Beyond Competition for Incorporations

Ehud Kamar[*]

January 2005

This article documents and analyzes a powerful form of regulatory competition — competition for investments — that has been transforming national corporate laws in the European Union in recent years. Unlike the competition for incorporations that shapes Delaware corporate law, and by some accounts the corporate laws of other American states as well, competition for investments stems from firms' inability to incorporate outside the jurisdiction in which they operate, and is designed to attract capital and direct investments in local businesses, rather than incorporations by foreign businesses. The high political payoffs that await successful participants in the competition for investments enable them to overcome opposition that could stop them if they competed for incorporations. And, together with the fact that no single jurisdiction can dominate the market for investments, these payoffs drive multiple jurisdictions, including large ones, to compete. Allowing firms to incorporate outside the jurisdiction in which they operate, as a recent series of European Court of Justice rulings requires, may or may not breed competition for incorporations. Either way, however, as long as the competition for investments does not lose its steam, the effect on firms will be quite the same. Judging from the reforms that the competition for investments has fueled so far, it will be positive.

---

[*] Visiting Professor, New York University School of Law; Associate Professor, University of Southern California Law School. I would like to thank Scott Altman, Jennifer Arlen, Oren Bar-Gill, Stephen Choi, Michael Dorff, Luca Enriques, Ronald Garet, Elizabeth Garrett, Jeffrey Gordon, Gillian Hadfield, Howell Jackson, Marcel Kahan, Gregory Keating, Daniel Klerman, Edward McCaffery, Brian Raphael, Pierre Salmon, Nicolai Schwarz-Gondek, Eric Talley, Mark Weinstein, and workshop participants at the Harvard Law School and Swiss Institute of Technology Conference on Corporate Lawmaking in the European Union held on October 29-30, 2004, Southwestern University Law School, and University of Southern California Law School for helpful comments.

Introduction

The notion that states may compete for incorporations by tailoring their corporate laws to the preferences of corporate decisionmakers has long fascinated legal commentators. It is easy to see why. The competition paradigm provides a powerful analytical tool for evaluating the entire body of corporate law without having to ponder the merits of every detail individually. All that is needed is to examine the preferences of those who make incorporation decisions. As long as they prefer laws that maximize the value of the firm — and only then — these will be the laws that states will produce.

Almost half a century of legal scholarship produced scores of articles explaining state corporate laws in the United States as a product of just such competition.[1] The basic facts are undisputed. Firms in the United States are free to incorporate in any one of fifty states and the District of Columbia regardless of where they conduct their business; states introduce legal innovations and copy from each other; Delaware, the state that innovates and copies more than the rest, prospers by attracting the most incorporations; and everybody claims to offer a competitive corporate law. Putting the pieces together led commentators to agree that at least Delaware competed for incorporations. Their only disagreement was on whether other states compete as well,[2] and whether corporate decisionmakers pull the competition in a desirable direction.[3]

From here it was only a small step to apply the same analysis to other parts of the world. The European Union was a natural place to start.[4] Only it did not meet a necessary condition for an incorporations market to evolve. Unlike states in the United

1 [Cite]

2 [Cite]

3 [Cite]

4 For a separate inquiry focused on Canada and its ten provinces, see Jeffrey G. MacIntosh & Douglas Cumming, The Role of Interjurisdictional Competition in Shaping Canadian Corporate Law, 20 Int'l Rev. L. & Econ. 141 (2000); Ronald J. Daniels, Should Provinces Compete? The Case for a Competitive Corporate Law Market, 36 McGill L.J. 130 (1990).

States, most member states in the European Union follow the so-called real-seat rule, which prevents companies operating in them from incorporating abroad.[5] If only that had changed, commentators argued, intense competition for incorporations would immediately follow and lead member states to ensure their laws satisfy corporate decisionmakers.[6]

This moment of truth has arrived. In fact, it arrived several years ago, when the first in a series of decisions by the European Court of Justice came down requiring member states to recognize companies incorporated in other member states and refrain from imposing the local corporate law on them.[7] Will the new freedom to choose where

---

5 See Eddy Wymeersch, The Transfer of the Company's Seat in European Company Law, 40 Common Mkt. L. Rev. 661, 666-73 (2003) (reviewing legal barriers to incorporation abroad).

6 See Brian Cheffins, Company Law: Theory, Structure and Operation 443 (1997) (arguing that legal professionals may drive the United Kingdom to compete for incorporations); Simon Deakin, Regulatory Competition versus Harmonization in European Company Law, *in* Regulatory Competition in European Company Law: Comparative Perspectives 190, 204-05 (Daniel C. Esty & Damien Geradin eds., 2001) (arguing that lawyers and accountants may drive member states to compete for incorporations); Gerard Hertig & Joseph A. McCahery, Corporate and Takeover Law Reforms in Europe: Misguided Harmonization or Regulatory Competition?, 4 Eur. Bus. Org. L. Rev. 179, 187 (2003) (arguing that small member states may compete for incorporations to obtain chartering revenue); Luca Enriques, EC Company Law and the Fears of a European Delaware, 15 Eur. Bus. L. Rev. 1259, 1273 (2004) (arguing that a freedom to choose where to incorporate may pressure national legislators in European Union to emulate other jurisdictions' rules to avoid losing companies already incorporated in them to other member states); Eddy Wymeersch, Company Law in the Twenty-First Century, 1 Int'l & Comp. Corp. L.J. 331, 339 (1999) (arguing that a freedom to choose where to incorporate is certain to stimulate competition between member states); but see Matthias Baudisch, From Status to Contract? An American Perspective on Recent Developments in European Corporate Law, *in* The European Union and Governance 23, 54 (Francis Snyder ed., 2003) (arguing that sufficient incentives to compete for incorporations exist in the United States but not in the European Union).

7 See Case 212/97, Centros Ltd v. Erhvervs-og Selskabsstyrelsen, [1999] E.C.R. I-1459 (requiring the Danish authorities to recognize a British company operating in Denmark); Case 208/00, Überseering BV v. Nordic Construction Company Baumanagement GmbH (NCC), [2002] E.C.R. I-9919 (requiring the German authorities to recognize a Dutch company operating in Germany); Case 167/01,

to incorporate unleash a wild race among member states to win incorporations just as it allegedly has in the Unite States?

Maybe, though not very likely. Even in the United States only Delaware is indisputably competing for incorporations. The extent to which other states compete is far from certain.[8] There is no reason to believe that member states of the European Union will be any more interested in incorporations. Indeed, the European Union may remain without a single member state engaged in this pursuit because the member state that corporate decisionmakers consider the most viable destination for incorporation is the United Kingdom, which — unlike Delaware — does not compete for incorporations today and is unlikely to begin doing so in the future.

This does not mean that corporate law in the European Union will stand still. It certainly has not done so in the last fifteen years. These years saw a surge in corporate governance legislation sweeping the largest and most industrialized member states. Only it was not competition for incorporations. The reforms took place without any member state relaxing the restrictions on incorporating abroad, and apply only to companies headquartered locally. They were prompted by mounting pressure on member state governments to inspire trust in their securities markets, which were becoming important but vulnerable drivers of economic growth at a time of mass privatizations, international

---

Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd, [2003] E.C.R. I-(30.9.2003) (requiring the Dutch authorities to recognize a British company operating in the Netherlands). While these three decisions are most commonly cited in describing the trend, earlier decisions making similar holdings exist. See, e.g., Case 79/85, D.H.M. Segers v. Bestuur van de Bedrijfsvereniging voor Bank- en Verzekeringswezen, Groothandel en Vrije Beroepen, [1986] E.C.R. 2375 (requiring the Dutch authorities to recognize a British company operating in the Netherlands).

8 See Marcel Kahan & Ehud Kamar, The Myth of State Competition in Corporate Law, 55 Stan. L. Rev. 679 (2002) (presenting evidence that no American state but Delaware is actively pursuing incorporations and explaining states' lethargy by a combination of economic and political disincentives to compete); see also Lucian Bebchuk & Assaf Hamdani, Vigorous Race or Leisurely Walk: Reconsidering the Debate on State Competition over Corporate Charter, 112 Yale L.J. 553 (2002) (arguing that Delaware's competitive advantages deter other states from competing).

capital and mobility, and corporate scandals. In other words, it was competition for capital and direct investments.

The renaissance of corporate legislation in the European Union is not just unrelated to any market for incorporations. It *draws* on the fact that no such market exists. Companies headquartered in member states with inferior corporate laws would be less disadvantaged in the quest for capital, and their home member states would see less urgency in reforming their corporate laws, if companies could easily incorporate abroad. But they cannot. They are hamstrung by the corporate laws of their home member states. Ironically, ensuring that local corporate law meets the expectations of the international investor community is a pressing need for member state legislatures precisely because firms *cannot* incorporate elsewhere. This is certainly competition, and very intense one at that, but it owes its very existence to the fact that a market for incorporations does not exist.

Competition for investments is different from competition for incorporations not only in its origin but also in its strength. The incentives for lawmakers to pass laws that would stimulate economic growth and address public concerns about corporate mismanagement are much stronger than their incentives to pass laws that would attract incorporations by foreign firms. Competition for investments can therefore overcome political and economic obstacles that competition for incorporation cannot.

The policy implications of this analysis depart significantly from the received wisdom about the likely outcome of allowing European companies to incorporate in other member states. Granting firms the ability to incorporate abroad may not only fail to foster regulatory competition in corporate law, but indeed may *weaken* the regulatory competition that already exists. To be sure, the outcome will be different if enough local companies remain incorporated in their home member states. The lack of regulatory interest in companies that incorporate abroad would then be offset by the drive to continue to develop the law for the benefit of local companies. This drive may persist especially if the reforms of the last decade have sufficiently transformed national economies and politics to create a momentum that can perpetuate itself. But this outcome is not guaranteed. If too many companies incorporate abroad, or if the momentum created by previous reforms is not stable, corporate laws in member states whose firms exit in droves will atrophy. The result may well be a correlation between the retention of local incorporations on the one hand, and the quality of corporate law on the other hand. But it will reflect a softening of the competition for investments, rather than the emergence of competition for incorporations.

This analysis contributes to a growing literature on convergence of corporate governance and path dependence. One strand in the literature identifies the limits to the power of globalization to pull corporate laws around the world towards greater efficiency.[9] The other strand holds that these limits, while real, will over time yield to the forces pushing for change.[10] This article complements the debate by documenting the forces of convergence at play and relating them to the regulatory competition debate.[11] In particular, it recasts legal convergence as a form of regulatory competition that is not only more powerful than competition for incorporations but indeed dependent on the very

---

[9] See Lucian Bebchuk & Mark Roe, A Theory of Path Dependence in Corporate Ownership and Governance, 52 Stan. L. Rev. 127 (1999); see also William W. Bratton & Joseph A. McCahery, Comparative Corporate Governance and the Theory of the Firm, 38 Colum. J. Transnat'l L. 213 (1999).

[10] See Henry Hansmann & Reinier Kraakman, The End of History for Corporate Law, 89 Geo. L.J. 439 (2001); see also Ronald J. Gilson, Globalizing Corporate Governance: Convergence of Form or Function, 49 Am. J. Comp. L. 329 (2001).

[11] Previous commentators have anecdotally mentioned changes in corporate laws in the European Union driven by competition for investments as part of their analysis of competition for incorporations. See Joseph A. McCahery & Erik P.M. Vermuelen, Limited Partnership Reform in the United Kingdom: A Competitive, Venture Capital Oriented Business Form, 5 Eur. Bus. Org. L. Rev. 61, 75 (2004); William W. Bratton & Joseph A. McCahery, The New Economics of Jurisdictional Competition: Devolutionary Federalism in a Second-Best World, 86 Geo. L.J. 256, 256-59 (1997) (yardstick competition). This article reverses the focus. It argues that competition for investments far exceeds in importance the competition for incorporations as an explanation of corporate lawmaking in the European Union, and analyzes the fundamental differences between the two types of competition.

absence of a necessary for competition for incorporations to exist.[12] Moreover, it argues that, in a departure from the predictions of the convergence literature, recent history shows that competition for investments may push lawmakers to lead the way to convergence more rapidly than firms. The reason for this is threefold. First, lawmakers can transform the legal system as a whole and thus overcome complementarities that have developed between its parts. Second, lawmakers can solve firms' collective action problem. Third, in a twist of logic, lawmakers can create value by ignoring the transition costs that reform imposes on existing firms and focus instead on their own political capital, which is tied to the success of new firms that result from privatizations.

[Provide a roadmap to the article]

I. Competition for Investments

Until recently, firms in most member states of the European Union were unable to incorporate abroad. Competition for incorporations was thus impossible. But this lack of legal domicile mobility did not prevent the emergence of another type of regulatory competition. This competition is hardly hidden. It is very visibly and seems to motivate member states to do everything they would do if they competed for incorporations. They

---

[12] My analysis contributes to the economic theory of yardstick competition, or benchmark competition. The concept of yardstick competition — the comparison of the performance of monopolistic suppliers that provide similar products to different markets — was originally developed as a mechanism for ensuring that regulated monopolies do not overcharge customers. See Andrei Shleifer, A Theory of Yardstick Competition, 16 Rand J. Econ. 319 (1985). Subsequently, yardstick competition was suggested as a method voters use to evaluate local lawmakers. See Pierre Salmon, Decentralisation as an Incentive Scheme, 3 Oxford Rev. Econ. Pol. 24 (1987). A contemporaneous work applies the concept of yardstick to offer a stylized analysis of corporate lawmaking in the European Union. See Pierre Salmon, Interjurisdictional Yardstick Competition, Corporate Governance, and European Integration (unpublished manuscript, Oct. 2004). This article is different in that it provides a detailed account of specific legal reforms and relates competition for investments to competition for incorporations.

reform their laws. They imitate each other. They protect shareholders. Only they are not competing for incorporations. They are competing for capital and direct investments.[13]

The pursuit of investments involves the creation of a hospitable business environment. In part, this means the granting of financial incentives in the form of tax breaks, subsidies, loans, monopoly rights, and other direct transfers. In another part, it means offering the necessary physical and legal infrastructure on which businesses rely for their development. For many years, corporate taxation was the main dimension on which states competed for investments. But globalization of capital, product, and labor markets, together with economic integration of the European Union, rendered tax competition insufficient. The need to shore up national financial deficits pushed some member states to mass privatization, which in turn increased the extent of public stock ownership and the dependence on equity markets. [Continue]

---

[13] While commentators disagree on the extent to which the pursuit of incorporations motivates most American states, they agree that it explains the speed with which Delaware innovates and copies innovations from other states. Compare Kahan & Kamar, supra note 8 (arguing that only Delaware adopts legal innovations to attract incorporations) and Bebchuk & Hamdani, supra note 8 (same) with Roberta Romano, The Advantage of Competitive Federalism for Securities Regulation 75-83 (2002) (arguing that states other than Delaware also adopt legal innovations to attract incorporations). For the original thesis that competition for incorporations inspires innovation and diffusion in corporate law, see Roberta Romano, Law as a Product: Some Pieces of the Incorporation Puzzle, 1 J.L. Econ. & Org. 225, 233-42 (1985).

A. The Old Way: Tax Incentives

A time-honored method of stimulating the economy is offering tax incentives.[14] In the European Union, the member states most often mentioned in this regard are Ireland and the Netherlands.[15] Ireland is known for charging low taxes on business conducted within its borders.[16] It aggressively pursues foreign businesses by claiming to have "one of the most beneficial corporate tax environments in the world," and the lowest corporate tax rate in the European Union.[17] The motivation behind this taxation system is no secret. As recently explained by Ireland's finance minister in rejecting a call from France and Germany to establish a minimum corporate tax rate:

---

14 Tax incentives designed to stimulate economic activity, which are considered a legitimate form of competition, are distinguishable from tax incentives designed to cash in on economic activity conducted in another country in return for sheltering this activity from being taxed at a higher rate by that other country. According to corporate practitioners, the latter type of tax incentives "may look attractive, but if the real management is to remain in another place, that territory is likely to assert taxing jurisdiction." See Public Takeovers in Europe, Freshfields Bruckhaus Deringer Memorandum to Clients, at 32 (Summer 2004), http://www.freshfields.com/practice/corporate/publications/pdfs/publictakeovers/Europe2004.pdf [hereinafter Freshfields Bruckhaus Deringer Public Takeovers Memorandum].

