter 4 is dedicated to the regulatory competition in the EU. First, the differences from its American counterpart will be pointed out, the material used will mainly consist of literature. This is followed by a presentation of some of the de facto changes in the Member States' legislation and of the incorporation patterns of the companies so far.

Chapter 5 will focus on the mechanisms behind the changes is presented in chapter 4. Explanations provided by the literature will be put forward along with an analysis why the changes took place and how the development of the regulatory competition has been from the initiation until recently.

Chapter 6 will aim to predict, based on the earlier patterns and the underlying causes from previous two chapters, how the development and the regulatory competition within the EU will continue. After these predictions there will also be a focus on Brexit and its potential effects on the regulatory competition and whether the predictions will be affected by Brexit.

Finally, in chapter 7 conclusions of the previous chapters and their material and analyses will be summarised and presented.

1.5 Method

The first research question, *what is regulatory competition?* is a descriptive question. This writer will answer the question by first assessing the European market and its regulation, which put the playing field for the regulatory competition in place. In doing so, a legal-dogmatic research method will be used, where firstly the Treaties are investigated, followed by a review of relevant case-law and finally a short dive into the legal literature to nuance the situation. The legal-dogmatic research method is, generally, the core of every legal paper. However, depending on the subject in question, the material chosen can widely vary. After the playing field in which the regulatory competition operates has been settled, the regulatory competition as a phenomenon in the EU will be further described.⁴

The second research question, *what are the potential benefits and draw-backs of regulatory competition?* has rather the nature of an evaluative question. But also a comparison between the relatively new system in the EU and the relatively old system in the US will be made. The American regulatory competition has had more time to develop and might therefore show the impacts clearer than the young European regulatory competition. Consequently, the material used to answer this question will primarily be the legal literature. This research question will be answered by first reviewing, with a legal doctrinal approach, the various authors in the debate from Europe and the US. The debate in both the EU and the US will be compared. Some of the literature used will include empirical data as well as interdisciplinary elements, which will be discussed as well where relevant, but the aim of this

⁴ Claes Sandgren: *Rättsvetenskap för uppsatsförfattare*, Stockholm 2015, p. 39-40.

question, as well as this thesis, is not to become an empirical study or discuss whether regulatory competition is right or wrong from a societal perspective. The aim is merely to investigate the theoretical framework surrounding regulatory competition to better understand the background to be able to answer the following research questions. Therefore, even though this is an evaluative question, this writer will attempt to keep the answer from moving too far away from the strictly legal literature.

The third research question, *what impact has the European regulatory competition had so far?* is a mixture between a descriptive and an explanatory question. The discussion will be centred on the legal literature, with elements of empirical data that is necessary due to the nature of this question, if no data is provided it will be impossible to establish an impact or trend. Even though it could be argued that an interdisciplinary method could shed further light upon the actual changes caused by the regulatory competition and potentially give a more colourful picture of the future development, this writer has instead chosen to focus on a legal doctrinal approach. Since the aim of this work, as above stated, primarily is to investigate regulatory competition as a legal phenomenon and the economic, financial and other consequences it brings as a consequence are only of secondary interest to the aim of this paper as a whole. The aim of this research question is to explain, not to evaluate the fitness of regulatory competition as a policy, and due to this reason this writer decided to use a legal doctrinal approach rather than an interdisciplinary method.⁵

The final question, *what effect might Brexit have on the regulatory competition?* is not strictly speaking an explanatory question, but rather logical assumptions, with the aim to predict the future development, based on the earlier result from what the impact has been so far, historical lessons from the US and considering how the regulatory competition is formed within the EU. This writer will, based on previous three research questions, aim to try to establish a pattern and see if any conclusions can be drawn regarding the future development of the regulatory competition. Once such predictions have been made this writer will attempt to see if any of the predictions can be expected to change course due to Brexit. Since this is a subject that is highly interesting right now, there is already some literature regarding the potential impacts, even though the actual Brexit still lies far ahead. So even though the answer of this question mainly will be based on the conclusion of the three previous research questions, this new literature can support the analysis and argumentation.

⁵ Jan M. Smits: *What is legal doctrine? On the aims and methods of legal-dogmatic research*, Maastricht European Private Law Institute Working Paper No. 2015/06.

2. The current legal situation

2.1 Provisions

The freedom of establishment is regulated in chapter 2 TFEU under the section Right of Establishment. For company mobility article 49, 52 and 54 TFEU are the relevant articles.

The second paragraph of TFEU article 54 defines “companies” as “*firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law*”.

Article 49 TFEU provides all natural persons, which have a citizenship in a Member State, with the right to set up a primary establishment, i.e. to incorporate a company, within the territory of any Member State. Article 49 furthermore abolishes all restrictions on setting up a secondary establishment through an agency, a branch or a subsidiary.

Article 54 TFEU stipulates that legal persons, who are formed in accordance with the law of a Member State, must be treated as equals of natural persons for the purpose of chapter 2 TFEU.

Nonetheless, article 52.1 TFEU provides exceptions for when restrictions to the freedom of establishment could be justified. Regulatory actions that provide a special treatment solely because of a subject’s nationality “on grounds of public policy, public security or public health” are to be considered as justified.

2.2 Article 54 TFEU - Equal treatment of natural and legal persons

Any measures taken by a Member State that will hinder, or render less attractive, the exercise of the fundamental freedoms that are guaranteed by the Treaty can be divided into either direct discrimination (overt) or indirect discrimination (covert). Below the ECJ case law for both direct and indirect discrimination will be laid out.

2.2.1 Direct discrimination

An example of direct discrimination can be found in the case of *Data Delecta*⁶ where ECJ established that the Treaty demanded perfect equality in the treatment of persons which in the situation is governed by the Union law and nationals of the Member State in question. In the light of this ECJ found that a Swedish rule that required foreign persons to post a security

⁶ Case C-43/95.

for court costs was directly discriminatory since no such rule existed for persons of Swedish nationality.⁷

In *Royal Bank of Scotland*⁸, ECJ established that Greek tax rules, which applied a higher tax rate for companies that had their seat in another Member State than Greece, were discriminatory. Since the different rules applied solely on the ground of nationality, this was direct discrimination.⁹

ECJ ruled in *Commission v. France*¹⁰ that the registered office of a company, in the sense of having the registered office, central administration or principal place of business, served as the connecting factor with a particular Member State in the same way as nationality is the connecting factor for natural persons. If a Member State were allowed to treat a company differently only because this company's registered office were located in another Member State, then the provision of equal treatment between legal and natural persons would be deprived of any meaning. Consequently, all direct discrimination on the grounds of location of a company's seat is prohibited.¹¹

Since article 54 TFEU establishes that legal and natural persons are to be treated the same, the conclusion can be made that the Treaty demands perfect equality in the treatment between legal persons regardless of where their office is located. The only case in which direct discriminatory measure can be allowed and justified is if an express derogation is provided by article 52 TFEU on the grounds of public policy, public security or public health. However, to be allowed the measure must also be considered as proportionate.¹²

2.2.2 Indirect discrimination

In *Sotgiu*¹³ ECJ established that the prohibition against all types of discrimination of natural persons covered not only direct discrimination, but also all forms of indirect discrimination that through the application of a criterion of differentiation will lead to the same discriminatory result.¹⁴

In the later decision of *Commerzbank*¹⁵, ECJ refers to *Sotgiu* and establishes that since legal persons are to be treated in the same way as natural persons, any indirect discrimination that in fact leads to the same discriminatory result is forbidden also for legal persons.¹⁶

⁷ *Ibid.*, para. 16.

⁸ C-311/97.

⁹ *Ibid.*, para. 32.

¹⁰ Case 270/83.

¹¹ *Ibid.*, para. 18.

¹² Catherine Barnard: *The Substantive Law of the EU - The Four Freedoms*, Oxford 2013, p. 341.

¹³ Case 152/73.

¹⁴ *Ibid.*, para. 11.

¹⁵ Case C-330/91.

The conclusion to be made from case-law is that discrimination, direct or indirect, on the grounds of where a company has its seat is breaching the prohibition against discrimination stipulated in article 49 TFEU.

2.2.2.1 The Discrimination model or the Restriction formula

While judging whether a measure is indirectly discriminatory or not is it important to notice that there are different perspectives upon how indirect discrimination is identified. The term “indirect discrimination” was the first term used by ECJ in case-law. Indirect discrimination was identified as when a rule was written and applied without discrimination but de facto resulted in discrimination (the “Discrimination model”).¹⁷

ECJ adopted later on, in *Säger*-case¹⁸, an approach, which can be called the “Restriction formula”, where the discrimination is seen from the perspective of market access. Instead of evaluating if the measure in question results in de facto discrimination, the focus is on the impediment created by the national measure.¹⁹

The Restriction formula could be applied with a wider scope than the Discrimination model, since ECJ in the former case investigates whether the national measure in question is a restriction liable to prohibit, impede or render less attractive the free movement, regardless whether or not the measure is qualified as an indirect discrimination in accordance with the Discrimination model. All cases qualified by the Discrimination model will also be qualified by the Restriction formula, but it is possible that a measure could impede the market access without qualifying as de facto resulting in discrimination. In the legal academic literature, there has been discussion which approach is the most suited.²⁰

The categorization of the different options of approach could be made even further into a formal or substantive market access. But the ECJ seems to be somewhat inconsistent in its application of market access/discrimination tests.²¹

For the scope of this work it will not be necessary to further investigate the different models of how indirect discrimination can and should be constructed by the ECJ. It is possible that the different approaches could give varying answers to what measures are allowed and by doing so slightly affect the landscape in which the regulatory competition operates. However, the focus of this work is on the effects caused by regulatory competition in a

¹⁶ *Ibid.*, para. 14.

¹⁷ C-398/92, Para 16.

¹⁸ C-76/90.

¹⁹ *Ibid.*, para. 12.

²⁰ Catherine Barnard: *The Substantive Law of the EU - The Four Freedoms*, New York 2010, p. 239-262.

²¹ Catherine Barnard and Simon Deakin: *Market Access and Regulatory Competition*, Oxford 2002, p. 204-213.

broader picture and further discussions regarding the qualification of an indirect discriminatory measure will not be conducted.

2.2.2.2 Justifications

A restrictive measure that is indirect discriminatory can in some cases be allowed if an express derogation is made in the Treaties, such as article 52 TFEU, or if the measure is justified due to public interests.

In order to be justified the restriction must, according to *Kraus*²², fulfil the following four conditions:

1. It must be applied in a non-discriminatory manner;
2. It must be justified by imperative requirements in the general interest;
3. It must be suitable for securing the attainment of the objective which they pursue;
and
4. It must not go beyond what is necessary in order to attain it.²³

Consequentially, there are only small possibilities for a Member State to impose justified indirectly restrictive measures. However, the size of the margin in which Member States can impose such restrictive measures will depend on how narrowly the requirements established in *Kraus* are construed. For the aims of this work it is necessary to further crystallize the landscape in which regulatory competition operates, so further case-law will be discussed below in regards of primary establishment, secondary establishment and from a tax perspective.

2.3 Article 49 TFEU - Primary establishment

There are two possible options when a company moves its seat:

- A. The company transfers its seat from Member State A to Member State B, but the law of Member State A remains as the applicable law.
- B. The company transfers its seat from Member State A to Member State B and the applicable law is changed to the law of Member State B. With other words is the company converting itself into a company incorporated under the law of the new Member State.

In *Daily Mail and General Trust*²⁴, ECJ establish that the existence of a company is determined by the national legislations of the Member States.²⁵ Consequentially, it is up to

²² C-19/92.

²³ *Ibid.*, para. 32.

²⁴ C-81/87.

the national legislation of a Member State to determine what the requirements under its jurisdiction are to gain, or maintain, the status as a company.²⁶ So, in case A. it is up to the national law of each and every Member State to determine whether a company registered under its laws can move seat to another Member State and still keep the law of the Member State of registration as the law applicable to the company.

In a Member State applying the “Real seat doctrine” (siège réel), both a registration and an actual administrative centre (the “seat”) within the territory of the Member State are required. Hence, above mentioned case A. is not possible for a company incorporated in a Real seat country, such as Germany. Member States which, in contrast to Real seat countries, only require a registration and allows a company to have its actual administrative centre, its seat, wherever it pleases apply the “Incorporation doctrine” (siège statutaire). In Member States applying the Incorporation doctrine, such as UK, a scenario like case A. is generally possible.

Nonetheless, a Member State that allows its companies to move the seat will retain the right to put up certain requirements that should be fulfilled before the move take place. If these requirements are not fulfilled before the company moves its seat from the Member State of registration, the company will possibly lose its legal status as a company there. Since the company then would not be a company incorporated under a foreign Member State, it must follow the rules of incorporation of the new Member State to which it moved its seat and loses the protection given by the freedom of establishment.²⁷

In both *Daily Mail and General Trust* and *Cartesio*²⁸ the companies in question lacked the basic requirement, to be a company incorporated in accordance to a law of a Member State. Since they were no longer such companies, and therefore did not have legal capacity, they could not enjoy any of the freedom protected under the Treaties. In *Überseering*²⁹, on the other hand, a Dutch company moved from the Netherlands, while still complying with the Dutch law, to Germany. Since the company in question was incorporated in accordance to a law of a Member State, the Netherlands, the restrictive measures taken by Germany were prohibited.³⁰

ECJ further established in *Cartesio* that a company which decides to conduct a move such as in case B. may not be prevented by the old Member State to do so. *Cartesio* explicitly establishes that the old Member State cannot require the winding-up or liquidation of the

²⁵ *Ibid.*, para. 19.

