The Function of Corporate Law and the Effects of Reincorporations in the U.S. and the EU

Federico M. Mucciarelli*

In the U.S., corporations can be incorporated in any of the fifty states and can "reincorporate" afterwards in any other state. However, the competence of the state where a company is incorporated is limited: on the one hand, it is restricted by federal laws and, on the other hand, it regulates only the "internal affairs" of corporate activities. Consequently, in the U.S. reincorporations are a relatively easy task, because they only shift rules that address the shareholder—board relation, while creditors and other stakeholders are not affected.

In the EU, we find a partially similar scenario. In the last decade, the European Court of Justice has liberalized initial incorporations and in 2005 the cross-border directive opened the doors to freedom of reincorporation from one Member State to another. In the EU, however, reincorporations have a much different impact than on the other side of the Atlantic, because the agency problems between shareholders and the board are bundled with the agency problems between shareholders and creditors, all being in the competence of the Member State of incorporation. In the EU, therefore, any change of the applicable corporate law risks jeopardizing creditors. Sophisticated creditors will discount this risk from the credit rate or will protect themselves through specific covenant, but unsophisticated creditors will bear entirely the risk of opportunistic reincorporations. For this reason, many EU Member States provide mechanisms for creditors' protection in case of reincorporation, often by requiring the debtor to give a security or to pay the debts that are not yet due. These mechanisms are aimed at avoiding negative externalities, yet they make reincorporations more expensive and will impede a certain number of efficient transactions.

I. INTRODUCTION 423
II. REINCORPORATIONS IN THE U.S. AND IN THE EU 426
  A. *Reincorporations in the U.S.* 426
  B. *Reincorporations in the EU* 427
    1. Before the Revolution 429
    2. Revolution Step 1: The Liberalization of Initial Incorporation 430
    3. Revolution Step 2: Reincorporations Through Cross-Border Mergers 432
      a. ECJ Case Law from *Daily Mail* to *Cartesio* 432
      b. The Dismissed Proposal of a Directive on Cross-Border Reincorporations 433

---

* © 2012 Federico M. Mucciarelli. New York University Global Research Fellow 2010/2011—University of Modena and Reggio Emilia, Associate Professor of Business Law/CEFIN – Center for Research in Banking and Finance. I would like to thank Marcel Kahan for his invaluable comments and suggestions and for the long discussions on previous versions of this Article; Carsten Gerner-Beuerle, Martin Gelter, Stefano Lombardo, Wolf-Georg Ringe, Maxi Scherer, and Mathias Siems for several important suggestions and remarks. All errors are mine.

c. The European Company as a Vehicle for Reincorporations 434
d. The Cross-Border Merger Directive 435

III. COMPANY LAW AND FEDERALISM: VERTICAL POWER ALLOCATION IN THE U.S. AND IN THE EU 437
- *A. Federal Corporate Law in the United States* 437
- *B. Harmonization of Corporate Law in the EU* 441

IV. THE SCOPE OF CORPORATE LAW IN THE U.S. AND IN THE EU 444
- *A. Corporate Agency Relations and the Law* 444
  1. Agency Problems Between Shareholders and the Board 445
  2. Agency Problems Between Minority and Control Shareholders 445
  3. Agency Problems Between Shareholders and Creditors 446
  4. Choice of Forum 448
- *B. The Scope of Corporate Law in the U.S. and the EU* 449
  1. The Scope of Corporate Law in the U.S. Under the "Internal Affairs Doctrine" 449
  2. The Scope of Corporate Law in the EU 454
     a. Creditor Protection and the Scope of Corporate Law 454
     b. Creditor Protection Mechanisms in Corporate Law and the Role of Insolvency Law 456

V. REGULATING REINCORPORATIONS IN "BI-STAKEHOLDER" AND "MULTI-STAKEHOLDER" JURISDICTIONS 458
- *A. Redistributive Effects of Reincorporations* 459
- *B. Reincorporations and Efficiency* 460
- *C. Reincorporations' Effects in "Bi-Stakeholder" Corporate Laws: The U.S.* 461
- *D. Reincorporations' Effects in "Multi-Stakeholder" Laws and the Mechanisms To Protect Creditors: The EU* 462
- *E. "Multi-Stakeholder" Corporate Laws, Creditors' Protection and the Constraints to Regulatory Competition* 466

VI. CONCLUSION 467

I. INTRODUCTION

Freedom to reincorporate is an important prerequisite of regulatory competition in corporate law. According to the model of a perfect "market for corporate law," corporations should be allowed to select the corporate law they prefer, regardless of the country where the firm's activities take place or where the corporate headquarters are located. In this way, the corporation would actually "buy" the most attractive corporate law out of a menu of alternatives (i.e., the different jurisdictions). In this scenario, corporations would be free to choose the preferred law at the moment of the original incorporation and to change the applicable law afterwards without the need to liquidate in the original state. In other words, under this model, a free demand for corporate law requires freedom of incorporation as well as freedom of reincorporation. If reincorporations are allowed, companies can threaten the state of origin to switch to the law of a different state. This threat may trigger a regulatory competition, if domestic policy makers have incentives, such as franchise fees, to attract incorporations and to avoid domestic corporations fleeing to a different jurisdiction.

This model is a reality in the U.S., where corporations are initially formed in the state of their headquarters and then often reincorporated in Delaware upon going public. In the U.S., as a consequence of that, legal and economic scholars have engaged in an intense debate on the efficiency of free choice of law and on the real existence of a regulatory competition among states. While some scholars hold that the regulatory competition among U.S. states to attract incorporations has positive effects upon shareholders' value ("race to the top" theory),[1] others hold that such competition ultimately leads to a "race to the bottom" or to protection of the board's interest at the expense of shareholders and creditors.[2] However, in recent years intermediate theories have been developed, arguing that regulatory competition leads "nowhere in

1. Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 275-76, 283, 287, 289, 292 (1977); Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J. L. ECON. & ORG. 225, 225 (1985).

2. William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 663-66, 669, 705 (1974); Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1442-44 (1991-1992).

particular"[3] or that, after the "victory" of Delaware, no real competition exists anymore.[4]

A similar debate arose in the EU after the European Court of Justice (ECJ) and EU derivative law had liberalized initial incorporations and midstream reincorporations by way of cross-border mergers. Certainly, Member States of the EU have less incentives than their American counterparts to compete with each other in order to attract corporations, with the consequence that regulatory competition is less developed in the EU than in the United States.[5] However, after the liberalization of reincorporations in the EU, one could easily argue that, at least regarding the demand-side of regulatory competition, the United States and the EU are now similar, because in both a certain, although not identical, degree of free choice of corporate law exists.

Are we really sure that when referring to "reincorporations," Americans and Europeans mean the same thing? In this Article, I argue that they do not, and that the transatlantic debate is affected by a misunderstanding of the real nature of midstream choice of corporate law in the United States and the EU. The goal of this Article is to unveil this misunderstanding.

First of all, we must remember that corporate governance rules aim at addressing three fundamental agency relations: between shareholders and the board; between majority and minority shareholders; and between shareholders and creditors or other stakeholders (including employees, lenders, suppliers, and customers). With this in mind, we can rephrase the question of what is a "reincorporation" in this way: what set of rules can corporations intentionally shift from one jurisdiction to another and which agency relations are affected by this transaction?[6]

In this regard, the U.S. and EU models diverge, because in the United States, midstream reincorporations change a more limited set of

---

3. William W. Bratton, *Corporate Law's Race to Nowhere in Particular*, 44 TORONTO L.J. 401, 401-03 (1994).

4. *See* Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 555-57 (2002) (discussing the absence of a real threat to Delaware's dominance, due to barriers to entry into the market for corporate laws); Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679, 684-86 (2002-2003) (according to Kahan and Kamar, entry barriers are not sufficient to explain the lack of regulatory competition, which depends also on political reasons); *see also* Michal Barzuza, *Delaware's Compensation*, 94 VA. L. REV. 521, 523-25, 526-28 (2008) (arguing that the Delaware franchise fee is not optimal and induces Delaware to create a law that increases board's powers).

5. *See* Luca Enriques, *EC Company Law and the Fears of a European Delaware*, 15 EUR. BUS. L. REV. 1259, 1259 (2004).

6. In legal terms, the question arises regarding the characterization of what is "corporate law" for private international law purposes.

rules than in the EU. Indeed, in the U.S. corporate law is not entirely in the competence of the states, because the federal government also has a word to say. Additionally, in the U.S. the competence of the state of incorporation is more limited than in the EU: according to the "Internal Affairs Doctrine," which is the established conflict-of-law criterion for corporate law, only the shareholders—managers relations are in the exclusive competence of the state of incorporation, while creditors' protection mechanisms are either outside the doctrine or federalized. In other words, in the U.S., the regulation of the agency relations between shareholders and creditors is unbundled from other agency problems. Consequently, creditors in the U.S. rely much more upon other pieces of regulation, such as federal insolvency law.

By contrast, in the EU, the states of incorporation are generally competent to also regulate mechanisms for creditors' protection. Regarding creditors' protection, however, EU Member States regimes are not uniform and it seems difficult to collapse them into a single model, despite the effort to harmonize corporate law through EU directives. Indeed, some Member States pursue the goal to protect creditors of "private" corporations also through bankruptcy law mechanisms. Because the state of incorporation has a default competence also to govern corporate bankruptcies, in any event, in the Member States of the EU the three fundamental agency relations (shareholders—board, majority—minority shareholders, and shareholders—creditors) are bundled together and, consequently, reincorporations change a broader set of rules than in the U.S.

In order to compare the U.S. and the EU, we should find a common denominator between them. While the U.S. is a true federal state, the EU is a supranational or regional entity with a hybrid nature.[7] Nonetheless, and being aware of the differences of these two entities, a comparison of the reincorporation mechanisms is possible because in both the U.S. and the EU the Member States have the competence to charter corporations, while the central bodies enjoy regulatory powers over corporate law issues. Furthermore, both the U.S. and the EU are big integrated markets where corporations are free to conduct business and to trade without being discriminated vis-à-vis domestic corporations. In the following pages, for the sake of simplicity, I will refer to both the U.S. and the EU, as "federal" states or entities, and to "federal" bodies or government,

---

7. *See* Ingolf Pernice, *The Treaty of Lisbon: Multilevel Constitutionalism in Action*, 15 COLUM. J. EUR. L. 349, 352-53 (2008-2009).

meaning the federal government in the U.S. and the Commission, the Council, and the European Parliament in the EU.

This Article will start by describing in Part II the reincorporation options available to corporations in the U.S. and in the EU. In Part III, I will address the vertical allocation of regulatory powers between federal bodies and the states in the U.S. and the Member States in the EU. We will see that in the U.S., despite corporations being chartered by the states and governed mainly by state law, the U.S. Congress and other federal bodies have enacted a significant portion of modern U.S. corporate law; meanwhile in the EU, directives have partially harmonized the corporate law rules of Member States. In Part IV, I will discuss the main difference between the U.S. and the EU, which concerns the scope of corporate law. In Part V, I will ask whether these differences have any impact on efficiency and redistribution. In particular, I will argue that the "multi-stakeholder" nature of many EU jurisdictions obliges them to protect creditors from opportunistic reincorporations into another Member State with a lower level of creditors protection. These mechanisms of creditor protection against opportunistic reincorporations, however, risk producing overregulation and unnecessarily increasing the costs of reincorporation. This makes the EU market for corporate law less dynamic than in the U.S.

II. REINCORPORATIONS IN THE U.S. AND IN THE EU

Corporations chartered under the law of one of the states in the U.S. or one of the Member States of the EU can reincorporate into another Member State without the need to liquidate. However, in the EU, unlike the U.S., freedom of reincorporation is a recent achievement. Indeed, until a few years ago a number of EU Member States did not allow domestic companies to "reincorporate" under the law of another Member State. Only in 2005 was a European directive enacted that allowed cross-border mergers throughout the EU and gave European corporations a legal mechanism to reincorporate from one Member State to another.[8]

A. *Reincorporations in the U.S.*

In the U.S., the fundamental choice-of-law criterion for corporate law is the "Internal Affairs Doctrine," pursuant to which the state of incorporation is competent to regulate internal corporate matters and the

8. Council Directive 2005/56/EC, 2005 O.J. (L 310) 1, 2.

other states should recognize validly incorporated companies.[9] Depicted in this way, the Internal Affairs Doctrine seems to be a version of the "incorporation theory" applied in the U.K. and in the other common law countries. Indeed, a number of similarities exist, the most important of which is that corporations do not need to have their business or headquarters in the territory of the state of incorporation in order to be validly incorporated.

However, differing from English law, companies incorporated in one of the states of the U.S. can validly reincorporate into another state without the need to liquidate. Technically, under the law of most states of the U.S., as well as the Model Business Corporation Act, reincorporations are implemented through cross-border mergers, whereby a company merges into a newly incorporated "shell" corporation in the state of arrival.[10] The "emigrating" corporation does not need to transfer its headquarters or its business into the new state of incorporation. Therefore, U.S. corporations can freely choose their preferred corporate law, both at the moment of initial incorporation and afterwards, regardless of the locations of their headquarters and businesses.

Midstream reincorporations play a significant role in the U.S. market for corporate law. Indeed, U.S. corporations are initially chartered in the "home state" where their businesses and headquarters are, but upon going public most of them decide to reincorporate in Delaware, even though their businesses and activities remain in their states of origin.[11] In other words, Delaware competes with other states in the U.S. to attract already existing corporations into its jurisdictions.

B. Reincorporations in the EU

In the EU, Member States, which are competent to charter corporations,[12] do not share a common choice of law criterion. As is well known, Member States' choice of law criteria can be roughly divided into

9. RESTATEMENT (SECOND) OF THE LAW: CONFLICT OF LAWS § 296 (1969) ("In order to incorporate validly, a business corporation must comply with the requirements of the state in which incorporation is to occur regardless of where its activities are to take place or where its directors, officers or shareholders are domiciled."); *id.* § 297 ("Incorporation by one state will be recognized by other states.").

10. *See* Model Bus. Corp. Act Ann. § 11.02 (1984).

11. Romano, *supra* note 1, at 225; Lucian Arye Bebchuk & Alma Cohen, *Firms' Decisions Where To Incorporate*, 46 J.L. & ECON. 383, 385-86 (2003).

12. *See* Jens C. Dammann, *Freedom of Choice in European Corporate Law*, 29 YALE J. INT'L L. 477, 487-91 (2004) (regarding EU law before the enactment of the Directive on cross-border mergers).

opposite fields.[13] On the one hand, according to the "incorporation theory," companies are governed by the state of incorporation, regardless of the location of business or headquarters. On the other hand, under the "real seat theory" companies are governed by the law of the state where the headquarters are located. The question as to whether reincorporations are allowed or not, however, is independent from the choice of law criterion adopted. Consequently, until a few years ago a number of Member States did not allow reincorporations at all, either by way of cross-border mergers or by way of "direct reincorporations" by transferring the registered office[14] and the registration in a public registrar[15] from the original country to the new one.

However, this situation is slowly changing for intra-EU reincorporations due to the recent development of EU derivative law and the ECJ's case law. Indeed, in recent times the EU has enacted a directive enabling cross-border mergers, so that corporations now have at their disposal a legal mechanism to reincorporate in another Member State.

---

13. Although this divide is, at a deeper glance, an oversimplification, I will nonetheless use it for the sake of simplicity. *See* Jan Wouters, *Private International Law and Companies' Freedom of Establishment*, 2 EUR. BUS. ORG. L. REV. 101, 103-07 (2001); Massimo V. Benedettelli, *Libertà comunitarie di circolazione e diritto internazionale privato delle società*, RIVISTA DI DIRITTO INTERNAZIONALE PRIVATO E PROCESSUALE 569 (2001).