15 See William W. Bratton & Joseph A. McCahery, Tax Coordination and Tax Competition in the European Union: Evaluating the Code of Conduct on Business Taxation, 38 Common Mkt. L. Rev. 677, 701 (2001) (noting that Ireland and the Netherlands are known for their hospitable tax regime); Gimme Shelter: Is Tax Competition among Countries a Good or a Bad Thing?, Economist, Jan. 29, 2000 (reporting widespread tax competition around the world and naming Ireland, the Netherlands, and Luxembourg as the member states of the European Union engaged in tax competition).

16 See, e.g., e-mail from Jiampiero Miccoli, Associate, Janni, Magnocavallo, Fauda, Brescia e associati, Milan, to Ehud Kamar, Aug. 19, 2004 (noting that certain Italian pharmaceutical companies have their production plants in Ireland because taxation on production there is low); Christine Kelly, Finance Bill 2004 — Holding Company Provisions, http://www.idaireland.com/uploads/documents/Finance_Taxation/Finance_Bill_2004.doc (explaining that a recent bill to improve the tax treatment of Irish holding companies was designed to encourage holding companies to expand their activities in the areas of financial control, research and development, and intellectual property so as to become a hub for European activities of their respective groups).

17 [Cite]

> Ireland had successfully and determinedly pursued a policy of low personal and business taxation, including our 12.5 per cent rate of Corporation Tax, with spectacular success. We have created a dynamic employment and investment-friendly environment in which over 300,000 new jobs have been created and countless tens of thousands of existing jobs maintained over the past 7 years.[18]

The Netherlands is known for its favorable taxation of holding companies.[19] Corporate law practitioners are well aware of these advantages.[20] Here too the goal is to

---

18 Press Release, McCreevy Rejects Corporation Tax Harmonisation Proposals (Ireland Department of Finance, June 8, 2004), http://www.finance.gov.ie/Viewtxt.asp?DocID=2187&CatID=1&m=n&StartDate=01+January+2004.

19 See Andrew Ross Sorkin, Is the Dutch Advantage Unsettling Europe?, N.Y. Times, April 2, 2000, at Money and Business 4. Recently, Ireland started to compete with the Netherlands in this market. See also Abigail St. John Kennedy, Ireland, *in* The International Financial Law Review Guide to Mergers and Acquisitions 2004, http://www.legalmediagroup.com/IFLR/ includes/print.asp?SID=5248 (Ireland) (reporting a government proposal from 2004 to exempt from tax gains from disposition of substantial shareholding in subsidiaries located in the European Union or in countries with which Ireland has a taxation treaty, and offer improved double tax credits on foreign dividends).

20 See Miccoli, supra note 16 (noting that most major Italian companies have their holding company in the Netherlands because so far taxation on dividends there has been lower than in Italy); Interview with Christopher Norall, Partner, and Rony P. Gerrits, Associate, Morrison & Foerester, Brussels, June 22, 2004 [herinafter Norall & Gerrits Interview] (noting that many holding companies operate from the Netherlands because of its tax benefits); Telephone Interview with Scott V. Simpson, Partner, Skadden, Arps, Slate, Meagher & Flom, London, Jul. 27, 2004 (noting that tax advantages stemming from international treaties have attracted to the Netherlands holding companies such as Italian fashion house Gucci Group NV and American real estate company Rodamco North America NV). Scott Simpson has represented Gucci Group since 1997 and represented Westfield Group (Australia) in its 2002 acquisition of Rodamco North America. See http://www.skadden.com/index.cfm?contentID=45&bioID=1261.

stimulate the economy.[21] Accordingly, a condition to enjoying the tax breaks for holding companies is establishing physical presence in the Netherlands.[22] Ireland and the Netherlands are not the only member states that use tax incentives to attract business. Other member states do the same.[23]

Offering tax incentives is very different from using corporate law to attract incorporations.[24] Delaware, the paragon of competition for incorporations, relies on its corporate legal regime, rather than on tax breaks, to attract incorporations, and its goal is to have companies choose it as their legal domicile, rather than as their physical home. Indeed, the tax Delaware charges to companies is higher than the tax other American

---

[21] See e-mail from Ernst Barten, Stibbe, Amsterdam to Ehud Kamar, Sept. 22, 2004 (noting that the purpose of offering tax incentives to Dutch holding companies is to make the Netherlands attractive as a business location).

[22] See id. (noting that a Dutch holding company must be managed and controlled in the Netherlands to be exempt from tax in the Netherlands on gains arising from holding or selling shares of a qualifying subsidiary and to be able claim a tax deduction for interest paid to purchase these shares); Ernst & Young, Ireland 12.5% Corporate Tax and Other Tax Advantages (Nov. 2002), http://www.ey.com/global/download.nsf/Ireland/tax_12.5_percent_corporate_tax/$file/12.5percent%20brochure.pdf (noting that companies, regardless of their place of incorporation, are Irish tax-resident if they are managed and controlled in Ireland).

[23] For discussions by corporate lawyers of tax advantages their member states offer to companies, see Menelaos Kyprianou, Cyprus as a Venue for the Establishment of a Holding Company, Int'l Bus. Law., Apr. 2004, at 66 (Cyprus); Bente Møll Pedersen & Michael Hertz, Legal Aspects of Acquiring a Publicly Traded Danish Company, Int'l Bus. Law., Sept. 2000, at 365, 368 (Denmark); Erik Björkeson & Peter Sjögren, The New Holding Company Regime in Sweeden, Delphi & Co. Memorandum to Clients, Feb. 2004, http://www.delphilaw.com/data/content/DOCUMENTS/ 20043516225871 8The%20new%20Holding%20Company%20Regime%20in%20Sweden.pdf (Sweden).

[24] Indeed, even municipalities, which are unable to offer incorporations, dole out substantial tax incentives to attract business. See, e.g., Gary Washburn, Boeing Got a Lot, but It Isn't Alone, Chi. Trib., May 13, 2001, at 1 (noting that Chicago has been using tax concessions quite liberally to attract business to the city).

states charge, not the other way around.[25] By contrast, Ireland strives to build its manufacturing and services sectors, rather than the list of foreign businesses using its law. Accordingly, it relies on tax incentives, rather than its corporate legal regime, to achieve this goal.[26]

B. The New Way: Corporate Law

[This section is incomplete. It will provide richer details of the economic integration and the legal reforms it propelled.]

Tax breaks are not the only way to stimulate the economy. There are many other inducements that can be offered to entice business. They all go under the label of business-friendly legislation. The globalization of capital markets, together with the economic integration of the European Union, has made corporate law an important component of the business-friendly legislation package that lawmakers in the various members states are expected to provide.

The reason for this, ironically, is that firms currently *do not* have the freedom to incorporate abroad. They are prisoners in their home member states. If member states are to attract investments in local companies they must therefore see to it that the legal protection they afford to investors does not fall behind. This pressure did not exist several decades ago, when capital markets were segmented and investments were local. But the globalization of capital markets and the economic integration of the European Union in recent years have created a new reality in which member states cannot take

---

[25] See Kahan & Kamar, supra note 8, at 690 t.1 (comparing annual taxes for incorporation in the fifty states and the District of Columbia).

[26] See http://www.idaireland.com (website of the Ireland Development Authority, which bills itself as an "Irish Government agency with responsibility for securing new investment from overseas in manufacturing and internationally traded services sectors" and advertises Ireland's "skilled and flexible workforce," "[o]ne of the lowest corporate tax rates in the world," "[y]oungest and one of the best educated populations in Europe," and a "positive political and economic environment"— without mentioning the Irish corporate legal regime).

investor behavior for granted, and cannot afford to lose investments — including investments by their own citizens — by keeping on their books unattractive corporate laws that automatically apply to any company conducting business within their borders.[27]

As recently as two decades ago, capital markets were local. Part of the reason was regulation. [Summarize tax and other legal barriers that used to constrain inflow and outflow of capital in the European Union and abroad.] Another part of the reason was technology. [Summarize hurdles to foreign investment caused by old information technology.] In the last decade, however, a lot has changed. [Summarize changes: information technology, deregulation, the euro, international legal, financial, and accounting services.] The result has been a surge in foreign capital investment worldwide. American and British institutional investors alone have increased the percentage of foreign investments in their portfolios from _____ in 1980 to _____ in 2000.[28] Today, they hold ___ of the publicly traded stock in the European Union, compared to ____ they held in ____, adding an important consideration to the political

---

[27] The pressure on jurisdictions to provide hostage local companies with the necessary legal environment for growth is analogous to the pressure that illiquid institutional investors exert on companies to raise their corporate governance standards. See John C. Coffee, Liquidity Versus Control: The Institutional Investor as Corporate Monitor, 91 Colum. L. Rev. 1277 (1991) (arguing that the size of institutional investments in public companies, the need to diversify investments, and the demand for investment portfolios that track stock indexes all limit liquidity and force intuitional investors to monitor managers more than they would otherwise); Edward B. Rock, The Logic and (Uncertain) Significance of Institutional Shareholder Activism, 79 Geo. L.J. 445 (1991) (same). Both are pressures to change debilitating rules when those governed by them cannot escape their application — a tradeoff referred to by economists and political scientists as a resort by the regulated population to voicing its discontent with the rules in the absence of an exit option. See Albert O. Hirschman, Exit Voice and Loyalty: Responses to Decline in Firms, Organizations, and States (1970).

[28] [Complete data and provide a citation.] Between 1987 and 1996, United States investors nearly tripled the portion of foreign investments in the value of their stock portfolio, from 3.8% to 10%. See Linda Tesar & Ingrid Werner, The Internationalization of Securities Markets Since the 1987 Crash, *in* Brookings-Wharton Papers on Financial Services 281 (1998).

calculus of lawmakers in the European Union.[29] During the same period, continental European institutional and retail investors have increased their foreign investment from ____ to ____. [30] Their willingness to invest domestically can no longer be taken for granted.

Product markets have also become more integrated as a result of deregulation and technological advances. [Summarize changes.] This transformation has intensified competition for investments in a number of ways. First, it has pressured firms to grow while depleting their internal cash reserves and forcing them to raise new capital or use their stock as acquisition currency.[31] Second, it has motivated firms to move production abroad to lower costs, including costs associated with operating under the law of their home member state. Third, it has shrunk the profits into which managers could dip to extract private benefits of control, weakening their incentives to resist legal reform.[32]

---

[29] [Complete data and provide a citation.]

[30] According to a recent survey of European stock exchanges, globalization and the introduction of the euro have resulted in a trend among institutional investment managers towards international diversification, and in the emergence of foreign institutional investors as the driving force of European markets. At the same time, domestic institutional investors increased their holdings abroad rather than in domestic markets to achieve similar international diversification. See Federation of European Stock Exchanges, European Share Ownership Structure 2002, at 3, http://www.fese.org/statistics/share_ownership/share_ownership.pdf [hereinafter Share Ownership Survey].

[31] A well-known example is the acquisition of United States carmaker Chrysler by German carmaker Daimler Benz in [1999], which required the acquiring company to register its stock in the United States and subject itself to United States accounting principles prior to the acquisition. Malcolm C. Baker, Fritz Foley & Jeffrey Wurgler, The Stock and Investment: Evidence from DFI Flows (Harvard University Working Paper 2004) find that "foreign direct investments, which are often simply cross-border acquisitions, increase with the current aggregate market-to-book ratio of the acquirer's stock market and decrease with subsequent returns on that market." Stefano Rossi & Paolo F. Volpin, Cross-Country Determinants of Mergers and Acquisitions, 74 J. Fin. Econ. 277 (2004) find that acquirers are based in countries with better corporate governance.

[32] See Mark J. Roe, Rents and their Corporate Consequences, 53 Stan. L. Rev. 1463 (2001) (arguing that the availability of monopoly rents helps to explains the persistence of weak shareholder

The globalization of capital and product markets triggered a series of corporate law reforms in member states across the European Union as part of their effort to stimulate the economy in an increasingly competitive environment. The most direct way by which corporate law reform promised to achieve this goal was by attracting equity capital.[33] In the new environment of capital mobility, member state legislators could no longer take for granted the retention of domestic capital investments. Nor could they indulge the hope that foreign capital would flow into the state only because it could. They had to ensure that local laws were in line with international standards. These standards were known. Institutional investors advertised exactly what they were.[34] And they were taken seriously by businesses and lawmakers alike.[35]

---

protection in European corporate law); Alexander Dyck & Luigi Zingales, Private Benefits of Control: An International Comparison, 59 J. Fin. 537 (2004) [product market competition lowers monopoly rents and leaves less room for extracting private benefits of control].

[33] Mobile capital includes not only equity, but also debt. But as investors with a fixed (as opposed to residual) claim to corporate assets, creditors can easily protect their interest by contract and do not need to rely on corporate law protection. [Cite] Indeed, the public corporate debt market is larger than the public corporate equity market in the United States despite the focus of corporate law in the United States on shareholder protection. [Cite].

[34] For example, CalPERS (California Public Employees' Retirement System), the largest public pension fund in the United States and the third largest in the world, had at the end of July 2004 assets worth $163.5 billion, $34.2 billion of which were shares of companies outside the United States. It dedicates a section of its website to its corporate governance philosophy in general and international investments in particular, with tailored corporate governance principles for investment in the United Kingdom, Germany, and France. See International Corporate Governance, http://www.calpers-governance.org/principles/international/; see also Gilson, supra note 10, at 346-47 (discussing the international corporate governance initiatives of CalPERS). Similarly, Hermes, one of the largest fund managers in the United Kingdom, managed at the end of June 2004 assets worth $82 billion, $23 billion of which were shares of companies outside the United Kingdom. Like CalPERS, it dedicates a section of its website to corporate governance in general and international corporate governance in particular, with translation to French and Italian. See http://www .hermes.co.uk/publications/publications_corporate_governance.htm.

[35] See, e.g., Deborah Ball, Minority Holders in Italy Finally Are Gaining Clout, Wall St. J., May 19, 2000, at A17 ("Italian companies are increasingly reforming their historic practices to the accepted

Quite separately from helping to finance local industry, corporate law reform could boost the economy also by deepening local stock markets.[36] Deep stock markets contribute to economic development in a number of related ways. First, they facilitate the growth of local businesses and through stock offerings and mergers.[37] Second, they nurture the local venture capital industry by providing an outlet for liquidating investments in startup companies.[38] Third, and perhaps most important politically, they strengthen the local financial services industry and solidify local financial centers which, in addition to being drivers of the national economy, can be rather influential. All of these considerations have been at play in the transformation of corporate laws in the European Union in recent years.

Finally, in addition to its direct effect on effect on capital investments, it could attract direct investments in the economy. The effect of corporate law on direct investment is quite intuitive. Efficient corporate law lowers the pressure on firms to locate operations abroad to escape an inefficient corporate law at home.

---

standards of corporate governances as viewed by U.S. investors. This gospel has already been spreading elsewhere in Europe. For instance, a shareholder activist in Germany sued Daimler Benz AG and Deutsche Bank AG over executive compensation, forcing both behemoths to modify their plans. And France this year was the site of one of Continental Europe's first proxy battles."); see also Freshfields Brukhaus Deringer, The Takeover Directive (May 2004), http://www.freshfields.com/practice/corporate/publications/pdfs/TakeoverDirective_Mayr04.pdf [hereinafter Freshfields Brukhaus Deringer Takeover Directive Memorandum] (predicting that takeover laws in the European Union will converge due to market pressures).