²⁶ *Ibid.*, para. 20.

²⁷ *Ibid.*, para. 20.

²⁸ C-210/06.

²⁹ C-208/00.

³⁰ Catherine Barnard: *The Substantive Law of the EU - The Four Freedoms*, Oxford 2013, p. 319.

company before it moves as such measures would constitute prohibited restrictions in the freedom of establishment.³¹

In *Vale*³² a reversed situation from *Cartesio* took place. A company that wished to move was allowed to do so by the state it currently was incorporated in, but not by the state it wished to incorporate into. ECJ once again stated that it was up to the national law to decide the requirements that needs to be fulfilled for a company to be considered incorporated under the national law of that state. However, it was an unjustified restriction of the freedom of establishment for a state to allow its own companies to move to other states but not to allow foreign companies to move into that state.³³

Hence, if the companies in *Daily Mail and General Trust* and *Cartesio* instead of a case A.-move wished to have done a case B.-move, their old Member States would not be allowed to put up any restrictions, assumed that the companies fulfilled the requirements regarding incorporations of their new Member States.³⁴

Nonetheless, it is according to ECJ not inconceivable that overriding requirements relating to the general interest may justify certain restrictive measures, such as the protection of the interests of creditors, minority shareholders, employees and taxation authorities. Such restrictions would however be subject to certain conditions and not even the aforesaid objectives can justify such drastic measures as denial of legal capacity, as was seen in *Überseering*.³⁵

2.4 Article 49 TFEU - Secondary establishment

In *Commission v. Italy*³⁶, ECJ established that a regulation which stipulated that certain types of businesses can only be conducted through primary establishment was to be considered as a forbidden restrictive measure. However, an e contrario interpretation of the wording in *Commission v. Italy* opens for a possibility that such restrictive measures might be allowed anyway, but only if the measure is an indispensable instrument to achieve certain aims of public policy.³⁷

The prohibition of restrictive measures against secondary establishments was in *Segers*³⁸ extended to cover also the employees of a secondary establishment.

³¹ *Ibid.*, para. 113.

³² C-378/10.

³³ *Ibid.*, para. 36.

³⁴ Catherine Barnard: *The Substantive Law of the EU - The Four Freedoms*, Oxford 2013, p. 319.

³⁵ C-208/00, para. 92-93.

³⁶ C-101/94.

³⁷ *Ibid.*, para. 31.

³⁸ C-79/85.

A Member State may deny a company the right of establishment in case the company is conducting business in an abusive or fraudulent manner. According to Saydé it is a fine line between regulatory mobility and the abuse of Union law, there will be an overlap between regulatory mobility and abusive cross-border practices. It comes as a natural consequence that there is a grey area between promoting regulatory mobility and encourage cross-border abusive practices.³⁹

In *Segers* it was however established that the mere fact that the company in question is conducting all of its business in another Member State than the Member State in which it is registered cannot be considered sufficient proof of such abuse, or of fraudulent behaviour.⁴⁰

Segers is quoted in the *Centros*-case⁴¹ that further clarifies the extent of a company's right to secondary establishment. *Centros* was a company incorporated in the UK by two Danish citizens. Danish corporate law required a substantially higher minimum capital than what was required in the UK. Since the Danish entrepreneurs wished to not bind up any capital in the company, they decided to incorporate their company in the UK, but with the only purpose to conduct business in Denmark. As a response, the Danish authorities refused to register the company's branch in Denmark, as the authorities were of the opinion that the entrepreneurs were conducting fraud since their only reason to incorporate in the UK were to avoid the Danish rules regarding minimum capital. The ECJ did not agree with the Danish authorities and established that it is immaterial if a company was formed only with the purpose of establishing itself in another Member State than the Member State of incorporation.⁴² The ECJ established that the objectives to combat or penalize fraud might be justified reasons for imposing certain obligations. Nonetheless, a Member State cannot on those grounds justify the denial to a foreign incorporated company of a branch registration in the Member State.⁴³

Two years after *Centros*, the ECJ once again confirmed its rulings in *Inspire Art*⁴⁴ by establishing that it did not constitute abuse to incorporate in a particular Member State with the sole purpose to benefit from the favourable legislation of that Member State. The mere fact that the company conducted no business whatsoever where it was registered did not provide sufficient evidence of fraudulent or abusive behaviour.⁴⁵ The ECJ further established that abuse must be assessed on a case-to-case basis.⁴⁶

³⁹ Alexandre Saydé: *Abuse of EU Law and Regulation of the Internal Market*, Oxford 2014, p. 279.

⁴⁰ *Ibid.*, para. 16.

⁴¹ C-212/97.

⁴² *Ibid.*, para. 18.

⁴³ *Ibid.*, para. 38.

⁴⁴ C-167/01.

⁴⁵ *Ibid.*, para. 96 and 139.

⁴⁶ *Ibid.*, para. 105.

2.4.1 Equal treatment in matters of tax

In tax law there is often a distinction between residents and non-residents and different rules will apply for these two categories. Resident companies are liable for their world-wide profits (unlimited taxation) while non-resident companies are liable only for the profits sourcing from the state of taxation (limited taxation). Even though the concept of residency does not coincide with nationality, it is a fair assumption that non-residents of a Member State in most cases will be nationals of another Member State. Many secondary establishments will be considered as non-residents and as a consequence thereof receive a different treatment than a resident company. Hence, an argument could be made that it is indirectly discriminatory to treat residents and non-residents differently. This argument is however invalid. The ECJ established in *Schumacker*⁴⁷ that generally speaking the situation of a resident and a non-resident are not comparable, as a consequence thereof is discrimination on the basis of residency impossible.⁴⁸

This differentiation is not considered to breach the Treaty since the distinction fall within the ambit of the fiscal principle of territoriality and thereby is outside the scope of the Treaty.⁴⁹

2.4.2 Justified restrictions

*Futura Participations*⁵⁰ regarded a Luxembourg regulation that required all tax payers to have a Luxembourg bank account to be allowed to carry forward losses. For a foreign company the Luxembourg rule resulted in a double burden, where two sets of accounting rules had to be followed, the Luxembourg rules and the rules of its Member State of incorporation. The ECJ established that the rule was justified on the grounds ensuring an efficient fiscal supervision, but it was not proportionate. Luxembourg was allowed to demand clear and precise demonstration of losses but it is not reasonable to refuse a non-resident company the carriage of losses simply because it did not kept proper account in Luxembourg.⁵¹

⁴⁷ C-279/93.

⁴⁸ *Ibid.*, para. 30-31.

⁴⁹ C-250/95, para. 22; C-446/03, para. 39; and C-279/93, para. 34.

⁵⁰ C-250/95.

⁵¹ *Ibid.*, para. 25-26, 31, 43.

3. Regulatory competition

3.1 Theoretical background

Regulatory competition is by Barnard and Deakin described as a process where legal rules are selected through competition between different jurisdictions, in EU's case the jurisdictions of the Member States. To make regulatory competition possible the actors, in this case all European companies, must be able to choose between two or more legal systems.⁵²

If one is allowed to choose, one tends to choose the most advantageous system. Therefore, a competition begins between the different legal systems within the decentralized zone. If one system cannot adapt and become more efficient and attractive for the users, it will simply not be used to the same extent as a system that is more efficient and attractive. The whole EU is today one zone where any citizen is free to establish himself in a primary or secondary manner. This means that all the Member States of the EU today are engaged in a race against each other to find the best legislation to attract companies to use their national legal system instead of any of the other Member States'. Companies tend to choose the most relaxed legislation since this means less work for the same revenues, which ultimately is every company's goal. The European companies are indeed allowed to choose the most relaxed legislation if they wish to do so, that is the whole idea of the freedom expressed by the Treaty.⁵³

An effective regulatory competition is supposed to enhance diversity and promote experimentation to find the most suitable and effective legislation to match with the preferences of the customers of the law. Regulatory competition creates an incitement for the legislators to always improve and stay up to date. This pressure should make the law better adapted to the needs of the companies, which are the ones affected by the corporate law. Since the customers are allowed to choose freely between the different solutions chosen by the jurisdictions available, the different legislations can effectively be compared. Regulatory competition therefore promotes the flow of information on effective law-making and forces the jurisdiction to always strive after finding new, innovative and adequate legislations and optimize their legislation to stay competitive. Regulatory competition is therefore supposed to increase the quality and standard of the laws in a decentralized entity.⁵⁴

⁵² Catherine Barnard and Simon Deakin: *Market Access and Regulatory Competition in The Law of the Single European Market*, Oxford 2002, p. 198-199.

⁵³ See further in C-212/97.

⁵⁴ Catherine Barnard and Simon Deakin: *Market Access and Regulatory Competition in The Law of the Single European Market*, Oxford 2002, p. 199.

Another important argument for regulatory competition is that it boosts the amount of new start-ups. Law matters for the financing of economic activities, if the law promotes entrepreneurial activities it will also increase the comparative success of the economy it governs.⁵⁵

3.2 Competitive federalism and reflexive harmonization

There are different theories of how regulatory competition should be conducted to reach optimal effect. The two most prominent theories are competitive federalism and reflexive harmonization. Competitive federalism strives to create as pure conditions as possible for regulatory competition to exist in. All potential obstacles should be removed and the playing field should be as equal as possible for all parties. The use of harmonizing rules should be applied to hold the competition in equilibrium and cut away the negative externalities that appear within the federal area. Supply and demand should be balanced against each other to achieve a healthy and stable progress.⁵⁶

With reflexive harmonization, on the other hand, the aim is not so much the competition itself but rather the process through which exploration, information and knowledge is created, mobilized and shared. The end goal is impossible to anticipate since the end goal is the creation of something new, earlier unknown or non-existing, but more efficient and better adapted for the practicalities of the modern world. It is fundamental that some level of diversity and autonomy is protected and kept within the different entities of the federal area since without the diversity the potential scope of the regulatory competition will be severely limited. More variation will yield in a higher possibility of solving potential legislative issues within the federal area. The federal intervention consequently must consist of two aims: to protect local diversity and at the same time make sure that sub-optimal development, such as a race towards the bottom, does not occur.⁵⁷

3.3 Delaware and the race to the bottom

Some writers are of the opinion that regulatory competition is a recipe for disaster. According to Cary, the regulatory competition among the federal states of the US, which has a similar decentralized structure as the EU, causes a race to the bottom.⁵⁸

⁵⁵ Lars Hornuf,; *Regulatory Competition in European Corporate and Capital Market Law*, Antwerp 2012, p. 7-8.

⁵⁶ Simon Deakin: *Legal diversity and regulatory competition: Which model for Europe?* in *European Law Journal*, Vol. 12, No. 4 (2006), pp. 440-454.

⁵⁷ Simon Deakin: *Two Types of Regulatory Competition: Competitive Federalism versus Reflexive Harmonisation A Law and Economic Perspective on Centros* in *Cambridge Yearbook of European Legal Studies* Vol. 2, No. 1 (2000), pp. 231-260.

⁵⁸ William L. Cary: *Federalism and Corporate Law: Reflections upon Delaware* in *The Yale Law Journal*, Vol. 83, No. 4 (1974), p. 663-705.

According to Cary it started in the end of the 19th century when the state of New Jersey introduced the first modern and liberal corporate statute in the US. The liberal approach became a success in the sense that it attracted a lot of entrepreneurs from all over the US to incorporate their companies in New Jersey instead of their home state. Shortly afterwards Delaware saw it as an opportunity to acquire a new source of income by enacting a liberal statute as well and attracting new incorporations from other states. It worked very well and when New Jersey later amended their statute, to once again become more restrictive, Delaware took the leading role as the state with the most corporate friendly environment, a lead they kept ever since.⁵⁹

The other federal states understandably wanted to keep the companies incorporated under their jurisdictions and preferably also attract some new incorporations. So they were forced to relax their statutes and emulate Delaware by make their own jurisdictions more attractive in the eyes of the entrepreneurs. All the time Delaware, keen to keep its lead, continued to relax and liberalize their statute even more. Consequently, the state governments started to lose influence over the corporations since the state governments constantly were forced to create an ever more attractive environment to please the entrepreneurs. From the governments' perspective a race towards the bottom was initiated.⁶⁰

It is understandable that Delaware has an interest in keeping its status as the most favourable jurisdiction to incorporate in. When Cary wrote his famous article, a quarter of Delaware's income came from incorporations and one third of all the companies listed at the New York Stock Exchange were incorporated in Delaware. The importance for the economy of Delaware had made the liberal incorporation statute into a public policy of the state.⁶¹

These numbers have only increased further since then. Today are more than half of all publicly traded companies in the US and 60% of the Fortune 500 companies incorporated in Delaware and the State of Delaware named itself to the "corporate capital of the world".⁶²

But while the race might be good for Delaware's economy, it is bad for all the other states that get less incorporations in their jurisdictions. It is also bad for the shareholders and investors in the incorporated companies, as a big part of Delaware's success is based on prioritizing the management's interests over the shareholders' interests. When Cary wrote his article only 14 states required reports from the management to be made to the shareholders and this was not even a mandatory requirement in all these 14 states.⁶³

⁵⁹ *Ibid.*

⁶⁰ *Ibid.*

⁶¹ *Ibid.*

⁶² [Dedo.delaware.gov/industries/corporate-headquarters](http://dedo.delaware.gov/industries/corporate-headquarters) accessed January 14, 2017.

⁶³ William L. Cary: *Federalism and Corporate Law: Reflections upon Delaware* in *The Yale Law Journal*, Vol. 83, No. 4 (1974), p. 663-705.