14. I will use the English language "registered office" instead of "statutory seat," which is used in continental European Member States. However, we should bear in mind that these two concepts are not identical. In continental European jurisdictions, the articles of incorporation should explicitly indicate where the "statutory seat" is located and the corporation should file for registration at the office of the registrar that is competent for that territory. Consequently, if a corporation wants to change jurisdiction—provided that the jurisdiction of origin allows this transaction—it should first amend the articles of incorporation, by adding the new "statutory seat," and then transfer the registration from the original Member State to the new one. In other words: the simple amendment of the "statutory seat" as such is not sufficient to change the applicable law and is rather an ancillary indication of the intention to transfer the registration. *See* Peter Behrens, *Die Umstrukturierung von Unternehmen durch Sitzverlegung oder Fusion über die Grenze im Licht der Niederlassungsfreiheit im Europäischen Binnenmarkt (Art. 52 und 58 EWGV)*, 23 ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT 1, 5 (1994).

15. European corporations should be registered in a public registrar, which should be located in the same Member State of incorporation, whose corporate law applies. See First Council Directive of 9 March 1968 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community. First Council Directive 68/151/EEC, art. 3, 1968 O.J. (L 65) 8 (EC) ("In each Member State a file shall be opened in a central register, commercial register or companies register, for each of the companies registered therein."); *see* Jonathan Rickford, *Current Developments in European Law on the Restructuring of Companies: An Introduction*, 15 EUR. BUS. L. REV. 1225, 1246-47 (2004); Wolfgang Schön, *The Mobility of Companies in Europe and the Organizational Freedom of Company Founders*, 2 EUR. CO. FIN. REV. 122, 139 (2006).

1. Before the Revolution

Until recently, reincorporations were not generally allowed throughout the EU and a number of Member States prohibited domestic companies from reincorporating abroad, either directly or by way of cross-border mergers.

Such prohibitions of "outbound" reincorporations are independent from the choice-of-law criterion adopted by the state of origin. Indeed, the application of either the "incorporation theory" or the "real seat theory" is irrelevant to the question as to whether companies can change the state of incorporation without the need to liquidate. For instance, despite the U.K. and Germany following opposite choice-of-law criteria, their laws converge regarding the limits posed on the freedom to "emigrate." The difference between these two states is that according to English law a transfer abroad of the registered office is simply impossible,[16] while under German law any transfer abroad of the registered office or of the corporate headquarters may lead to the liquidation of the company and to the taxation of its assets.[17]

Other states allow reincorporation, but restrict the practical availability of this transaction with the aim of protecting minority shareholders and creditors of domestic corporations. For instance, under French law "private" limited liability corporations can enter into a direct

16. Under English conflict of law, the competent jurisdiction for corporate affairs is such where the original domicile of the corporation is located and, therefore, reincorporations are not allowed. Attorney-General v. Jewish Colonization Ass'n, [1900] 2 Q.B. 556, 571, 574; Baelz v. Public Trustee, [1926] 1 Ch. 863, 863; Gasque v. Comm'rs of Inland Revenue, [1940] 2 K.B. 80, 84 ("The domicil of origin, or the domicil of birth, using with respect to a company a familiar metaphor, clings to it throughout its existence."); Carl Zeiss Stiftung v. Rayner & Keeler Ltd. & Others (No.3), [1970] 1 Ch. 506, 544; Nat'l Trust Co. v. Ebro Irrigation & Power Co., [1954] 3 D.L.R. 326, 333; Int'l Credit & Inv. Co v. Adham, [1994] 1 B.C.L.C. 66; *see* A. FARNSWORTH, THE RESIDENCE AND DOMICILE OF CORPORATIONS 71 (1939); Dan Prentice, *The Incorporation Theory—The United Kingdom*, 14 EUR. BUS. L. REV. 631, 633 (2003); DICEY, MORRIS & COLLINS ON THE CONFLICT OF LAWS 1336, 1337 (Lawrence Collins, et al. eds., 14th ed. 2006).

17. *See* Bayerisches Oberlandesgericht [BayObLG] [Bavarian High Regional Court] May 7, 1992, BAYOBLGZ 113, 1992 (Ger.); Bundesgerichtshof [BGH] [Federal Court of Justice] Mar. 21, 1986, 97 BGHZ 334, 1986 (Ger.); Bernhard Groβfeld, *Internationales Gesellschaftsrecht*, *in* VON STAUDINGERS KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH 605 (Jan Kropholler ed., 1998); Marc-Philippe Weller, *Zum Identitätswahrenden Wegzug Deutscher Gesellschaften*, 29 DEUTSCHES STEUERRECHT, 1218 (2004); Reichsgericht [RG] [court of last resort for civil and criminal matters] June 5, 1892, 7 RGZ, 68, 1892 (Ger.) (*obiter dictum*); *see* Friedrich Keßler, *Das für die Aktiengesellschaft massgebende Recht*, 3 ZEITSCHRIFT FÜR AUSLÄNDISCHES UND INTERNATIONALES PRIVATRECHT 758, 768 (1929). However, a different opinion holds the decision to transfer the registered office abroad simply null and void: Bayerisches Oberlandesgericht [BayObLG] [Bavarian High Regional Court] February 11, 2004, DIE AKTIENGESELLSCHAFT [AG] 266, 2004 (Ger.); Oberlandesgericht München [OLG München] October 4, 2007, ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT [ZIP] 2124, 2007 (Ger.).

reincorporation only if shareholders approve such a transaction unanimously;[18] in contrast, French "public" corporations can decide to reincorporate with a simple majority, but only to another Member State or to states with which France has signed an international agreement.[19] In Spain, direct reincorporations have been explicitly allowed and regulated in 2009[20] through a complex proceeding aimed at protecting minority shareholders and creditors. Regarding cross-border mergers, some Member States, such as Italy,[21] France, and Spain allowed these transactions even before the enactment of the European Cross-Border Merger Directive, while other Member States, such as Germany, Austria, Luxembourg, and the Scandinavian states prohibited such transactions.[22]

2. Revolution Step 1: The Liberalization of Initial Incorporation

In the last decade, the ECJ has banned[23] unreasonable restrictions posed by Member States to "inbound" transfers of headquarters of foreign corporations[24] and to "inbound" cross-border mergers.[25]

---

18. CODE DE COMMERCE [C. com.] art. L 223/30 (Fr.).

19. CODE DE COMMERCE [C. com.] art. L 225/97 (Fr.); *see* Hervé Le Nabasque, *L'incidence des Normes Européennes Sur le Droit Français Applicable aux Fusions et au Transfert de Siège Social*, 123 REV. SOCIÉTÉ 81 (2005).

20. Structural Changes of Commercial Companies, Act 3/2009, B.O.E. n.3, Apr. 4, 2009 (Spain).

21. Italian law allows cross-border mergers, yet it is still unclear whether direct reincorporations are feasible. The conflict of law criterion for corporations refers, similarly to English law, to the country "where the incorporation occurred." L. 31 Maggio 1995, N. 218 art. 25 (It.). Consequently, reincorporations should not be permitted, as conflict of law refers to the original place of incorporation not to any subsequent places of "re-incorporation." However, the Italian Civil Code (articles 2437 and 2473) allows corporations to transfer their statutory seat abroad, in which case dissenting shareholders have the right to withdraw from the company. *Id.* arts. 2437, 2473. Additionally, as a matter of fact, reincorporations are commonly implemented in the Italian business practice and accepted by many local offices of the registrar, despite the contrary opinion of the majority of case law. Therefore, if we look at the "law in action," we should assimilate Italy to the countries that allow reincorporations, while the "law on the book" is uncertain. *See* FEDERICO M. MUCCIARELLI, SOCIETÀ DI CAPITALI, TRASFERIMENTO ALL'ESTERO DELLA SEDE SOCIALE E ARBITRAGGI NORMATIVI (2010).

22. Mathias M. Siems, *The European Directive on Cross-Border Mergers: An International Model?*, 11 COLUM. J. EUR. L. 167, 169-70 (2004-2005).

23. These restrictions are violations of the EU freedom of establishment. Pursuant to article 49 of the Treaty on the Functioning of the European Union, the freedom of establishment grants to citizens and corporations of EU Member States the right to establish themselves in other Member States and to set up branches and subsidiaries, without being discriminated and without suffering unreasonable restrictions and burdens. Consolidated Version of the Treaty on the Functioning of the European Union art. 49, May 9, 2008, 2008 O.J. (C 115) 47 [hereinafter TFEU]. In addition, pursuant to article 63 TFEU, restrictions to free movements of capital are banned within the EU as well as with third states. TFEU art. 63.

24. Case C-212/97, Centros Ltd. v. Erhvervs-og Selskabsstyrelsen, 1999 E.C.R. I-1484; Case C-208/00, Überseering BV v. Nordic Construction Co. Baumanagement GmbH, 2002

Consequently, domestic restrictions on the activities of pseudo-foreign corporations are allowed only if they fulfill the four conditions of the s.c. "Gebhard test" established by ECJ case law: "they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it."[26] In practice, this means that the state of incorporation is free to decide autonomously the policy goals to be pursued through corporate law and to set the level of shareholders' and creditors' protection. This also means that the other Member States, where companies run their businesses or have their headquarters, should accept rules, policy goals, and the level of creditors' protection decided by the state of incorporation.[27]

To sum up, corporations can be chartered in any Member State and can run their businesses in another state, provided that the state of incorporation allows them to dissociate their registered offices and activities. The liberal decisions of the ECJ have encouraged a flourishing market for initial incorporations throughout the EU. Unlike the U.S., the actors in this market are "private" corporations: indeed, a relevant number of limited liability corporations in recent years were formed in states with low capital requirements, typically in the U.K., but pursue their businesses exclusively in other Member States.[28]

E.C.R. I-9943; Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd., 2003 E.C.R. I-10195.

25. Case C-411/03, SEVIC Systems AG, 2005 E.C.R. I-10825.

26. Case C-55/94, Reinhard Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, 1995 E.C.R. I-4186.

27. The rationale is that creditors rely upon legal certainty and to the accounting statement published under the law of origin. This rationale is realistic for sophisticated adjusting creditors, yet it is doubtful that non-adjusting creditors can really rely exclusively upon transparency and that they do not deserve a protection from the state where the business is conducted. *See* Horst Eidenmüller, *Mobilität und Restrukturierung von Unternehmen im Binnenmarkt*, 59 JURISTENZEITUNG 24, 28 (2004).

28. *See* Marco Ventoruzzo, *"Cost-Based" and "Rules-Based" Regulatory Competition: Markets for Corporate Charters in the U.S. and in the E.U.*, 3 N.Y.U. J. L. & BUS. 91, 103-07 (2006); Marco Becht, Colin Mayer & Hannes F. Wagner, *Where Do Firms Incorporate? Deregulation and the Cost of Entry*, 14 J. CORP. FIN. 241, 255 (2008). *But see* William W. Bratton, Joseph A. McCahery & Erik P.M. Vermeulen, *How Does Corporate Mobility Affect Lawmaking? A Comparative Analysis*, 57 AM. J. COMP. L. 347, 366 (2009) (noting the declining volume of incorporation mobility after the first wave).

3. Revolution Step 2: Reincorporations Through Cross-Border Mergers

a. ECJ Case Law from *Daily Mail* to *Cartesio*

Regarding restrictions placed by the Member State of incorporation on reincorporations abroad, the ECJ's case law is much more uncertain. In the leading case, *Daily Mail* of 1988, the ECJ declared that corporations are products of domestic state law and that their existence depends entirely on the jurisdiction of incorporation.[29] The consequence is that the state of incorporation can prohibit domestic companies from transferring their headquarters or registered offices into another state. *Daily Mail* has always been considered a milestone of the ECJ's case law, so that Member States felt free to prohibit domestic corporations from reincorporating abroad.

In the last twenty years, however, some corporate tax decisions seem to adopt different views without openly challenging *Daily Mail*.[30] Eventually, the ECJ in the *Cartesio* ruling of 2008[31] partially contradicted *Daily Mail*, by stating in an *obiter dictum*[32] that Member States can keep their own substantive and conflict law for domestic corporations[33] but cannot "requir[e] the winding-up or liquidation of the company, in preventing that company from converting itself into a company governed

29. Case C-81/87, The Queen v. H.M. Treasury & Comm'rs of Inland Revenue, *ex parte* Daily Mail & Gen. Trust plc, 1988 E.C.R. 5483.

30. Case C-264/96, Imperial Chemical Industries plc (ICI) v. Kenneth Hall Colmer (Her Majesty's Inspector of Taxes), 1998 E.C.R. I-4695; Case C-446/03, Marks & Spencer plc v. David Halsey (Her Majesty's Inspector of Taxes), 2005 E.C.R. I-10837; Case C-196/04, Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd. v. Comm'rs of Inland Revenue, 2006 E.C.R. I-7995; Federico M. Mucciarelli, *Company 'Emigration' and EC Freedom of Establishment:* Daily Mail *Revisited*, 9 EUR. BUS. ORG. L. REV. 267, 279-80 (2008); Carsten Gerner-Beuerle & Michael Schillig, *The Mysteries of Freedom of Establishment After Cartesio*, 59 INT'L & COMP. L.Q. 303, 306 (2010) (regarding the *Cartesio* case generally).

31. Case C-210/06, Cartesio Oktató és Szolgáltató bt., 2008 E.C.R. I-09641; *see* Veronika Korom & Peter Metzinger, *Freedom of Establishment for Companies: The European Court of Justice Confirms and Refines Its* Daily Mail *Decision in the Cartesio Case C-210/06*, 1 EUR. CO. & FIN. REV. 125, 154 (2009); Gerner-Beuerle & Schillig, *supra* note 30.

32. The case at stake in *Cartesio* was not one of reincorporation, but of simple relocation of the administrative seat from Hungary to Italy, without the aim to change applicable company law. Therefore the second prong of the *Cartesio* ruling, according to which reincorporations should be allowed throughout the EU, is an *obiter dictum* with doubtful binding force. Case C-210/06, *Cartesio*, 2008 E.C.R. I-09641.

33. *Id.* ¶ 110 ("[A] Member State has the power to define both the connecting factor required of a company if it is to be regarded as incorporated under the law of that Member State.").

by the law of the other Member State."[34] This part of the decision is merely an *obiter* with doubtful binding force, yet it is extremely significant, since it signals what policy the court will pursue if a question on a "direct reincorporation," by way of transfer of registered office, is submitted to it.

b. The Dismissed Proposal of a Directive on Cross-Border Reincorporations

Despite the ECJ's dithering for many years, reincorporations were eventually liberalized by EU derivative law in the last decade. However, this liberalization was not pursued directly by allowing "direct reincorporation" abroad, but by allowing cross-border mergers.

The enactment of the 14th directive on the harmonization of corporate law on direct reincorporations has been on the agenda of the European Commission for several years,[35] yet such a proposal was eventually dismissed in 2007. The first detailed project for a directive was presented in 1997, but was not approved.[36] In 2002, a panel of corporate law specialists, entrusted by the EU Commission to develop reform proposals for European company law (the "High Level Group"), strongly recommended liberalizing reincorporations throughout the EU, as a way to implement both efficient allocation of resources and the quality of domestic laws.[37] Following this suggestion, the Action Plan of the Commission of 2003 to modernize company law identified the directive on reincorporation among their priorities; indeed, the 14th directive was also on the Lisbon Agenda of 2005.[38] Such a directive would have allowed "direct reincorporations" from one state to another and, at the same time, would have protected minority shareholders, creditors, and employees. Nonetheless, and despite the repeated calls of

---

34. *Id.* ¶ 112. In other words, Member States can prohibit domestic corporations to transfer their headquarters abroad but cannot prohibit them to reincorporate under the law of another European jurisdiction.