[36] See Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny.

[37] See Wendy Carlin & Colin Meyer, How Do Financial Systems Affect Economic Perfromance?, *in* Corporate Governance: Theoretical and Empirical Perspectives 137 (Xavier Vives ed. 2000) (finding evidence that equity markets are associated with national economic growth through research and development).

[38] See Bernard S. Black & Ronald J. Gilson, Venture Capital and the Structure of Capital Markets: Banks versus Stock Markets, 47 J. Fin. Econ. 243 (1998).

The agents of legal change varied across member states according to their institutional and political settings. In some member states, interest groups that would benefit from the change openly demanded it. This seems to have been the case in Germany.[39] [Complete] In other member states, individual reformers in the government acted as political entrepreneurs by personally pushing for change.[40] This seems to have been the case in Italy. [Complete]

The competition for investments has had a very noticeable impact on member state legislation. Consider the following anecdotes.

In 1998, Germany passed a law expanding the responsibilities of supervisory boards of directors and shifting their allegiance away from banks and closer to

---

39 See Theodor Baums, Company Law Reform in Germany, 3 J. Corp. Legal Stud. 181, 181-82 (2003) (noting that the reasons for Germany's corporate law reform were corporate scandals involving German companies, the need to reconcile the law with foreign law that applies to cross-listed German companies, the need to meet the expectations of foreign institutional investors who buy shares of German companies, the transformation of the German pension system into one partly based on institutional investors managing privately invested capital, competition among regulators to offer corporate law that meets the need of the market, and the need to offer flexibility to German companies financed by venture capital). The foreword to the corporate governance code written by Theodor Baums, chair of the panel that drafted it, explains: "The institutionalization and internationalization of shareholdings, the globalization of capital markets and the rapid development of information technologies have placed our corporate law system under increasing pressure to adapt to the ever changing requirements of the market." See German Government Panel on Corporate Governance: Summary of Recommendations, *in* Theodor Baums, Company Law Reform in Germany, at 12 (Institut für Bankrecht Arbeitspapier Nr. 100, 2002), http://www.jura.uni-frankfurt.de/baums/ subheading Arbeitspapiere, or http://ssrn.com/abstract=329962 [hereinafter Baums Working Paper]. This same rationale is echoed in the statement of the chancellery minister when the proposal was presented to the German chancellor. See Hans Martin Bury, German Government to Reform Company Law and Strengthen Germany's Financial Market, *in* Baums Working Paper, id. at 13 ("The Panel's recommendations aim to improve corporate management and supervision, transparency and competition. They improve the protection of stockholders and strengthen Germany's financial market.").

40 See Russel Hardin, Collective Action 35-37 (1982) (describing political entrepreneurs as public figures who advance their own careers by promoting a certain public or group interest).

shareholders.[41] The British and American influence on this law is evident.[42] Yet its enactment was inspired by domestic developments rather than a desire to attract incorporations. The immediate reason for the legislation was a series of highly visible corporate failures that were blamed on bank board representatives sleeping at the switch.[43] The legislation was also part of an ongoing transition towards shareholder capitalism following a major privatization effort two years earlier.[44] What clearly did not stand behind the new legislation, which was restricted to companies headquartered in Germany, was competition for incorporations.[45] Rather, this and other corporate law

---

[41] See Theodor Baums & Anja Birkenkaemper, Corporate Governance in Germany (Oct. 1998), http://ssrn.com/abstract=158038 (describing the legislation).

[42] See John W. Cioffi, Expansive Retrenchment: The Regulatory Politics of Corporate Governance Reform and the Foundations of Finance Capitalism, *in* The State after Statism: New State Activities in the Age of Globalization and Liberalization (Jonah D. Levy ed., forthcoming 2005) (describing that political roots of corporate governance reforms that were implemented in Germany in the 1990s and were modeled after British and American corporate laws).

[43] See Jeffrey N. Gordon, Pathways to Corporate Governance? Two Steps on the Road to Shareholder Capitalism in Germany, 5 Colum. J. Eur. L. 219, 220-21 (1999) (describing the board failures at Daimler-Benz, Metallgesellschaft, Schneider, and Klöckner-Homboldt-Deutz that precipitated the 1998 corporate law reform).

[44] See Jeffrey N. Gordon, An International Relations Perspective on the Convergence of Corporate Governance: German Shareholder Capitalism and the European Union, 1990-2000 (European Corporate Governance Institute Law Discussion Paper No. 6/2003; Harvard Law and Economics Discussion Paper No. 406, Feb. 2003), http://ssrn.com/abstract=374620 (linking the expansion of stock ownership in public companies, the launch of a stock trading platform for young companies, the tightening of legal protection of shareholders, and the growing acceptance of a market for corporate control to the privatization of Deutsche Telekom in 1996).

[45] Internal developments also motivated other legal reforms in Germany around that time. Thus, for example, a committee appointed by the German government recommended a corporate governance code addressing the operation of audit committees, director and officer insurance, executive compensation disclosure, and director independence — the focus of similar regulation in the United States around the same time. This move was prompted by a series of peculiarly similar corporate scandals in Germany and abroad, such as the collapse of German construction giant Philip Holzmann in November

reforms in Germany in the last decade have been part of an effort to boost economic growth.[46]

In 2004, a sweeping reform of Italian corporate law went into effect. The reform was "expressly inspired by comparative analysis in that a number of new governance and financing options for Italian companies were borrowed or 'transplanted' from other systems."[47] While the reform made Italian corporate law more flexible, it did not abandon the real-seat rule because it was not meant to attract incorporations.[48] Currently, the Italian parliament is mulling over a bill to reform audit committees drafted after the collapse of the dairy producer Parmalat in 2003.[49] The conceptual framework of the bill is reminiscent of reforms introduced in the United States following the collapse of the energy giant Enron in 2001. But the motivation for the bill is to respond to the needs of the local industry, not to attract incorporations. This is precisely how it was described in the press.[50] It simply draws on lessons from abroad to achieve this goal.[51]

1999. See Telephone Interview with Joachim von Falkenhausen, Partner, Latham & Watkins LLP, Hamburg, June 28, 2004 [hereinafter von Falkenhausen Interview].

46 See Janet Guyon, The Trials of Josef Ackermann, Fortune, Jan. 26, 2004, at 111 (noting six years later that Germany was still "struggling to liberalize its labor laws, overhaul its pension system, cut unemployment benefits, and reform its corporate governance rules in order to boost growth, which was flat in 2003").

47 See Marco Ventoruzzo, Experiments in Comparative Corporate Law: The Recent Italian Reform and the Dubious Virtues of a Market for Rules in the Absence of Effective Regulatory Competition 4 (Working Draft, June 14, 2004), http://ssrn.com/abstract=556601.

48 The reform responded to the introduction of foreign investors to Italian capital markets and to a shift in political alliances and economic power caused by low interest rates and a concomitant transfer of capital from government bonds to the stock market. See Richard Deeg, Remaking Italian Capitalism? The Politics of Corporate Governance Reform, 28 W. Eur. Pol. (forthcoming 2005).

49 See Robert Galbraith, Italian Parliament Stalls Rise of Audit Committees, The Accountant, Aug. 26, 2004, at 11.

50 See Turning Sour, Economist, Jan. 3, 2004; Not So Super Consob, Economist, Feb. 7, 2004 (reporting that the government "is keen to rush through a new law to reform financial regulation in Italy

In 2004, a new bill was introduced in the Dutch parliament setting forth new requirements regarding the election of directors, shareholder approval for major corporate changes, shareholder proposals, and voting by holders of share depository receipts. The background for the reform was not a government plan to attract foreign incorporations, but rather a series of major domestic bankruptcies, financial scandals, and lavish executive compensation packages that caused a public uproar.[52] The proposal was nonetheless informed by solutions given elsewhere in the world to similar problems. In particular, it was said to reflect increasing sensitivity in the accountancy profession to the need for independence in conducting corporate audits "due to international developments (the Sarbanes-Oxley Act, IAS/IFRS, and various financial scandals such as Enron, Parmalat and Ahold."[53]

In 2003, a law came into effect in France that formed a single corporate regulator in lieu of three regulatory bodies that had shared this responsibility in the past. One of the goals of this change was to "help restore investors' confidence in the financial markets in the wake of recent US and European financial scandals."[54]

In 1999, a takeover law modeled after the British City Code on Takeovers and prohibiting managers from thwarting unsolicited public tender offers came into effect in

---

because of the collapse of Paramalat," which "destabilised Italy's fragile banking sector and left the reputation of the country as a wise place in which to invest more than a little dented").

[51] The accounting scandals that shook corporate America and resulted in significant changes in the law did not go unnoticed in Italy even before the Parmalat debacle. See Robert Galbraith, Disappointment and Dissatisfaction in Italy, The Accountant, Sept. 25, 2002, at 16 (reporting on stories of accounting scandals in the United States are fueling calls for accounting reforms in Italy).

[52] See Jan Louis Burggraff & Joyce Winnubst, The Netherlands, *in* The International Financial Law Review Guide to Mergers and Acquisitions 2004, http://www.legalmediagroup.com/IFLR/includes/print.asp?SID=5250.

[53] See Burggraff & Winnubst, id.

[54] See Nicolas Bombrun & François Mary, France, *in* The International Financial Law Review Guide to Mergers and Acquisitions 2004, http://www.legalmediagroup.com/IFLR/includes/print.asp?SID=5243.

Austria. The law was not meant to attract incorporations. Accordingly, it applies only to target companies that are located and listed in Austria.[55]

In 1998, the British department of trade and industry commissioned a comprehensive review of the country's corporate law. The review became the basis of a 2002 government proposal to reform the law, which is still pending. Some commentators argue that this British initiative is evidence of competition for incorporations.[56] It is not. It is evidence of competition for capital and direct investments. Its self-proclaimed aim was "to develop a simple, modern, efficient and cost effective framework for carrying out business activity in Britain for the twenty-first century,"[57] it focused on the "small private

---

55 See Nick Callister-Radcliffe et al., Rejection of the EU Takeover Directive — The Implications, Int'l Bus. Law., Sept. 2001, at 338, 339-40; see also Peter M. Polak, Austria, *in* The International Financial Law Review Guide to Mergers and Acquisitions 2004, http://www.legalmediagroup .com/IFLR/includes/print.asp?SID=5232.

56 See, e.g., Gerard Hertig & Joseph A. McCahery, The U.S. Concept of Granting Corporations Free Choice among State Corporate Law Regimes as a Model for the European Community, 4 Eur. Bus. Org. L. Rev. 179, 186 (2003); Joseph A. McCahery & Erik P.M. Vermeulen, The Evolution of Closely Held Business Forms in Europe, 26 J. Corp. L. 855, 875 (2001); Deakin, supra note 6, at 205.

57 See Department of Trade and Industry, Corporate Law and Governance: Modernising Company Law, http://www.dti.gov.uk/cld/review.htm. The reform was presented as part of a broader policy of economic development, which included in an earlier stage steps to "[create] the conditions for macro-economic stability" by "[ensuring the country's] public finances were put in order" and "[giving] independence to the Bank of England so that decisions on interest rates were taken for economic rather than political reasons," thereby "providing business with the foundations for growth and consumers with low prices and competitive markets," and setting the stage for "promoting enterprise and raising productivity" by fitting corporate law "for the twenty-first century and beyond." See Preface by the Secretary of State, Modernising Company Law, Command Paper CM 5553, at 3 (Jul. 2002), http://www.dti.gov.uk/ companiesbill/prelims.pdf. See also Kevin Brown & Michael Peel, Blueprint to Help Bring Business 'Into the 21st Century', Fin. Times, Jul. 27, 2001 (reporting that the trade and industry secretary explained the need for the reform by saying that "UK company law, once regarded as the best in the world, has fallen well behind that of other countries" and that "[y]ears of neglect have left us with an archaic Victorian system that is holding British business back.")

companies" that constitute the majority of "1.5 million companies in Great Britain,"[58] it "was given a broad welcome by business groups,"[59] and its delay was heavily criticized by representatives of the local industry.[60]

Finally consider voluntary codes of corporate governance. By the end of 2001, there were no less than thirty-five codes setting best practices of corporate governance in the various member states of the European Union. Twenty-five of these codes were issued after 1997.[61] The codes were not identical, but they were similar.[62] Subsequent years saw the introduction of additional corporate governance codes. They too embodied similar solutions of different member states to common concerns regarding executive compensation, financial auditing, and public disclosure.[63] The engine behind this like-mindedness was not competition for incorporations. No such competition existed. Instead, it was the integration of capital and product markets.

The legal innovation and diffusion in these examples is not the product of competition for incorporations. Even commentators who anticipate such competition in the European Union acknowledge its absence today and regard large industrialized member states as unlikely candidates for spearheading it. Yet it was these member states

---

[58] See The Government Policy, Modernising Company Law, Command Paper CM 5553, at 15-16 (Jul. 2002), http://www.dti.gov.uk/companiesbill/part2.pdf.

[59] See Brown & Peel, supra note 57 (reporting that supporters of the reform included the Institute of Directors and the Trade Union Congress).

[60] See Andrew Parker, Delay on Company Law Reform Attached, Fin. Times, Jul. 11, 2003, at 4 (noting that industry organizations such as the Confederation of British Industry and the Federation of Small Businesses attacked the government for delaying the corporate law reform, and that the member of the opposition party who serves as shadow trade and industry said that "the government's failure to proceed with a swift overhaul of company law undermined its pro-business stance.").

[61] See Weil, Gotshal & Manges, Comparative Study of Corporate Governance Codes Relevant to the European Union and Its Member States 2 (Jan. 2002), http://europa.eu.int/comm/internal_market/en/company/company/news/corp-gov-codes-rpt_en.htm.

[62] See id.

[63] [Cite]

that adopted the most sweeping legal reforms. Far from trying to win new incorporations or not to lose existing ones — neither of which can motivate laws applicable only to local businesses — member states in these examples modified their laws to attract investments to their economy. Sometimes they innovated. Often they borrowed from others.[64]

II. The Incentives to Compete

The ability and willingness of individuals to shop for laws is not enough for regulatory competition to develop. Another condition is a desire by lawmakers to respond. This condition is not easily met. In the United States, birthplace of the competition for incorporations theory, only Delaware pursues incorporations by foreign firms. Other states at most make far weaker efforts to retain incorporations by local firm, or indeed, some would argue, do not compete at all. By contrast, the incentives to compete for investments can be strong, both because the rewards to such competition are much higher and because they accrue to all competitors rather than only to one. The intensification of competition in the markets for capital, products, and labor in recent years as a result of globalization set the stage for this competition to develop in the European Union by raising the gains that could be expected from using corporate law to attract investments beyond its past level, and indeed beyond what could be expected from using corporate law to attract incorporations. The dramatic response by member states

---

[64] In some cases, member states copied foreign law specifically at the request of local companies. Germany, for example, reconciled its corporate accounting standards in [2001] with the standards used abroad to enable German companies that wished to list their stock overseas to do so without having to prepare two sets of financial statements. See Eric Nowak, Recent Developments in German Capital Markets and Corporate Governance, 14 J. Applied Corp. Fin. 35, 44 (2001) (linking the legislation to the listing of Daimler Benz in the United States as part of its merger with Chrysler). For illustration of the two sets of financial statements that used to be filed by German companies listed in the United States prior to the change, see Deutsche Telekom Consolidated Financial Statements for 1996, at 61-62, available at http://download-dtag.t-online.de/englisch/investor-relations/4-financial-reports/annual-reports/1996/abschluss.pdf. Germany also changed its law in [2001] under pressure from corporate managers and investment banks to allow the use of stock option compensation as in the United States. See von Falkenhausen Interview, supra note 45.

that followed leaves no doubt about the potential of competition for investments to shape corporate law. Apparently, the potential is high.