The reason for the unbalance is that it tends rather to be the corporate management than the shareholders or investors that make decisions regarding the legal domicile of a company. Hence, to attract incorporation Delaware had to make their jurisdiction attractive to the management. To please the management and keep the incorporations, and the bundled lucrative franchise taxes, Delaware must continue to be responsive to the demands and wishes of the corporate managements.⁶⁴

3.3.1 The debate regarding the Delaware effect

Cary's pessimistic view got a huge impact on the legal debate in the US when his article was published. But his perspective was not the only one. The arguments presented by Cary got heavily rejected by, amongst other, the influential Winter who wrote that Cary's theory and the arguments he based it on were implausible. Winter meant that the whole idea that Delaware promoted management over investors were bizarre, if the market were not suitable for investors, then the investors would find somewhere else to invest their money. Hence, if it were true that the company statute in Delaware promoted the management at the expense of the investors, then the companies in Delaware would be less successful than their counterparts incorporated in other states, which certainly was not true according to empirical evidence. According to Winter, the regulatory competition in the US was rather a race to the top than a race to the bottom.⁶⁵

However, ten years after his first response to Cary, Winter revised his categorical view of the regulatory competition as a race to the top and he acknowledged that competition not necessarily always has to result in optimal results. The outcome might also become sub-optimal because the legislators might be driven by other reasons than maximal tax revenue. These other motives might taint the positive effect to some extent. But it was, according to Winter, still completely clear that Cary's article was wrong even if Winter himself might not have been completely right in his first response.⁶⁶

In 1996, Easterbrook and Fischel took a view similar to Winter's later revised position. They argued that the theory of a race to the top by the time they were published must be considered as refuted. But even so that the US regulatory competition still constituted a powerful positive tendency, as even though the possibility for opportunism did not completely disappear the regulatory competition put an effective restraint on it. Therefore, there was no need for federal interruption of the competition, as the competition already

⁶⁴ Simon Deakin: *Legal diversity and regulatory competition: Which model for Europe?* in *European Law Journal*, Vol. 12, No. 4 (2006), pp. 440-454.

⁶⁵ Ralph Jr. Winter: *State Law, Shareholder Protection, and the Theory of the Corporation* in *Journal of Legal Studies* Vol. 6, No. 2 (1977), pp. 251-292.

⁶⁶ Ralph Jr. Winter: *The "Race for the Top" Revisited: A Comment on Eisenberg* in *Columbia Law Review* Vol. 89 (1989), pp. 1526-1529.

created an upward moving trend. If anything, too much federal involvement would risk having negative impact on the development of corporate legislation in the long run.⁶⁷

More recently, in 2002, Bebchuk *et al* took a critical view upon the claim that empirical evidence renders Cary's notorious article implausible. In their article they show that it is true that the empirical evidence of Cary's article lack robustness, but even if more robust evidence would be produced it still would not rule out the possibility of a race towards the bottom.⁶⁸

Deakin takes the standpoint that it is important to remember that Delaware's total domination of the US corporate law is a direct consequence of the federal decision not to intervene in the competition between the states, even if the federal government very well had the right to intervene. Furthermore, according to Deakin the Delaware effect rather than leading to the top or the bottom per se, leads towards convergence in corporate legislation. As convergence is unpredictable, the competition might indeed lead to an efficient, near optimal result, but it might also lead to a sub-optimal or negative result. According to Deakin is the race towards convergence unavoidable in a competitive federalism such as in the US.⁶⁹

Deakin further claims that it is unlikely to ever reach a consensus in the debate whether the legislation development of Delaware has caused an efficient outcome or not. The total dominance of Delaware in the market of corporate law within the US makes it more or less impossible to measure its performance since no other benchmarks of any actual value can be established and compared against.⁷⁰

3.3.2 Incentives to win the race

In American academic literature there are two factors generally mentioned as the most prominent incentives for a state to attract incorporations. The most important are the various fees and taxes which a state can take from the companies, and the most lucrative are the franchise taxes. These franchise taxes, as previously mentioned, do account for a large portion of Delaware's tax revenue. Another important and often mentioned incentive is to create more business opportunities, and thereby income, for the local legal advisors. The yearly boost in income for the small, but influential, Delaware State Bar Association is estimated to well surpass USD 150 million per year. It is however important to keep in mind that this is a relatively small income compared to, for example, the yearly incomes of major New York based law firms. Even though this is a much welcomed income for Delaware and

⁶⁷ Frank Easterbrook and Daniel Fischel: *The Economic Structure of the Corporate Law*, London 1996, p. 222-223.

⁶⁸ Lucian Bebchuk; Alma Cohen and Allen Ferrell: *Does the Evidence Favor State Competition in Corporate Law?* in *California Law Review* Vol. 90, No 6 (2002), pp. 1775-1822.

⁶⁹ Simon Deakin: *Legal diversity and regulatory competition: Which model for Europe?* in *European Law Journal*, Vol. 12, No. 4 (2006), pp. 440-454.

⁷⁰ *Ibid.*

its bar association, an equal increase in income would not constitute any more significant incentive for a larger state.⁷¹

⁷¹ Martin Gelter: *The structure of regulatory competition in European corporate law* in *Journal of Corporate law Studies*, Vol. 5, No. 2 (2005), pp. 247-284.

4. Regulatory competition in the EU

The ECJ's approach to market access has profound implications for the nature of the law-making process and for the content of legal rules in a variety of substantive areas. From *Centros* and *Inspire Art* it is clear that it is an inherent right of the freedom of establishment for a company to incorporate in a different Member State than the one it aims to conduct its business in. Consequently, the market access and regulatory competition are bundled together in the EU. Whenever the ECJ reviews the national laws of the Member States it does so against the criteria of how far such laws obstruct, or promote, economic mobility, and by doing so the ECJ is also necessarily defining the scope and nature of a form of regulatory competition.⁷²

Deakin is of the opinion that the regulatory competition within the EU, in general, is rather a regulatory competition of reflexive harmonization than a competitive federalism. While the US federal government acts more in the manner of a monopoly-regulator, the EU legislator seeks to promote the regional diversities by creating space for autonomous solutions to exist alongside each other. Deakin takes labour law as an example, where the EU legislator decides upon a floor of rights as a basic threshold of standard from which the Member States are prohibited to derogate from. However, the Member States are fully free, even encouraged, to apply higher standards than the ones set as a minimum by the EU. In the US on the other hand, the regulatory competition takes the form of competitive federalism.⁷³

4.1 Differences between the EU and the US

4.1.1 Historical differences

Gelter points out that it is, first of all, important to notice the fundamental difference between the starting positions of the regulatory competition in the US and in the EU. The early start in the US, during the end of the nineteenth-century, opened for a quick process of concentration due to its convergence with the rapid industrialization of the US taking place at the same time. Gelter claims that the whole development of Delaware as a quasi-monopolist as provider of corporate law is the result of a historical accident which it is

⁷²Catherine Barnard and Simon Deakin: *Market Access and Regulatory Competition in The Law of the Single European Market*, Oxford 2002, p.198.

⁷³ Simon Deakin: *Two Types of Regulatory Competition: Competitive Federalism versus Reflexive Harmonisation A Law and Economic Perspective on Centros* in *Cambridge Yearbook of European Legal Studies* Vol. 2, No. 1 (2000), pp. 231-260.

impossible to recreate today. It is simply not reasonable to believe that any mass migration of large firms on a similar scale would happen in Europe in the twenty-first century.⁷⁴

Gelter's opinion has support in the literature, Enriques takes a similar stand and is of the opinion that today, in difference from the late-nineteenth-century, there are not many revolutionary new innovations possible in corporate law that would radically change the balance in favour of one Member State in the way that happened in the US with Delaware. The modern corporate laws are simply too sophisticated to allow such a radical change that would be needed to create a situation similar to the one in the US.⁷⁵

Deakin makes an important remark to bear in mind regarding the historical development: even though regulatory competition has been a phenomenon in the US for a long time it is still a relatively new occurrence in the EU. The effects of the regulatory competition have consequently not had much time to develop in Europe and will be less obvious and drastic than the effects of the older regulatory competition in the US.⁷⁶

Consequently, it might be safer to take Gelter's strong opinions with a grain of salt because, even if his view is well supported and he provides well formulated and thoughtful arguments in his article, the regulatory competition in the EU is still in its very early stages. Many well renowned writers, such as Drury⁷⁷ and the aforementioned Deakin⁷⁸, are taking a more vigilant and careful position regarding the historical aspects than Gelter does when he describes Delaware's quasi-monopolistic situation as an historical accident.

4.1.2 Lacking incentives

As mentioned, it has mainly been the possibility of gaining extra revenues from franchise taxes that fuelled the regulatory race in the US. This incentive does however not exist in the regulatory competition in the EU. A franchise tax, as the one in the US, is not possible in the EU due to the Directive on indirect taxes on the raising of capital.⁷⁹ Article 5 of this directive provides a list in which respects it is prohibited to impose indirect taxes, Article 5 (c) stipulates:

“(c) registration or any other formality required before the commencement of business to with a capital company may be subject by reason of its legal form;”

⁷⁴ Martin Gelter: *The structure of regulatory competition in European corporate law* in *Journal of Corporate Law Studies*, Vol. 5, No. 2 (2005), pp. 247-284.

⁷⁵ Luca Enriques: *EC Company Law and the fears of a European Delaware* in *European Business Law Review*, Vol. 15, No. 6 (2004), pp. 1259-1274.

⁷⁶ Simon Deakin: *Legal diversity and regulatory competition: Which model for Europe?* in *European Law Journal*, Vol. 12, No. 4 (2006), pp. 440-454.

⁷⁷ Robert Drury: *The “Delaware syndrome”: European fears and reactions* in *Journal of Business Law*, (2005), pp. 709-744.

⁷⁸ Simon Deakin: *Legal diversity and regulatory competition: Which model for Europe?* in *European Law Journal*, Vol. 12, No. 4 (2006), pp. 440-454.

⁷⁹ Directive 2008/7/EC concerning indirect taxes on the raising of capital.

In the joined cases of *Poente Carni* and *Cispadana Construzioni*⁸⁰ was this prohibition, by ECJ, considered to include annual fees.⁸¹

Other taxes which are permitted in the EU, such as corporate tax could, according to Gelter, not replace the importance of franchise taxes to create a similar incentive. This view is supported by Cheffins who is of the opinion that the only way extra corporate tax would create any new tax income of relative importance to the UK were if the migrating companies also chose to physically move their actual business to the UK, instead of only moving their registered office.⁸²

Gelter further argues that an incentive on par with the franchise tax of Delaware would not exist in the EU even if the aforementioned Directive on indirect taxes on the raising of capital were abolished. He is of the opinion that to be able to receive any substantial taxes a quasi-monopolistic position, like the one Delaware occupies, would have to be reached first. Since there are no prerequisites to repeat the historical accident that gave Delaware its dominant position, would a hypothetical abolishment of the Directive on indirect taxes on the raising of capital not affect the regulatory competition in the EU significantly.⁸³

Furthermore, the importance of increased advisory income is not especially high and it must be taken into account that even the smaller Member States in the EU, such as Luxembourg, have significantly larger annual income than Delaware. The potential boost in income due to increased advisory income would consequentially be negligible for any Member State, especially unless a quasi-monopoly is achieved, which is unlikely since no Member State has a position similar to Delaware's and lack the opportunity to achieve such position in any near future.⁸⁴

Nonetheless, even if the direct incentives attributed to the development in the US do not exist in the EU, there are still indirect incentives. Member States, from which many entrepreneurs migrate to instead incorporate abroad, will lose political control since corporate law is a means with which a state can implement its political agenda.⁸⁵

Consequently, there will still be incitements for a Member State to not lose incorporations to other Member States but to rather gain incorporations by attracting entrepreneurs from abroad, and by doing so promote their own domestic legal market and legal products. This is

⁸⁰ Joined Cases C-71/91 and C-178/91.

⁸¹ *Ibid.*, para. 32.

⁸² Brian R. Cheffins: *Company law theory, structure and operation*, Oxford 1997, p. 345.

⁸³ Martin Gelter: *The structure of regulatory competition in European corporate law* in *Journal of Corporate Law Studies*, Vol. 5, No. 2 (2005), pp. 247-284.

⁸⁴ *Ibid.*

⁸⁵ Marco Becht; Collin Mayer and Hannes Wagner: *Where Do Firms Incorporate? Deregulation and the Cost of Entry* in *Journal of Corporate Finance* Vol. 14, No. 3 (2008), pp. 241-256.

the reason why regulatory competition in the EU has been described as more defensive than its American counterpart.⁸⁶

4.1.3 Closed vs. public corporations

It is also of significant importance to point out that that Delaware's quasi-monopoly in the US is in the market of public corporations. No US state has such dominant position in the market of closed companies. There might exist a near optimal legislative standard solution in regards for public corporations, but the variety among the demands for the closed companies is believed to be much more widespread than its public counterparts. Also, there are more individual and unpredictable factors to take into account regarding the market demands of closed companies. Closed companies tend to have fewer and more influential shareholders and the personal ideas and requirements of these shareholders will possibly affect the decisions of the company to a greater extent.⁸⁷

But even for public corporations it is reasonable to expect different market demands in the EU and the US. While the Delaware-formula has worked well in the US, the European market is more diverse and has less uniform shareholder patterns. Another important factor is that no common European market regulator, like the American Securities and Exchange Commission, exists and there is no pan-European stock exchange comparable to the New York Stock Exchange, which covers all of the US. Consequentially, the market for public corporations is much more diverse in Europe than in the US. Hence, it is harder to find a similar concept to Delaware's one-size-fits-all solution.⁸⁸

4.1.4 Impediments on the European market

American academic literature has mostly studied the effects of the regulatory competition on the management and the shareholder while leaving out other stakeholders that have a potential interest in the company law. This might simply be because creditor protection to a high degree is left outside of the scope of the American regulatory competition and the institutional creditors are less concentrated in the US than in the EU and therefore less influential. However, creditors have a larger impact in Europe on the legislative changes and might therefore be able to promote reforms in their line of business. Or the creditors might in their business benefit the companies incorporated in certain jurisdictions with more advantageous interests and by doing so make the jurisdictions in question more attractive for the entrepreneurs. Even if the creditors might be the most influential stakeholder

⁸⁶ Georg-Ringe Wolf: *Corporate Mobility in the European Union – a Flash in the Pan?* in *European Company and Financial Law Review*, Vol. 10, No. 2 (2013), pp. 230-267.