35. Such directive should have been the 14th directive on corporate law harmonization, and in the following text I will refer to it also as the project for a XIV directive.

36. *See* Robert R. Drury, *Migrating Companies*, 24 EUR. L. REV. 354, 362-68 (1999); Karsten Engsig Sørensen & Mette Neville, *Corporate Migration in the European Union*, 6 COLUM. J. EUR. L. 181, 195-97 (2000).

37. JAAP WINTER ET AL., REPORT OF THE HIGH LEVEL GROUP OF COMPANY LAW EXPERTS ON A MODERN REGULATORY FRAMEWORK FOR COMPANY LAW IN EUROPE 1-4 (2002), http://ec.europa.eu/internal_market/company/docs/modern/report_en.pdf,101 [hereinafter HIGH LEVEL GROUP REPORT].

38. *Communication from the Commission to the Council and the European Parliament—Modernising Company Law and Enhancing Corporate Governance in the European Union—A Plan To Move Forward*, at 23, COM (2003) 284 final (May 21, 2003).

the European Parliament to the Commission for submitting a proposal on corporate reincorporations, in 2007, the Commission decided to abandon the project.[39] The alleged reason was that such reform does not provide evident advantages that outweigh the risk that, by reincorporating abroad, a domestic company would displace Member States' authority in establishing their own policy goals through corporate law rules.[40] The final dismissal of the proposal came as quite a surprise, because during the last decade EU derivative law has turned in another direction by openly allowing cross-border reincorporations through the vehicle of the European Company and through cross-border mergers.

c. The European Company as a Vehicle for Reincorporations

The first step towards freedom of reincorporation was the Regulation on the European Company (*Societas Europaea*, hereinafter SE).[41] The SE is a type of corporation that is not established by any EU Member State but directly by EU law. However, the SE Regulation governs the SEs only partially, since the major part of their rules are established by the Member State where the registered office is located.[42] In practice, SEs are domestic joint stock corporations with a "federal" EU vest. One of the reasons to create this new kind of company with EU legitimation was to allow cross-border reincorporations and transfer of the registered office from one Member State to another. Indeed, SEs can change the applicable "gap-filling" national law by transferring the registered office abroad,[43] which makes the SE a potential vehicle to avoid restrictions on reincorporations placed by Member States.[44] However, the SE is not a vehicle for free choice of law because its administrative seat should be placed in the same country as the registered office, with the consequence that, in order to change the applicable

---

39. Comm'n of the European Cmty., *Impact Assessment on the Directive on the Cross-Border Transfer of Registered Office* § 2(5), SEC (2007) 1707 (Dec. 12, 2007) [hereinafter *Impact Assessment IV Directive*].

40. *See id.* § 8.

41. Council Regulation (EC) No. 2157/2001 of 8 October 2001 on the Statute for a European Company (SE), 2001 O.J. (L 294) 1 [hereinafter SE Regulation].

42. *Id.* art. 9(1).

43. *Id.* art. 7. Additionally, SEs can transfer their registered office outside the EU; the Member State of the registered office is competent to regulate the consequences of this decision: Wolf-Georg Ringe, *The European Company Statute in the Context of Freedom of Establishment*, 7 J. CORP. L. STUD. 185, 208-09 (2007).

44. Luca Enriques, *Silence Is Golden: The European Company as a Catalyst for Company Law Arbitrage*, 4 J. CORP. L. STUD. 77, 79-80 (2004); Horst Eidenmüller, Andreas Engert & Lars Hornuf, *Incorporating Under European Law: The Societas Europaea as a Vehicle for Legal Arbitrage*, 10 EUR. BUS. ORG. L. REV. 1, 2-4 (2009).

company law, SEs have to shift both the registered office and the administrative seat into the new jurisdiction.[45]

d. The Cross-Border Merger Directive

Freedom of midstream reincorporation throughout the EU was eventually imposed by the EU on Member States by enacting a directive on cross-border mergers in 2005,[46] which introduced a specific proceeding to implement these transactions.[47] A company incorporated in one Member State, therefore, can now incorporate a new "shell" company in another Member State and then merge into it, without risking that the state of origin might tax its hidden reserves.[48] Therefore, European corporations seem to benefit from a "U.S. style" mechanism to reincorporate in another Member State.[49] This mechanism, in addition, as well as cross-border transfers of SE's registered office, is tax neutral according to EU derivative law.[50] This means that cross-border mergers do not give rise to any taxation in the state of origin of the corporation.

Despite these similarities, some differences between the EU and the U.S. still exist. The first is that EU derivative law does not unify

---

45. SE Regulation, *supra* note 41, art. 7; *see* Ringe, *supra* note 43, at 190 (noting that article 7 of the SE Regulation violates the EC freedom of establishment); *see also* Jodie A. Kirshner, *"An Ever Closer Union" in Corporate Identity?: A Transatlantic Perspective on Regional Dynamics and the* Societas Europaea, 84 ST. JOHN'S L. REV. 1273, 1314 (2010) (finding that interviews show that the need to move the headquarters is an obstacle to reincorporation). However, the SE Regulation does not provide for any specific definition of "administrative seat." Two alternative interpretations are possible. On the one hand, we might hold that "administrative seat" is the place where the board meets, in which case free choice of law does not suffer any great restriction, because cheap flight connection allow board's members to fly easily to the country of the registered office. Enriques, *supra* note 44, at 81. By contrast, if we adopt a more strict concept of "administrative seat," for instance the place where day-by-day administrative decisions are taken, then regulatory arbitrages becomes more implausible and the SE would be an unsuitable device for free choice of corporate law. Daniel Zimmer & Wolf-Georg Ringe, *Comment to Article 7 SE Regulation*, *in* SE KOMMENTAR n.12 (Lutter & Hommelhoff eds., 2008).

46. Council Directive 2005/56/EC, 2005 O.J. (L 310) 1, 2 (EC). This directive was enacted long before the cross-border merger directive, yet it did not mandate Member States to accept such transactions. *See* Jens Dammann, *A New Approach to Corporate Choice of Law*, 38 VAND. J. TRANSNAT'L L. 51, 77-79 (2005).

47. Almost simultaneously, the ECJ banned prohibitions to cross-border mergers placed by the country of the post-merger company as a violation of EU freedom of establishment. Case C-411/03, SEVIC System AG, 2005 E.C.R. I-10825, paras. 30-31.

48. Council Directive 90/434/EEC, pmbl., 1990 O.J. (L 225) 1 (amended by council Directive 2005/10/EC, 2005 O.J. (L 58) 19).

49. Martin Gelter, *The Structure of Regulatory Competition in European Corporate Law*, 5 J. CORP. L. STUD. 247, 249-50 (2005); Siems, *supra* note 22, at 179; Horst Eidenmüller, *Die GmbH im Wettbewerb der Rechtsformen*, ZEITSCHRIFT FÜR ALLGEMEINES GESELLSCHAFTSRECHT 168 (2007).

50. Council Directive 2005/19/EC, 2005 O.J. (L 58) 19.

corporate choice-of-law criteria of Member States and does not ban the "real seat theory," which is still adopted by some Member States on domestically incorporated companies.[51] Consequently, if the Member State of arrival or the Member State of original incorporation follow the "real seat theory," reincorporations also require a transfer of the headquarters to the new jurisdiction.

Additionally, the proceedings of a cross-border merger are burdensome and time-consuming. These are the essential steps of the transaction, according to the Directive: (1) the transferring corporation needs to draw up a draft term of the merger and make it public on the domestic public register;[52] (2) the corporation should publish in the national gazette the essential elements of the transaction (which is a pretty expensive requirement);[53] (3) the board and an independent expert should draw up business and financial reports;[54] (4) the transaction should be approved by the shareholders meeting at least thirty days after

51. *See* Case C-210/06, Cartesio Okató es Szolgáltató bt., 2008 E.C.R. I-09641, para. 105; Christoph Teichmann, *Cartesio: Die Freiheit zum formwechselnden Wegzug*, 30 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 393, 397 (2009). In Germany, the "real seat theory" has been upheld by the Federal Court of Justice, at least for extra-EU corporations, that are recognized in Germany as German partnerships without limited liability. Bundesgerichtshof [BGH] [Federal Court of Justice] October 27, 2008, BGHZ 178, 2008 (Ger.) (Swiss company); Bundesgerichtshof [BGH] [Federal Court of Justice] October 8, 2009, GEWERBEARCHIV 223, 2010 (Ger.) (Singapore Company); Bundesgerichtshof [BGH] [Federal Court of Justice] March 15, 2010, NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT 712, 2010 (Ger.). The Federal Court of Justice claims that the real seat theory is part of German customary case law and can be repealed only by an explicit act of the Parliament. However, the reform of 2008 of the limited liability corporations (that was considered not sufficiently explicit by the BGH) has abolished the duty of German corporations to keep their place of business and their headquarters in the same city as the registered office (see the repealed § 4(2) *GmbHG* and § 5(2) *AktG*). It is not clear whether German companies can now transfer their headquarters abroad (which would be at odds with the real seat theory), but the opinions of the Federal Court of Justice seem to point in the opposite direction. Jochen Hoffmann, *Die stille Bestattung der Sitztheorie durch den Gesetzgeber*, 34 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 1581 (2007); Walter Bayer & Jessica Schmidt, *Grenzüberschreitende Sitzverlegung und grenzüberschreitende Restrukturierungen nach MoMiG, Cartesio und Trabrennbahn*, 173 ZEITSCHRIFT FÜR DAS GESAMTE HANDELSRECHT UND WIRTSCHAFTSRECHT (ZHR) 735, 749 (2009); Marc-Philippe Weller, *GmbH-Bestattung im Ausland*, 43 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 2029, 2030 (2009). *But see* HERIBERT HIRTE, KAPITALGESELLSCHAFTSRECHT 465 n.7.14 (2009). Additionally, we should take into account that in 2008 a legislative project has been presented to the German Parliament by the Ministry of Justice, drafted by a commission of experts, which will replace the real seat theory with the incorporation theory. CENT. ASS'N OF GERMAN BUS. ASS'NS, STELLUNGNAHME DER CDH ZUM REFERENTENENTWURF FÜR EIN: GESETZ ZUM INTERNATIONALEN PRIVATRECHT DER GESELLSCHAFTEN, VEREIN UND JURISTISCHEN PERSONEN (2008), *available at* http://www.der-betreib.de/content/pdfft,227,344412.

52. Council Directive 2005/56/EC, art. 5, 2005 O.J. (L 310) 1, 2 (EC).

53. *Id.* art. 6.

54. *Id.* arts. 7-8.

the publication of the draft in the public register;[55] (5) the transaction and the documents should be submitted to judicial or notary supervision;[56] (6) eventually, the merger is published in the new register. Additionally, a significant number of Member States protect creditors of the merging company by granting them a right to judicially oppose the transaction within a certain time from its publication, or to obtain security or advanced payment. These mechanisms make the whole proceeding time-consuming and expensive, since creditors have at their disposal a certain amount of time, ranging from thirty to ninety days according to domestic regulation, to oppose the deal.

III. COMPANY LAW AND FEDERALISM: VERTICAL POWER ALLOCATION IN THE U.S. AND IN THE EU

Reincorporations shift the competence to regulate corporate governance from the state that originally chartered the company to a different one. To understand the magnitude of the effects of reincorporations, therefore, it is necessary to clarify which rules are shifted from the original state of incorporation to the new one. In federal legal systems, states might share the regulatory powers over corporate governance issues with the federal or central government. This is the case both in the U.S. and in the EU, where corporations are chartered by the Member States, but the federal government in the U.S., and the central bodies in the EU enjoy regulatory powers.[57]

A. Federal Corporate Law in the United States

As explained above,[58] in the U.S., the Internal Affairs Doctrine is widely established as the choice of law criterion for corporate law issues. Consequently, in order to know the content of corporate law, a simple

---

55. *Id.* art. 9; Third Council Directive 78/855/EEC, art. 8(a), 1978 O.J. (L 295) 36.

56. Council Directive 2005/56/EC, arts. 10 (premerger scrutiny), 11 (overall scrutiny of the completion of merger), 2005 O.J. (L 310) 9.

57. Not all federal states follow the same pattern: Canadian corporations, for instance, can be chartered both under federal and under state law. Yet the relation between federal level and lower jurisdictions is peculiar, since both "levels" have autonomous corporate laws. Consequently, corporations can choose to incorporate either under federal law (Canada Business Corporation Act [CBCA] 1985) or under one of the laws of the states. In addition, corporations can "move" from one state to another and also from federal law to state law, by following the procedure provided for by the original law (s.c. "continuance"). Therefore, Canadian corporations have at their disposal a broader menu of choices than U.S. ones because companies can move either horizontally, from one state to another, or vertically, from one state to the federal state. J. ANTHONY VANDUZER, THE LAW OF PARTNERSHIPS AND CORPORATIONS 2, 374-76 (2d ed. 2003).

58. *See* RESTATEMENTS (SECOND) OF THE LAW: CONFLICT OF LAWS § 297.

answer might be to look at the law of the state of incorporation. Things, as usual, are much more complicated than they first appear, and to have a full picture of U.S. corporate law it is necessary to enlarge our view and to examine the federal actors, namely Congress and the SEC, and their "vertical" relations to Member States.[59] Indeed, Congress has the power to enact legislation aimed at regulating commerce between states (Commerce Clause)[60] and, consequently, corporate governance issues can be federalized to address interstate commerce.[61] Furthermore, regarding the enforcement of the law, it is worth pointing out that in the U.S. any litigation related to federal rules is in the jurisdiction of federal courts, not of state courts. The presence of an autonomous federal circuit that deals with the interpretation of federal corporate law rules is a significant step towards the uniformity of this regulation through a body of judicial decisions.

In recent years, legal scholars have debated the role of federal actors on corporate governance and the existence of a "vertical" competition among Congress and the states to govern corporate law. While some scholars hold that federalization of corporate law is not significant because the regulation of agency relations between shareholders and the board has not been governed by federal law,[62] others have argued that the federalization of corporate law is a significant threat to states' powers and to Delaware's dominion over corporate law matters, with the consequence that corporate regulatory competition among states is substantially restricted by actual[63] or threatened federalization.[64] Another scholar, in addition, has stressed the democratic and political virtue of

---

59. To be sure, another federal source of corporate law are the stock exchange rules. For instance, § 303 the New York Stock Exchange manual bans no voting stocks and § 313 requires independent directors. *See* Arthur R. Pinto, *An Overview of United States Corporate Governance in Publicly Traded Corporations*, 58 AM. J. COMP. L. 257, 266 & n.50, 267 & n.56 (2010).

60. U.S. CONST. art. 1, § 8.

61. According to the U.S. Supreme Court, federal powers extend to corporate law cases only if a clear "indication of congressional intent" exists in the law. *See* Santa Fe Indus. Inc. v. Green, 430 U.S. 462, 479-80 (1977) (holding that rule 10b-5 does not extend to minority protection in case of short-form merger); Amedeo Arena, *The Doctrine of Union Preemption in the EU Single Market: Between* Sein *and* Sollen 19 (N.Y. Univ. Jean Monnet Working Paper 03/10), *available at* http://centers.law.nyu.edu/jeanmonnet/papers/10/100301.pdf.