A. Benefits

An important reason why competition for investments thrives where competition for incorporation might fail to get the attention of lawmakers is that its stakes are higher and its rewards are more suitable to becoming part of a political platform.[65]

1. Competition for Incorporations

Much has been said about the lure of the fiscal gains a jurisdiction can earn from incorporations by foreign companies and the profits its legal community can reap from providing services to these companies. The truth of the matter, however, is that only jurisdictions with limited financial means can be driven by the fiscal gains from incorporations, and the legal community, as enthusiastic as it may be about attracting incorporations, will need to point to significant gains to the entire polity in order to bring lawmakers to adopt corporate legislation that faces any significant opposition.

It is hard to estimate the potential of incorporations as a source of tax revenues. Any such estimate depends on the number of incorporated firms, their need of corporate law, and the alternatives available to them elsewhere.[66] It is easy, however, to observe

---

[65] Another difference between competition for incorporations and competition for investments is that only the former could theoretically be replicated by private regulators. The political contingency of the supply of corporate law by public lawmakers has led commentators to conclude that private lawmakers competing for incorporations would produce better and more varied corporate law. See Gillian Hadfield & Eric Talley, On Public versus Private Provision of Corporate Law (University of Southern California Center in Law, Economics and Organization Research Paper C04-13, June 2004). Private corporate lawmakers, however, could not capture the gains from economic development, and therefore would not be able to replicate the competition for investments.

[66] Member states do not have to tax incorporations directly. They can also, for example, tax the use of their courts or legal services by chartered firms. But these indirect taxes may not yield higher revenues. Court fees, which are meaningful only in legal regimes that rely on litigation, are borne at the first instance by shareholder plaintiffs, rather than chartered companies. Indeed, Delaware, which relies

the experience that Delaware has had in this regard. Delaware is a success story. It stands in the enviable position of attracting half the public companies in the United States,[67] and nearly all the public companies that incorporate outside their home state when they go public,[68] with virtually no political costs and only minimal financial costs. The result? A respectable tax revenue of $523 million forecasted for 2005 on budgeted outlays of [$15] million, constituting a fifth of total revenue.[69]

But this American dream may remain out of reach for member states of the European Union even as firm choice reaches their shores because taxing incorporated firms more than the cost of servicing them is not allowed under European Union law.[70] Not that such a tax would make a big difference. In 2003, gross domestic product in the United States was $10.9 trillion. The equivalent figure for the European Union was $8.2

---

heavily on courts in the administration of corporate law, imposes no such fees. Similarly, legal services taxes are borne only by firms that use local legal services, and can easily be avoided by using foreign legal services. More generally, it is fair to assume that decades of experimentation have brought Delaware close to optimizing its incorporation tax subject to political constraints. A new competing member state in the European Union is unlikely to derive significantly higher gains from a similar market.

67 See Guhan Subramanian, The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching, 150 U. Pa. L. Rev. 1795, 1813 (2002) (examining Delaware's share of 7807 public companies in 2000 included in Standard & Poor's Compustat database). Delaware public companies also tend to bigger than other public companies. While constituting half the public companies in the sample, they account for 59% of net sales. See id.

68 See Robert Daines, The Incorporation Choices of IPO Firms, 77 N.Y.U. L. Rev. 1563, 1563 (2002) (examining Delaware's share of 6671 initial public offerings between 1978 and 2000 included in Thomson Financial's SDC database).

69 See An Act Making Appropriations for the Expense of the State Government for the Fiscal Year Ending June 30, 2005, S.B. 320, 142nd Leg. (Del. 2004), http://www.state.de.us/budget/budget/fy2005/fy2005-sb320-budget-bill.pdf.

70 See Baudisch, supra note 6, at 51-52 (arguing that such a tax would violate Directive 69/335/EEC, raise constitutional concerns in many member states, and be resisted by business).

trillion.[71] Domestic stock market capitalization in the United States in that year was over $14 trillion. The equivalent figure for the European Union was $8 trillion.[72] Even if a single member state assumed overnight a similar position to the one enjoyed by Delaware, its tax revenue from incorporations would probably be lower because it would command a smaller market.[73] This revenue might be significant for some of the smallest member states. But, as the following section will explain, these member states lack the necessary legal infrastructure to attract the sort of large public companies that can generate such revenue.[74]

Another gain that is said to drive jurisdictions to compete for incorporations is the benefit to their lawyers from providing services to companies incorporated in them. But the obvious interest of lawyers in incorporations does not mean that lawmakers will cooperate. They will need a stronger reason to spend political capital on pushing through legislation that encounters any significant opposition.

The explanation for the ease with which the Delaware corporate bar routinely pushes its proposals through the state legislative process lies in the absence of any interest group in the state that might object to these proposals and the reliance of the state on the fiscal gains from incorporations.[75] Delaware lawyers, to be sure, gain handsomely

---

[71] See World Bank, Data & Analysis, http://www.worldbank.org/data/countrydata/countrydata.html (comparing data from the stock exchanges of Athens, Borsa Italiana, Budapest, Copenhagen, Deutsche Börse, Euronext, Helsinki, Ireland, Ljubljana, London, Luxembourg, Malta, Oslo, Spanish Exchanges (BME), Stockholm, Warsaw, and Wiener Börse in the European Union, and Amex, Nasdaq, and New York in the United States).

[72] See World Federation of Exchanges, Domestic Equity Markets, http://www.world-exchanges.org/WFE/home.asp?menu=315&document=2170 (reporting market capitalization of domestic

[73] See Miccoli, supra note 16 (describing as unrealistic the possibility that member states would compete for incorporations by companies that operate and pay income tax elsewhere).

[74] See infra Section II.B.1.

[75] See Romano, supra note 168, at 60 (arguing that Delaware corporate law is little affected by partisan lobbying because most Delaware companies operate outside the state).

from their state's thriving incorporations business.[76] But so does the state. It reaps fiscal gains from incorporations that pay for a fifth of its public consumption at minimal political and economic costs. With these symbiotic relations between local lawyers, politicians, and the state as a whole, no wonder Delaware corporate lawyers get their way.

By comparison, corporate lawyers in other states have a much harder time pushing legislation to attract incorporations precisely because interest groups existed in these states that resist their initiatives. It was politics, not the lack of support from corporate lawyers, that derailed an effort to form in Pennsylvania a corporate tribunal with judges appointed based on merit and without juries.[77] It was also politics that derailed an effort to form in Nevada a corporate tribunal without juries and with judges that do not rotate.[78] The lesson from these experiences is clear. It is not enough that corporate lawyers want the legislation to pass. If they are to overcome political objections, the public benefits to the state and the political benefits to lawmakers must at least appear significant.

2. Competition for Investments

Unlike the weak incentives that legislators have to compete for incorporations, their incentives to compete for investments are strong. So strong, in fact, that nowadays they threaten even the rights of employees, historically one of the strongest corporate constituencies in the European Union.[79]

---

[76] See Kahan & Kamar, supra note 8, at 694-98 (estimating the net profit per Delaware lawyer from incorporations at roughly $35,000 a year in 2000).

[77] See John L. Kennedy, Chancery Ct. Plan Sent to Senate, Legal Intelligencer, May 17, 1993, at 1.

[78] See Minutes of the Nev. Legis. Commission's Subcomm. to Encourage Corporations and Other Business Entities to Organize and Conduct Business in This State, 1999 Leg. 1999-2000 Interim Sess. (May 30, 2000) (testimony of A. William Maupin, Associate Justice, Supreme Court of Nevada).

[79] See supra note 125 and accompanying text.

Competition for investments can be billed as directly benefiting the entire citizenry. The difference between winning and losing in the competition for international capital is the difference between having billions of euros invested in local businesses and not having them. Part of the gain affects the state budget directly. In the case of state-owned firms undergoing privatization, a common phenomenon in the European Union in recent years, capital investments add to the state treasury. In the case of formerly state-owned firms that have already been privatized, access to capital markets allows the state to liquidate over time its remaining stake in the firm to address budget needs.

Another part of the gain affects the state and its lawmakers indirectly. For one thing, even in the case of privatized firms in which the state no longer holds any stock, maintaining the value of the stock is vital to the public trust in the government and the politicians associated with the privatization. The public outrage that can result from mismanagement in a firm that was not too long ago privatized may come back to haunt the politicians who backed the privatization. In fact, a major corporate scandal can shake up the government even if it involves a company that was never state owned to the extent that it affects local investors. This scenario is rather common because, despite the globalization of capital markets, investors tend to invest locally to exploit the information advantages they have in firms they know first hand.[80] Managerial overreaching in a

---

[80] [Provide data on the ratio of domestic to foreign investments by European investors.] See Hyuk Choe, Bong-Chan Kho & René Stulz, Do Domestic Investors Have an Edge? The Trading Experience of Foreign Investors in Korea (Dice Center Working Paper No. 2004-6, Mar. 23, 2004), http://ssrn.com/abstract=545685; Linda L. Tesar & Ingrid M. Werner, Home Bias and High Turnover, 14 J. Int'l Money & Finance 467 (1995); Ian Coopers & Evi Kaplanis, Home Bias in Equity Portfolios, Inflation Hedging, and International Capital Market Equilibrium, 7 Rev. Fin. Stud. 45 (1994); Thomas Gehrig, An Information Based Explanation of the Domestic Bias in International Equity Investment, 95 Scandinavian J. Econ. 97 (1993); Kenneth R. French & James M. Poterba, Investor Diversification and International Equity Markets, 81 Am. Econ. Rev. 222 (1991). Investor preference for local investments exists also within national borders. See Zoran Ivković & Scott Weisbenner, Local Does as Local Is: Information Content of the Geography of Individual Investors Common Stock Investments, 60 J. Fin. 267 (2005) and

major local firm therefore typically affects a large number of local citizens and results in political repercussions. Indeed, much of federal securities legislation in the United States — including the Securities Act of 1933, the Securities Exchange Act of 1934, the Williams Act of 1968, and the Sarbanes-Oxley Act of 2002 — was enacted in response to perceived abuses that affected domestic investors.[81]

Corporate scandals may lead not only to public outrage but also to massive stock sales by foreign investors in all local firms. The knowledge that a scandal involving a single domestic company can taint the entire economy creates a strong incentive for lawmakers to adopt legislation that will prevent a scandal before it happens and, if it already happened, to adopt legislation to prevent its reoccurrence.[82] If they have any doubt about their responsibility, the financial press will quickly erase it, as it did in the following article published after the collapse of Parmalat:

> Now, in Parmalat, an Italian food and milk-products company, Europe has a corporate scandal of truly Enronesque proportions. If the integrity of European business is to be restored, and public confidence in the continent's capital markets is to be sustained, Europe's response will have to be as determined and sweeping as America's . . .
>
> It has been tempting for international investors to think of Europe as a single investment space. The reality is that harmonisation of Europe's

---

the studies cited therein; Herald Hau, Location Matters: An Examination of Trading Profits, 56 J. Fin. 1959 (2001).

81 [Cite]

82 See, e.g., Nicholas George, Fin. Times, Jan. 19, 2004, at 24 (quoting the Swedish minister for financial markets expressing disappointment with the failure of business leaders to take effective measures to restore the confidence in Swedish business, "which has been rocked by several corporate scandals, the most high-profile example involving huge bonus payments and management perks at the financial services group Skandia," and expressing resolve to address the crisis in legislation if this failure continues).

> industrial and financial markets still has a long way to go. Local practices matter, never more so than when things go wrong . . .
>
> The danger to honest Italian business could not be clearer: their cost of capital will rise if investors begin to discriminate against a country that had been trying to shake off a reputation for dark dealings. In fact, this is precisely what international investors should now do. The sheer scale of the Parmalat scandal raises serious questions about Italian business practices which only a thorough, and very un-Italian, clean-up can now dispel.[83]

Moreover, even without corporate scandals, capital investments fuel economic development, and economic development is the lifeline of many politicians. Consequently, while privatizations and corporate scandals can certainly draw political attention to corporate governance, some attention can result merely from the desire to stimulate economic development in increasingly integrated capital, labor, and product markets. The boon to politicians in this case is not the direct contribution of funds to the state treasury but rather the ability to claim credit for job creation and national prosperity.

Competition for investments differs from competition for incorporations not only in its stakes but also in how much of these stakes jurisdictions internalize.[84] Shareholder displeasure with the corporate law of a jurisdiction that competes for incorporations can cost that jurisdiction mostly in lost tax revenues from new incorporations. Its effect on tax revenues from firms already incorporated in the jurisdiction should be minimal

---

83 Turning Sour, Economist, Jan. 3, 2004.

84 The analysis here takes the current structure of incorporation tax as given. A different structure of incorporation tax, such as one based on firm market capitalization, would make jurisdictions that compete for incorporations internalize more of the effects their corporate law has on firm value. It so happens, however, that this is not the tax structure jurisdictions that compete for incorporations choose. See Michal Barzuza, Price Considerations in the Market for Corporate Law, 25 Cardozo L. Rev. 127, 211-12 (2004).

because these firms will tend to remain incorporated in the same jurisdiction and continue to pay incorporation taxes.[85] By contrast, shareholder displeasure can cost a jurisdiction that competes for investments in lower productivity and loss of access to capital markets by local firms. Every bit of this cost will be remembered by voters come election day.

The market for investments is different from the market for incorporations not only in its higher stakes but also in its ability to sustain vigorous participation by multiple jurisdictions. There are two related reasons for this. The first reason is the difference in stakes. Delaware, the leading state of incorporation in the United States, currently earns about $500 million a year by taxing incorporations. If Delaware were to split this amount with an equal rival, each would collect no more than half. This is not a whole lot for a state, and certainly not a lot for a country. By contrast, the stock capitalization of public companies alone in the European Union was $8 trillion in 2003. A conservative estimate of the foreign investments in these companies in that year exceeds $2 trillion.[86] Splitting this amount and the economic development it can generate many ways still leaves to all member states enough worth fighting for.

---

[85] Reincorporations are not a common event in the life of firms even where they are old practice. Between 1990 and 2000, 2298 companies went public as Delaware companies. See Daines, supra note 68, at [page] t.A4. During almost the same period, only 208 public companies reincorporated into Delaware. See Subramanian, supra note 67, at 1821. The rarity of reincorporations stems in part from the fact they require joint action by shareholders and managers, and may also require the firm to change lawyers. This may explain why threats influential lawyers made in the past to advise their clients to reincorporate out of Delaware in response to unpopular court rulings turned out to be vacuous. See Jeffrey N. Gordon, Corporations, Markets, and Courts, 91 Colum. L. Rev. 1931, 1958-59 & n.95 (1991). In the European Union, the costs of reincorporation can be expected to be higher. They may also involve, for example, obtaining the consent of employees, as well as changing lawyers, accountants, and financial advisors.

[86] In the years 2000 and 2001, foreign institutional investors held between 30% and 40% of publicly traded stock in the United Kingdom, Spain, Norway, France, Sweden, and Poland, between 20% and 30% percent in Germany, Greece, Portugal, and Denmark, 15% in Italy, and 5% in Estonia. See Share Ownership Survey, supra note 30, at 40.

The second reason is that the market for investments does not share the properties that make the incorporations market one in which the winner takes all. Delaware is the legal domicile of half the public companies, and virtually all companies that incorporate outside their home state when going public, in the United States. But it carries this burden with stride. Indeed, judging from its modest outlays for its chartering business,[87] and its efforts to attract additional business to its division of corporations and five-judge chancery court,[88] Delaware could easily handle the chartering of all public companies in the United States if only given the chance. The market for capital is different from the market for incorporations because it channels investments to physical businesses. Investor-friendly legislation can certainly attract to a jurisdiction more capital than its share of the global pool of other means of production. But there is a limit. As production increases, it reaches a point in which the cost of less mobile means of production and other local resources becomes too high.[89] This limit gives hope to other jurisdictions that, with proper legislation, they too can attract some of the capital and other means of production.