⁸⁷ Martin Gelter: *The structure of regulatory competition in European corporate law* in *Journal of Corporate Law Studies*, Vol. 5, No. 2 (2005), pp. 247-284.

⁸⁸ *Ibid.*

besides the shareholders and the management, the employees and other stakeholders in the companies will also have a bigger impact in the EU than in the US. The more and stronger interests that pull in different directions make the European market more diversified than its American counterpart.⁸⁹

Gelter argues that the widely different market demands within the EU, compared to the US, must also be considered. A distinct impediment on the European market is the many languages. While English is the official language in all the US states, Europe has numerous languages. Nonetheless, Member States with English as an official language might have a slight advantage on the European market since English is a widely understood language throughout the whole the EU. But even so, sub-markets for other major European languages, such as a German-speaking or French-speaking sub-market, could be created. Besides the language barrier, different legal traditions makes the situation for an entrepreneur that chose to incorporate abroad more uncertain which also constitutes an impediment. Additionally, the accounting standards are different within different Member States, which also creates uncertainty for foreign entrepreneurs.⁹⁰

The theory that there is a European language barrier can be countered by an argument that the issue of language can be solved by hiring incorporation agencies which, as will be explained below, were one of the significant factors behind the wide popularity the UK achieved as a place of incorporation. The incorporation agency can, for a relatively cheap price, provide the legal expertise needed to make the incorporation in a foreign country with a different legal tradition. Even though a counter-argument like the aforementioned can be constructed, this writer is of the opinion that the language would constitute some form of barrier, maybe causing the entrepreneur to be extra hesitant about incorporating abroad since he is completely dependent on the agency hired to take care of the incorporation. Furthermore, the entrepreneur incorporating abroad will still be in a foreign and unknown legal arena once the start-up is done and the business continues without the incorporation agency's help, and this will constitute a disadvantage for the entrepreneur for several years to come, until he is as comfortable in the foreign jurisdiction as he is on home-ground. Hence, this writer is of the opinion that the aforementioned counter-argument does not nullify the language barrier.

Hence, it is likely that the cost and time-consumption of incorporating under a foreign jurisdiction in the EU, at least in most cases, will be higher than on the US market. Especially for smaller firms and start-ups the extra costs and uncertainty of incorporating in a foreign jurisdiction will in many cases exceed the advantages and therefore create a bias for the home country in question.⁹¹

⁸⁹ *Ibid.*

⁹⁰ *Ibid.*

⁹¹ *Ibid.*

Also for larger and already well-established companies it would simply not be cost effective to change their place of incorporation just to win some minor advantages. In the EU the larger multinational companies, rather than setting up one big corporation operating throughout the whole continent, set up local subsidiaries that can operate and blend into the local environment of each Member State. Also in the US this solution seems to successively turning into the more preferred option.⁹²

A final factor that cannot be ignored is that the debate, which shapes the decision of the legislators, in Europe will take place on national level rather than on an federal or intra-European level. In Europe the political and public pressure over specific issues is often concentrated on a national level. Even though European regulation in general tends to deal with fundamental issues is it a slow and time consuming process and there is room for national legislation as well. So, in case of a crisis, or of a demand for immediate intervention, it is rather the national legislator that intervenes in Europe instead of the EU, while in the US this rests upon the federal legislator.⁹³

Gelter is not alone in his scepticism towards a comparison between the EU and the US. Many other writers rule out the possibility of a Delaware style race to the bottom in the sense that investor and creditor protection legislation will be significantly less protective in the future as a consequence of the European regulatory competition. The differences between the regulatory competition in the US and in the EU are simply too great.⁹⁴

4.2 Brakes in the the EU legislation

To hinder the regulatory competition in the EU from turning into a race to the bottom where the protection for shareholders and creditors successively decreases due to the competition, there are certain brakes incorporated in the EU legislation to stop such negative development.⁹⁵

⁹² Robert Drury: *The "Delaware syndrome": European fears and reactions* in *Journal of Business Law*, (2005), pp. 709-744.

⁹³ Martin Gelter: *The structure of regulatory competition in European corporate law* in *Journal of Corporate law Studies*, Vol. 5, No. 2 (2005), pp. 247-284.

⁹⁴ Robert Drury: *The "Delaware syndrome": European fears and reactions* in *Journal of Business Law*, (2005), pp. 709-744.

⁹⁵ Catherine Barnard: *The Substantive Law of the EU - The Four Freedoms*, Oxford 2013, p. 331.

4.2.1 Reversed discrimination and the Real seat doctrine

One of these brakes is reversed discrimination. While a Member State must accept a company that is incorporated according to the law of another Member State, a Member State is allowed to demand higher requirements from its own domestic market.⁹⁶

The reversed discrimination allows Member States whose law follows the Real seat doctrine to demand from their own companies to still have a de facto connection to their Member State. This is what happened in case of *Cartesio* for example. However, as explained above, the first Member State must still recognize companies incorporated according to the law of another Member State even if this other Member State has substantially different rules, see *Überseering*.⁹⁷

The Real seat doctrine is supposed to bring the advantage, besides the logical appeal that a company should be incorporated and regulated within the jurisdiction where it actually conducts its business, of providing better protection for shareholders and creditors since each individual Member State still remains in control over the companies that are active within its jurisdiction. So in that sense the Real seat doctrine could be seen as a form of brake as well. However, it is questionable if such a protection is provided to any greater extent since there would still be ways for a company to hold their management in one jurisdiction and hence gain domicile while the de facto core of its business is conducted elsewhere.⁹⁸

However, Saydé means that the Real seat doctrine in practice often will lead to a restriction in the choice of home-jurisdiction because the potential advantages of a company law often are outweighed by the fact that a real connection to the country of incorporation is needed. Incorporation on the other hand is better fitted for artificial choice of home-jurisdiction and therefore will lead to free choice of host law.⁹⁹

4.2.2 Mandatory requirements

Another brake is the mandatory requirements originally imposed in *Cassis de Dijon*¹⁰⁰. Mandatory requirements allow the Member States to set a floor of basic protection to the competitive process. The mandatory requirements allow the Member States to have some degree of autonomy by allowing each and every Member State to set some ground rules based on public interest and policy from which it is impossible to deviate, even if these rules

⁹⁶ *Ibid.*, p. 203.

⁹⁷ *Ibid.*, p. 203-204.

⁹⁸ Robert Drury: *The "Delaware syndrome": European fears and reactions* in *Journal of Business Law*, (2005), pp. 709-744.

⁹⁹ Alexandre Saydé: *Abuse of EU Law and Regulation of the Internal Market*, Oxford 2014, p. 285.

¹⁰⁰ Case 120/78.

are discriminatory. However, a rule based on mandatory requirements is subjected to a rule of reason-test combined with a concept of proportionality where the measure must be considered fit and proportionate for what it aims to achieve.¹⁰¹

How effective this floor is depends on how the mandatory requirements are interpreted. If interpreted very extensively, the Member States can protect much of their local interests and even give these an advantage compared to other Member States. If interpreted too restrictively, they are not in reality effective brakes against the race to the bottom.¹⁰²

4.3 Impact of the regulatory competition in the EU

4.3.1 The regulatory competition's effect on the incorporation patterns 1997-2006

Historically entrepreneurs incorporated their company in the country they wished to conduct business in. But when *Inspire Art* was judged by ECJ the 30th of September 2003 it must have, at the very latest, been completely clear for the entrepreneurs in the EU what the new possibilities to incorporate abroad were. The UK, of the available countries in the EU, had by this time the relatively simplest incorporation procedures and the lowest costs of incorporation in the eyes of most entrepreneurs. As a result there was an explosion of foreign entrepreneurs that chose to incorporate in the UK. Between 1997 and 2006 over 120 000 new private limited companies were established in the UK by citizens from other Member States. In absolute numbers the biggest migration of incorporation was from Germany, France and the Netherlands. 48 000 of the total incorporations were German. In 1997 only 600 German entrepreneurs incorporated in the UK, while by the end of 2006 the number had increased to 16 000.¹⁰³

According to Becht *et al*, the many migrations that took place up until 2006 could be explained by the lower set up costs and especially the low minimum capital requirement in UK compared to the Member States from which the entrepreneurs emigrated. Becht *et al* came to the conclusion that lower total incorporation costs were valued much higher by entrepreneurs, when choosing jurisdiction to incorporate in, than other factors such as legal certainty, set up time, language barriers or complexity of the administrative procedures. The reason why all these other factors lost relevance was the introduction of incorporation agents on the UK market. For a cheap price these agents provide all the service needed to

¹⁰¹ Catherine Barnard and Simon Deakin: *Market Access and Regulatory Competition in The Law of the Single European Market*, Oxford 2002, p. 204.

¹⁰² *Ibid.*, p. 204.

¹⁰³ Marco Becht; Collin Mayer and Hannes Wagner: *Where Do Firms Incorporate? Deregulation and the Cost of Entry* in *Journal of Corporate Finance* Vol. 14, No. 3 (2008), pp. 241-256.

set up a new limited liability company in a very short time and hence other factors are negligible for the individual entrepreneur.¹⁰⁴

4.3.2 National legal reforms and the effects thereof 2000-2011

In 2012 Hornuf conducted a study to investigate if the regulatory competition changed the incorporation requirements of the Member States and if these potential changes were followed by an increased amount of new incorporations. According to his data, the Member States which apply the Real seat doctrine saw a drop in the average minimum capital requirement for limited liability companies from around EUR 11 000 in 2000 to around EUR 7500 in 2011. In Member States applying the Incorporation doctrine, the average minimum capital requirement dropped from just above EUR 7000 in 2000 to just below EUR 5000 in 2011.¹⁰⁵

The amount of incorporations increased in all Member States in Hornuf's study. The highest increase was in Hungary, which completely abolished its minimum capital requirement, while the smallest increase was in Spain, who did not decrease its minimum capital requirement at all.¹⁰⁶

It is however important not to confuse the amount of new start-ups with the amount of newly incorporated limited liability companies. Since limited liability companies are not the only company form available in the Member States, it is possible that the reforms just caused a movement from one company form to another and by doing so switched around the numbers but did not affect the total amount of companies. For example: while the amount of new limited liability companies increases, the amount of new sole proprietorships might at the same time decrease so the actual amount of new start-ups remain on the same level as previously. Another example on a pan-European level, would be that the new incorporations might just be companies that otherwise would have been incorporated in another Member State, in that case the reforms did not create any new start-ups but just a flow of incorporations from one Member State to another, as happened with the UK. So, with this borne in mind the total amount of new start-ups might be constant or even decreased even if the amount of new limited liability companies might have increased.¹⁰⁷

When Hornuf checked the total amount of new start-ups within each and every Member State included in his study, he found that in some Member States the total amount had increased, but in some Member States the total amount did not increase, and in Hungary the

¹⁰⁴ *Ibid.*

¹⁰⁵ Lars Hornuf, *Regulatory Competition in European Corporate and Capital Market Law*, Antwerp 2012, p. 10.

¹⁰⁶ *Ibid.*, p. 23.

¹⁰⁷ *Ibid.*, p. 26.

total amount had actually decreased for unknown reasons. The total amount of incorporations in whole of the EU were not checked, and it is therefore possible that the reforms could have created a flow of incorporations from other Member States to the ones included in Hornuf's study. However, Hornuf drew the conclusion that it was clear that the reforms did to some extent stimulate new start-up activities in general.¹⁰⁸

4.3.3 The German legal reform as an example of defensive regulatory competition

As seen above, Germany was the big loser in the early years of regulatory competition, up until 2006. By 2006 the flow of incorporations, from Germany to the UK, per month had more than doubled compared to 2004. But 2006 was also the last great year for the migratory flow of incorporations from Germany to the UK. In 2010 and 2011 the amount of German incorporations was more or less negligible again. This development was showed in a study made by Ringe. In November 2008 Germany reformed its corporate law and introduced a new form of limited liability company that required no minimum capital. It was frequently claimed by writers that the legal reforms in Germany, as well as elsewhere, were a factor that significantly affected the incorporation pattern of the entrepreneurs. For example, Hornuf's earlier mentioned study concludes that the legal reforms seem to have been a prominent factor in the changed incorporation behaviours that his study was showing. Therefore Ringe conducted a study with the aim to establish a correlation between the German reform of 2008 and the decreasing flow of incorporations from Germany to the UK.¹⁰⁹

Ringe's study partly overlapped with the earlier mentioned studies. As one step of his study Ringe therefore compared his results, during the overlapping time, with the results of Becht *et al*. The ratio between the numbers in the two studies was consistent, but Becht *et al* had higher numbers in absolute amounts. As a consequence thereof the reliability increases of both Ringe's study and of the study conducted by Becht *et al*, since the two separate studies came up with very similar results. Both studies used data from the FAME database of the English Companies House. However, the definition of a migrating company does slightly differ between the two studies, which explain why the absolute numbers of incorporations were not identical.¹¹⁰

Ringe came to the result that 48 103 migrations from Germany to UK took place between 2004 and 2011. The peak was, as above mentioned, during 2006 but from that point the incorporation flow was rapidly declining. By 2009, less than 200 German entrepreneurs a

¹⁰⁸ *Ibid*, p. 10 and 26.