62. *See* Romano, *supra* note 1; *see also* Richard M. Buxbaum, *Is There a Place for a European Delaware in the Corporate Conflict of Laws?*, 74 RABELS ZEITSCHRIFT 1, 14 (2010); Lucian A. Bebchuk & Assaf Hamdani, *Federal Corporate Law: Lessons from History*, 106 COLUM. L. REV. 1793, 1832-34 (2006).

63. Bebchuk & Hamdani, *supra* note 62, at 1793 (maintaining state competition produces a race to the bottom, which is mitigated by federal interventions).

64. Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 601-02 (2003); Mark J. Roe, *Delaware and Washington as Corporate Lawmakers*, 34 DEL. J. CORP. L. 1, 11-12 (2009) (arguing Delaware is always exposed to the risk of federalization on corporate law matters).

federalization of corporate law and has shown that Delaware case law shows a positive reaction to the threat of federalization posed by the Sarbanes-Oxley Act (SOX).[65] Finally, according to an intermediate opinion, in the aftermath of the Enron scandal, Delaware tacitly delegated to the federal government the enactment of certain strict rules that would have caused a high political cost.[66]

In addition, the debate on vertical competition also has a normative side: for scholars who hold that horizontal regulatory competition can produce negative externalities, inefficiencies, and ultimately a "race to the bottom" in corporate law, federal intervention is the proper solution.[67] The "race to the top" theory leads to the opposite result by limiting federal intervention into internal affairs of the corporation.[68]

To be sure, a number of corporate governance issues of listed corporations[69] have been federalized, mainly as a response to economic or financial crises. The first wave of federalization occurred during the New Deal through the Securities & Exchange Act of 1934, which is still the backbone of federal corporate governance regulation, and its norms need to be implemented by SEC rules.[70] The second relevant wave of federalization of corporate law occurred almost seventy years later, through the SOX, which was enacted in 2002 as a response to the Enron scandal.[71] Eventually, the third step of federalization was embodied in the Dodd-Frank Act of 2010, which was the reaction to the big economic crisis of 2008.[72]

---

65. Renee M. Jones, *Rethinking Corporate Federalism in the Era of Corporate Reform*, 29 J. CORP. L. 625, 643-46 (2003-2004).

66. Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1619 (2005) (arguing Delaware implicitly delegates some specific matters to the federal government when it is in a better political position to address them).

67. Cary, *supra* note 2, at 663; Bebchuk, *supra* note 2, at 1437.

68. *See* Daniel R. Fischel, *The "Race to the Bottom" Revisited: Reflections on Recent Developments in Delaware's Corporate Law*, 76 NW. U. L. REV. 913, 921-23 (1981-1982).

69. In contrast, federal law has not intervened to regulate private limited liability corporations. Thus, a decision of such companies to reincorporate from one state to another has a much broader impact on their rules, because the entire set of rules in the competence of the states will be shifted from one state to another.

70. To be sure, SEC rules should not exceed the power conferred by the Securities Exchange Act. *See* The Business Roundtable v. SEC, 905 F.2d 406, 407 (D.C. Cir. 1990) (holding SEC Rule 19c-4, which barred U.S. securities exchanges from listing dual-class stock corporations, was deemed to be exceeding the powers conferred by art. 19 of the Securities & Exchange Act).

71. The Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (amending different sections of Titles 11,15, 28 and 29 U.S.C.).

72. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

As a result, federal law regulates some issues that are relevant for corporate governance and that, to a certain extent, also belong to the internal affairs of the corporation. The most important of these provisions are:

- Proxy voting, which is an important issue in widely held corporations where shareholders face collective action problems and rational apathy.[73] Recently, the Dodd-Frank Act has modified such regulation, authorizing the SEC to issue new rules aimed at facilitating proxy access.[74]
- Mandatory disclosure rules of relevant concentration of shareholdings.[75]
- General antifraud provisions[76] and the ban on insider trading developed by federal courts and the SEC.[77]
- Regulation of internal auditors and audit committees, aimed at granting their independence and transparency.[78]
- Provisions on conflict of interests of corporate bodies,[79] which address the relations between the board and shareholders and clearly belong to the internal affairs of the corporation.[80]

---

73. Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 § 14(a) (codified at 15 U.S.C. § 78(a) (2006)).

74. The Dodd-Frank Act § 971 states that the SEC has authority to promulgate a so-called "proxy access" rule pursuant to which shareholders would be allowed to use the company's proxy statement to nominate candidates to the board of directors. On August 25, 2010, the SEC enacted a new regulation (Rule § 240.14(a)-11) that allows shareholders with at least three percent of the shares and who held these shares for at least three years, to put forward their own board member nominee (for up to twenty-five percent of the board's seats) in the company's proxy materials. The U.S. Chamber of Commerce challenged the rule in an administrative court and, as a response, the SEC has suspended its application until the 2012 proxy season. The new SEC rules on the proxy access have raised an intense debate. Bo Becker, Daniel Bergstresser & Guhan Subramanian, *Does Shareholder Proxy Access Improve Firm Value? Evidence from the Business Roundtable Challenge* 2-3 (Harvard Bus. Sch., Working Paper 11-0523, 2012) (showing that the new rules are considered value enhancing by the market); Marcel Kahan & Edward Rock, *The Insignificance of Proxy Access*, 97 VA. L. REV. 1347, 1408-09 (2011) (showing that the new rules do not significantly reduce the cost of proxies as compared with the general proxy contest).

75. Securities Exchange Act of 1934 § 13(d).

76. General Rules and Regulations Promulgated under the Securities Exchange Act of 1934, Rule 10b-5, 17 C.F.R. § 240.10b-5 (2012).

77. *See* United States v. O'Hagan, 521 U.S. 642 (1997); Dirks v. SEC, 463 U.S. 646 (1983); Chiarella v. United States, 445 U.S. 222 (1980); United States v. Chestman, 947 F.2d 551 (2d Cir. 1991); SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968).

78. Sarbanes-Oxley Act of 2002, §§ 201, 203-204, 301-304.

79. *Id.* § 402.

80. *See* Robert B. Thompson, *Corporate Federalism in the Administrative State: The SEC's Discretion To Move the Line Between the State and the Federal Realms of Corporate Governance*, 82 NOTRE DAME L. REV. 1143, 1151 (2007); E. Norman Veasey, *What Would Madison Think? The Irony of the Twists and Turns of Federalism*, 34 DEL. J. CORP. L. 35, 47 (2009).

- Regulation of executive compensation through the Dodd-Frank Act, which requires shareholders' advisory vote on boards' compensation,[81] mandates full independence of compensation committees,[82] provides additional disclosure of compensation plans,[83] and extends the original clawback rules of executive compensation.[84]

Consequently, in the U.S., due to the partial federalization of the regulation of listed corporations, the effects of reincorporations of such companies are limited to the issues left to state law. As we have seen above, reincorporations are relevant because corporate laws are not identical across countries. However, whenever uniformity is reached, reincorporation does not play a significant role. In the U.S., therefore, free choice of corporate law and the regulatory competition among states are partially constrained by the fact that states do not enjoy an exclusive competence on corporate law issues. This means that corporations are not completely free to choose the preferred law, since part of corporate law rules are not at their disposal.[85] In practice, using the words in a less than technical fashion, we can say that "reincorporations" (meaning the change of lawmaker) are possible for state rules, but are not possible for federal regulation of listed corporations.

B. Harmonization of Corporate Law in the EU

In the EU, as in the U.S., Member States are competent to charter and regulate corporations. Using the language of the ECJ, "companies are creatures of the law and, in the present state of Community law, creatures of national law."[86] Nonetheless, EU federal bodies have some important powers in the field of corporate law and securities regulation.

In the EU, the allocation of legislative powers between federal bodies (the EU Commission, the Council, and the European Parliament) and the Member States reflects the "hybrid" constitutional nature of the EU, which is not a true federal state. The vertical allocation of powers between the EU bodies and the Member States is shaped by the general

---

81. Dodd-Frank Act § 951. A similar rule was embodied in the Emergency Economic Stabilization Act of 2008 for companies that received financial assistance in the aftermath of the 2008 economic crisis. *See* Pub. L. No. 110-343 § 111, 122 Stat. 3765 (2008).

82. Dodd-Frank Act § 952.

83. *Id.* § 953.

84. *Id.* § 954.

85. *See* Mark J. Roe, *Regulatory Competition in Making Corporate Law in the United States—And Its Limits*, 21 OXFORD REV. ECON. POL'Y 232, 232 (2005).

86. Case C-81/87, The Queen v. H.M. Treasury & Comm'rs of Inland Revenue, *ex parte* Daily Mail & Gen. Trust plc, 1988 E.C.R. 5505.

principle of "subsidiarity."[87] Regarding corporate law, the Treaty on the Functioning of the European Union (TFEU) grants to the EU the power to enact directives to harmonize the internal laws of Member States with the purpose of realizing an internal market.[88] In this regard, the EU's effort has always been underlined by the idea that a minimum level of harmonization of corporate laws is essential for establishing a single internal market and for avoiding the "race to the bottom" that regulatory competition would have, allegedly, produced.[89]

Consequently, a number of EU directives have been enacted since 1968, addressing the most significant issues of corporate law regulations, namely: disclosure and registration mechanisms, nullity of the corporations, boards' powers and *ultra vires*,[90] incorporation's mechanisms, capital requirements and mechanisms to protect creditors',[91] mergers and divisions,[92] accounting and auditing rules,[93] takeover bids,[94] and shareholders' rights.[95]

However, legal scholars in recent years have increasingly challenged the validity and efficiency of the general goal of harmonizing corporate law.[96] Additionally, the real impact of these harmonization directives is highly debated: while a traditional and widespread opinion considers the process of harmonization a significant element of a new "European

---

87. TFEU art. 5(3) ("Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level.").

88. TFEU art. 50(2)(g).

89. *See* HERBERT WIEDEMANN, GESELLSCHAFTSRECHT I, 51 (1980).

90. First Council Directive 68/151/EEC of 9 March 1968, 1968 O.J. (L 65) 8, on Co-ordination of Safeguards Which, for the Protection of the Interests of Members and Others, Are Required by Member States of Companies Within the Meaning of the Second Paragraph of Article 58 of the Treaty, with a View to Making Such Safeguards Equivalent Throughout the Community, as Amended and Then Codified by Directive 2009/101/EC, 2009 O.J. (L 258) 11.

91. Second Council Directive 77/91/EEC, 1976 O.J. (L 026) 1.

92. Sixth Council Directive 82/891/EEC, 1982 O.J. (L 378) 47.

93. Fourth Council Directive 78/660/EEC, 1978 O.J. (L 222) 11; Seventh Council Directive 83/349/EEC, 1983 O.J. (L 193) 1.

94. Directive 2004/25/EC, 2004 O.J. (L 142) 12.

95. Directive 2007/36/EC, 2007 O.J. (L 184) 17.

96. *See* Jan Wouters, *European Company Law:* Quo Vadis*?*, 37 COMMON MKT. L. REV. 257, 272-75 (2000) (arguing harmonization can be at odds with the subsidiarity principle introduced by the Maastricht Treaty in 1993); STEFANO LOMBARDO, REGULATORY COMPETITION IN COMPANY LAW IN THE EUROPEAN COMMUNITY: PREREQUISITES AND LIMITS 16-17 (2002); Luca Enriques & Matteo Gatti, *The Uneasy Case for Top-Down Corporate Law Harmonization in the European Union*, 27 U. PA. J. INT'L ECON. L. 939, 939, 943-44 (2006).

corporate law,"[97] other scholars are much more skeptical about the ability of directives to really harmonize national laws and legal cultures.[98]

As detailed above, harmonization directives do not produce the same kind of uniformity as U.S. federal law. First of all, a number of such directives provide minimum harmonization only, so that Member States can adopt more stringent rules. Additionally, many directives grant to Member States a choice among a number of alternative options.[99] Furthermore, in the EU the courts of the Member States have jurisdiction to interpret and enforce the domestic rules that implement EU directives. The absence of a federal system of courts is the most profound element that divides the EU from the U.S. Indeed, the powers of the ECJ[100] are limited to those enumerated in the TFEU[101] and the ECJ can decide on the interpretation of EU law only upon preliminary reference made by national courts, not after a direct suit brought by private parties,[102] with the exception of actions against legislative acts that directly affect the plaintiff.[103] Finally, a number of directives apply only to "public" joint stock corporations, while "private" limited liability corporations are often outside the range of the harmonization.[104]

In sum, in the EU the vertical allocation of powers in corporate law matters is shaped differently than in the U.S. because the "federal" bodies do not and cannot have the power to regulate such matters entirely, but exercise a "soft" form of regulation through directives,[105] whereby they leave to Member States the last word in determining corporate law rules.

---

97. *See* Christian Kersting, *Corporate Choice of Law—A Comparison of the United States and European Systems and a Proposal for a European Directive*, 28 BROOK. J. INT'L L. 1, 1-2, 51 (2002-2003).

98. Luca Enriques, *EC Company Law Directives and Regulations: How Trivial Are They?*, 27 U. PA. J. INT'L ECON. L. 1, 1-2 (2006).

99. *Id.* at 23-31.

100. TFEU art. 19(1) (stating the Court of Justice of the EU includes the Court of Justice, the General Court (First Instance), and some specialized courts).

101. Such competence include: decisions upon compliance of Member States to EU law (TFEU art. 258), review of legality of EU legislative acts (TFEU art. 263), decisions upon lack of due actions by EU bodies (TFEU art. 265), interpretation of TFEU and EU law (TFEU art. 267), and compensation for damages caused by EU bodies (TFEU art. 268).

102. *Id.* art. 267.

103. *Id.* art. 263(3).

104. The Second Directive (capital requirements), the Third Directive (mergers), and the Fourth Directive (division) do not apply to private limited liability companies.

105. In recent years, EU bodies have exercised a weaker form of harmonization by way of "recommendations," according to TFEU art. 288. *E.g.*, Commission Recommendation 2004/913/EC, 2004 O.J. (L 385) 55; Commission Recommendation 2005/162/EC, 2005 O.J. (L 52) 51 (regarding the regime for the remuneration of directors of listed companies and the complementing recommendation).

IV. THE SCOPE OF CORPORATE LAW IN THE U.S. AND IN THE EU

This Part addresses the questions of which set of rules shareholders (and/or the board, according to internal corporate legislation) can intentionally shift from one jurisdiction to another and of the impact of such changes. One possible answer might be that, after the "reincorporation," corporate law rules will be in the exclusive competence of the new state. This answer, however, would be too simplistic. First of all, we must clarify what "corporate law" means, since we cannot assume that this concept is identical in all jurisdictions. Secondly, even if the state of origin and the state of arrival agree upon the realm of corporate law, i.e., upon the sets of rules that are shifted from the competence of the first to the competence of the latter, this would not entirely clarify what impact the reincorporation will have on the interests involved in corporate activities. Indeed, the same agency problem might be addressed by a different type of rules and through different strategies. To understand the impact of reincorporations upon real interests, we must engage in a functional analysis of the law by focusing our attention on the function of the different sets of rules that regulate corporate interests. Indeed, corporations have complex relations among different classes of stakeholders: shareholders, creditors, (e.g., banks, employees, or suppliers) and the board. These relations are regulated by different sets of rules, only some of which will change after a reincorporation. To understand this issue it is necessary to classify the relevant interests and to depict the different legal strategies aimed at addressing the agency problems arising from their relations.