---

87 See supra note 69.

88 [Cite]

89 See Charles M. Tiebout, A Pure Theory of Local Expenditures, 64 J. Pol. Econ. 416 (1956). Previous analyses of corporate lawmaking in federal systems, including my own, have analogized the competition for incorporations to the regulatory competition described by Tiebout. See, e.g., Ehud Kamar, A Regulatory Competition Theory of Indeterminacy in Corporate Law, 98 Colum. L. Rev. 1908, 1948 n.156 (1998); Roberta Romano, The Future of Hostile Takeovers: Legislation and Public Opinion, 57 U. Cin. L. Rev. 457, 466 n.21 (1988) (same); John C. Coffee, Jr., Competition Versus Consolidation: The Significance of Organizational Structure in Financial and Securities Regulation, 50 Bus. Law. 447, 453 n.27 (1995); Frank H. Easterbrook & Daniel R. Fischel, Mandatory Disclosure and the Protection of Investors, 70 Va. L. Rev. 669, 691 n.29 (1984). Competition for investments, however, is closer in nature to the Tiebout model because in both jurisdictions have limited capacity. While in theory jurisdictions should also have limited capacity for incorporations, in practice this capacity is sufficiently high as to be a nonbinding constraint on their output.

B. Costs

Competing is costly. It is a sad realization that any participant in a market for goods or services learns very quickly. Competing for incorporations is costly too. It differs from competition in the private sector only in that it involves political costs in addition to economic ones.[90] The costs that stand out in the European Union are the cost of building legal infrastructure and the cost of overcoming resistance from interest groups. The former cost inhibits competition by small member states. The latter cost inhibits competition by large ones. The combination of the two leaves precious little ground for competition to develop. While these costs do not disappear in competition for investments, they can be offset by the higher stakes it involves, which can induce even industrialized jurisdictions with developed legal infrastructure to compete, and can mollify even strong interest groups by forcing them to bear the cost of their resistance.

1. Competition for Incorporations

Impressed with how tiny Delaware has made the pursuit of incorporations a state priority, some commentators identify the smallest member states in the European Union as candidates for competing for incorporations on the theory that they could value the modest gains incorporations can generate.[91] But these member states lack the necessary legal infrastructure to attract incorporations. Consider, for example, Estonia, Latvia, and Malta, the member states with the smallest budgets in the European Union, with total government revenues in 2002 of less than €3 billion each.[92] It is true that these member

---

[90] See Kahan & Kamar, supra note 8, at 730-35.

[91] See Dammann, supra note 6, at 528-30 (listing Estonia, Hungary, Cyprus, the Czech Republic, Latvia, Lithuania, Malta, Poland, and Slovakia as potential competitors).

[92] Survey of the State Budget, at 4 (Republic of Latvia Ministry of Finance, Dec. 2002), http://www.fm.gov.lv/image/file/Dec_02a.pdf; Economic Indicators, at 18 (Malta National Statistics Office, 2004), http://www.nso.gov.mt/Indicators/econindic.pdf; General Government Finance Statistics 2002, at Item 1 (Ministry of Finance of the Republic of Estonia, Dec. 31, 2002), http://www.fin.ee/?id=3064.

states might be interested in incorporations. Only their interest is not enough.[93] Corporate laws in these member states are antiquated versions of German or French corporate law that had been in hibernation for several decades and only recently received a facelift to meet the minimum requirements of the European Union.[94] These member states also rank low in the European Union in political stability, rule of law, and control of corruption.[95] It is hard to believe any of them would attract the sort of large public companies that generate for Delaware the bulk of its profit.[96]

---

[93] While corporate law is not their strongest point, all of the new member states have historically offered foreign businesses an array of tax incentives regarded by the European Commission as harmful. See Daniel Dombey, New EU Entrants Fail to Cut Tax Breaks, Fin. Times, Jul. 22, 2003, at 6. Malta, for example, has been better known for its advantageous taxation of offshore holding companies than for its corporate law. See Good Havens, Economist, Sept. 30, 1995, at 90 (noting tax exemptions for offshore holding companies); Godfrey Grima, Malta Aspires to Become a Leading Financial Centre, Fin. Times, Dec. 9, 2003, at 3 (noting displeasure of the European Commission with taxation of offshore holding companies in Malta).

[94] See Marie-Agnes Arlt, Cécile Bervoets, Kristoffel Grechenig & Susanne Kalss, The Status of the Law on Stock Companies in Central and Eastern-Europe: Facing the Challenge to Enter the European Union and Implement Company Law, 4 Eur. Bus. Org. L. Rev. 245 (2003) (describing the corporate laws of the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Slovenia).

[95] See World Bank Institutes, Governance Indicators: 1996-2002 — Global Comparative Charts, http://www.worldbank.org/wbi/governance/govdata2002/excelgraphs.html (ranking these member states in the bottom half of the European Union); Transparency International, Corruption Perceptions Index 2004, http://www.transparency.org/cpi/2004/cpi2004.en.html (same). These member states also rank low in the European Union in an indicator of competitiveness that combines economic performance, government efficiency, business efficiency, and infrastructure. See World Competitiveness Yearbook, http://www01.imd.ch/documents/wcy/content/ranking.pdf.

[96] Experience shows that it is large public companies that can generate for a popular incorporation state the bulk of its benefits. Without their active involvement in incorporations, lawmakers have little reason to compete. See Marcel Kahan & Ehud Kamar, Price Discrimination in the Market for Corporate Law, 86 Cornell L. Rev. 1205, 1251 t.3 (2001) (reporting that about 1600 large public companies out of more than 200,000 Delaware companies on average generated for the state two-thirds of its franchise tax revenue over the 1997-1999 period).

Recognizing the disadvantages of these member states, some commentators look to Luxembourg, the smallest developed member state in the European Union, to carry the torch of competition.[97] Perhaps. But Luxembourg is not that small. In 2003, its revenue was €6.35 billion, three times higher than Delaware's.[98] Accordingly, it has done absolutely nothing to signal any intention to compete for incorporations despite much academic speculation that it should.[99] It did not rush to amend its law to allow foreign companies to incorporate in it. It did not even respond to the call for comments on a proposal for a directive that would enable companies to reincorporate.[100] To be sure,

---

[97] See Dammann, supra note 6, at 528-30 (mentioning Luxembourg, along with Ireland, Portugal, and Greece as potential candidates); Hertig & McCahery, supra note 6, at 187 (mentioning Luxembourg and Ireland as potential candidates).

[98] See State of Delaware Financial Overview Fiscal Year 2004, http://www.state.de.us/budget/budget/fy2004/operating/04FinancialOverview.pdf (noting a budget of $2.3 billion in 2003). The exchange rate in 2003 ranged between 0.94 and 0.81 euro for one U.S. dollar. Jens Dammann argues that the relevant figure for a state's incentive to compete for incorporations is its gross domestic product, rather than its budget, because it reflects the extent of economic activity that could be taxed should the need arise in the future, and notes that Luxembourg's gross domestic product is one-half of Delaware's. See Dammann, supra note 6, at 528. As a practical matter, however, state policymakers tend to consider existing budgetary needs, rather than hypothetical ones, and value any revenue source according to its relative contribution to that budget.

[99] While Luxembourg used to attract some incorporations by protecting investor privacy, international pressure to combat money laundering has narrowed this tax loophole in its law. See Telephone Interview with Guido Fauda, Partner, and Giampiero Miccoli, Associate, Janni, Magnocavallo, Fauda, Brescia e associati, Milan, Jul. 28, 2004.

[100] Of 127 responses to the call by the European Commission in 2004 for comments on the proposal, 52 responses came from Germany, 21 from France, 9 from the Netherlands, 7 from Belgium, 6 from Spain, 5 from the United Kingdom, 4 from each of Finland and Portugal, 3 from each of Austria, Greece, and Italy, 2 from each of the Czech Republic and Estonia, 2 from undisclosed countries, and 1 from each of Denmark, Ireland, and Sweden. No responses came from Luxembourg, Cyprus, Hungary, Lithuania, Latvia, Malta, Poland, Slovakia, or Slovenia. See Public Consultation on the Outline of the Planned Proposal for a European Parliament and Council Directive on the Cross-Border Transfer of the Registered Office of a Company, http://europa.eu.int/yourvoice/results/transfer/index_en.htm.

Luxembourg may begin to show interest in incorporations as the freedom to incorporate abroad becomes established in the European Union.[101] But there is reason to doubt that it will. Corporate law is not its strong point. In fact, along with other corporate laws in the French tradition, it receives the lowest marks in international comparisons.[102] The backbone of the Luxembourg economy is private banking.[103] Few lawyers outside Luxembourg are familiar with Luxembourg corporate law, and many would find the fact that English is not an official language in Luxembourg to be a deterrent.[104] That Luxembourg will compete for incorporations by the sort of public companies that can generate significant profits is not impossible. It is just unlikely.

This lack of legal infrastructure is particularly problematic because of the need to offer a viable alternative to incorporation in the United Kingdom. Unlike Luxembourg, or any other member state for that matter, the United Kingdom does not have to revamp its law or build legal infrastructure from scratch to attract incorporations. Its law already

---

[101] Note that a market in which only one state attempts to attract incorporations is quite different from a market in which many states compete. See Kahan & Kamar, supra note 8, at 736-47 (comparing a market with a single competing state among many inactive ones with a market in which several states compete).

[102] See Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, Law and Finance, 106 J. Pol. Econ. 1113 (1998).

[103] In 1998, Luxembourg and Switzerland refused to be bound by the Organization for Economic Co-Operation and Development's guidelines for combating harmful tax competition because these guidelines called for sharing information about the income of individuals and businesses with foreign tax authorities. See Harmful Tax Competition: An Emerging Global Issue, Annex II, at 73 (OECD, Jan. 1, 1998), http://www.oecd.org/dataoecd/33/0/1904176.pdf. Luxembourg maintains its refusal to exchange this information today. See The OECD's Project on Harmful Tax Practices: The 2004 Progress Report, at 10 (OECD, Mar. 22, 2004), http://www.oecd.org/dataoecd/60/33/30901115.pdf.

[104] See The Galling Rise of English, Economist, Feb. 27, 2003 (noting that English has become the language of business in the European Union). It is irrelevant that many Luxembourgians speak English because this language is not used in courts.

offers both flexibility and shareholder protection,[105] and legions of legal and financial professionals both inside and outside its borders are already familiar with it.[106] This track record is important. In the early twentieth century, when New Jersey drove away its chartered companies with tough antitrust laws, incorporators looked no further than Delaware because it already had the law they wanted. The United Kingdom appears to be the instinctive choice for them in the European Union for similar reasons.[107]

The United Kingdom, however, is not competing for incorporations, and is not likely to do so in the future.[108] It is too big to care about the modest incorporation fees it

---

[105] British corporate law does contain a duty to consider employee interests. See Company Act of 1980, § 309. However, in reality, this duty is used by management to justify actions not favored by shareholders, rather than being used by employees to claim protection of their interest. See Company Law Review Steering Group, Modern Company Law for a Competitive Economy — The Strategic Framework 41 ¶ 4.1.21 (Feb. 1999), http://www.dti.gov.uk/cld/comlawfw/framewrk.pdf.

[106] Unlike most other member states, the United Kingdom already allows local businesses to incorporate abroad. That virtually none of them ever incorporates in other member states or, for that matter, in the United States, suggests that the British law appeals to their managers and shareholders more than the alternatives.

[107] See David F. Hickok & Thomas Schürrle, The "Inspire Art" Judgment of the European Court of Justice: New Ways to Structure Acquisitions in the European Union?, Debevoise & Plimpton Memorandum to Clients and Friends (Jan. 20, 2004), http://www.debevoise.com/publications/pubsdetail.asp?pubid=1011201232004&typeid=4# [hereinafter Debevoise & Plimpton Memorandum]; *Inspire Art:* New Opportunities for Corporate and Private Equity Structuring, Latham & Watkins Corporate Department Client Alert No. 372 (Feb. 26, 2004), http://www.lw.com/resource/Publications/_pdf/pub931_1.pdf [hereinafter Latham & Watkins Memorandum]; Herald Halbhuber, National Doctrinal Structures and European Company Law, 38 Common Mkt. L. Rev. 1385, 1403 (2001) ("England is widely perceived as the most likely candidate for a European Delaware"); see also UK Governance Is the Best in Europe, Accountancy, Apr. 3, 2004, at 113 (citing a report by Brussels research firm Deminor's conclusion that "Britain has Europe's best corporate governance while Germany, Spain and the Netherlands have among the worst").

[108] Some commentators argue that the legal and accountancy professions in the United Kingdom have both the desire and power to cause the United Kingdom to compete for incorporations. See supra note 56 and accompanying text. I understand the motivation behind the British proactiveness differently.

can hope to collect, and does not even bother to charge such fees.[109] The reason its corporate law is liberal is its common law tradition. Indeed, what some regard as the centerpiece of British corporate law — The City Code on Takeovers and Mergers — applies only to companies headquartered in the United Kingdom,[110] and was introduced in the 1960s — long before incorporations abroad were thought possible in the European Union — in response to a public uproar against abuses in the domestic takeover market.[111] Similarly, the corporate governance requirements of the government sponsored listing rules apply only to companies that use the London Stock Exchange for primary listing.[112] These important parts of the law were designed with local businesses in mind, and given the difficulty of enforcing them on foreign businesses, will probably continue to apply only locally in the future.[113]

The costs of building legal infrastructure are only part of the costs involved in competing for incorporations. Other costs result from the need to overcome political opposition. Lawmakers will not spend political capital to attract incorporations just

---

109 See Cheffins, supra note 6, at 435.

110 See City Code on Takeovers and Mergers, Introduction, http://www.thetakeoverpanel.org.uk.

111 See Stephen Kenyon-Slade, Mergers and Takeovers in the US and UK Law and Practice 506-07 (2004) (noting that the impetus for establishing the code and the panel enforcing was widespread criticism of the issuance of large block of shares by Metal Industries to white squire Thorn Electrical to ward off an attempted takeover by Aberdare Holdings' in 1967).

112 See United Kingdom Listing Authority, The Listing Rules ¶¶ 17.12, 11.14, http://www.fsa .gov.uk/pubs/ukla/chapt17-3.pdf. Of 133 foreign European Union firms listed on the London Stock Exchange on July 30, 2004, only 15 firms out had their primary listing there. Of these, 11 firms were Irish, 1 was German, 1 was Danish, and 2 were Italian. The total number of Irish companies listed on the London Stock Exchange was 58. See London Stock Exchange, List of Companies, http://www.londonstockexchange.com/en-gb/pricesnews/statistics/listcompanies/.

113 Corporate lawyers bemoan the refusal of the British City Panel on Takeovers to apply the City Code on Takeovers and Mergers to companies incorporated and listed in the United Kingdom but operating abroad. See Freshfields Bruckhaus Deringer Public Takeovers Memorandum, supra note 14, at 17 (noting that these so-called "orphan" companies currently "have to include certain takeover precautions in their articles of association to reassure investors").

because it might benefit the state. They will first consider its effect on their career. Their considerations will include, for example, the magnitude of the benefit, the time and likelihood it will materialize, their ability to claim personal credit for it, the repercussions of failing, the availability of alternative legislative projects worthy of their attention, and the opposition they will face.[114]

It is beyond the scope of this article to catalogue all the political costs that could stand in the way of competition for incorporations. Suffice is to say that these costs can be substantial because an intricate web of interest group politics shape corporate law in many of them, especially the ones possessing the necessary legal infrastructure to attract incorporations. Developed member states tend to carry significant political baggage that would cripple them in a market for incorporations. One such political hurdle is strong labor. If there is one matter on which managers and shareholders agree it is about limiting employee influence over corporate strategy.[115] Yet this is also among the most sensitive political issues in these member states. A related hurdle is protectionism. Efficient corporate law is one that allocates corporate assets to their best use. Yet it requires neutrality that politicians tend to lack when it implies the transfer of local businesses to foreign hands.[116] This protectionist impulse has so far stymied efforts in

---

[114] See Kahan & Kamar, supra note 8, at 727-35; cf. R. Douglas Arnold, The Logic of Congressional Action 68-71 (1990).