¹⁰⁹ Georg-Ringe Wolf: *Corporate Mobility in the European Union – a Flash in the Pan?* in *European Company and Financial Law Review*, Vol. 10, No. 2 (2013), pp. 230-267.

¹¹⁰ *Ibid*.

month chose to incorporate in the UK. At the end of the study that number had decreased even further to about 50 incorporations a month. At the height of the peak 21.46% of all German incorporations were made in the UK and at the end of the study in 2011 only 1.13% of the incorporations were made in the UK. Furthermore, Ringe noticed that by February 2012 about 72 % of the companies involved in his study had been dissolved or were in default, while 18 % still were active, which is a very high failing rate.¹¹¹

Another remarkable discovery was that the Austrian development looks almost identical with Germany, even though Austria never had any law reform¹¹² similar to the German one. So the comparison between the German and Austrian development suggests that the German law reform did not create much of a change at all. This conclusion is further reinforced by the earlier results in Ringe's study which indicate that the changes in Germany started too early, already before the German reform of 2008, and therefore the reform could not have been the decisive factor in the changed incorporation patterns.¹¹³

¹¹¹ *Ibid.*

¹¹² Austria has however reformed their minimum capital requirement twice since Ringe conducted his study. First by lowering the capital requirement from 25 000 Euro to 10 000 Euro, see GesRÄG 2013 (BGBl I 2013/109), and later by increasing it to 35 000 Euro, see §§ 6, 6a österreichisches GmbHG.

¹¹³ Georg-Ringe Wolf: *Corporate Mobility in the European Union – a Flash in the Pan?* in *European Company and Financial Law Review*, Vol. 10, No. 2 (2013), pp. 230-267.

5. Analysis of the regulatory competition in the EU

5.1 Causes behind the rising emigration from 2000 to 2006

As previously seen, the trilogy of *Centros*, *Überseering* and *Inspire Art* initially caused a flood wave of new incorporations in the UK by entrepreneurs from different Member States. Even if the exact numbers are hard to establish, all three of the above mentioned studies, Becht *et al*, Hornuf and Ringe, indicate that the migration is significant in absolute numbers but also in relative to the total amount of incorporations, at least for some of the jurisdictions from which the biggest amount of entrepreneurs migrated.

Becht *et al* concluded that the engine behind the migration were of the low set-up costs. The other factors were not as important since incorporation agencies provided cheap expert help to incorporate in UK. This theory has been acknowledged by other writers in the academic literature. There is consensus among the writers used in this thesis, who expressed an opinion on this matter, that Becht *et al*'s conclusion is correct.

5.2 The turning point in 2006 and subsequent law reforms

As seen in the studies by Hornuf and Ringe, the initial interest for incorporating in UK decreased in several Member States a few years after *Inspire Art*. By 2009 the interest to incorporate in the UK was not very high anymore, at least not among German and Austrian entrepreneurs. The fear of potential loss of political influence in the field of company law created law reforms in several countries, such as Germany, the Netherlands, France and Spain.

Hornuf attributed his results, that the amount of domestic incorporations as well as the total amount of new start-ups increased, to the law reforms that were forced by the pressure on the national legislators created by the regulatory competition. He concludes, in line with the results of Becht *et al*, that the strongest contributing factor to the reversal of the migration development was the decreased minimum required capital. Hornuf is of the opinion that his study does not solely constitute evidence for the theory that regulatory competition promotes entrepreneurial activities, which would promote comparative economic success and hence be a significant advantage for a state, nonetheless is his study according to him an argument pointing in that direction and therefore a strong argument for the success of regulatory competition.¹¹⁴

¹¹⁴ Lars Hornuf: *Regulatory Competition in European Corporate and Capital Market Law*, Antwerp 2012, p. 30-31.

During the initial years after the *Centros* judgement was delivered, the image of foreign incorporation was largely positive in the business community. It was seen as a sign of innovative business organization, as a rational and sound choice. The popularity created an effect of imitation where entrepreneurs followed each other and incorporated in the UK due to social norms and expected lower costs. This positive image changed, at least in Germany, when it started to become apparent that the companies incorporated in the UK by foreign entrepreneurs in much higher frequency used abusive practices and had insolvency problems. This negative view became a more or less a commonly accepted somewhere in the mid-2000s. German legislators also caught up with the abusive practices and extended the German prohibition system for disqualification of directors to also apply to foreign companies in March 2006. About that time the UK extended their disqualification system to also apply for foreign directors. In April 2006 German legislators imposed tougher insolvency obligations for foreign companies. As it became seen as a bad thing to incorporate abroad, and especially in the UK, the amount of foreign incorporations decreased along with the decreasing reputation of the migration.¹¹⁵

Furthermore, many of the migrating entrepreneurs did underestimate the expenses of running their business as a UK limited liability company. By the end of 2000s the image of this type companies was rather negative, at least in Germany.¹¹⁶

5.3 The migration and its bundled quality issues

That the financial factor was the driving factor behind the massive migration in the early years and this was demonstrated by Becht *et al* when they noticed how quite small differences in minimum capital requirements had a large impact on the incorporation rate.¹¹⁷

According to Drury it is in Europe rather the smaller companies and start-ups that tend to migrate since even a relatively small amount of money, such as a few thousand Euro, have a big impact on their business.¹¹⁸

But while the start-ups and small-scale entrepreneurs are behind the big flow of migrating incorporations in the EU, the situation in the US is a bit different. As previously mentioned it is big companies that tend to incorporate in the regulatory winner in the US – Delaware. Delaware's huge success is dependent on that big companies incorporate in Delaware. As

¹¹⁵ Georg-Ringe Wolf: *Corporate Mobility in the European Union – a Flash in the Pan?* in *European Company and Financial Law Review*, Vol. 10, No. 2 (2013), pp. 230-267.

¹¹⁶ *Ibid.*

¹¹⁷ Marco Becht; Collin Mayer and Hannes Wagner: *Where Do Firms Incorporate? Deregulation and the Cost of Entry* in *Journal of Corporate Finance* Vol. 14, No. 3 (2008), pp. 241-256.

¹¹⁸ Robert Drury: *The "Delaware syndrome": European fears and reactions* in *Journal of Business Law*, (2005), pp. 709-744.

Gelter pointed out in his article, not even Delaware has managed to make any substantial change in the incorporation pattern among smaller companies or start-ups. The demands from these latter two categories are so diverse and individual that it would be almost impossible to acquire a quasi-monopoly for one player among dozens of others. Furthermore, it is also likely that there is little interest from the different states in the US to attract such small or new companies since the major incentive for Delaware are the franchise revenues that the big companies bring back to Delaware from their activities throughout the US. Smaller companies do not, generally speaking, tend to have any major franchise incomes and hence they would, in absolute numbers, only generate a very small boost in the tax income for Delaware.

Drury is also of the opinion that with the migrating start-up companies comes not only expanded influence for the winning Member State's corporate legislation, but also certain problems. Since one of the primary reasons behind the migration of these start-ups is to combat trivial problems, such as providing the cost of minimum capital requirements, the side-effect of having the most attractive jurisdiction will be that it attracts unscrupulous operators who aim to cheat the system.¹¹⁹

Hornuf's earlier mentioned study that claims to show some of the benefits brought by the regulatory competition and by the lowered minimum capital requirements that followed as a consequence thereof, is a quantitative study that does not deal with potential quality issues of the companies in question. Hornuf himself points out this weakness and flags for the risk that a lot of the newly created start-ups soon after their launch will go bankrupt. The same weakness is also found in the study conducted by Becht *et al*, who also pointed it out in their study. It is, according to Hornuf, possible that the low minimum capital requirements primarily attract entrepreneurs with little capital, bad qualifications and insufficient experience.¹²⁰

The ignorance of quality issue most certainly undermines Hornuf's conclusion, in regard to the positive effects on entrepreneurship, in this writer's mind. Ringe points out that a vast majority of the German incorporations in UK very soon after their incorporation were dissolved. These were the entrepreneurs that were attracted by the lower minimum capital, but if this conclusion is extended to the entrepreneurs that were attracted all around Europe in Hornuf's study, it means that it is probably not only UK companies owned by German nationals that were dissolved soon after their incorporation, but that the same is likely true for any entrepreneurs, anywhere, that were attracted by lowered minimum capital requirements.

¹¹⁹ *Ibid.*

¹²⁰ Lars Hornuf, *: Regulatory Competition in European Corporate and Capital Market Law*, Antwerp 2012, p. 31.

5.4 Analysis of development

First of all, it is clear that there are different approaches to regulatory competition, and the result of the regulatory competition does not only depend on which model is chosen but also on how the market, which it is implemented on, is modelled and governed. There seems to be more or less consensus in the legal literature that the differences between the regulatory competition in the EU and the US and between their respective markets are too great to really be comparable. Even if some lessons can be learned from the two, the risks, the advantages and the incentives are by far too different to make assumptions in the EU based on the American experience. Maybe the only decently secure conclusion regarding the European regulatory competition that can be drawn by studying and analysing the American experience is that the European regulatory competition will not result in a quasi-monopoly such as Delaware's.

Nonetheless, even if the downside might not be as pitch-black as Cary predicted in his famous article, the European regulatory competition might still pose a risk to negatively impact the European system. According to Barnard and Deakin the main risk for the European market is that the regulatory competition could become a race towards uniformity. A race towards uniformity does not sound as discouraging as a race towards the bottom, but a race towards uniformity is still the exact opposite of the diversity and innovativeness that were supposed to be the benefits that justified regulatory competition in the first place.

However, as have been shown in this thesis, the regulatory competition has not created any massive migrations, except from a few Member States such as Germany, France and the Netherlands, to UK during a limited time in the early years after *Inspire Art*. The European migration, in difference from the American, has been due to the attractiveness of the rules regarding incorporation of new companies rather than the advantages in the company law itself. In Europe there has been no significant migration of already established companies. As Drury stated, it would simply not be cost effective for larger corporation to change their place of incorporation just to win some minor advantages.

Nonetheless, the regulatory competition has caused, directly or indirectly, several Member States to noticeably lower or even abolish their minimum capital requirements. On the other hand, it is important to remember that not all Member States did reform their company law, some Member States, such as Austria, Belgium, Estonia and Lithuania, have not changed their minimum capital requirements without causing any massive migration wave of entrepreneurs and start-ups to other Member States. Furthermore, some Member States, such as Poland and Slovenia, actually increased their minimum capital requirements.¹²¹

¹²¹ www.repository.cam.ac.uk/handle/1810/256566 accessed June 26, 2017.

As several writers have concluded it does seem like the amount of new start-ups have increased, slightly but not insignificantly, within the Member States that changed their regulations to be more attractive. But at the same time, Austria was not affected differently than Germany by the regulatory competition, even though Austria did not adjust its minimum capital requirement when Germany did. This suggests that even if the minimum capital requirement might be important for the attractiveness of a certain jurisdiction it is not a completely decisive factor on the European market. Furthermore, Ringe's results indicate, as stated above, that both the quality and the success rate of the newly attracted incorporations from other Member States to the UK has been lower than usual.

Consequently, a new type of regulatory competition has been created in Europe. Even though there are good possibilities for corporate mobility, only migration in a small scale actually takes place, at least once the first, wild years of experimentation after *Inspire Art* passed. This writer would like to describe the regulatory competition in Europe as a low intensive competition. While there are some movement of incorporations between the Member States driven by, as Ringe assumes, by a few well informed and knowledgeable entrepreneurs, who rather than looking for a cheaper option, look for a more fit company law for their specific purpose, the wide majority of all the entrepreneurs stay in their home jurisdiction.

It is clear that the legal reforms only played a minor part in limiting the movement. It seems it was rather the misjudgement by the entrepreneurs of how high the de facto barriers were in regard to operating in a foreign country, with different legal traditions, accounting standards, language etc., which caused the stop of the widespread migration seen in the early 2000s. Nonetheless, even if the consequences for a Member State that is not reforming its company law seem to be quite small, the regulatory competition has been a contributing factor to several legal reforms throughout the EU. So even if the regulatory competition is low in intensity the pressure created by it caused several Member States to update with their company law, so while pressure might be lower than in the US it is still quite significant. It is clear that the main tendency of the reforms has been to decrease or abolish the minimum capital requirements.