A. *Corporate Agency Relations and the Law*

Each corporate governance system addresses the fundamental agency problems between corporate stakeholders (control shareholders, minority shareholders, the board and creditors) through different mechanisms and strategies.[106] In order to understand the effects of reincorporations upon corporate interests, it is necessary to briefly describe such different strategies.

---

106. *See* HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE 35, 39 (1996); John Armour, *Who Should Make Corporate Law? EC Legislation* versus *Regulatory Competition*, 58 CURRENT LEGAL PROBS. 369, 372 (2005). *See generally* KONRAD ZWEIGERT & HEIN KÖTZ, EINFÜHRUNG IN DIE RECHTSVERGLEICHUNG 3, 33-36 (1996); Hein Kötz, *Alte und neue Aufgaben der Rechtsvergleichung*, 57 JURISTENZEITUNG 257 (2002).

1. Agency Problems Between Shareholders and the Board

The agency relation between shareholders and the board is addressed primarily by the board's duties and liabilities, by rules on board appointment and removal, and by the rules on shareholders' derivative action.[107] These are typical "corporate law" issues belonging to the internal affairs of the corporation.

However, if corporate ownership is widely held and the capital market is sufficiently developed, the market for corporate control is a powerful force of board discipline and, consequently, takeover regulation and the board's duties vis-à-vis unsolicited offers play a crucial role to regulate the agency relation between the board and shareholders. By contrast, if shareholder ownership is concentrated, the reduction of the agency costs arising from the board—shareholder relation relies mostly upon classical *ex ante* mechanisms such as the board's liability, derivative suits, and the activity of internal supervisory bodies.[108]

2. Agency Problems Between Minority and Control Shareholders

The agency problems between minority and control shareholders are relevant primarily in companies with concentrated ownership (as is mostly the case in continental Europe), where they are far more significant than such between shareholders and the board.[109] We can distinguish the following two classes of opportunistic behaviors of majority shareholders against minorities: (1) transactions that advantage, directly or indirectly, the private economies of majority shareholders at the expense of corporate assets (s.c. "tunneling"); (2) transactions that dilute minority ownership, such as mergers or raising of new capital without preemptive right.[110] The goal of reducing agency costs derived from the relation between majority and minority shareholders might be pursued through different strategies, such as: (1) procedural or

---

107. In general, we can say that shareholders are interested in maximizing the value of the corporation and that the board is hired to pursue this goal. The reality might be different, especially in widely held corporations, since the board might be tempted to pursue self-serving goals that do not maximize shareholder wealth. On the other hand, had the board no discretional powers to decide on the merit of general strategies or the day-by-day business, corporations would not work efficiently and effectively.

108. In all circumstances, a powerful force is the labor market for managers: the more this market is restricted (i.e., the less alternative jobs are available managers) the more managers will make firm-specific investments and, consequently, will require certain safeguards.

109. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 229 (1991).

110. Pierre-Henri Conac, Luca Enriques & Martin Gelter, *Constraining Dominant Shareholders' Self Dealing: The Legal Framework in France, Germany, and Italy*, 4 EUR. COMPANY FIN. L. REV. 491, 496 (2007).

transparency requirements, (2) restrictions on the "abuse" of majority powers, (3) limits on concealed distributions to majority shareholders, and (4) special rules on groups of companies and intragroup liabilities.[111]

3. Agency Problems Between Shareholders and Creditors

The third agency problem concerns the relations between shareholders and creditors and stems from the limited liability enjoyed by shareholders. In particular, the s.c. "defensive asset partitioning" protects shareholders' private assets from claims of corporate creditors[112] and, by limiting the risk suffered by shareholders, induces them to invest in risky activities.[113] At the same time, the s.c. "affirmative asset partitioning," which protects corporate assets from claims of shareholders' private creditors, partially transfers risks to creditors.[114] Shareholders could, for instance, distribute excessive resources,[115] enhance the risk profile of the corporation,[116] or increase the debt leverage (s.c. debt dilution).[117] *Ex ante*, sophisticated "adjusting" creditors can discount from the credit price the risk of opportunistic behaviors of shareholders,[118] or can require contractual covenants that accelerate the loan under specific triggering

111. *See* MATHIAS SIEMS, CONVERGENCE IN SHAREHOLDER LAW 199-210 (2008). In widely held corporations, when the market is developed and liquid, minority shareholders have the weapon of selling their shares on the market. Additionally, other sets of norms protect shareholders by considering them as investors and market participants: insider trading, market transparency and prospectus regulation, and takeover regulation.

112. Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387, 393-94 (2000).

113. Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 97 (1985).

114. This is particularly evident when insolvency approaches: if the corporation recovers thanks to the risky activities, shareholders will gain the entire surplus, while, if the corporation fails, shareholders will lose only the invested capital. *See* Easterbrook & Fischel, *supra* note 113, at 96. However, limited liability also has positive effects for creditors, because it reduces their monitoring costs. *See* Hansmann & Kraakman, *supra* note 112, at 398. For proposals to restrict limited liability, see David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 COLUM. L. REV. 1565, 1573 (1991) (arguing that tort creditors should have priority over secured creditors); Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879, 1892-93 (1991) (suggesting pro rata unlimited liability for tort claims).

115. John Armour, Gerard Hertig & Hideki Kanda, *Transactions with Creditors*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 115, 116 (2d ed. 2009); Armour, *supra* note 106, at 367.

116. William W. Bratton, *Bond Covenants and Creditor Protection: Economics and Law, Theory and Practice, Substance and Process*, 7 EUR. BUS. ORG. REV. 39, 48 (2006); Paul Davies, *Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency*, 7 EUR. BUS. ORG. L. REV. 301, 306 (2006).

117. *See* Luca Enriques & Jonathan R. Macey, *Creditors Versus Capital Formation: The Case Against the European Legal Capital Rules*, 86 CORNELL L. REV. 1165, 1169 (2001); Armour, Hertig & Kanda, *supra* note 115, at 117; Bratton, *supra* note 116, at 46.

118. Leebron, *supra* note 114, at 1585.

circumstances,[119] or securities, such as a lien that has priority in case of insolvency.[120] Therefore, adjusting creditors do not need any specific protection.[121] By contrast, "nonadjusting" creditors cannot impose on the corporate debtor any specific security or covenant and cannot discount the risk of default from the market price, so the entire risk of opportunistic behaviors will fall on their backs.[122] The law might address the agency problems between shareholders and creditors through transparency strategies, such as mandatory registration[123] or disclosure duties, and through rules or standards aimed at avoiding opportunistic behaviors of shareholders or at minimizing their impact on corporate activities. In this regard, the fundamental distinction is between rules aimed at preventing creditors' damages (*ex ante* strategies) and rules operating after corporations become insolvent (*ex post* strategies).[124] *Ex ante* rules are, for example, minimum capital requirements or the different kinds of "solvency tests" aimed at establishing the assets' proper value to be held in specific circumstances. *Ex post* strategies are, among other things, avoidances of fraudulent conveyances and concealed distributions within a bankruptcy proceeding,[125] or directors' liabilities

---

119. Clifford W. Smith, Jr. & Jerold B. Warner, *On Financial Contracting: An Analysis of Bond Covenants*, 7 J. FIN. ECON. 117, 129 (1979); John Armour, *Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law*, 63 MOD. L. REV. 355, 373 (2000).

120. PAUL L. DAVIES, INTRODUCTION TO COMPANY LAW 69-70 (2002); *see also* Lucian A. Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857, 859 (1996).

121. Richard A. Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499, 507 (1975-1976); Easterbrook & Fischel, *supra* note 113, at 105; Leebron, *supra* note 114, at 1585.

122. *See* Hansmann & Kraakman, *supra* note 114, at 1920; Bebchuk, *supra* note 2, at 1489. "Nonadjusting creditors," however, could free ride on the covenant and securities obtained by "adjusting creditors." *See* Enriques & Macey, *supra* note 117, at 1172; Luca Enriques & Martin Gelter, *Regulatory Competition in European Company Law and Creditor Protection*, 7 EUR. BUS. ORG. L. REV. 417, 430 (2006). This is true if the adjusting creditor requires the corporation to provide for general financial covenant, whereby the debtor is obliged to maintain certain assets or financial value. Externalities can nonetheless arise when the securities required by adjusting creditors are personal and enjoy priority in case of insolvency (typically liens and other "rights in rem"). *See* Eilís Ferran, *The Place for Creditor Protection on the Agenda for Modernisation of Company Law in the European Union*, 3 EUR. CO. FIN. L. REV. 178, 192 (2006).

123. *See* John Armour & Michael J. Whincop, *The Proprietary Foundations of Corporate Law*, 27 OXFORD J. LEGAL STUD. 429, 456 (2007) (stating that registration is a regulatory strategy aimed at reducing transaction costs).

124. David A. Skeel, Jr., *An Evolutionary Theory of Corporate Law and Corporate Bankruptcy*, 51 VAND. L. REV. 1325, 1328 (1998).

125. Marcel Kahan, *Legal Capital Rules and the Structure of Corporate Law: Some Observations on the Differences Between European and U.S. Approaches*, *in* CAPITAL MARKETS AND COMPANY LAW 145, 147 (Klaus J. Hopt & Eddy Wymeersch eds., 2003).

towards the corporation or its creditors in case of insolvency or for having delayed the filing of insolvency.[126]

4. Choice of Forum

To have a full picture of how the law addresses the fundamental agency relationships, the enforcement mechanisms also have to be taken into account. For instance, a good corporate law "on the books" with a high standard of shareholder or creditor protection, might be weakened by an inefficient civil procedure or if judges defer to shareholders' or boards' decisions.[127]

The example of Delaware law is enlightening. Delaware corporate law is extensively judge-made law and the creation of legal rules and standards is partially delegated to the judiciary.[128] Delaware's judge-made law is doctrinally indeterminate[129] and, to some extents, Delaware's courts do not simply "apply the law" but take policy decisions. In addition, the quality of Delaware's courts and civil proceeding is one of the reasons that induce firms to reincorporate in Delaware. Certainly, corporate law cases can be litigated outside Delaware,[130] however such cases do not contribute to the evolution of Delaware case law and foreign courts simply apply Delaware precedent in a rather passive way. Therefore,

---

126. Take two examples from European countries. First, the wrongful trading in English corporate law: within insolvency proceedings, upon liquidator's request, directors can be made liable towards the insolvent corporation if it is proven that they knew, or should have known, that no reasonable possibility existed to avoid insolvency, unless they have undertaken all possible measures to protect creditors. Insolvency Act of 1986, 1986, C. 45, § 214 (Eng.); *see* DAVIES, *supra* note 120, at 96. Second, the *Insolvenzverschleppungshaftung* in Germany: directors have the duty to file for insolvency when the corporation is not able to pay its debts or in case of balance-sheet insolvency (§ 15a *Insolvenzordnung*) and are made liable towards both creditors and the corporations if they delay such filing. THOMAS BACHNER, CREDITOR PROTECTION IN PRIVATE COMPANIES: ANGLO-GERMAN PERSPECTIVES FOR A EUROPEAN LEGAL DISCOURSE 188-89 (2009).

127. *See, e.g.*, Luca Enriques, *Do Corporate Law Judges Matter? Some Evidence from Milan*, 3 EUR. BUS. ORG. L. REV. 765, 809 (2002) (showing deference of Italian judges from Milan to the majorities' decision).

128. Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1074 (2000); Kahan & Rock, *supra* note 66, at 1591-93.

129. Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1909 (1998); Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1207 (2001).

130. *See* John Armour, Bernard S. Black & Brian R. Cheffins, *Is Delaware Losing Its Cases?* 3 (Univ. of Cambridge Faculty of Law Legal Studies Research Paper Series, Paper No. 11/08, 2011) (according to whom there is evidence of a race to litigate Delaware law outside of Delaware courts); *see also* Faith Stevelman, *Regulatory Competition, Choice of Forum, and Delaware's Stake in Corporate Law*, 34 DEL. J. CORP. L. 57, 100 (2009) (stressing the role of lawyers in the choice of forum).

choice-of-forum criteria are relevant to an understanding of the characteristics of a corporate governance system.[131]

B. The Scope of Corporate Law in the U.S. and the EU

If we bear in mind that the concept and the functions of "corporate law" are diverse across jurisdictions, we can also understand why and to what extent the U.S. and EU diverge regarding reincorporations. The most significant divergence is related to the effects produced by reincorporations, which are more limited in the U.S. than in the EU. The main reason for this is that the province of corporate law in the U.S. is narrower than in the EU.

1. The Scope of Corporate Law in the U.S. Under the "Internal Affairs Doctrine"

Within the boundaries set by federal intervention, corporate law in the United States is a state affair, so that corporations moving from one state to another shift the set of rules which are in the competence of the state. As we have seen above, the horizontal distribution of competence among states is generally governed by the Internal Affairs Doctrine, which was originally adopted by U.S. state courts during the nineteenth century, in a time when corporations' activities were predominantly domestic.[132]

Despite a different view expressed by the Delaware Supreme Court,[133] the Internal Affairs Doctrine does not seem to be mandated by

---

131. To be sure, in the international arena, positive and negative conflicts of jurisdiction can easily arise whenever two countries adopt conflicting criteria, although within regional or federal legal systems such conflicts are often addressed by specific pieces of legislation. This is the case in the EU, whereby according to the "Brussel I" Regulation on jurisdiction Commission Regulation 44/2001, art. 22, 2001 O.J. (L 12) 1, the most important internal affairs should be litigated in the Member State of the "seat." Such matters are, "the validity of the constitution, the nullity or the dissolution of companies or other legal persons or associations of natural or legal persons, or . . . the validity of the decisions of their organs." However, the concept of "seat" is to be established according to each Member States' own private international law, so that conflict of jurisdiction can still arise. In addition, other typical "internal" or "corporate law" matters, such as derivative suits, are not comprised in this list. *See* Massimo V. Benedettelli, *Conflicts of Jurisdiction and Conflicts of Law in Company Law Matters Within the EU 'Market for Corporate Models': Brussels I and Rome I After* Centros, 16 EUR. BUS. L. REV. 55, 61-62 (2005); Tobias H. Tröger, *Choice of Jurisdiction in European Corporate Law—Perspectives of European Corporate Governance*, 6 EUR. BUS. ORG. L. REV. 3, 23-24 (2005).

132. Frederick Tung, *Before Competition: Origins of the Internal Affairs Doctrine*, 32 J. CORP. L. 33, 68-69 (2006).

133. *In re* Topps Co. S'holders Litig., 924 A.2d 951, 963 (Del. Ch. 2007); VantagePoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108, 1115-16 (Del. 2005); *see also* McDermott

the Dormant Commerce Clause of the U.S. Constitution[134] as a necessary mechanism to facilitate interstate commerce.[135] The U.S. Supreme Court addressed this issue in *CTS Corp. v. Dynamics Corp. of America* by upholding an Indiana anti-takeover law that applied only to corporations incorporated in Indiana. In this case, the Court's main goal was to grant that one single jurisdiction regulates internal corporate affairs, rather than assessing the proper conflict of law criterion.[136] Indeed, the Internal Affairs Doctrine, as choice-of-law criterion, can suffer exceptions when a state different from the state of incorporation has "a more significant relation to the occurrence and the parties."[137] In addition, two states, namely California and New York, partially apply domestic corporate law

---

Inc. v. Lewis, 531 A.2d 206 (Del. 1987) (applying application of Panamanian corporate law to a corporation incorporated in Panama and operating in Delaware).

134. The Commerce Clause grants to the Congress the power to regulate commerce among states. This Clause, however, implicitly prohibits states from hindering interstate commerce even in absence of federal law. U.S. CONST., art. I, § 8, cl. 3.