[115] See Marco Pagano & Paolo Volpin, The Political Economy of Corporate Governance, Am. Econ. Rev. (forthcoming 2005) (finding that employee protection tends to be stronger, and shareholder protection tends to be weaker, in proportional, as opposed to majoritarian, electoral systems); Mark J. Roe, Political Preconditions to Separating Ownership from Corporate Control, 53 Stan. L. Rev. 539 (2000) (arguing and presenting evidence that social democracies tend to have weaker shareholder protection).

[116] The desire to protect local industry has many a time driven elected officials in developed member states of the European Union to weigh in when major domestic manufacturers were about to be sold to foreign buyers. See, e.g., Andrew Bulkeley & Ross Tieman, Fighting the Inevitable in France, Corp. Control Alert, June 2004, at 20 (describing the intervention by the French government to stir the French pharmaceutical Aventis away from the Swiss acquirer Novartis and into the hands of its domestic rival Sanofi-Synthelabo in 2004); Patrick Jenkins, Ackermann's Agenda: Deutsche Bank Grapples With

the most developed member states to pass legislation that might expose domestic manufacturers to foreign acquisitions.[117]

All these political hurdles can easily retard legislation that would attract incorporations at the expense of domestic labor and production. This hindrance can be significant. Laws mandating labor representation on the board of directors or requiring consultation with employees in mergers are hardly the way to go if member states are to attract incorporations because neither managers nor shareholders gain from these

---

Divisions Over Strategy, Fin. Times, Sept. 16, 2004, at 19 (describing the lobbying by German powerhouses Siemens, Deutsche Telekom, and SAP to prevent foreigners from buying Deutsche Bank); Paul Betts & Victor Mallet, A French Solution, Fin. Times, Jul. 3, 2002, at P18 (describing the political opposition that blocked the acquisition of French oil company Elf Aquitaine by the Italian group Eni in 1999 and the acquisition of the Belgian company Société Générale de Belgique by the Italian financier Carlo De Benedetti in 1988). European governments have been particularly persistent in using so-called golden shares to block the acquisition of privatized companies by foreign buyers. See Carlta Vitzthum, Madrid Exercises Its 'Golden Shares' on Foreign Deals, Wall St. J., May 18, 2000, at A23 (describing the government blocking of an acquisition of the Spanish company Telefonica by the Dutch company KPN, an acquisition the Spanish Hidroelectrica del Cantabrico by Electricité de France, and an acquisition of Telecom Italia by Deutsche Telekom). In 2003, the European Court of Justice declared this practice illegal. See James Kanter, EU's Top Court Further Curbs Use of Golden Shares, Wall St. J., May 14, 2003, at A12. But the motivation to avert acquisitions of major local companies by foreign buyers persists. See Daniel Dombey & Hugh Williamson, Germany Tells Brussels It Will Not Alter VW Law, Fin. Times, Jul. 13, 2004, at 11 (describing a showdown between Germany and the European Commission over a law specifically designed to protect carmaker Volkswagen from foreign acquisitions).

[117] See Freshfields Brukhaus Deringer Takeover Directive Memorandum, supra note 35 (explaining that what ended the 14-year debate over the takeover directive was a comprise allowing member states to permit antitakeover defenses); John W. Cioffi, Restructuring 'Germany, Inc.': The Corporate Governance Debate and the Politics of Company Law Reform, 24 L. & Pol. 355 (2002) (describing opposition in Italy to legislation that would expose Italian firms to takeovers by British and Dutch firms); Scott V. Simpson, The Effect of the 13th Directive on US Bidders, *in* The International Financial Law Review Guide to Mergers and Acquisitions 2004, http://www.legalmediagroup.com/IFLR/includes/print.asp?SID=5275 (explaining that the permission granted in the takeover directive to member states banning antitakeover defenses to exempt defenses against bidders not subject to a similar ban protects European firms from takeovers by American firms).

requirements. And while commentators still disagree on the effect of antitakeover laws on incorporations,[118] they agree that American states that adopted them in the past were motivated solely by a desire to shelter local businesses from foreign acquisition and did not consider their effect on incorporations.[119] If these states were to follow Delaware, whose law is driven solely by the pursuit of incorporations, they would have adopted much milder antitakeover statutes, if any at all.[120]

---

[118] Compare Lucian Bebchuk, Alma Cohen & Allen Ferrell, Does the Evidence Favor State Competition in Corporate Law, 90 Cal. L. Rev. 1775 (2002) (arguing that corporate decisionmakers favor states with antitakeover statutes) and Guhan Subramanian, The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching, 150 U. Pa. L. Rev. 1795 (2002) (same) with Robert Daines, The Incorporation Choices of IPO Firms, 77 N.Y.U. L. Rev. 1563 (2002) (finding no evidence that antitakeover laws affect incorporation decisions) and Marcel Kahan, The Demand for Corporate Law: Statutory Flexibility, Judicial Quality, or Takeover Protection? (NYU Law and Economics Research Paper No. 04-017, June 2004), http://ssrn .com/abstract=557869 (same).

[119] See Henry N. Butler, Corporate-Specific Anti-Takeover Statutes and the Market for Corporate Charters, 1988 Wis. L. Rev. 365 (describing state antitakeover statutes as an effort to shelter local businesses from takeovers); William J. Carney, The Production of Corporate Law, 71 S. Cal. L. Rev. 715, 750-51 (1998) (same); Roberta Romano, The Future of Hostile Takeovers: Legislation and Public Opinion, 57 U. Cin. L. Rev. 457, 461 n.11 (1988) (same).

[120] Some commentators argue that Delaware makes up with case law upholding the use of poison pills for what it misses in antitakeover legislation. See Bebchuk, Cohen & Ferrell, supra note 118, at 1803-04. However, Delaware adopted its mild antitakeover statute in early 1988. See An Act to Amend Chapter 1, Title 8, Delaware Code Relating to the General Corporation Law, 66 Del. Laws, c. 204, § 1 (Feb. 2, 1988). The Delaware Chancery Court at that time did not allow the use of poison pills against takeover bids deemed inadequate by management. See AC Acquisitions Corp. v. Andreson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986). This judicial approach persisted after the enactment of the antitakeover statute. See Grand Metropolitan, PLC v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988); City Capital Associates v. Interco, Inc., 551 A.2d 787 (Del. Ch. 1988). It was not until 1989 that the Delaware Supreme Court rejected this approach and allowed expressed greater deference to the board and management. See Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1152-53 (Del. 1989).

2. Competition for Investments

It is hard to compare the costs of harnessing corporate law to compete for investments to the costs of doing so to compete for incorporations. Some of the costs are higher in the case of the former type of competition, other costs are higher in the latter, and still other costs are the same. This section therefore does not argue that competition for investments will always be present where competition for incorporations is not. Only that it can. In the European Union it already has.

Consider first the cost of building legal infrastructure. This cost is the same when member states compete for investments as when they compete for incorporations. In either case, only member states that provide quality legislation, regulation, adjudication, and legal services can compete. The difference is that in the case of competition for investments the member states that possess the necessary legal infrastructure, which tend to be the larger and more developed ones, are not precluded from competing. The member states that have been the most active in the wave of corporate law reforms of recent years are not the smallest in the European Union. They may well be the largest. It is beyond the scope of this article to determine whether being a large and developed member state is in itself a motivation to use corporate law to stimulate economic development. But evidently it is not an impediment.

Member states with underdeveloped legal infrastructure would find the pursuit of incorporations particularly challenging because they would need to match the solid legal infrastructure of the United Kingdom. It does not matter that the United Kingdom is not competing for incorporations. Any member state that wished to attract incorporations would still have to offer a viable alternative. Competition for investments is different. It does not lend itself to being won by a single member state because the product for sale is a package that contains more than corporate law. Even if all corporate decisionmakers agree that the combination of legal infrastructure and substantive corporate law in the United Kingdom is superior to that in any other member states, not all firms will choose the United Kingdom as their home, and not all capital investments will flow into the United Kingdom. Both businesses and investments will be spread among member states in accordance with the distribution of means of production, both physical and legal. It should be entirely possible for a member state offering, for example, cheap labor, low taxes, or rich natural resources, to use corporate law to stimulate economic development even if its legal infrastructure falls short of the United Kingdom's.

By contrast, consider the political costs of overcoming opposition to corporate law reform. Some of these costs are the same in competition for investments and in competition for incorporations because they stem from opposition by interest groups that are not directly affected by production activity. Nevada, for example, abandoned in the 1990s a plan to designate judges who would hear only business disputes because this would have required a protracted constitutional amendment and would have reopened an earlier debate about designating judges to hear only family disputes.[121] Pennsylvania scrapped around the same time an initiative to form a chancery court with no juries in part due to opposition from public interest lawyers who were concerned that low income individuals might find themselves in that court.[122] Because the opposition in both instances did not come from corporate constituencies, it would have likely been the same regardless of whether the reform had affected mostly local firms (as in competition for investments), or firms operating in other states (as in competition for incorporations).

But opposition to corporate law reform can also come from corporate constituencies, such as employees, consumers, or residents in areas where production takes place. These groups can show greater resistance to corporate law reform when it affects local firms. The failed Pennsylvania chancery court initiative serves again as a useful example because it was opposed not only by the public interest bar but also by

---

[121] See Minutes of the Nev. Legis. Commission's Subcomm. To Encourage Corporations and Other Business Entities to Organize and Conduct Business in This State, 1999 Leg., 1999-2000 Interim Sess. (May 30, 2000) (testimony of A. William Maupin, Associate Justice, Supreme Court of Nevada), available at http://www.leg.state.nv.us.

[122] See Mark A. Tarasiewicz, Chancery Ct. Opposed by Bar Ass'n, Resolution Is Withdrawn, Legal Intelligencer, June 1, 1992, at 1.

labor unions.[123] These unions presumably would have been less resistant to the reform had it affected mostly corporations operating in other states. They cared about the reform and had the clout to block it because it would have affected a great number of local employees. This is to be contrasted with the restraint that Delaware has shown in not adopting strong antitakeover statutes despite their popularity with labor unions. Few local employees were affected by that policy because most Delaware firms are based in other states.[124]

Since competition for investments affects mainly local businesses, it will normally encounter stronger opposition than competition for incorporations. But this opposition can be muted if competitive pressures in the markets for products, capital, and labor compel local corporate constituencies to internalize the cost of inefficient corporate law and accept reform. This is forcefully illustrated in the recent push in Germany to relax the requirement that employee representatives fill half the seats on the boards of large companies.[125] Such a reform was unthinkable only a decade ago. Today it is widely regarded as essential to preventing business from fleeing Germany in an

---

[123] See John L. Kennedy, Chancery Ct. Plan Sent to Senate, Legal Intelligencer, May 17, 1993, at 1.

[124] See Romano, supra note 168, at 57-60.

[125] See Matthew Karnitschnig, German Board Law Targeted, Wall. St. J., Oct. 28, 2004, at A13 (reporting a "declaration of war" by the German Industry Association and the German Employers Association on a "pillar of the German workers' movement that has defined labor relations for a generation" — the rights of employees to half the seats on supervisory boards of big corporations — "as companies increasingly shift factories and jobs from Germany to cheaper, less regulated markets"); Gail Edmondson, Cut Labor's Clout on German Boards, Bus. Wk, Nov. 15, 2004, at 84 (noting that relaxing the decades old codetermination rules "could be a secret bullet against outsourcing and high unemployment"); David Gow, Chill Enters Cosy German Boardrooms, Guardian, Oct. 25, 2004, at 22 (citing the president of Kiel Institute for World Economics opining that Germany's codetermination "must be adapted to meet modern demands for entrepreneurial flexibility, especially among foreign investors" and noting that "the most telling business argument for change is that co-determination is an obstacle to cross-border mergers or, as in the case of Hoechst and Rhone-Poulenc (now Aventis), forces the transfer of the company headquarters outside Germany").

increasingly integrated and competitive economic environment.[126] The reform will no doubt adversely affect German employees. But the alternative of losing jobs to employees in other member states is worse.[127] Union leaders know this, employer representatives know this, and lawmakers know this.[128]

III. Normative Implications

Standard accounts of corporate lawmaking in federal systems explain both the rate at which jurisdictions innovate and the degree to which these innovations accommodate corporate decisionmakers as a product of competition for incorporations. This does not mean, however, that the law must stagnate when this type of competition is absent. Competition for investments has powerful and quite different effects of its own. It can readily spread over many jurisdictions, including large and developed ones, without any one jurisdiction dominating the market. And it affects companies based on their physical location rather than based on their choice. This explains why corporate legal reforms marshaling shareholder rights have been spreading in the European Union notwithstanding the absence of freedom to incorporate abroad and, as will be explained further below, why introducing such freedom may undermine this trend. A freedom to incorporate abroad may thus be a mixed blessing. On the one hand, it frees firms from having to wait for their home jurisdiction to bring the quality of local corporate law up to

---

[126] Workers Cut Back: Germany's Codetermination Law Must Adapt to New Times, Fin. Times, Nov. 1, 2004, at 18 (noting that "global competition and European integration are finally putting pressure on … the 28-year-old law that gives employees equal representation on the supervisory boards of large companies").

[127] The danger of job loss was illustrated vividly in the threats made by the large German microprocessor maker Infineon to relocate into Switzerland to cut taxes and labor costs associated with Germany's codetermination. See Matthew Karnitschnig, Infineon May Shift Base from Germany, Wall St. J., Apr. 29, 2003, at A1; A Warning Shot, Wall St. J., Apr. 30, at A8.

[128] The pressure on German labor unions to accept a cutback on their codetermination rights is part of a general pressure on them and on labor unions in other member states to share the burden of economic recovery under threats of layoffs. See Matthew Karnitschnig & Marcus Walker, Firms in Germany Pressure Unions to Accept Change, Wall St. J., Dec. 21, 2004, at A14.

the level available elsewhere. On the other hand, to the extent that it weakens the pressure on jurisdictions with inferior corporate law to improve, it deprives firms locked in these jurisdictions of the improvements that more intense competition for investments would generate.

A. Competition for investments and Competition for Incorporations Compared

In order to understand how the introduction of a freedom to incorporate abroad will affect corporate lawmaking in the European Union, it is helpful to first compare the regulatory dynamics today, when this freedom is missing and member states compete for only investments, to a world in which this freedom exists and member states compete only for incorporations. This comparison is not meant to suggest that the introduction of the freedom to incorporate abroad will replace the existing competition for investments with competition for incorporations. It will probably not. Its purpose is rather to situate the current regulatory dynamics in the European Union against those postulated in traditional analyses of corporate lawmaking in federal systems, and mark the two as extreme points along a continuum of possible regulatory dynamics that later sections will explore.

1. Who Competes and How

Perhaps the most apparent distinction between competition for investments and competition for incorporations is in the type and the number of jurisdictions likely to compete.