6. Predictions about the future

6.1 A small but steady migration

It is clear from the study conducted by Ringe that the migratory flow of incorporations to the UK has substantially stagnated and is now on a very low level. Most incorporations seem, once again, to be made in the home jurisdiction of the entrepreneur in question. But a certain amount of migratory incorporations still take place, Ringe's explanation for this is that the wild western era of the opportunistic amateurs, that hopes to save a few thousand euros by incorporating abroad, now is over. The wide majority of entrepreneurs simply do not gain enough on incorporating abroad, as the barriers are much higher than the relatively small benefits. Furthermore, the benefits are only initial: spread out over several years the money saved by avoiding a minimum capital is almost negligible. The barriers, on the other hand, such as language, unfamiliarity with the foreign company law and the potential stereotypes such company faces at its home market, are persistent. Consequently, instead of the opportunistic and uninformed amateurs, that were the cause for the early waves of migration, enters the knowledgeable and well-informed entrepreneur who after careful considerations concluded that certain features in the company law in another Member State are advantageous compared to the company law in his home country and therefore decides to migrate. This type of entrepreneurs will, according to Ringe, be the primary source of migration in the years to come.¹²²

However, some of the above mentioned writers, such as Drury, touch upon an idea that there generally is a certain type of entrepreneurs that find the barriers of the corporate mobility as minor impediments and at the same time find the minimum capital requirement of major importance. This type of entrepreneurs can be described as opportunistic and less wealthy and also, at least according to Hornuf, as low quality entrepreneurs. According to this writer, this latter category of entrepreneurs, as well as the well-informed and knowledgeable entrepreneurs as suggested by Ringe, could be the group fuelling the basic level of migration within the EU. This opportunistic-type of entrepreneurs could also very well have been part of the reason for the early rise in migration, due to the earlier unmet need which caused a rush once an opportunity for a more open market emerged and all of these low quality opportunists, that did not have the possibility to avoid minimum capital requirements before, at once used the new possibilities to migrate. This theory is supported by the fact that a wide majority of all the new companies in the UK were dissolved soon after their incorporation.

Neither of above two explanations for the small, but steady, flow of migration can be held as the truth since neither opinion has any empirical data as support, it is just pure speculations

¹²² Georg-Ringe Wolf: *Corporate Mobility in the European Union – a Flash in the Pan?* in *European Company and Financial Law Review*, Vol. 10, No. 2 (2013), pp. 230-267.

from the writers in question. Either of them might be true, it could also be a mixture, where some of the migrating entrepreneurs are the low quality opportunists looking to save a few thousand euros and some are knowledgeable professionals that are very much informed about the different company laws and migrate because of more subtle differences than the minimum capital requirement, or it might be a fourth completely different answer that is the truth. In any case, it seems like some migration still persists, and the flow has been described as steady by both Hornuf and Ringe. There is no reason to doubt their data and there seem to have been no major policy changes, which could disrupt this flow, since the articles in question were published. So unless some unexpected and major reform occurs to change this development, this writer makes the assumption that the low intensive migration will continue to exist for an foreseeable future, but not cause any major pressure on the national legislator in itself as it is simply too small fraction of all the entrepreneurs that emigrate to really make a difference on a level of national policy.

6.2 The abolishment of minimum capital requirement

Hornuf suggests that the trend among the Member States, both of the Real seat doctrine and of the Incorporation doctrine, is that there is a process of minimizing the formalities and requirements. This trend is especially clear for the minimum capital requirements. The minimum capital requirement, according to several of above cited studies, has at least previously been the main factor to decide a jurisdiction's attractiveness for new start-ups. Start-ups have been the main target for the regulatory competition so far in the EU. Hence, it would be a logical assumption that minimum capital requirements eventually will be abolished, or at least minimized, within the EU due to the regulatory competition.

This assumption is tempting but not necessarily true. Some Member States have not adjusted their minimum capital requirements, without it resulting in migration patterns significantly different from those in the Member States that did change, which implies that minimum capital requirement is not that critical of an issue after all. Maybe the big bulk of entrepreneurs are held back from migrating because they regard the barriers as too high and the advantage of a lower minimum capital requirement as too small to motivate a migration. Consequently, the tempting assumption, that minimum capital requirements eventually will be abolished, cannot be confirmed, due to the fact that the market demand does not seem to require an abolishment of the minimum capital requirement.

It is however important to notice that there is a debate in the legal and financial literature whether the minimum capital requirement is needed at all and what benefits or disadvantages it results in. There is no consensus in this debate. The writers that are pro-minimum capital requirement are of the opinion that it sorts out at least some unserious entrepreneurs from the market already before they ever get started. By sorting already in advance of the start-up upcoming failures are prevented and quality companies that

produce good results and technological development are promoted. The writers against minimum capital requirements are on the other hand of the opinion that minimum capital requirement only is a mean for bureaucrats to earn money and that such a barrier can only repress entrepreneurial activities and is thereby negative for the economy.¹²³

Ringe and Drury argue that there seems to be pretty solid evidence that minimum capital is not a very effective instrument to protect creditors. Armour *et al*¹²⁴ are of the opinion that as the minimum capital requirement is a matter only at the formation it is a poor measure for creditor protection. Any potential creditor that will enter into contracts with the newly formed company can calculate the associated risks into the cost of giving the credit in question as the capital of the newly formed company then already is known to the creditor. Armour *et al* therefore takes the opinion that if the minimum capital requirements afford any protection at all it is rather protection for tort victims.

Legislators do share the opinion that minimum capital requirements play a small role as a mean of creditor protection, for example: the Dutch government did abolish its minimum capital requirement in 2012.¹²⁵ The Dutch government motivated their decision to abolish the minimum capital requirement due to the non-existent protection it provided. The Dutch government meant that the minimum capital requirement however gave a feeling of protection that was directly harmful, and furthermore any specific minimum amount was bound to be arbitrarily set out, which could not be accepted.¹²⁶

The Swedish government, in its preparatory note Prop 2009/10:61, did argue that the protection given to the creditors by the minimum capital was weak and the whole purpose could be questioned. However, the Swedish government did not completely abolish its minimum capital requirement but only cut the required amount in half, leaving a minimum requirement of SEK 50.000.¹²⁷ The reason why some of the Swedish minimum capital requirement was left was to assure some minimum level of seriousness and quality of the entrepreneur and company. If a certain amount of money has to be invested into the company, it will sift out at least some of the most unqualified and unserious actors and ensure some kind of minimum quality level, even if it will not afford any noticeable protection to the creditors.¹²⁸

Consequently, it is both possible and likely that the importance of minimum capital requirements will diminish in the future due to changes in national policies, as has already

¹²³ Lars Hornuf: *Regulatory Competition in European Corporate and Capital Market Law*, Antwerp 2012, p. 12.

¹²⁴ John Armour, Holger Fleischer, Vanessa Jane Knapp and Martin Winner: *Brexit and Corporate Citizenship*, European Corporate Governance Institute (ECGI) - Law Working Paper No. 340/2017.

¹²⁵ Staatsblad van het Koninkrijk der Nederlanden, 2012, 301.

¹²⁶ Tweede Kamer, vergaderjaar 2006-2007, 31 058, nr. 3, p. 22-27.

¹²⁷ SFS 2010:89 Lag om ändring i aktiebolagslagen (2005:551).

¹²⁸ Swedish Prop. 2009/10:61.

been seen in several Member States. This development is not driven primarily by the demand created by regulatory competition in strict sense, but rather due to a believed peer-pressure created by the regulatory competition and also by the fact that the efficiency of the protection afforded by minimum capital requirement can be questioned. As has been shown, it is not necessary for a Member State to reform and abolish or cut its minimum capital requirement, but many Member States have chosen to do so anyway since so many other Member States are doing so.

It is also likely that the minimum capital to a certain extent also might be kept by some Member States, as it can fulfil other functions than its traditional role as a means of creditor protection. If it is public policy to aim to keep the most unserious actors away from the market, even if it would be at the expense of a few lost potentially qualitative entrepreneurs, then minimum capital requirement is perceived as an adequate means to achieve this aim.

6.3 A race towards what?

First of all there is the question, is there is a race at all? As Ringe indicated, the migratory flows seem to have decreased to an almost insignificant level. As was discussed in chapter 4.1, the differences between the EU and the US seem to make a race towards the bottom, in the manner as described by Cary regarding Delaware, very unlikely. However, Gelter is still of the opinion that a race towards the bottom cannot be completely ruled out, even if it might look differently than its American counterpart. Nonetheless, the migration is today on a low but steady level, the wide majority of entrepreneurs simply cannot gain enough on incorporating abroad as the barriers are much higher than the relatively small benefits from incorporating abroad. Even though some migrations take place every month the wide impact of regulatory competition, as seen in the early years after *Centros* and *Inspire Art*, is not likely to emerge again.

However, the possibility for the entrepreneurs of the Member States to incorporate abroad might in itself create a pressure on the national legislators to keep up with the development in the other Member States. This pressure could in return result in a race towards uniformity, such as Barnard and Deakin describes as a possibility, see chapter 5.4. But this writer questions if the pressure is high enough to create any actual race, as the migratory flows are so low and Member States that have not adapted to the general trend of substantially decreasing or abolishing the minimum capital requirements seem to have done relatively good anyway.¹²⁹

A further indicator that the regulatory competition de facto does not apply such pressure that certain jurisdictions cannot cope and have to radically change, is that there still are

¹²⁹ See for example the comparison between Germany and Austria made in Ringe's study.

several Real seat jurisdictions in the EU, even though this should be much a less competitive doctrine than the incorporation doctrine.¹³⁰

So while a race does not seem to take place, at least it creates an increased awareness among the national legislators of the external pressure by the Single market, and the possibilities for entrepreneurs to incorporate abroad. This can be seen as a good thing as it pushes the legislators to stay awake, aware and think fresh, which should increase the overall quality of the legislation. Also on an individual level it is an advantage for the entrepreneurs. If an entrepreneur finds a certain jurisdiction more attractive than the barriers surrounding it, he can just incorporate abroad. Both these factors might indeed be the reason behind the slight, but not insignificant, increase in entrepreneurial activities that Hornuf saw in his study. Overall it seems that the regulatory competition in the EU today is of low intensity and will not force any drastic reforms or market changes, even if it is a motivational factor for the national legislators to keep the company laws up to date.

6.4 Brexit

On March 29, 2017 did the British Prime Minister May trigger article 50 TFEU, which stipulates that a Member State may withdrawal from the EU.¹³¹ The framework and agreement for the withdrawal shall be negotiated within two years from the date when article 50 TFEU was triggered. As a consequence, the UK will exit the EU in March 2019 (this withdrawal will hereinafter be referred to as “Brexit”).¹³²

In this chapter 6.4 the term “EU” will have the meaning of the EU without the UK, as it will be onwards from March 29, 2019.

As of Brexit there will be no relations between the EU and the UK, except if there has been any bilateral treaties agreed upon, or through multilateral trade treaties such as WTO, GATT and CETA. If the UK exits the Single market, the freedom of establishment will not apply to UK citizens and companies anymore, since the UK becomes a third party country. A UK company that wants to operate within a Member State must therefore comply with the national rules of the relevant Member State it wishes to operate within, unless there are EU rules that applies to third party countries which, however, is a rare exception. Member States may therefore refuse access to UK companies (while on the other hand the UK will

¹³⁰ Peter Böckli; Paul L. Davies; Ellis Ferran; Guido Ferrarini; José M Garrido Garcia.; Klaus J. Hopt; Adam Opalski; Alain Pietrancosta; Markus Roth; Rolf Skog; Stanislaw Soltysinski; Jaap W. Winter; Martin Winner and Eddy Wymeersch: *The consequences of Brexit for companies and company law*, University of Cambridge Faculty of Law Research Paper No. 22/2017.

¹³¹ www.bbc.com/news/uk-politics-39431428 accessed April 13, 2017.

¹³² Article 50 TFEU

naturally get the right to refuse access to companies from the EU). UK companies may also, when operating within the EU, be treated in a discriminatory way.¹³³

As of the moment when this thesis is written, no final withdrawal agreement has been reached, hence it is not clear upon what terms the withdrawal will be made. But May has announced that the aim for the UK is to not be a part of the Single market after Brexit, but only to keep some elements of free trade.¹³⁴ As a consequence, it is reasonable to assume that the cross border mobility for incorporation of limited liability companies between the UK and the EU will be severely affected. Within the framework of this thesis, this writer will make the assumption that the UK will take the position of a third-party country, outside of the Single market, and that the cross border mobility for companies will be affected in such way that the UK limited liability company cease to be a viable actor in the regulatory competition. This writer makes this assumption because it is the most likely course of actions according to legal writers¹³⁵ and also because if agreements are made to leave the cross border mobility essentially unchanged, no major difference from today's situation is to be expected since nothing changed from the perspective of regulatory competition.

For the scope of this work, two interesting changes might potentially take place as a consequence of Brexit. First, the situation of relative balance and low intensity achieved in the regulatory competition, as earlier described in this chapter 6, might be shaken which will initiate a different direction of development. Since the old winner of the regulatory competition leaves the playing field it might start a new race as the leading position is up for the grab. Secondly, the companies owned by EU citizens that already took advantage of the cross border mobility and incorporated in the UK might be seriously affected by the changed rules.

6.4.1 Effects on companies already incorporated in the UK

Regarding the effects on the UK companies that operate within the EU, it is first of all important to notice the difference between operating through a subsidiary and operating through a branch. A subsidiary is a separate legal entity that is incorporated in the country where the business operations in question take place. On the other hand, a UK company can

¹³³ Peter Böckli; Paul L. Davies; Ellis Ferran; Guido Ferrarini; José M Garrido Garcia.; Klaus J. Hopt; Adam Opalski; Alain Pietrancosta; Markus Roth; Rolf Skog; Stanislaw Soltysinski; Jaap W. Winter; Martin Winner and Eddy Wymeersch: *The consequences of Brexit for companies and company law*, University of Cambridge Faculty of Law Research Paper No. 22/2017.