135. Richard M. Buxbaum, *The Threatened Constitutionalization of the Internal Affairs Doctrine in Corporation Law*, 75 CAL. L. REV. 29, 29-33 (1987); Dammann, *supra* note 46, at 92; Timothy P. Glynn, *Delaware's* VantagePoint*: The Empire Strikes Back in the Post-Post-Enron Era*, 102 NW. U. L. REV. 91, 118-23 (2008) (arguing *VantagePoint* is unpersuasive, since U.S. Supreme Court case law does not point to a constitutional relevance of the internal affairs doctrine).

136. CTS Corp. v. Dynamics Corp., 481 U.S. 69, 86 (1987) (citing Indiana law, requiring majority voting to take over Indiana corporations, is compatible with the Dormant Commerce Clause) (emphasis added): "*No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders*"; it is an "*accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares*." *See* Amanda Acquisition Corp. v. Universal Foods Corp., 877 F.2d 496 (7th Cir. 1989); Tyson Foods Inc. v. McReynolds, 865 F.2d 99 (6th Cir. 1989). *But see* Edgar v. MITE Corp., 457 U.S. 624 (1982) (holding that the Illinois antitakeover statute, regulating takeover bids of corporations with significant assets in Illinois, was a violation of the Dormant Commerce Clause). The Court distinguished *CTS* from *Edgar* because the Illinois antitakeover statute did not apply only to Illinois corporations, while the Indiana antitakeover law applied only to Indiana corporations and regulated their internal affairs. *See* Kersting, *supra* note 97, at 6-8.

137. RESTATEMENT (SECOND) OF THE LAW: CONFLICT OF LAWS § 302 (2d ed. (1969)).

(1) Issues involving the rights and liabilities of a corporation, other than those dealt with in § 301, are determined by the local law of the state which, with respect to the particular issue, has the most significant relationship to the occurrence and the parties under the principles stated in § 6.

(2) The local law of the state of incorporation will be applied to determine such issues, except in the unusual case where, with respect to the particular issue, some other state has a more significant relationship to the occurrence and the parties, in which event the local law of the other state will be applied.

rules to foreign unlisted corporations having their business in the domestic territory.[138]

The major difference between the Internal Affairs Doctrine and the conflict of law mechanisms followed in the Member States of the EU, however, is related to the set of rules to which the choice of law criterion applies. In other words, the real difference concerns the province of corporate law for private international law purposes, which is narrower in the U.S. than in the EU. Indeed, the scope of the Internal Affairs Doctrine is limited to specific matters, such as shareholders' rights, boards' duties, and shareholders' financial duties, whilst the rules aimed at creditors' protection are either federalized, or outside the scope of the doctrine.[139]

Although some rules aimed at avoiding opportunistic behaviors of shareholders against creditors belong to the Internal Affairs Doctrine, they do not seem to be effective. The most significant "corporate law" mechanism to protect creditors is the restriction of the distribution of dividends to shareholders. In many states, dividends can be paid only if the distribution would not cause insolvency and cannot be paid out of stated capital.[140] However, under the law of many states (with the important exception of California[141]) either the board or the shareholders can shift parts of the stated capital into the surplus account[142] and, additionally, the board can partially alter the valuations of the balance sheet using the Generally Accepted Accounting Principles (GAAP) criteria.[143] Consequently, dividend restrictions and legal capital requirements are ineffective and trivial.

---

138. CAL. CORP. CODE § 2115 (West 2010); N.Y. BUS. CORP. LAW §§ 1319-1320 (McKinney 2003); *see* Matt Stevens, *Internal Affairs Doctrine: California Versus Delaware in a Fight For the Right To Regulate Foreign Corporations*, 48 B.C. L. REV. 1047, 1047-49 (2007); Onnig H. Dombalagian, *Choice of Law and Capital Markets Regulation*, 82 TUL. L. REV. 1903, 1909-11 (2008).

139. *See* Theresa A. Gabaldon, *The Story of Pinocchio: Now I'm a* Real *Boy*, 45 B.C. L. REV. 829, 840-42 (2004); Larry E. Ribstein & Erin Ann O'Hara, *Corporations and the Market for Law*, 2008 U. ILL. L. REV. 661, 694 (opining that the Internal Affairs Doctrine is an "optical illusion").

140. *See* DEL. CODE ANN. Tit. 8, § 170 (2010) (stating that directors can pay dividends out of the capital surplus or, alternatively, out of net profit of the current or previous year); *see also* Model Bus. Corp. Act Ann. § 6.40 (2008) (stating that directors can pay dividends if there is a surplus off assets out of liabilities, and only if, after the distribution, the corporation would be still able to pay its debts when they fall due).

141. CAL. CORP. CODE § 500.

142. In Delaware, the directors can transfer stated capital associated with no par stock into surplus account without shareholders' approval, while a reduction of stated capital associated with par stocks should be approved by shareholders' general meeting. DEL. CODE ANN. § 244(a)(4).

143. Model Bus. Corp. Act Ann. § 6.40.

A somewhat similar function of protecting creditors is embodied in the doctrine of "duty shifting," according to which directors' duties are shifted from shareholders to creditors when the corporation enters serious financial distress. According to recent Delaware case law, however, the duty shift is triggered by the "insolvency" of the corporation,[144] as only from that moment do creditors become residual claimants of corporate activities. Additionally, the duty shift doctrine applies in very limited circumstances, because directors have incentives to enter into a Chapter 11 restructuring proceeding. The doctrine, therefore, does not really change the fundamental goal of the board's duties to enhance shareholder value.

Consequently, even though the law of the state of incorporation provides some kind of protection against opportunistic or excessive distributions, creditors rely mostly upon other legal mechanisms, namely fraudulent transfers, equitable subordination and veil piercing, and upon private contracting.

a. *Fraudulent transfer*. The most important of these mechanisms are fraudulent transfer rules, which are not part of the Internal Affairs Doctrine.[145] Fraudulent transfers rarely emerge outside bankruptcy proceedings, in which case the federal rules on fraudulent conveyances, embodied in the Bankruptcy Act of 1978,[146] apply, unless the trustee shows that state law allows avoiding a transfer that would not be avoided under federal law.[147] In the latter case, however, the applicable state law is not that of the state of incorporation of the debtor, but the law of the state that governs the transaction.[148]

---

144. N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 101-02 (Del. 2007) (ruling that creditors do not have direct claims for breach of fiduciary duty when a corporation is in the zone of insolvency). The "duty shift doctrine" was properly formulated by *Credit Lyonnais Bank Nederland v. Pathe Communications Corp.*, 1991 WL 277613, at *30 (Del. Ch. Dec. 30, 1991), according to which, however, the triggering moment was the "vicinity of insolvency." *See* Henry T.C. Hu & Jay Lawrence Westbrook, *Abolition of the Corporate Duty to Creditors*, 107 COLUM. L. REV. 1321, 1336-38 (2007).

145. Thomas H. Day, *Solution for Conflict of Laws Governing Fraudulent Transfers: Apply the Law that Was Enacted To Benefit the Creditors*, 48 BUS. LAW. 889, 892-93 (1993).

146. 11 U.S.C. § 548(1) (2011).

147. *Id.* § 544(b).

148. However, the precise choice-of-law criterion to establish the applicable state law on fraudulent transfers is still disputed. A common answer is to apply choice of law of the state of the forum, following *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 496 (1941). However, *Klaxon* was referred to federal diversity jurisdiction and aimed at avoiding "vertical" forum shopping, but it is not yet clear whether it should be extended also to other competences of federal courts, like in bankruptcy litigation. *Id.* at 1021. *See* John T. Cross, *State Choice of Law Rules In Bankruptcy*, 42 OKLA. L. REV. 531, 573-74 (1989) (stating that the federal court should select substantive state law, which would be chosen by the state court and that would adjudicate the dispute outside of bankruptcy); Alex Mills, *Federalism in the European Union and the United*

b. *Equitable subordination*. Under the equitable subordination doctrine, debts owed by a company towards its controlling shareholders are recharacterized as equity, if the transaction between the corporation and the insider did not occur within the bounds of reason and fairness.[149] For our purposes it is relevant to point out that equitable subordination is part of federal bankruptcy law,[150] not of state law, and, consequently, a reincorporation from one state to another would not change the applicable standard.

c. *Veil piercing*. Finally, under specific circumstances, a dominant shareholder can be held directly liable towards creditors by way of piercing the corporate veil.[151] Veil piercing, therefore, is ineffective for widely held corporations, which do not have a controlling or a dominant shareholder. Additionally, even though veil piercing is generally governed by the state of incorporation, its exclusive power is not undisputed and the state where a corporation conducts its business might claim to be competent to regulate this issue.[152]

d. *Corporate debentures and financing contracts*. Furthermore, it is worth mentioning that, since corporate debentures and financing contracts are outside the scope of the Internal Affairs Doctrine, they often embody choice-of-law clauses that refer to a different state as the applicable law.[153]

To sum up, we can say that creditors' protection in the U.S. relies mainly on rules that do not belong to the province of corporate law pursuant to the Internal Affairs Doctrine. Creditors' protection mechanisms that are part of the Internal Affairs Doctrine (namely, dividend restrictions) are not effective to address the agency costs between shareholders and creditors, therefore, the most important common denominator of creditors' protection in the U.S. is the federal

---

States: Subsidiarity, Private Law, and the Conflict of Laws, 32 U. PA. J. INT'L L. 369, 420-24 (2010).

149. *See* Costello v. Fazio, 256 F.2d 903, 909-10 (9th Cir. 1958).

150. Bankruptcy Act, 11 U.S.C. § 510(c)(1) (2001).

151. Zaist v. Olson, 227 A.2d 552, 558 (Conn. 1967); Walkovszky v. Carlton, 223 N.E.2d 6, 7-8 (N.Y. 1966).

152. *See, e.g.*, Provident Gold Mining Co. v. Haynes, 159 P. 155, 157 (Cal. 1916) (regarding the application of California law); Multi-Media Holdings, Inc. v. Piedmont Ctr. 15 LLC, 583 S.E.2d 262, 264 (Ga. Ct. App. 2003) (regarding the Georgia law on veil piercing applies to a Delaware corporation); P. John Kozyris, *Corporate Wars and Choice of Law*, 1985 DUKE L.J. 1, 64; Hansmann & Kraakmann, *supra* note 114, at 1921-24 (stating that unlimited liability of shareholders is tort law, not corporate law); Tung, *supra* note 132, at 94 n.311.

153. *See* U.C.C. § 1-301(c)(1).

bankruptcy law.[154] In other words, in the U.S., the agency relation between shareholders and creditors is unbundled from the other agency relations.

The most important area that is in the exclusive competence of the state of incorporation is the regulation of the board's fiduciary duties and its liability towards shareholders. Therefore, reincorporations in the U.S. affect mainly the board—shareholders and the majority—minority relationship (to the extent that they are not regulated by federal rules, as we have seen above), while the agency problems between shareholders and creditors are substantially unaffected by these transactions.

2. The Scope of Corporate Law in the EU

a. Creditor Protection and the Scope of Corporate Law

In contrast to the U.S., EU Member States do not share a common conflict-of-law doctrine for corporations. While an increasing number of states follow the s.c. "incorporation theory," others still apply, at least to domestic corporations or to foreign extra-EU corporations, the "real seat theory," according to which corporations are governed by the law of the state where they have their headquarters. Both theories, however, face an identical preliminary issue, namely to establish the scope of the applicable "corporate law." In this regard, European Member States seem to share a common general understanding on which topics are to be governed exclusively by the country of incorporation and this common denominator of the scope of corporate law also covers mechanisms for creditors' protection that in the U.S. are outside the Internal Affairs Doctrine.

Although it would not be correct to collapse all Member States' corporate laws into a single model, we can find patterns common to many of them. The most significant and controversial corporate law mechanism to restrict distributions is the legal capital requirement. This mechanism is mandated for joint stock companies by the Second Directive on company law, but is often applied by Member States to private limited liability corporations, although in a less stringent way. If the mechanism of legal capital is in place, distributions to shareholders are allowed only to the extent that the net assets exceed the stated

---

154. Article 1, Section 8 of the U.S. Constitution gives the Congress the power to enact a uniform bankruptcy law throughout the U.S. Despite this provision, a definitive uniform bankruptcy law was enacted only in 1898, probably as a response to the increased continental relevance of corporate insolvencies and to the need to effectively organize railroad reorganizations. *See* David A. Skeel, Jr., *Rethinking the Line Between Corporate Law and Corporate Bankruptcy*, 72 TEX. L. REV. 471, 476, 486 (1994); Skeel, *supra* note 124, at 1353-58.

capital.[155] This limit to distribution is backed by other rules on "capital maintenance," such as limits to concealed distributions, which tackle underpriced transfers to shareholders.[156] Additionally, in case of capital reduction, under the Second Directive creditors, "whose claims antedate the publication of the decision" to reduce the capital, at least have the right to obtain a security for claims that have not yet fallen due.[157] The mechanism of the legal capital has been challenged in recent years, as we will see in the next pages. However, in a number of EU Member States, corporate law mechanisms are in place to limit excessive distributions to shareholders that put the solvency of the debtor at risk. These mechanisms are governed by the law of the state of incorporation. Indeed, EU directives assume that the harmonized issues have to be regulated by just one jurisdiction. Additionally, some directives explicitly establish that the competent state is the one where the "registered office" is located.[158] Among these harmonized issues some are U.S. style "internal affairs" of the corporation, while other ones are aimed at creditors' protection, such as registration mechanisms, and all regulations aimed at protecting capital and avoiding excessive distributions in public companies.[159]

---

155. In some Member States, restrictions on distributions are more stringent. For instance, in the German joint stock companies, distributions are allowed only out of profits deducting a quote for legally undistributable reserves. Aktiengesetz [AktG] [German Stock Corporation Act], Sept. 6, 1965 § 57(3), § 58(4). Under English corporate law, companies may not make distributions if in previous years has had losses that have not been yet replaced. Companies Act, 2006, c. 46, § 830 (Eng.).

156. As examples of concealed distributions, under German law, see Bundesgerichtshof [BGH] [Federal Court of Justice], Nov. 13, 1995, NEUE JURISTISCHE WOCHENSCHRIFT 589 (1996); UWE HÜFFER, AKTIENGESETZ KOMMENTAR §§ 8-9 (9th ed. 2010). Under English law, see *Aveling Barford Ltd. v. Perion Ltd.*, [1989] B.C.L.C. 626 (Eng.); John Armour, *Avoidance of Transactions as a 'Fraud on Creditors', at Common Law*, *in* VULNERABLE TRANSACTIONS IN CORPORATE INSOLVENCY 281, 296-97 (John Armour & Howard Bennett eds., 2003); PAUL L. DAVIES, GOWER & DAVIES' PRINCIPLES OF MODERN COMPANY LAW 290-91 (8th ed. 2008); BACHNER, *supra* note 126, at 115-20.

157. Second Council Directive 71/91/EEC, art. 32, 1976 O.J. (L 026) 1, 10.

158. *See* Directive 2007/36/EC, art. 1, 2007 O.J. (L 184) 17, 19; Directive 2004/25/EC, 2004 O.J. (L 142) 12, 16 (stating that the duties of the target's board are in the competence of the Member States of the target's registered office).