Competition for incorporations naturally involves only a handful of small jurisdictions, or a single small jurisdiction, because the benefits from attracting incorporations are modest and because firms gravitate towards the jurisdiction with the largest number of incorporations. In the United States, that jurisdiction is Delaware, a state with ___ citizens, $__ billion in revenues, and a gross domestic product of $____

billion.[129] A similar pattern in the European Union would mean a clustering of incorporations in a single small member state and a lack of attention by larger member states to incorporations.[130]

Competition for investments is different. Its higher stakes and the inability of firms to cluster in a single jurisdiction enable any number of jurisdictions of any size to compete. These are the dynamics of corporate lawmaking in the European Union today, where competition for investments has been fueling corporate law reforms even — and perhaps especially — in the largest and most developed member states. It is beyond the scope of this article to empirically test whether large and developed jurisdictions use corporate law to compete for investments more than other jurisdictions. This would certainly be consistent with the visible corporate law reforms in such member states as Germany, Italy, and France in recent years, and could be explained by the pressure for regulatory reform that a developed industry can apply on lawmakers and the likelihood that a developed jurisdiction will posses the necessary legal infrastructure to compete.[131] But it is not necessary to resolve this question here. Regardless of whether large and developed jurisdictions use corporate law to compete for investments more than other jurisdictions, they certainly do not appear to fall behind them.

While competition for investments attracts a different set of competing jurisdictions than competition for incorporations, the incentives that the two types of competition create for competing jurisdictions are similar. In both cases, competing

---

[129] U.S. Census Bureau, States Ranked by Revenue and Expenditure Total Amount and Per Capita Total Amount: 2002, http://www.census.gov/govs/state/02rank.html (revised Jun. 2004) (revenue);

[130] [Cite commentators who predict that member states will compete for incorporations].

[131] It is beyond the scope of this article to empirically test whether larger and more developed jurisdictions compete harder than others for investments through corporate law reforms. But the vigor with which member states such as Germany, Italy, and France have been doing just that lately makes this very possible. Other determinants that may affect the propensity to compete for investments through corporate law reform include government budget deficit, privatizations, exposure of local industry to foreign competition, and demand by local industry for additional capital.

jurisdictions produce the law most likely to win the approval of both managers, who must initiate corporate decisions, and shareholders, who must consent to them. In the European Union, this has thus far resulted in a trend towards shareholder protection, a reassuring sign for the view that regulatory competition yields a race to the top.[132] More specifically, however, the trend has been towards adopting rules and practices similar to those in the United Kingdom and the United States.[133] The use of Anglo-American corporate law as a reference point is noteworthy. There are many ways to protect shareholders. But the Anglo-American way is a particularly effective one because, with the advent of international law firms, investment banks, and accounting firms, it has become the gold standard in shareholder protection worldwide.[134]

---

[132] See Pagano & Volpin, supra note 115 (finding that over the 1990s shareholder protection improved on average in 45 countries despite the absence of changes in electoral systems or legal origin, and concluding that in that decade there was international convergence in shareholder protection); Accountancy, supra note 107 (citing a report by Brussels research firm Deminor's conclusion that corporate governance standards are improving in Continental Europe's as a whole).

[133] While British corporate law and American corporate law are similar, important differences between them do exist. An example of a British rule with no American equivalent that has spread across the European Union is the rule mandating a buyer of a substantial equity stake in a company to offer to buy the remaining shares on the same terms. For the British rule, see Kenyon-Slade, supra note 111, at 676. For its adoption in other member states, see Eric Nowak, Investor Protection and Capital Market Regulation in Germany, *in* The German Financial System 425, 443-44 (Jan Pieter Krahnen & Reinhard H. Schmidt eds., 2004) (Germany); Polak, supra note 55 (Austria); James Blitz, Italian Takeover Reforms Take Shape, Fin. Times, Feb. 12, 1998, at 2 (Italy); Bombrun & Mary, supra note 54 (France); Vincent Dirckx & Yolande Meyvis, Belgium, *in* The International Financial Law Review Guide to Mergers and Acquisitions 2004, http://www.legalmediagroup.com/IFLR/ includes/print.asp?SID=5240 (Belgium), Pedro Pérez-Llorca & Oriol Armengol, Spain, *in* The International Financial Law Review Guide to Mergers and Acquisitions 2004, http://www.legalmediagroup.com/IFLR/includes/print.asp?SID=5254 (Spain); St. John Kennedy, supra note 19 (Ireland); Thomas Nygren, Niclas Högström & Sophia Westman Melèn, Sweden, *in* The International Financial Law Review Guide to Mergers and Acquisitions 2004, http://www.legalmediagroup.com/IFLR/includes/print.asp?SID= 5256 (Sweden).

[134] See Michael Klausner, Corporations, Corporate Law, and Networks of Contracts, 81 Va. L. Rev. 757, 841-47 (1995) (arguing that the value of a corporate legal system increases in the number of its

2. Firms Whose Costs of Incorporating Abroad Are Low

Having identified the key differences between the current competition for investments among member states of the European Union and the competition for incorporations — the fact that the current competition for investments involves large industrialized jurisdictions across the continent rather than a single or a few small jurisdictions, and the fact that the beneficiaries of this competition are local corporations in competing jurisdictions rather than foreign corporations that incorporate in them — it becomes a simple matter to describe, if not to measure, the effects of the two types of competition on social welfare.

The beneficiaries of competition for incorporations would be firms that are currently located in member states that do not offer the best corporate law in the European Union and that would incorporate abroad. Italian firms, for example, may well benefit from the efforts of Italian lawmakers to improve local corporate law. But these efforts do not mean that Italian corporate law is the best in the European Union today or, more importantly for the analysis, the best that would be found in the European Union if member states competed for incorporations. From the perspective of Italian firms that would incorporate abroad, competition for incorporations would be preferable to the current competition for investments because it would grant them access to the leading corporate law in the European Union.

These Italian firms would also reap the benefits of higher scale economies in the production and the consumption of corporate law than available to them today. The current inability of companies in the European Union to incorporate abroad creates balkanization. It is impractical for all, or even most, firms to operate in one member state. They must spread geographically and be governed by different legal regimes.

users). For standardization in the contracts governing investments other than in stock, see Stephen Choi & Mitu Gulati, Innovation in Boilerplate Contracts: An Empirical Examination of Sovereign Bonds, 53 Emory L.J. (forthcoming 2005) (sovereign bonds); Marcel Kahan & Michael Klausner, Standardization and Innovation in Corporate Contracting (Or 'The Economics of Boilerplate'), 83 Va L. Rev. 713 (1997) (corporate bonds).

While these regimes may over time come to resemble each other, they do not offer the full benefits that a single regime governing all firms would offer in administrative and judicial expertise, access to legal services, comprehensive case law, and comparability among firms. All of these benefits would be available to European firms if they incorporated in a single jurisdiction as American firms do.

3. Firms Whose Costs of Incorporating Abroad Are High

Not all firms would rush to incorporate abroad even if they were free to do so. Many small companies — mostly private, but also public — would consider the cost of incorporating abroad to be too high, especially if it entails changing lawyers. In the United States, where there are no language or culture barriers to incorporating in Delaware while conducting business in another state, and where legal advice on Delaware law is readily available nationwide, the vast majority of private companies incorporate in their home state. In 1999, for example, Delaware was the legal domicile of only 230,000 companies out of roughly 5 million companies in existence nationwide.[135] Even public companies do not necessarily incorporate in Delaware. Only half of them, typically the larger ones, do.[136] Many companies in the European Union would find themselves in a similar position if they were to choose where to incorporate. It is hard to tell whether their attachment to their home jurisdictions would be higher or lower than that of companies in the United States because the greater diversity of corporate laws in the European Union compared to the United States would raise both the costs and the benefits of incorporating abroad. The nature of the barriers these companies would face to incorporating abroad, however, would be the same.

---

[135] Compare Kahan & Kamar, supra note 96, at 1251 t.3 (reporting that 229,249 companies paid franchise tax in Delaware in 1999), with United States Census Bureau, Statistical Abstract of the United States 2002, at 471, http://www.census.gov/prod/2003pubs/02statab/ business.pdf (reporting that 4,936,000 companies filed tax returns in the United States in 1999).

[136] See Robert Daines, Does Delaware Law Create Value?, 62 J. Fin. Econ. 525 (2001) (noting that public companies that incorporate in Delaware tend to have higher total assets than companies that incorporate in other states).

Another group of companies that would find incorporation abroad costly is companies whose employees, creditors, or managers would oppose the move.[137] Shareholders and managers would probably support incorporation in a member state with minimal employee or creditor protection.[138] But while their agreement would be enough for incorporating new companies,[139] existing companies would need to negotiate with employees and creditors with vested rights.[140] Moreover, managers themselves could be reluctant to reincorporate if they believed the foreign law overly limited their

---

137 See Bebchuk & Roe, supra note 9, at 143-47 (arguing that entrenched participants in firms may block even efficient structural changes if these changes would harm them). Note that not all companies will be deadlocked by such divergence of preferences because they buy the consent of the participant blocking the reincorporation. There will probably be firms, however, for which the cost will be too high. How many firms will fall under this category only time will tell. Compare Bebchuk & Roe, id. at 147-48 (suggesting that many efficient changes can be expected to be blocked) with Hansmann & Kraakman, supra note 10, at 460-62 (suggesting that few efficient changes can be expected to be blocked).

138 See Debevoise & Plimpton Memorandum, supra note 107; Latham & Watkins Memorandum, supra note 107.

139 Much like the protagonists of the famous European Court of Justice decisions requiring member states to recognize foreign incorporations — Centros, Überseering, and Inspire Art — the only companies attempting to incorporate outside their home member state thus far have been start-up companies aiming to avoid minimum capital requirements. See von Falkenhausen Interview, supra note 45; Telephone Interview with Rudolf H. Haas, Partner, Latham & Watkins, Frankfurt, June 29, 2004.

140 Both existing and proposed European Union legislation protect vested rights of creditors and employees of companies that merge with foreign companies or reincorporate abroad. See Council Regulation (EC) No. 2157/2001 of 8 October 2001 on the Statute for a European Company (SE) §§ 1, 8(7), 24(1), 34, OJ L 294/1; Council Directive Supplementing the Statute on the European Company with Regard to the Involvement of Employees § 7, OJ L 294/22; Proposal for a Directive of the European Parliament and of the Council on Cross-Border Mergers of Companies with Share Capital §§ 2, 14, COM 2003/703, http://europa.eu.int/eur-lex/en/com/pdf/ 2003/com2003_0703en01.pdf; Company Law: Commission Consults on the Cross Border Transfer of Companies' Registered Offices, IP/04/270, http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/04/270&format=HTML&aged=0&language=EN&guiLanguage=en.

discretion.[141] They would not even need to sue to block the reincorporation. They would simply not initiate it.[142]

These immobile firms would benefit from competition for incorporations only if they happen to be located in a member state that would compete for incorporations more than it competes today for investments. But since, unlike competition for investments, competition for incorporations would likely involve mainly small jurisdictions, few firms fall under this category.[143] Other immobile firms would fare worse than they do now because mobile firms in their member states would incorporate abroad and leave them with a smaller network of domestic incorporations and a legislature that has fewer reasons than today to maintain the quality of local corporate law.

While it is easy to identify the advantages and disadvantages of the current competition for investments in the European Union compared to competition for incorporations — the gain to immobile firms from the wider spread of competition, and the loss to mobile firms from the ban on incorporation abroad — it is hard to assess which effect dominates. On the one hand, there are probably many more immobile firms

141 The Sarbanes-Oxley Act of 2002, which has been criticized in the United States on precisely these grounds (see, e.g., Roberta Romano, The Sarbanes-Oxley Act and the Making of Quack Corporate Governance, 114 Yale L.J. (forthcoming 2005)), is commonly viewed as the main reason for the decline in the popularity of American stock listing among foreign issuers. See Silvia Ascarelli, Citing Sarbanes, Foreign Companies Flee U.S. Exchanges, Wall St. J., Sept. 20, 2004, at C1; Shanny Basar, Corporates Reduce Foreign Listings, Fin. News, Feb. 2, 2003; Craig Karmin & Kate Kelly, For Stock Listings, the U.S. Pull Gets Weaker, Wall St. J., Nov. 12, 2002, at C1.

142 This should be contrasted with the ease with which New Jersey and its successor Delaware attracted reincorporations by promising minimal antitrust regulation. See Joel Seligman, A Brief History of Delaware's General Corporate Law of 1899, 1 Del. J. Corp. L. 249, 270 (1976). There is little doubt that, in the absence effective federal antitrust enforcement, reincorporation into New Jersey or Delaware could have significantly harmed consumers. Only consumers could not stop it.

143 See U.S. Bureau of Census, Statistical Abstract of the United States, 2004-2005, http://www.census.gov/prod/2004pubs/04statab/pop.pdf, at 21 (ranking Delaware as sixth smallest jurisdiction in population), 213 (ranking Delaware as third smallest jurisdiction in area), 428 (ranking Delaware as the ninth smallest jurisdiction in gross state product),

than mobile firms. That only a fraction of American firms incorporate in Delaware while operating in other states suggests as much. On the other hand, immobile firms tend to need corporate law less than others. This explains why Delaware attracts less than five percent of incorporations by private firms but roughly half of incorporations by public firms, and why it charges the latter much higher taxes.[144]

B. The Effects of Firm Choice on the Competition for investments

Comparing the social welfare implications of the current competition for investments in the European Union with those of competition for incorporations is only the first step towards informing the debate about the desirability of firm choice in the European Union or, indeed, anywhere else. To be sure, with the European Court of Justice expressing growing impatience with member states that do not recognize foreign corporations, and with the European Commission appearing poised to pass a directive that would lift existing barriers to cross-border mergers, the freedom to pick any member state corporate law seems to be just around the corner for European Union companies. But allowing firms to incorporate abroad will not necessarily replace the current competition for investments by competition for incorporations. It may just as well weaken the competition for investments without introducing any new competition for incorporations or, if it does introduce such competition, it may result in the coexistence of the two types of competition. This section outlines the social welfare implications of each of these scenarios.

1. The Incentives to Compete

While the ability to incorporate abroad may or may not accelerate the development of member state corporate laws or make them more favorable to shareholders by encouraging one member state or more to compete for incorporations, it may lead to the very opposite results by discouraging member states from using their corporate laws to compete for investments. Member states will have fewer reasons to

[144] See Kahan & Kamar, supra note 96.

worry about the quality of their corporate law once firms become free to choose where to incorporate because local corporate law will then not matter as much as it does today to their prosperity.

Local corporate law clearly does not matter as much in the United States. New York corporate law, for example, imposes personal liability on the ten largest shareholders of a company for unpaid salaries and wages.[145] It is a rule investors consider highly unattractive. But it does not prevent New York from being one of the most prosperous states and home to numerous companies. All it means is that many of these companies incorporate in Delaware instead of New York.[146]

The freedom to choose where to incorporate will thus bring the regulatory dynamics in the European Union closer to the ones in United States but, ironically, this may weaken, rather than strengthen, the incentives many member states currently have to develop their laws and ensure they meet investor expectations because fewer local firms will use their corporate law and because these firms will tend to depend on corporate law less than the firms that incorporate abroad.[147] Unless the firms that incorporate

---

145 See N.Y. Bus. Corp. Law § 630 (McKinney 2002).

146 See Frederick Attea, State Has Hard Time Following a Lead, Bus. First in Buffalo, Apr. 17, 2000, at 30 (noting that shareholder liability for wages and salaries is the main reason why many New York businesses incorporate in Delaware); Michael M. Membrado & Christopher J. Gulotta, Navigating the Formation of Start-Up Companies, N.Y. L.J., Sept. 18, 2000, at S6 (same).