¹³⁴ www.bbc.com/news/uk-politics-37507129 accessed June 27, 2017.

¹³⁵ Peter Böckli; Paul L. Davies; Ellis Ferran; Guido Ferrarini; José M Garrido Garcia.; Klaus J. Hopt; Adam Opalski; Alain Pietrancosta; Markus Roth; Rolf Skog; Stanislaw Soltysinski; Jaap W. Winter; Martin Winner and Eddy Wymeersch: *The consequences of Brexit for companies and company law*, University of Cambridge Faculty of Law Research Paper No. 22/2017.; Thomale in conflictoflaws.net/2016/regulatory-competition-in-a-post-brexit-eu/; and ¹³⁵ Dirk Jannott; Petra Stoeckle; Peter Hocke: *The good news about Brexit in Business Law Magazine*, No. 3 (2016), pp. 3-5.

also operate through a branch, which is not a separate entity but a part of the UK entity that operates in a foreign country.

A question that arises regarding the already incorporated UK companies is: how many UK companies will actually be affected? As Ringe concluded in his above mentioned study, most of the UK companies started by EU entrepreneurs were liquidated soon after their incorporation in the UK, but even so there must be some companies left. According to Armour *et al*, there are still a notable amount of companies incorporated in the UK by EU entrepreneurs. The total number of entrepreneurs registered in the UK from eight of the Member States was about 103.000 according to Armour *et al*. Based on the average for these eight Member States, Armour *et al* concluded that these numbers imply that there might be as much as 335.000 companies in the UK that actually are controlled by entrepreneurs from other Member States.¹³⁶

However, this writer wants to point out that one of the eight Member States from which the numbers used by Armour *et al* are extracted is Germany, who was responsible for roughly 61.000 of the 103.000 companies. If Germany were excluded from the calculation, the average for the remaining seven Member States would have been just below 7.000, instead of 12.000 as it is with Germany included. As France and the Netherlands, which were the second and third biggest sources, behind Germany, for the migration showed in Becht *et al*'s study also were included in the selected eight, the eight Member States behind the 103.000 companies can hardly be seen as representative for the whole of the EU. Indeed, the number of affected companies should be higher than 103.000, as this number only represents eight of the 27 Member States left in the EU, but this writer sees it as unlikely that as much as 335.000 companies in the UK will be affected, as the method behind that conclusion does not seem to take in account the wide discrepancies between the different Member States regarding the migration of incorporations.

6.4.1.1 Branches

Since the UK companies after Brexit will be considered as third-party country companies, branches of the UK companies in the EU will have to comply with the national rules and regulations surrounding foreign branches in the relevant Member State within which they operate. The access may be restricted by each national state in accordance with public interest, without the interference of EU regulations. However, most Member States have in practice previously not been very harsh with their restrictions towards third-party countries since it is perceived as beneficial for the national economy to have extensive trade relations with not only Member States but also third-party countries. It is therefore not very likely

¹³⁶ John Armour, Holger Fleischer, Vanessa Jane Knapp and Martin Winner: *Brexit and Corporate Citizenship*, European Corporate Governance Institute (ECGI) - Law Working Paper No. 340/2017.

that the UK companies frequently will be denied access to the Single market only on the ground that they are foreign, even if they will face new restrictions.¹³⁷

Even though it is unlikely that the UK companies frequently will have their branches denied access, or even get restricted on the basis of national company law, there can still be new and potentially severe complications for these companies. Such an obstacle could be the legal regimes for formally foreign companies that apply in several Member States which can, among other things, require a special registration. Furthermore, even if the national company laws of the Member States might allow the UK companies to operate within their territories, various other regulations in regard to public interests will apply. As a result could, for example, companies operating in regulated businesses (such as banking) be required to operate through a subsidiary and/or acquire a permit or license to conduct business in their field of activity.¹³⁸

According to Adamski and Rumiński, it is likely that these companies from the UK will have their legal capacity respected, at least in Poland which is a Real seat country, but they might have to incorporate a local subsidiary to be able to continue their business in Poland, and they will have to obtain additional permits and concessions to be able to continue their business once they are no longer protected by the freedom of establishment.¹³⁹

Even more severe problems could arise in Germany and Austria, which also apply the Real seat doctrine. Even if a company is incorporated in accordance with the laws of a third-party country, Germany and Austria will consider the company as a pseudo-foreign company, and therefore apply their company law on the company in question, if the central administration of the company de facto is placed within Germany or Austria respectively. As a result, the owners of a pseudo-foreign company can be held personally liable for the company's actions or debts as the company should have been incorporated where its seat was located but was not, and hence is not recognized as a company. However, in Germany and Austria there is currently a debate about whether the pre-Brexit incorporations in the UK by German and Austrian entrepreneurs shall be treated differently than if they have been incorporated in a non-EU country or in the UK but after the Brexit. The argument behind this position is that it would be unreasonable to be held liable for something you could not predict at the time of incorporation, such as Brexit. It was only because of later changes, which the entrepreneurs in question could not control, that the company stopped complying with the national regime of Germany or Austria. So, if the principles of intertemporal law are applied, the pre-Brexit

¹³⁷ Peter Böckli; Paul L. Davies; Ellis Ferran; Guido Ferrarini; José M Garrido Garcia.; Klaus J. Hopt; Adam Opalski; Alain Pietrancosta; Markus Roth; Rolf Skog; Stanislaw Soltysinski; Jaap W. Winter; Martin Winner and Eddy Wymeersch: *The consequences of Brexit for companies and company law*, University of Cambridge Faculty of Law Research Paper No. 22/2017.

¹³⁸ *Ibid.*

¹³⁹ www.noerr.com/en/newsroom/News/poland-what-does-brexit-mean-for-the-cross-border-mobility-of-british-companies.aspx accessed March 29, 2017.

pseudo-foreign companies should be recognized as companies even if they are pseudo-foreign companies. The same result of recognition is achieved if the German principle of the protection of legitimate expectations would be applied. However, this latter argument has faced hard opposition in the academic debate. A third possibility has been presented in the German debate, that the pre-Brexit pseudo-foreign companies shall be protected to the extent of liabilities from pre-Brexit, while any liabilities post-Brexit will be treated as it regards a pseudo-foreign company and the owners should be personally liable.¹⁴⁰

In Member States that apply the Incorporation doctrine Brexit will not interfere with the legal status of the UK companies, as these are incorporated local companies in accordance with the national laws of the third-party country in question. Nonetheless, Brexit might raise issues for such companies also in Member States applying the Incorporation doctrine, such as in the Netherlands. In the Netherlands, a company is fully recognized as such if it is properly incorporated also in a country outside of the EU, but for non-EU companies there are additional requirements. These additional requirements are in practice so burdensome that a company from a third-party country essentially will have to comply with the Dutch company law. As was seen in *Inspire Art*, these requirements were not acceptable for companies from Member States as it would have been discriminating, but when the UK no longer is a Member State, these Dutch rules will once again apply to companies from the UK.

6.4.1.2 Subsidiaries / Real seat issues

If on the other hand a company operates in the Single market through a subsidiary, with other words through a locally incorporated company, this company has previously been regarded as a protected EU legal person, regardless of where its shareholders or management are established. But when Brexit has taken place, the UK companies, that own the subsidiaries, will instead be considered as coming from an unprotected third party country, which might also affect the status of their subsidiaries in the EU.

In Member States that apply the Real seat doctrine, problems might arise since it is a basic requirement for a company with its seat within a Real seat country to both be registered and have its seat of management within the country. As explained above it is not sure that the UK companies will be recognized as companies, at least not in Germany and Austria, but rather will be deemed as pseudo-foreign companies. As a consequence, the status of the subsidiaries can be questioned as it is in doubt where effective management and ownership is located, which could lead to the refusal from the host Member State to recognize also the subsidiaries of these UK companies. Böckli *et al* consider this scenario as generally unlikely, but still not completely unrealistic. If Brexit would lead to the refusal of recognition of the UK companies' subsidiaries in a Member State, the national laws on unincorporated

¹⁴⁰ John Armour, Holger Fleischer, Vanessa Jane Knapp and Martin Winner: *Brexit and Corporate Citizenship*, European Corporate Governance Institute (ECGI) - Law Working Paper No. 340/2017.

company forms would apply, which in extension would have severe implications for the affected owners as explained above.¹⁴¹

In any event and for both subsidiaries and branches, it is up to the substantive law of every Member State to decide how companies from third-party countries will be treated. Even if there is some academic debate on the subject, it is impossible to conclude with certainty what will happen until either the national legislators or national courts in each and every Member State have clarified the situation. As the situation is unclear and the stakes are high for the owners of the affected companies, this writer draws the conclusion that the prudent owner from the EU of a UK company operating within the Single market, will consider and most likely come to the conclusion that it is smarter and safer to move the business to a company incorporated in a Member State.

6.4.2 Restart of the regulatory competition

From the perspective of this work, the affected border mobility for the already existing foreign incorporated companies in the UK is mostly interesting because it is possible that a whiplash effect can be created, where extensive migration from the UK back to various Member States emerge in the wake of Brexit. As above discussed, the consequences of Brexit risk to be severe both for the affected companies' possibilities to do business within the EU and the owners' liability. It is therefore likely that a substantial amount of the EU entrepreneurs incorporated in the UK will consider incorporating in a Member State instead.

Until the two year period of the UK withdrawal from the EU expires, the UK will remain a Member State just like before and its citizen can rely on the freedoms of the Single market. Since the entrepreneurs that now incorporated their companies in the UK might want to continuously have access to the Single market and all its benefits many of the entrepreneurs will use this two year period to establish a company within a Member State. This could create a sudden rush of incorporations to one or a few winner-jurisdictions.¹⁴²

Thomale¹⁴³ is of the opinion that it is possible that this whiplash effect will occur. Since neither the cross-border merger directive¹⁴⁴ nor any ECJ judgements, such as *Cartesio*, will

¹⁴¹ Peter Böckli; Paul L. Davies; Ellis Ferran; Guido Ferrarini; José M Garrido Garcia.; Klaus J. Hopt; Adam Opalski; Alain Pietrancosta; Markus Roth; Rolf Skog; Stanislaw Soltysinski; Jaap W. Winter; Martin Winner and Eddy Wymeersch: *The consequences of Brexit for companies and company law*, University of Cambridge Faculty of Law Research Paper No. 22/2017.

¹⁴² Peter Böckli; Paul L. Davies; Ellis Ferran; Guido Ferrarini; José M Garrido Garcia.; Klaus J. Hopt; Adam Opalski; Alain Pietrancosta; Markus Roth; Rolf Skog; Stanislaw Soltysinski; Jaap W. Winter; Martin Winner and Eddy Wymeersch: *The consequences of Brexit for companies and company law*, University of Cambridge Faculty of Law Research Paper No. 22/2017..

¹⁴³ Chris Thomale in <http://conflictoflaws.net/2016/regulatory-competition-in-a-post-brexit-eu/>, accessed April 4, 2017.

¹⁴⁴ Directive 2005/56/EC on cross-border mergers of limited liability companies.

apply once Brexit is of effect, the UK incorporated companies that want to migrate to a Member State must acquire the consent of the UK. Because the entrepreneurs, naturally, do not want to be left to the mercy of the national policies in the UK, they will migrate already before Brexit. The relevant question, according to Thomale, is where they will migrate. Some top alternative for a migrating UK company are the Irish LTD, the Dutch B.V. and the German GmbH. Brexit could therefore be a revival of the more intense regulatory competition, seen in the early years after *Centros* and *Inspire Art*. This further raises the question who will be the winner of the race this time and whether the race will be to the top, in form of legal reforms, or towards the bottom through deregulation.¹⁴⁵

As discussed above, the German courts may start to require that a UK incorporated company shall have its seat in the UK to be recognized as a UK company in Germany. Therefore, Jannot *et al* believe, just like Thomale, that at least the German entrepreneurs incorporated in the UK will transform cross-border to avoid personal and unlimited liability. But Jannot *et al* seem to take the view that most German entrepreneurs will incorporate home in Germany and that the situation is be reversed compared to how it was during the start of the regulatory competition. The revival of the early days' regulatory competition is not discussed in their article.¹⁴⁶

The legal writers are not yet certain about the consequences of Brexit for companies incorporated in the UK but operating within Real seat Member States and with their management somewhere else than in the UK. There is some kind of risk picture, but there is not much available legal literature, and the literature that exists is, as illustrated by above mentioned articles, not very precise or detailed. Nonetheless, the uncertainty in itself is a strong message to the affected entrepreneurs. The market does not like uncertainties and it seems to this writer, as expressed above, likely that the relevant entrepreneurs will rather than passively wait for Brexit to take place and see what happens. It is better to take action and protect themselves against potential problems. It is even possible that the uncertainty affects more than if the consequences were clear but negative. If you as an entrepreneur do not know what will happen you cannot possibly take countermeasures, therefore it would be wiser to take advantage of the time frame, until the effectiveness of Brexit, and reincorporate, at least if your company operates within a Real seat jurisdiction. With the rationale that most entrepreneurs will be logical and do what is perceived as best for them and that these entrepreneurs are not afraid of emigration, after all these are the same entrepreneurs that went through the troubles of emigrating in order to avoid a relatively small regulatory requirement in the first place, this writer draws the conclusion that a new wave of migration of incorporations soon will take place. But this time instead of migration to the UK, it will be a migration from the UK to the Member States.

¹⁴⁵ <http://conflictoflaws.net/2016/regulatory-competition-in-a-post-brex-it-eu/> accessed April 4, 2017.