159. Additionally, a "re-label" of corporate law rule as insolvency law is allowed only to the extent that it does not restrict the fundamental freedom of establishment and the free movement of capitals provided for by the TFEU. Consequently, creditors' protection rules belonging to the realm of bankruptcy law, which applies to pseudo-foreign corporations having the COMI on the domestic territory, might be considered by the ECJ as a disproportionate obstacle to freedom of establishment. In this respect, we should bear in mind that domestic classifications are irrelevant for the application of EU law, so that the ECJ's only concern is that certain policy or regulatory strategies do not unreasonably restrict the freedom of establishment or free movement of capital. Enriques & Gelter, *supra* note 122, at 449.

b. Creditor Protection Mechanisms in Corporate Law and the Role of Insolvency Law

As detailed above, in many Member States of the EU, "corporate law" does not only address the internal affairs of the corporation, but also the agency relationship between shareholders and creditors. To be more precise, part of the rules aimed at creditor protection are characterized as "corporate law" for choice-of-law purposes and are regulated by the country of incorporation. Consequently, reincorporations from one Member State to another will also shift creditor protection mechanisms.

The Second Directive on corporate law has partially harmonized such mechanisms for joint stock corporations, while for limited liability corporations no harmonization measure has been adopted yet. Therefore, reincorporations of limited liability corporations might have a broader impact than reincorporations of joint stock companies, since creditors' protection mechanisms are more differentiated across Member States. This does not mean that reincorporations of joint stock corporations are irrelevant for the involved constituencies. Member States, by implementing the harmonizing directives, have a certain degree of flexibility at their disposal, with the consequence that corporate law can diverge across Member States even in harmonized fields.

This scenario is further complicated by the fact that insolvency and tort law often play a significant role as to creditors' protection. In this regard, the regulatory strategies of Member States often diverge. For instance, under English law creditors are protected mainly by insolvency law mechanisms.[160] Additionally, in recent years many continental European Member States, perhaps as a form of defensive regulatory competition, have relaxed the mechanism for creditors' protection of "private" limited liability corporations in a way that seems to mimic the English model.[161] This is particularly significant, since limited liability

---

160. In English law, the following insolvency law mechanisms for creditors protection are available: extended right to file for insolvency; fraudulent and wrongful trading, and boards' duties in the vicinity of insolvency; fraudulent conveyances. *See* Alexander Schall, *The UK Limited Company Abroad—How Foreign Creditors Are Protected After* Inspire Art *(Including a Comparison of UK and German Creditor Protection Rules)*, 16 EUR. BUS. L. REV. 1534, 1537-40 (2005).

161. In France, the minimum legal capital was repealed for the *société à responsabilité limitée*. Loi 2003-721 du août 2003 pour l'initiative économique élaborée [Law 2003-721 of August 1, 2003 on Economic Initiative], JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O] [OFFICIAL GAZETTE OF FRANCE], Aug. 5, 2003, amending art. L223-2 C. Comm. In Italy, after the reform of company law enacted in 2003, initial shareholders of private limited liability corporations (*società a responsabilità limitata*) can pay shares with a bank guarantee. ITALIAN C.C. art. 2364(4). Recently, a new reform has allowed to form *Società a responsabilità limitata* with just one euro of legal capital, if their shareholders are younger than thirty-five years old.

corporations are the prevalent actors of regulatory arbitrages in the EU. The consequence is that creditors may be forced to rely upon *ex post* mechanisms embodied in insolvency law, or upon other mechanisms such as veil piercing,[162] whose conflict-of-law criteria are not uniform across Member States.[163] Alternatively, adjusting creditors will simply discount the perceived increased risk of their debtor from the interest rate or will protect their interests by requiring adequate covenants in the contracts.

Furthermore, in recent years many legal scholars have challenged the real efficacy of the mechanisms of the legal capital to prevent shareholder opportunism at the expense of creditors and avoiding insolvency; instead, they advocate the adoption of a different mechanism, such as the "solvency test," that bars distributions that would lead the company to insolvency, regardless of its effects on the legal capital,[164] thus taking into account the liquidity of a corporation.[165] If these criticisms are confirmed, and to the extent that a more effective "corporate law" mechanism to avoid opportunistic behaviors of

---

ITALIAN C.C. art. 3463-bis. In Germany, a minimum capital requirement was repealed for private limited liability companies (*Gesellschaft mit beschränkter Haftung*) in 2008, if specific transparency requirements are fulfilled. GmbHG § 5a.

162. Veil piercing liability can be a valid creditor protection device if the corporation has a single or dominant shareholder and if an abuse of the legal personality emerges. Veil piercing, however, is useless for listed or widely held corporations.

163. Veil piercing is considered in many Member States as part of the *lex societatis* and, consequently, governed by the state of incorporation. KAREN VANDEKERCKHOVE, PIERCING THE CORPORATE VEIL 581 (2007). In some Member States, however, veil piercing is characterized as insolvency or tort law. For example, in German law, veil piecing (*Existenzvernichtungshaftung*) was recently characterized as belonging to tort law also for private international law purposes. *See* Bundesgerichtshof [BGH] [Federal Court of Justice] July 16, 2007, NEUE JURISTISCHE WOCHENSCHRIFT 2689 (2007); Bundesgerichtshof [BGH] [Federal Court of Justice] Jan. 7, 2008, NEUE ZEITSCHRIFT FÜR INSOLVENZRECHT 196 (2008); Eva-Maria Kieninger, *The Law Applicable to Corporations in the EC*, 73 RABELS ZEITSCHRIFT 607, 613-14 (2009); PETER KINDLER, INTERNATIONALES HANDELS- UND GESELLSCHAFTSRECHT, MÜNCHENER KOMMENTAR BGB § 618 (5th ed. 2010) (stating that veil piercing is part of insolvency law or, alternatively, of tort law).

164. *See* HIGH LEVEL GROUP REPORT, *supra* note 37, at 87; Wolfgang Schön, *Balance Sheet Tests or Solvency Tests—Or Both?*, 7 EUR. BUS. ORG. L. REV. 181, 189, 193 (2006); Paolo Santella & Riccardo Turrini, *Capital Maintenance in the EU: Is the Second Company Law Directive Really That Restrictive?*, 9 EUR. BUS. ORG. L. REV. 427, 449-54 (2008).

165. *See* FRIEDRICH KÜBLER, AKTIE, UNTERNEHMENSFINANZIERUNG UND KAPITALMARKT 30 (1989); Dan Prentice, *Corporate Personality, Limited Liability and the Protection of Creditors*, *in* CORPORATE PERSONALITY IN 20TH CENTURY 99 (Ross Grantham & Charles Rickett eds., 1998); Enriques & Macey, *supra* note 117, at 1194; Ferran, *supra* note 122, at 190. The "solvency test," however, is compatible with the legal capital mechanism, as is shown by the German reform of limited liability corporations. *GmbHG* § 64; *AktG* § 92(2). *See* Ulrich Noack & Michael Beurskens, *Modernising the German GmbH—Mere Window Dressing or Fundamental Redesign?*, 9 EUR. BUS. ORG. L. REV. 97, 113-14, 119 (2008).

shareholders is not in place, the result is straightforward: creditors rely upon other mechanisms to find protection.

In sum, on the one hand, Member States' strategies for creditor protection, despite the harmonization of legal capital for joint stock corporations, are not entirely identical; consequently, reincorporations change the applicable creditor protection mechanisms and risk jeopardizing creditors. On the other hand, some Member States of continental Europe are reducing creditor protection mechanisms embodied in "corporate law" for limited liability corporations; additionally, the capacity of the legal capital to protect creditors has probably been overestimated in past years.

We can conclude, therefore, that creditors, at least of limited liability corporations, rely also upon insolvency law or tort law mechanisms, similarly to the United States. However, a relevant difference between the U.S. and the EU persists regarding the effects of reincorporations upon the applicable insolvency law. Indeed, in the EU, differently from the U.S., bankruptcy law is state law. Member States' bankruptcy laws are extremely inhomogeneous as to a number of issues that are extremely relevant for creditors, such as the initial moment of the insolvency proceeding, the board's liabilities in the vicinity of insolvency, and clawback action against fraudulent or preferential transfers. EU derivative law has only harmonized choice of law criteria:[166] pursuant to the Insolvency Regulation, insolvencies are governed by the law of the state where the Center of the Main Interests (COMI) of the debtor is located, which is presumed to be in the state of the registered office,[167] unless the contrary is proven. Consequently, unless creditors give evidence that the COMI is still in the original country, reincorporations will also shift the applicable insolvency law to the new state of incorporation and, in this way, a number of rules aimed at protecting creditors.

V. REGULATING REINCORPORATIONS IN "BI-STAKEHOLDER" AND "MULTI-STAKEHOLDER" JURISDICTIONS

The former Parts have revealed that the EU and the U.S. contrast as to the extension of rules that are shifted through a reincorporation: in the U.S., the state of incorporation has narrower powers than in the EU, because creditors' interests are excluded from the Internal Affairs

166. Council Regulation 1346/2000, 2000 O.J. (L 160) 1 (EC) [hereinafter Insolvency Regulation].
167. *Id.* art. 3.

Doctrine and because some significant corporate law and corporate governance issues have been federalized. Basically, the most important competence of state laws is to regulate the fiduciary duties of the board vis-à-vis the shareholders. Consequently, U.S. corporate law can be labeled as a "bi-stakeholder" system, meaning that its corporate law addresses only the relationship between shareholders and the board.

By contrast, in the EU, corporate laws of many Member States address the agency problems emerging between shareholders and creditors. We can label corporate laws of EU Member States as "multi-stakeholder" systems. In recent years, however, creditor protection is increasingly based on insolvency law, which is in the competence of the Member State of incorporation, unless creditors give evidence that the debtor's center of main interest is located in another Member State. In general, therefore, the state of incorporation, either through corporate law or through insolvency law mechanisms, is competent to govern the agency problems between shareholders and creditors, so that the regulations of all three relevant agency relationships are bundled together. Consequently, in the EU reincorporations can also affect creditors' interests, not only shareholders' value. This different stakeholder structure changes the regulatory competition "game" and the notion of "optimal" or "efficient" corporate law changes.

A. *Redistributive Effects of Reincorporations*

Reincorporations can have redistributive effects among stakeholders. Corporate governance rules are implicit elements of the contracts between the different corporate stakeholders, (shareholders, creditors and the board) and therefore, any midstream change of the applicable law implicitly changes such contractual relations. Such changes may advantage some stakeholders at the expense of others (redistributive reincorporations), depending on the rules that are shifted from one state to another. Such redistributions will occur along the line of the three agency relationship: between shareholders and the board, between majority and minority shareholders, and between shareholders and creditors.

The "direction" and the magnitude of such redistributions depend on the rules that are shifted from one jurisdiction to another. Indeed, corporate law rules are not neutral upon the balance of interests and can be inherently redistributive,[168] with the consequence that any change of

---

168. On the distinction between "significantly" and "insignificantly" redistributive rules, see Bebchuk, *supra* note 2, at 1461; Oren Bar-Gill, Michal Barzuza & Lucian Bebchuk, *The*

such rules has the effect of changing the former relation among corporate stakeholders. Hereunder, I detail some examples of such "redistributive" reincorporations.

a. Market for corporate law. If the state of arrival protects the board from the threat of unsolicited takeover bids while the original jurisdiction does not, this insulation from the market of corporate control will increase managers' ability to extract private benefits of control.

b. Shareholders' powers. If the new jurisdiction protects minority shareholders less than the original one, or gives shareholders less power, the reincorporation would increase the risk of opportunistic behaviors by majority shareholders at the expense of the minority.

c. Creditors' protection. If in the new jurisdiction capital requirements or fraudulent conveyance rules are less stringent or less efficient than in the original one, creditors' interests might be jeopardized,[169] at least for "nonadjusting creditors,"[170] unless other mechanisms are in place in the new state of incorporation to "compensate" for such reduced protections.

B. *Reincorporations and Efficiency*

Even if detrimental for one or more constituency, reincorporations may be beneficial for the overall value of the corporation. To understand the policy choices made by each jurisdiction as regarding reincorporations, we need to adopt a "benchmark" to assess the optimality or efficiency of reincorporations.

The fundamental alternative is between a Pareto and a Caldor-Hicks criterion.[171] A reincorporation is Pareto optimal if it increases the overall value of the nexus of contract and makes no constituency worse off (i.e., it does not produce a redistribution). By contrast, following a Kaldor-

---

Market for Corporate Law, 162 J. INST. & THEORETICAL ECONS. 134, 135 (2006). On the risk of opportunistic reincorporations in the EU, see Armour, *supra* note 106, at 397-98.

169. That is to say that the risk of the investment is higher in the new jurisdiction than it was in the former.

170. Adjusting creditors will discount the probability that the debtor corporation will change jurisdiction in a way detrimental to their interests. Consequently, the risk of opportunistic reincorporations at the expense of creditors will be suffered only by "nonadjusting creditors."

171. A change of a state of the world is "Pareto optimal" if the overall wealth is increased and no one is left worse off. By contrast, a change of a certain situation is efficient according to a Kaldor-Hicks criterion if the total wealth is increased, even if someone is made worse off. *See* Jules L. Coleman, *Efficiency, Utility, and Wealth Maximization*, 8 HOFSTRA L. REV. 509, 513 (1980); Richard A. Posner, *Utilitarianism, Economics, and Legal Theory*, 8 J. LEGAL STUD. 103, 114 (1979). The Kaldor-Hicks efficiency, however, differently from the Pareto criterion, requires a uniform standard of comparability among individual utilities. In our case, for example, it would be necessary to establish whether an enhancement of shareholders' welfare can be compared with a decrease of creditors' welfare.

Hicks efficiency criterion, a reincorporation is efficient if the advantages of some constituencies outweigh the losses suffered by others, so that the former may (at least theoretically) compensate the latter and be nonetheless better off.[172] Obviously, it is for the private actors to decide whether a given transaction is worth being pursued. The law, however, is not neutral and may play a role in striking the balance among the involved interests.

Reincorporations, like many other corporate transactions, are decided by a board and shareholders' joint will. In addition, legislators have to take a position on whether creditors deserve some kind of protection or a "voice" power in the decision on the reincorporation itself. In this regard, mirroring the respective constituency structures, the U.S. and EU follow opposite strategies, as we will see in the next paragraphs. The following table summarizes the policy issues raised by reincorporations in "bi-stakeholder" and "multi-stakeholder" corporate law systems.

Table: Summary of the Policy Issues of Reincorporations

Type of corporate law	Type of Ownership	Relevant Agency Relations
"Bi-Stakeholder" corporate law	Widely held companies	Shareholders—Board
	Privately held companies	Majority—Minority
"Multi-Stakeholder" corporate law	Widely held companies	a. Shareholders—Board b. Shareholders—Creditors
	Privately held companies	a. Majority—Minority b. Shareholders—Creditors

C. Reincorporations' Effects in "Bi-Stakeholder" Corporate Laws: The U.S.

As we have seen, in the U.S., freedom of reincorporations is the driver of regulatory competition for corporate law. Companies are formed originally in the "home state," but then often reincorporate to Delaware upon going public.