147 In theory, even the competitive drive of the United Kingdom, which will likely experience an inflow of incorporations, may dwindle because, like any other provider of a public good, it will share the returns to its lawmaking efforts with other member states whose firms will piggyback its corporate law. In practice, however, any weakening of the incentives of British lawmakers as a result of incorporations by foreign firms will likely be negligible. To be sure, the desire to stimulate the economy is, by the British government's own account, a source of motivation to develop corporate law. But this motivation is only one of many reasons that account for the present state of British corporate law, and not necessarily the most important reason. Indeed, the United Kingdom does not appear to be the most active member state in using corporate law to compete for investments, and most of the features of its corporate law that appeal to incorporators date long before this competition assumed the proportions it has today. To expect that

domestically need a different kind of corporate law from the law that the firms that incorporate abroad need — which will often not be the case[148] — their needs will likely receive less attention from lawmakers than they did prior to the departure of their peers.[149]

The analysis above outlines a possible outcome of the introduction of firm ability to incorporate abroad. It does not purport to predict the only possible outcome. The outcome may different, for example, if the last decade of intense competition for investments has created new institutional dynamics that will perpetuate the current pace and direction of corporate lawmaking. The outcome may also be different if a substantial number of companies face practical hurdles to incorporating abroad despite the freedom to do so. Nevertheless, to the extent that the present trend persists, it will be despite the new mobility, not because of it.

One mechanism that could sustain the existing momentum is adaptation of the market to the changed legal environment. The intense competition for investments that economic integration has fostered in the European Union may have altered the existing

---

corporate lawmaking in the United Kingdom will stall as a result of incorporations by foreign firms is just not realistic.

148 It is possible that private firms need different corporate law than public ones. See, e.g., Robert Charles Clark, Corporate Law 234-38 (1986) (advocating greater tolerance towards usurpation of corporate opportunities by insiders in private firms than by insiders in public firms). The American experience shows, however, that while it is mainly public firms that incorporate outside the state which they operate, half of public firms remain incorporated instate. See supra note 67.

149 The possibility that legislators will be glad to be relieved of the pressure to reform local law and take the blame when it fails is real. To a certain extent it has already been demonstrated in the changes that Germany made to its accounting rules in [1998] to enable German firms to list their securities in the United States and become subject to American securities law and listing rules. See supra note 64. For the argument that jurisdictions with less developed markets and corporate law can benefit from allowing local firms to piggyback more developed markets and corporate law abroad, see Black & Gilson, supra note 38; Edward B. Rock, Greenhorns, Yankees, and Cosmopolitans: Venture Capital, IPOs, Foreign Firms, and U.S. Markets, 2 Theoretical Inquiries L. 711 (2001).

institutional and political map and introduced new actors that would want to see the current legal trend continued. In Germany, for example, formerly creditor-oriented banks have embraced the corporate governance movement by shifting much of their operations from corporate lending to investment banking;[150] formerly corporatist managers have become more attuned to shareholder value as a result of the growing popularity of stock option compensation;[151] and formerly insular employees have started to invest their own pension money in stock.[152] To be sure, the interests of these groups continue to diverge, but the gap between them is narrower than it used to be. [153]

---

150 See John W. Cioffi, Governing Globalization? The State, Law, and Structural Change in Corporate Governance, 27 J.L. & Soc'y 572, 583 (2000) (noting that Dresdner Bank's acquisition of the London-based investment bank Kleinwort Benson, and Deutsche Bank's acquisition of the investment banks Morgan Grenfell in the United Kingdom and Bankers' Trust in the United States mark a transformation that has paved the way for corporate law reforms). Perhaps no bank has been more committed to this transformation than Deutsche Bank, which has filled its top posts with U.S.-trained investment bankers and reduced corporate lending. See Janet Guyon, The Trials of Josef Ackermann, Fortune, Jan. 26, 2004, at 111.

151 [Cite]

152 [Cite]

153 For a recent account of the persistence of old traditions in German corporate boards, see Patrick Jenkins, The Clubby World of German Business Refuses to Accept New Membership Rules, Fin. Times, Aug. 28, 2004, at 20. In reality, the spread of the corporate governance movement has been uneven across firms. Thus, while it was pressure from the corporate sector that drove Germany and the Scandinavian countries to block the inclusion of a ban on the use of dual-class stock as antitakeover defense (see infra notes 160 and 161), some companies in these same countries have recently decided to declassify their stock voluntarily. See Paul Betts, Companies Start to See the Case for Fairer Votes, Fin. Times, Feb. 17, 2004, at 20 (reporting voluntary decisions by L'Oréal in France, ABN Amro in the Netherlands, Nokia in Finland, and SAP and Metro in Germany to scrap dual-class stock capitalization). See also Richard Deeg, Path Dependency, Institutional Complementarity, and Change in National Business Systems, *in* Changing Capitalisms? Complementarities, Contradictions and Capability Development in an International Context (Glenn Morgan, Richard Whitley & Eli Moen eds., forthcoming 2005) (arguing that while several large German companies nowadays subscribe to the shareholder culture, many small companies do not).

The momentum can also be fueled by the companies that will remain practically locked in their home member state notwithstanding the freedom to incorporate abroad.[154] Numerous companies may find themselves in this position.[155] They will probably include, among others, small and midsize companies for which the cost will not be justified; companies whose managers, employees, or creditors resist the move; large companies that wish to be able to use their local political clout for shaping corporate law; and companies intent on avoiding the jurisdiction of foreign courts and regulators, which may extend to matters unrelated to corporate internal affairs.[156]

All these companies will be captives of their home member state's corporate law. As the freedom to choose where to incorporate will be of little relevance to them, the pressure on their home member state to satisfy their need of modern law will remain. Much of this legislation will be uncontroversial. It will involve making the law more flexible, adapting it to technological and economic developments, and improving the

---

[154] I am inclined to trust the instinct of corporate practitioners, who offer the following prediction regarding the future of takeover law in the European Union after the adoption of the takeover directive:

> Following adoption of the Directive, some significant differences of approach to takeover regulation within Europe will remain. . . . However, while the debate on the Directive has continued over the past 14 years, there have been other influences for change within Europe. In the last six years new takeover rules have been adopted in Germany (2002), Italy (1998) and Austria (1999). This is a response to a number of factors, including the increase in the takeover activity in these countries and the increasing internationalisation of the shareholder profiles of many companies. As companies seek to raise capital internationally, they invite more Anglo-Saxon practices in relation to the conduct of takeovers. So, even if the Directive does not in itself help achieve harmonisation in significant areas, there will be other pressures for this to happen over time as the press and other commentators draw attention to the variations in the effect of laws on the interests of shareholders. Nevertheless, there remain significantly different attitudes to stakeholder interests within Europe, and this is likely to perpetuate some differences for some time yet.

See Freshfields Brukhaus Deringer Takeover Memorandum, supra note 35.

[155] See supra Section III.A.3.

[156] [Verify and add a citation].

effectiveness of the institutions supporting it.[157] These uncontroversial attributes of corporate law are important. In the relatively uniform landscape of state corporate laws in the United States, they appear to tip the scales for incorporation decisions.[158] And in the European Union, they already figure prominently in discussions by corporate counsel of the possibilities that incorporation abroad presents.[159]

Legislation promoting the interests of shareholders at the expense of managers, employees, or creditors will of course meet with greater resistance. The persistence of employee board representation and antitakeover defenses in various member states demonstrates as much. But this does not mean that member states that have traditionally guarded the interests of managers, employees, or creditors will continue to do so in an unqualified way. At the urging of local managers, for example, Germany fought the

---

[157] Flexibility-increasing rules range from technical issues like using electronic communication to hold virtual shareholder meetings to substantive issues like designing hybrid securities. A recent example is the ordinance signed by the French president in June 2004 to modernize the country's securities law by removing procedural constraints on secondary stock offerings, enabling issuers to define the terms of preferred stock, and simplifying the treatment of convertible stock. See France Adopts New Legislation to Modernize Its Securities Laws, Cleary, Gottlieb, Steen & Hamilton Memorandum to Clients (Jul. 8, 2004), http://www.cgsh.com/files/tbl_ s5096AlertMemoranda%5CFileUpload5741%5C188%5C55-2004.pdf.

[158] See Kahan, supra note 118 (presenting evidence consistent with the argument that American firms tend to incorporate in states with flexible corporate statutes and effective courts).

[159] See Debevoise & Plimpton Memorandum, supra note 107 (discussing the benefits for bilateral joint ventures of avoiding supermajority voting requirement for issuing new stock, and the benefits for private equity investors of avoiding restrictions on the issuance of redeemable or convertible preferred stock); Recent Legal Developments in the European Union Regarding Cross-Border Transactions, Jones Day Memorandum to Clients, Apr. 2004, http://www1.jonesday.com/FILES/tbl_s31Publications/FileUpload137/1188/Recent%20Legal%20Develop.pdf (same).

inclusion of a ban on antitakeover defenses in the European Union takeover directive,[160] and passed a law expressly making antitakeover defenses legal. This did not stop Germany from adopting corporate governance reforms of which managers were less critical. Sweden also campaigned against banning antitakeover defenses in the takeover directive under pressure from local industry.[161] This did not stop the Swedish financial markets minister from publicly chastising local industry for not responding to corporate scandals and threatening to address the problem with legislation if this failure persists.[162] More generally, the quest for investments may well continue to lead member states to keep updating their laws and replicating shareholder protection available elsewhere. But it is local companies that will be the impetus for doing so, not companies that operate abroad.[163]

2. The Effects on Firms

The freedom to incorporation abroad will be good news for companies anywhere other than the member state with the most attractive corporate law whose costs of incorporating abroad are low. These mobile firms will see their options expand and will be able to choose between incorporating in their home member states and incorporating in any other member state whose law suits their needs. Since these firms will incur only

---

160 See Daniel Dombey, European Parliament Backs Takeover Directive Compromise, Fin. Time, Dec. 17, 2003, at 4 (reporting that Germany blocked the inclusion in the takeover directive of a ban on antitakeover defenses at the behest of large manufacturers like BASF and Volkswagen).

161 See Christopher Brown-Humes & Clare McCarthy, Family Fortunes Face Brussels Power Shift, Fin. Times, May 15, 2003, at P11 (reporting that Sweden, Finland, and Denmark blocked the inclusion in the takeover directive of a ban on dual-class stock capitalization under pressure from industrial barons such as the Walenberg family).

162 See George, supra note 82.

163 In principle, firms locked in their home member states may pressure lawmakers to reform local corporate law to help them compete for capital with local firms that incorporated abroad. But the pressure on lawmakers is likely to be stronger when no local firm can incorporate abroad and all firms rely on local corporate law for attracting foreign capital.

low costs if they incorporate abroad, they could gain, but not lose, from their freedom. They will forgo the opportunity to incorporate abroad only if they do not really need it.

The effect of the freedom to incorporate on firms that do not take advantage of it because doing so would be costly to them is more ambiguous. They will neither lose nor gain from this freedom to the extent that the incentives of lawmakers in their member states to maintain the quality of corporate law do not suffer as a result of the outflow of incorporations by other local companies. But they will lose — up to their cost of incorporating abroad — to the extent that the incentives of lawmakers in their member states suffer as a result of such corporate migration.

It is hard to tell which of these two possible outcomes will materialize. One can reasonably predict, however, that even if the former outcome materializes, the cost it will impose on firms that do not incorporate abroad will be smaller than the benefit firm choice will confer on firms that do incorporate abroad. The reason is twofold. On the one hand, lawmakers driven by the desire to stimulate the local economy are unlikely to lose interest in maintaining the quality of corporate law if a significant number of local firms with a strong need for it cannot incorporate abroad. On the other hand, as both logic and experience in the United States suggest, firms that do incorporate abroad tend to need corporate law more than firms that incorporate locally.

Viewed from this perspective, the introduction of firm choice to the current competition for investments comes close to achieving the benefits of both competition for investments and competition for incorporations while avoiding their costs. Competition for investments without firm choice benefits companies that would face high costs of incorporating abroad. Competition for incorporations benefits companies that face low costs of incorporating abroad. Competition for investments combined with freedom to incorporate abroad, assuming this freedom does not significantly weaken the competition, benefits both types of firms.

3. Competition for Incorporations as a Complement

One of the most debated questions among students of European Union corporate law since the possibility that firms in the European Union would become free to incorporate outside the jurisdiction in which they operate was first considered is whether the competition for incorporations, which to most commentators appeared inevitable, would advance or harm social welfare. Today, after a recent series decisions by the European Court of Justice has made this possibility a near reality, this question is more relevant than ever.

However, in light of the high costs and low benefits identified above that member states can expect if they decide to compete for incorporations, it is far from obvious that any of them will do so. Rather telling in this regard is the failure of all member states regarded as potential competitors to position themselves to compete or at least state an intention to do so. No member state has even bothered to the make its corporate law applicable only to companies incorporated in it — if its law had been different — to be able to compete. This inaction is notable considering the time that has passed since member states were put on notice that the days of the real-seat rule were numbered. In 1986, the European Court of Justice ordered the Dutch authorities to recognize a British company operating in the Netherlands.[164] The court reiterated its position to the Danish authorities, the German authorities, and again the Dutch authorities in subsequent decisions in 1999,[165] in 2002,[166] and in 2003.[167] The decisions stirred a storm among academics. A flurry of commentary examining the new reality from all possible angles

---

[164] See *Segers*, supra note 7. A subsequent decision upholding British restrictions on the relocation to the Netherlands of the corporate headquarters of a company incorporated and headquartered in the United Kingdom caused temporary uncertainty about the direction that the court was taking. See Case 81/87, The Queen v. H.M. Treasury and Commissioner of Inland Revenue, ex parte Daily Mail and General Trust PLC, [1988] E.C.R. 5483.

[165] See *Centros*, supra note 7.

[166] See *Überseering*, supra note 7.

[167] See *Inspire Art*, supra note 7.

quickly filled the pages of legal journals. The rewards to early entry being a lesson from Delaware's experience, one would have expected a mad rush to scrap the real-seat rule and bid for foreign incorporations.[168] But member states showed no interest in the competitive role that theory assigned to them. Not a mad rush, not even a lazy stroll. No reaction at all. Soon member states will have no choice but to delete the real-seat the rule from their laws. The European Commission is already drafting a new directive requiring them to do just that. But compliance with this requirement should not be mistaken for competition for incorporations. European capitals may have already revealed their lack of interest in this regard during two decades of apathy.

But would competition for incorporations make a difference? Perhaps less than most would think. From the standpoint of migrating firms, the specific identity of the jurisdiction in which they incorporate is secondary to the quality of its law. With or without competition for incorporations, the freedom to incorporate abroad would allow firms to incorporate in any member state they choose. Whether it is a member state that competes for incorporations or one that competes for investments, by and large, its law will be the same.

Conclusion

[Incomplete]

How different will be member state laws with freedom to incorporate but no competition for incorporations from what they could be with such competition? Perhaps not much.

Normally, the rate of legal innovation and diffusion, and the degree to which the law serves shareholders, can be expected to be higher in jurisdictions that pursue incorporations. In the United States, for example, Delaware appears to be consistently faster than other states in innovating and copying innovations from others. Other states

[168] See Michael Klausner, Corporations, Corporate Law, and Networks of Contracts, 81 Va. L. Rev. 757, 841-47 (1995); Roberta Romano, The Genius of American Corporate Law 37-44 (1993).

are slower because they do not pay as much attention to their laws. Delaware also appears to be more careful in balancing shareholders' preferences against managers', as evidenced by its decision not to match the potent antitakeover statutes that some other states adopted with a similarly potent statute of its own.[169] Other states have more powerful antitakeover statutes because local managers lobby for their enactment while out-of-state shareholders are largely ignored.

Competition for international capital currently provides member states with a stronger reason to update their laws and accommodate shareholders than would the hope of attracting incorporations. This motivation may weaken if incorporation abroad becomes an easy alternative for all firms to use. But to the extent that many firms find this option impractical — which is more likely to be the case in the European Union than it is in the United States — the need to support economic development by attracting foreign investment may continue the momentum of corporate innovation close to its present pace. This may compensate, and perhaps more than compensate, for the absence of competition for incorporations as a motivation to develop the law.

---

[169] See Kahan & Kamar, supra note 8, at 740; William J. Carney, The Political Economy of Competition for Corporate Charters, 26 J. Legal Stud. 303, 754-55 (1997); Romano, supra note 168, at 59.