¹⁴⁶ Dirk Jannot; Petra Stoeckle; Peter Hocke: *The good news about Brexit* in *Business Law Magazine*, No. 3 (2016), pp. 3-5.

The homecoming effect described by Jannot *et al* , where the entrepreneurs that incorporated in the UK due to regulatory benefits now have lost these benefits and therefore will incorporate home in Germany again, is not unlikely per se, but this author is of the opinion that the scenario described by Thomale is more likely. The entrepreneurs that migrated to the UK did so because they were prone to chase small regulatory benefits. If these entrepreneurs find another jurisdiction more beneficial than Germany, this writer can imagine that these entrepreneurs would be prone to rather choose this more beneficial jurisdiction instead of going home and comply with the company law they sought to avoid in the first place. It is, in this writer's mind, therefore likely that quite a big share of the migration from the UK will be to the jurisdiction perceived as most beneficial, as Thomale predicted. However, this writer is of the opinion that this homecoming or whiplash effect strictly speaking is not regulatory competition as the incitement that causes the migration is to stay within the Single market rather than to only choose a more advantageous company law. It is not due to the lacking qualities of the British company law, but only because the entrepreneurs wish to operate on a market which the UK will not be a part of post-Brexit.

This writer takes a sceptic stand towards conclusions of a revival of the regulatory competition, as predicted in the literature. With the exception of the migration of the directly affected UK companies there is no reason why any eruption in the migration should suddenly take place. The migration within the EU is relatively steady and not that big anymore as it was in the early years after *Inspire Art*, as shown above. Today there are also already several new cheap alternatives to the UK. Even if the English language is an advantage it is likely that cheap and effective incorporation agencies would emerge in other markets with beneficial company laws as well, in case there is a big enough market demand. Furthermore, many law firms already provide options to buy already incorporated companies, so called shelf companies. While the price is higher than incorporating yourself, you can still use the advantages of the regulations from the Member State of incorporation if that is what is sought. If it rather is a solution that is as cheap as possible that is sought, then there are plenty of alternatives to do it yourself, for example in Ireland where English also is the official language, or even at home depending in which jurisdiction the entrepreneur in question resides in, since many company laws changed due to the regulatory competition. There might be slightly higher language barriers for the other contenders of the most attractive company law, but the UK company law is not that unique or cheap compared to other alternatives anymore.

Even if there is a homecoming effect or a whiplash effect, it will not nullify the conclusion of Ringe that the wild western era is over now as it is generally known that it is, due to various reasons, not as beneficial or cheap to incorporate abroad as it initially was thought. The entrepreneurs that choose to incorporate in another Member State than their own might also do so due mainly due to other reasons and to achieve other benefits than to save a few

thousand euros on minimum capital, or they incorporate abroad only to soon after dissolve the company. So while a temporary homecoming or whiplash migratory peak is expected, it will not be equivalent to the migratory wave in the early years after *Centros* and *Inspire Art*, as most of these companies has been liquidated now. Moreover, this homecoming or whiplash will rather be a temporary effect and not a fundamental market change that revives the regulatory competition as it was seen in its early days.

If anything, the Brexit will rather reinforce the negative image of incorporating abroad. Even if Brexit is the first time a Member State exits the EU, it can serve as a warning example for the risks and potential problems that can arise if you as an entrepreneur choose to incorporate abroad if this other Member State leaves the EU.

7. Conclusions

This thesis has explained that regulatory competition is a competitive process through which the jurisdiction within a certain decentralized area develops and adapts to the market demands. The framework, set up by the EU legislation and case-law, within which the European regulatory competition takes place on the Single market has been described and the character of the regulatory competition in the EU has been assessed and compared with its American counterpart. It is clear that the American regulatory competition developed as it did due to unique historical circumstances and because the American market itself is very different from the European market. Therefore, the European and the American regulatory competition are not compatible enough to really be comparable on a detailed level.

The main benefits of regulatory competition have been identified as the increase in entrepreneurship it brings and as the pressure that comes with the competition, which forces the national legislators to stay up to date and keep the national company legislations efficient and attractive. On the down-side, the regulatory competition risks to force a negative development, where various interests have to step aside to the benefits of the companies. A Delaware-style race to the bottom is unlikely to happen in the EU. What more likely risks to happen is that the diversity gets lost as a Member States' company legislations move towards convergence because of the perceived pressure from regulatory competition, which is bad as it can result in sub-optimal development.

The impact of regulatory competition in the EU has so far been relatively big. It has been a contributing factor behind several national legal reforms and has been the subject of extensive academic debate. The actual migration of entrepreneurs was initially quite high in both absolute and relative amounts. However, the migratory flow soon declined, as it became obvious that the costs and difficulties of incorporating abroad, in a country using a foreign language and with a different legal tradition and accounting standard etc., were heavily underestimated. The concept of migrating also went through a reputational crisis where the public view shifted from a positive to negative. As a consequence, the migratory flows quickly declined in the second half of the 2000s, to become almost negligible in the 2010s.

Even if the level of migration now is low and it is obvious that the barriers to migrate are high, and therefore the pressure of regulatory competition is low, the regulatory competition still caused several legislation reforms even after all of these factors became apparent. But since the Member States that did not reform their legislations do not seem to have done especially much worse than the Member States that actually did reform, the pressure is maybe not objectively high. However, the perceived pressure by regulatory competition has made the national legislators more aware and willingly to reform anyway.

This development can be seen as a good thing. Nobody really loses, as the Member States that do not reform will not have a negative development and the Member States that do reform gain some new incorporations, in what is assumed to be an increase of entrepreneurial activities, as the reforms seem to have brought some positive development in that regard. For the entrepreneurs it is positive that the minimum capital requirements got lowered due to the regulatory competition, as the average European entrepreneur now has to lock less capital into his company, and the creditors and other actors do not really lose any protection from the decreased minimum capital requirements as the minimum capital requirement affords only a weak protection as best.

At this point, some type of balance in the regulatory competition has been achieved. Only a few entrepreneurs choose to incorporate abroad, on a national level it is, relatively, almost negligible amounts. However, the amount of migrations are decently steady, which indicates that the regulatory competition does fulfil some type of function as the freedom to choose, provided by the regulatory competition, is steadily attractive to certain fraction of all the entrepreneurs. It also hinders any national legislation from becoming too obsolete, unattractive and inefficient, as that would result in a mass-migration of companies once a national legislation has become so obsolete that the negative effects of it are higher than the barriers to incorporate abroad. The regulatory competition in the EU therefore is a guarantee of some type of common minimum standard of efficiency and attractiveness of the company law for the customers of that regulatory product, the companies.

Some writers are afraid that this balance will be disrupted by Brexit. As Brexit most likely will cause a flood wave of emigrations from the UK to other Member States, which could trigger regulatory competition to once again become a phenomenon of high importance. This writer came to the conclusion that even though Brexit likely will trigger some kind of homecoming or whiplash effect, as maybe one or two hundred thousand entrepreneurs previously incorporated in the UK now suddenly wish to incorporate in a Member State, it is only a temporary effect. Hence, there are no reasons why this would trigger the regulatory competition to bloom up again. There are already several other attractive choices than the UK, so that one out of several attractive jurisdictions exit the competition will not radically change the dynamic in the regulatory market.

Bibliography

Legislation:

Directive 2008/7/EC concerning indirect taxes on the raising of capital
Directive 2005/56/EC on cross-border mergers of limited liability companies
Regulation (EC) No 2157/2001 on the Statute for a European company (SE)
Treaty on the Functioning of the European Union
Treaty on the European Union
Österreichisches GmbHG (Austria)
SFS 2010:89 Lag om ändring i aktiebolagslagen (2005:551) (Sweden)
Staatsblad van het Koninkrijk der Nederlanden, 2012, 301 (the Netherlands)

Preparatory materials:

Tweede Kamer, vergaderjaar 2006-2007, 31 058, nr. 3 (the Netherlands)
Prop 2009/10:61 (Sweden)
GesRÄG 2013 (BGBl I 2013/109) (Austria)

Cases:

Case 152/73 Sotigiu
Case 120/78 Cassis de Dijon
Case 270/83 Commission v. France (Tax Credits)
C-79/85 Segers
C-81/87 Daily Mail and General Trust
C-76/90 Säger
C-71/91 Poente Carni and C-178/91 Cispadana Construzioni
C-330/91 Commerzbank
C-19/92 Kraus v. Land Baden-Württemberg
C-398/92 Mund&Fester v. Hatrex
C-279/93 Schumacker
C-101/94 Commission v. Italy (Security)
C-43/95 Data Delecta
C-250/95 Futura Participations
C-212/97 Centros
C-311/97 Royal Bank of Scotland
C-208/00 Überseering
C-167/01 Inspire Art
C-446/03 Marks & Spencer
C-210/06 Cartesio
C-378/10 Vale

Books:

Easterbrook, Frank and Fischel, Daniel : *Economic Structure and the corporate law*, London 1996.

Cheffins, Brian R.: *Company law theory, structure and operation*, Oxford 1997.

Barnard, Catherine and Deakin, Simon: *Market Access and Regulatory Competition in The Law of the Single European Market*, Oxford 2002.

Barnard, Catherine: *The Substantive Law of the EU - The Four Freedoms*, New York 2010.

Hornuf, Lars: *Regulatory Competition in European Corporate and Capital Market Law*, Antwerp 2012.

Barnard, Catherine: *The Substantive Law of the EU - The Four Freedoms*, Oxford 2013.

Saydé, Alexandre: *Abuse of EU Law and Regulation of the Internal Market*, Oxford 2014.

Sandgren, Claes: *Rättsvetenskap för uppsatsförfattare*, Stockholm 2015.

Articles:

Cary, William L.: Federalism and Corporate Law: Reflections upon Delaware in *The Yale Law Journal*, Vol. 83, No. 4 (1974), pp. 663-705.

Winter, Ralph Jr.: State Law, Shareholder Protection, and the Theory of the Corporation in *Journal of Legal Studies* Vol. 6, No. 2 (1977), pp. 251-292.

Winter, Ralph Jr: The "Race for the Top" Revisited: A Comment on Eisenberg in *Columbia Law Review* Vol. 89 (1989), pp. 1526-1529.

Deakin, Simon: *Two Types of Regulatory Competition: Competitive Federalism versus Reflexive Harmonisation A Law and Economic Perspective on Centros* in *Cambridge Yearbook of European Legal Studies* Vol. 2, No. 1 (2000), pp. 231-260.

Bebchuk, Lucian; Cohen, Alma and Ferrell, Allen: Does the Evidence Favor State Competition in Corporate Law? in *California Law Review* Vol. 90, No 6 (2002), pp. 1775-1822.

Enriques, Luca: EC Company Law and the fears of a European Delaware in *European Business Law Review*, Vol. 15, No. 6 (2004), pp. 1259-1274.

Drury, Robert: *The "Delaware syndrome": European fears and reactions* in *Journal of Business Law*, (2005), pp. 709-744.

Gelter, Martin: *The structure of regulatory competition in European corporate law* in *Journal of Corporate Law Studies*, Vol. 5, No. 2 (2005), pp. 247-284.

Deakin, Simon: Legal diversity and regulatory competition: Which model for Europe? in *European Law Journal*, Vol. 12, No. 4 (2006), pp. 440-454.

Becht, Marco; Mayer, Collin and Wagner, Hannes: Where Do Firms Incorporate? Deregulation and the Cost of Entry in *Journal of Corporate Finance* Vol. 14, No. 3 (2008), pp. 241-256.

Wolf, Georg-Ringe: *Corporate Mobility in the European Union – a Flash in the Pan?* in *European Company and Financial Law Review*, Vol. 10, No. 2 (2013), pp. 230-267.

Smits, Jan M.: *What is legal doctrine? On the aims and methods of legal-dogmatic research*, Maastricht European Private Law Institute Working Paper No. 2015/06.

Jannott, Dirk; Stoeckle, Petra; Hocke, Peter: The good news about Brexit in *Business Law Magazine*, No. 3 (2016), pp. 3-5.

Armour, John and Fleischer, Holger and Knapp, Vanessa Jane and Winner, Martin: Brexit and Corporate Citizenship, European Corporate Governance Institute (ECGI) - Law Working Paper No. 340/2017.

Böckli, Peter; Davies, Paul L.; Ferran, Eilis; Ferrarini, Guido; Garrido Garcia, José M.; Hopt, Klaus J.; Opalski, Adam; Pietrancosta, Alain; Roth, Markus; Skog, Rolf; Soltysinski, Stanislaw; Winter, Jaap W.; Winner, Martin and Wymeersch, Eddy: The consequences of Brexit for companies and company law, University of Cambridge Faculty of Law Research Paper No. 22/2017.

Electronic sources:

[Dedo.delaware.gov/industries/corporate-headquarters](http://dedo.delaware.gov/industries/corporate-headquarters), accessed January 14, 2017.

www.noerr.com/en/newsroom/News/poland-what-does-brex-it-mean-for-the-cross-border-mobility-of-british-companies.aspx, accessed March 29, 2017.

conflictoflaws.net/2016/regulatory-competition-in-a-post-brex-it-eu/, by Thomale, Chris as accessed April 4, 2017.

www.bbc.com/news/uk-politics-39431428, accessed April 13, 2017.

www.worker-participation.eu/European-Company-SE/Facts-Figures/Archive-of-SE-facts-figures2, accessed June 14, 2017.

www.repository.cam.ac.uk/handle/1810/256566, accessed June 26, 2017.

www.bbc.com/news/uk-politics-37507129, accessed June 27, 2017.