The U.S. debate on the "efficiency" of regulatory competition is almost exclusively focused on whether this competition, if it ever exists, maximizes shareholders' value. Advocates of the "race to the top" theory hold that market constraints (market for corporate control, credit market, and market of the product) will induce corporations to choose the law

---

172. *See* Stefano Lombardo, *Regulatory Competition in Company Law in the European Union After* Cartesio, 10 EUR. BUS. ORG. L. REV. 627, 646-47 (2009).

that enhances shareholders' value and, under the supply side, that the states of the U.S. have incentives to compete to attract reincorporations and to avoid domestic companies reincorporating abroad.[173] In contrast, the opposite "race to the bottom" theorists argue that Delaware law has increasingly disenfranchised shareholders and has shielded boards from the market for corporate control.[174] Yet for both theories the fundamental goal of corporate governance is to increase shareholders' value, so that creditors' interests do not enter into the scene.[175]

Why do U.S. scholars not take into account the creditors' interests? The reason is straightforward: corporate law is not aimed at creditors' protection, but addresses almost exclusively the shareholders—board and majority—minority agency relationships. In this "bi-stakeholder" world, the regulation of the agency relationship between shareholders and creditors is not bundled with the rules on the other agency problems. Consequently, reincorporations are neutral for creditors and the main policy issue is whether regulatory competition increases shareholders' value. Indeed, under an efficiency perspective a reincorporation that increases shareholders' welfare also increases the total value of the nexus of contracts, being the transaction irrelevant for creditors.[176] Consequently and coherently, U.S. law does not provide any form of creditors' protection from opportunistic reincorporations.[177]

D. Reincorporations' Effects in "Multi-Stakeholder" Laws and the Mechanisms To Protect Creditors: The EU

Turning our attention to reincorporations in the EU, we face a completely different scenario. As we have seen above, until 2005 reincorporations were not generally allowed in the EU, and a number of Member States prohibited such transactions. These prohibitions were not only the product of parochialism. Indeed, behind the veil of legal arguments adopted to support this option in different States, the main policy reasons underlying the ban of reincorporations was to protect creditors from redistributive reincorporations. In other words,

---

173. Winter, *supra* note 1, at 262-73; Fischel, *supra* note 68, at 919.

174. Cary, *supra* note 2, at 685-87; Bebchuk, *supra* note 2, at 1467-70.

175. To my knowledge the only remarkable exception is to be found in Bebchuk's seminal paper, *supra* note 2, at 1485-91. According to Bebchuk, reincorporations can produce negative externalities on a number of constituencies, among which are creditors. In Bebchuk's view, the damage for creditors, however, is not produced by the reincorporation itself, since he acknowledges that state law rules on creditors' protection are extremely weak, but by the whole mechanism of regulatory competition that induced the states to lower creditors' protection.

176. *See* Lombardo, *supra* note 172, at 631.

177. *See* Model Bus. Corp. Act Ann. (2008) § 13.02(b)(1).

jurisdictions that banned reincorporations held that these transactions would have redistributive effects at the expense of minority shareholders and creditors.

As we have seen above, in the law of EU Member States the agency problem between shareholders and creditors is partially bundled with the other agency relations. Consequently, in contrast to the U.S., reincorporations may damage creditors that have relied upon the application of certain rules.[178] Reincorporations, in other words, would change the rules of the game before the end of the play.

This scenario has been drastically changed by the enactment of the SE Regulation and the Cross-Border Merger Directive, which made reincorporations feasible by transferring the registered office of an SE or by way of cross-border merger. Reincorporations are decided by a combined decision of the board and the majority shareholders and it is realistic to assume that such transactions will not be decided in a way that damages either of them. Furthermore, in systems with concentrated ownership, the board will initiate a reincorporation only if the majority of shareholders supports it.[179] Reincorporations, however, even when they increase shareholders' value, might be detrimental for creditors, and if we also take into account the agency costs of credit, these might reduce the overall value of the nexus of contracts.

EU derivative law, while it allows reincorporations by way of cross-border mergers, does not ignore creditors and, therefore, requires Member States to protect them against opportunistic reincorporations.[180] By contrast, protection of minority shareholders is optional.[181] However,

---

178. Lombardo, *supra* note 172, at 632.

179. Additionally, European corporate governance gives to shareholders and minorities more rights than in the U.S., where shareholders powers are extremely limited. *See* Arthur R. Pinto, *The European Union's Shareholder Voting Rights Directive From an American Perspective: Some Comparisons and Observations*, 32 FORDHAM INT'L L.J. 587, 617 (2009).

180. Council Directive 2005/56/EC, art. 4, § 2, 2005 O.J. (L 310) 1.

181. *Id.* art. 4, § 2 ("A member state *may* . . . adopt provisions designed to ensure appropriate protection for minority members who have opposed the cross-border merger.") (emphasis added). Therefore, as to shareholders' protection, the common denominator of EU Member States is established by the Third Directive on domestic mergers, article 7(2): supermajorities and by special vote of each class of shares "whose right are affected by the transaction." *See* Marco Ventoruzzo, *Cross-Border Mergers, Change of Applicable Corporate Law and Protection of Dissenting Shareholders: Withdrawal Right Under Italian Law*, 4 EUR. COMPANY FIN. L. REV. 47, 59 (2007). However, if the ownership is concentrated, shareholders' vote, even with supermajorities, might turn out to be ineffective in preventing opportunistic reincorporations that damage minority shareholders. *See* Bebchuk, *supra* note 2, at 1477. Therefore, a number of Member States safeguard shareholders' interests by granting them appraisal rights. Appraisal rights, while protecting shareholders *ex post*, increase *ex ante* the cost of the reincorporation, which will be implemented only if the gains outweigh the cost to pay-out dissenting shareholders. *See* Daniel R. Fischel, *The Appraisal Remedy in Corporate Law*, 8 AM.

Member States are free to autonomously design the preferred mechanisms to protect creditors against the moral hazard of their debtor. Member States, therefore, are free to overregulate this issue and to place unnecessary burdens in the way of cross-border mergers.

A common mechanism to protect creditors is to oblige the corporation to provide a security or to pay credits that have not yet fallen due in advance. Similar mechanisms are commonly adopted in a significant number of EU Member States[182] and in Switzerland.[183] Creditors are often required to file a petition against or to judicially "oppose" the merger, in order to receive advance payment or a security, in which case the court assesses whether the reincorporation is detrimental for creditors or not. Advance payment or securities are very powerful devices to protect creditors' interests. The rationale behind this is to pursue a Pareto optimal by granting creditors an "exit option" from the nexus of contract.[184]

This "exit option," however, might lead to overregulation because it is also usually granted to adjusting creditors who do not need it. Indeed, only nonadjusting creditors deserve such protection, while adjusting creditors may have already discounted the risk of future reincorporation from the price or may have already protected themselves with adequate covenants or "commitment clauses."[185] A possible solution is to delegate to the courts the assessment of whether a specific reincorporation damages creditors. The main risk of this solution is that judges without an economic background, as is often the case in Europe, are probably not able to distinguish sophisticated "adjusting" creditors with *ex ante*

BAR. FOUND. RES. J. 875, 880 (1983). Additionally, the need of a special meeting of each class of shares, may become a very powerful weapon to block an undesired reincorporation: if the new law does not grant to the class of shareholders rights or powers identical to such attributed by the state of origin, each class of shares has de facto a veto—power on the transaction, that may transcend into a "blackmail" power. *See* Tröger, *supra* note 131, at 40 (no incentives to reincorporation in order to damage minority shareholders).

182. To my knowledge, "exit" mechanisms (security or advanced payment) are applied in Poland, Slovak Republic, The Netherlands, Germany, Italy, Estonia, Denmark, Czech Republic, Bulgaria, Belgium, and Austria. Such exit mechanisms might protect creditors from opportunistic reincorporations, yet they cannot force a corporation to a reincorporation that enhances value to creditors, but is detrimental for shareholders. Enriques & Gelter, *supra* note 122, at 433.

183. CODE DES OBLIGATIONS SUISSE [OR], CODE OF OBLIGATIONS, Mar. 30, 1911, art. 706(b) (Switz.); *see* Brigitte Tanner, *Die Generalversammlung*, OBLIGATIONENRECHT, V, vol. 5b, arts. 698-706b, 397 (Jörg Schmid ed., 2003).

184. Lombardo, *supra* note 172, at 647.

185. *See* Enriques & Gelter, *supra* note 122, at 432-33; *see also Impact Assessment IV Directive*, *supra* note 39, at 49 (opining that a general duty to provide security to creditors "would ensure more extensive protection of creditors' rights but they would add—sometimes unnecessary—financial and time cost to the transfer").

bargaining power from "nonadjusting" creditors who deserve to be protected.

Among creditors, it is also worth mentioning employees, who enjoy a higher degree of mandatory protection under EU law. Indeed, some Member States provide for "codetermination" mechanisms, under which the employees have the right to appoint a certain number (usually between one third and half) of members of the supervisory board, who often have the power to decide upon fundamental strategies.[186] The codetermination is embodied in domestic corporate laws and, consequently, reincorporations would disenfranchise the employees if the new state of incorporation does not have similar mechanisms. Indeed, as a basic principle, employee participation is governed by the law of the state where the registered office is located after the reincorporation by way of cross-border merger.[187] EU derivative law does not entirely delegate to Member States the protection of employees, but establishes a mandatory proceeding to deal with that issue.[188] A corporation and its employees must enter into negotiations, in order to establish the employees' rights after the merger. If the parties do not find an agreement, certain "standard rules," enacted for this purpose by the Member State of the new registered office, apply. The fundamental principle embodied in the directive is that employees keep the same rights that they had under the original law, unless the involved parties find a different agreement (s.c. principle "before/after").[189] However, in the case of cross-border mergers the "standard rules" apply only if, before the merger, no less than one-third of the employees were involved in codetermination.[190] Consequently, EU derivative law protects employees' rights with a mandatory proceeding, but at the same time, allows minor regulatory arbitrages aimed at weakening employees' participation rights.[191]

---

186. *See* Martin Gelter, *Tilting the Balance Between Capital and Labor? The Effects of Regulatory Arbitrage in European Corporate Law on Employees*, 33 FORDHAM INT'L L.J. 792, 802-03 (2009-2010).

187. Council Directive 2005/56/EC, art. 16(1), 2005 O.J. (L 310) 1.

188. Council Directive 2001/86/EC, art. 4, 2001 O.J. (L 294) 22 (supplementing the SE Regulation). The same mechanism is to be applied to cross-border mergers, although with some slight differences. Council Directive 2005/56/EC, 2005 O.J. (L 310) 1.

189. Council Directive 2001/86/EC, art. 7.

190. Council Directive 2005/56/EC art. 16(3)(e), 2005 O.J. (L 310) 1.

191. Indeed, one of the main reasons for the employment of European companies, as a mechanism to realize regulatory arbitrages, is to weaken employees' codetermination. *See* Gelter, *supra* note 186, at 810-18; *see also* Eidenmüller, Engert & Hornuf, *supra* note 44, at 1-20 (focusing on empirical findings).

E. "Multi-Stakeholder" Corporate Laws, Creditors' Protection and the Constraints to Regulatory Competition

In the last Subparts, we have seen how minority shareholders and creditors are protected from opportunistic reincorporations in a "bi-stakeholder" system like the U.S., and in "multi-stakeholder" corporate laws, like Member States of the EU. What emerged was that, when confronting the need to regulate reincorporations, the U.S. has an easier task because reincorporations are neutral, or at least not particularly relevant, for creditors. Consequently, the states in the U.S. do not really need to protect creditors from opportunistic reincorporations.[192]

In contrast, multi-stakeholder corporate laws, like Member States of the EU, need to find a much more complicated balance since reincorporations are not neutral for creditors.[193] In such systems, even reincorporations that increase shareholders' value may turn out to be detrimental for creditors, so that the total value of the nexus of contracts may be correspondingly reduced. If the state of origin does not provide for any mechanisms to avoid opportunistic reincorporations at the expense of creditors, domestic rules on creditors' protections would be at the disposal of the shareholders and the board.

As a consequence, adjusting creditors *ex ante*, might discount from the price of the credit the worst possible corporate law that the debtor may opt into afterwards, by requiring a higher interest rate, which would increase the total cost of credit. Alternatively, adjusting creditors may protect themselves with covenants that accelerate the loan in case of reincorporation. Only nonadjusting creditors, therefore, will suffer the risk of opportunistic reincorporation, unless they free ride on the covenants negotiated by adjusting creditors.[194]

To avoid these risks, as we have seen above, Member States provide for mechanisms for creditors' protection against redistributive reincorporations by way of cross-border mergers. The EU cross-border merger directive leaves Member States an adequate freedom to shape such mechanisms, in order to respect their different levels of creditor protection embodied in domestic corporate laws. Therefore, Member States with a high standard of creditor protection will probably provide strong protection mechanisms for creditors in the way of reincorporations abroad, and conversely, if general creditor protection in the

---

192. *See* LOMBARDO, *supra* note 96, at 175.

193. *Id.* at 180-82.

194. *See* Enriques & Macey, *supra* note 117, at 1172; Enriques & Gelter, *supra* note 122, at 430. *But see* Ferran, *supra* note 122, at 192 (stating that covenants advantage prevalently the party who negotiated it).

state of origin is low, protection mechanisms against reincorporations will be less stringent.

This "multi-stakeholder" tendency of corporate laws in the EU Member States affects also the mechanisms of regulatory competition. Indeed, creditors' protection mechanisms against opportunistic reincorporations are an obstacle in the way of free choice of corporate law. As we have seen above, in order to avoid negative externalities, Member States protect creditors from opportunistic reincorporations by giving them an "exit" option. If such mechanisms are too stringent, cross-border mergers might become costly or even impossible and a certain number of reincorporations that enhance shareholder value will not be implemented. This is particularly true because Member States' mechanisms to protect creditors usually do not distinguish between "adjusting" and "nonadjusting" creditors.

The real impact of creditor protection mechanisms against opportunistic reincorporations depends on a number of factors that are not easily predictable. On the one hand, for sophisticated creditors, like banks or financial institutions, these mechanisms are trivial, since such lenders will contractually require veto rights or acceleration covenants; on the other hand, for nonadjusting creditors, the "exit right" may turn out to be too costly and ineffective, due to the need to act in court.[195] Additionally, between these two classes of creditors, other creditors may exist, for whom the legal provision of an "exit right" is neither trivial nor so expensive as to prevent them from suing. At the same time, the exercise of such a right will increase the total cost of the transaction and might exclude a certain number of efficient reincorporations.

VI. CONCLUSION

EU law is the driver of the evolution of Member States' laws towards a more liberal approach to corporate mobility. Without the action of the EU bodies, Member States would defend their own domestic choice-of-law criteria and national privileges. Case law of the ECJ over the last few decades has banned unreasonable barriers to inbound transfers of foreign corporations and to cross-border mergers. However, regarding barriers to "outbound" reincorporations erected by Member States and midstream free choice of law, the EU is behind the U.S. This does not depend on a lack of actions by EU bodies, but on Member States' domestic policies. Indeed, the Cross-Border Merger Directive might be an efficient instrument for reincorporations, but

---

195. Enriques & Gelter, *supra* note 122, at 435.

Member States are still free to adopt mechanisms for creditors' and shareholders' protection that may impede this form of "indirect" reincorporation.

In contrast, in the U.S., states adopt the Internal Affairs Doctrine, allow outbound reincorporations, and do not protect creditors from opportunistic reincorporations and moral hazard of their debtor.

This difference between the U.S. and EU cannot be eliminated completely, since "corporate law" (i.e., the set of rules that are shifted from one state to another through a reincorporation) in the EU also aims at creditors' protection, in contrast to the U.S. Therefore, the fact that Member States protect creditors from incorporations mirrors the different scope of "corporate law." In general, it is predictable that if creditor protection relies more on "corporate law" than on other sets of rules, some kind of protection will be granted to creditors against opportunistic reincorporations. These mechanisms usually do not distinguish between adjusting and nonadjusting creditors and might burden the corporation with unnecessary costs and prevent a certain number of efficient reincorporations. This risk is unavoidable at the present stage of the development of corporate governance mechanisms in the EU, where corporate agency problems are partially bundled together and reincorporations risk jeopardizing creditors and other stakeholders.