Unlimited Private Ordering and Regulatory Competition for Corporate Europe?!

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Abstract

Globalization and activist European judges have unleashed competitive processes: Regulatory competition awards a premium to the most efficient corporate law system. Political economy analysis illustrates that Europe will benefit greatly from a decentralized system of corporate law-making. In this, private ordering has the potential for transforming established legal concepts more profoundly than regulatory competition between legislators. Under European law, private parties are entitled to choose their optimal corporate form from a menu of national laws, including crossovers between legal systems. As transnational corporate contracting reshapes private international law rules, national regulatory concepts are challenged. The European Union requires Member States to recognize creative, non-domestic results of private ordering and learning processes. A structural analogy with the private provision of public goods is found to exist. Private ordering may produce externalities or challenge national redistributive policies. National regulatory options are shown to be determined by the freedom of contract, the evolution of private international law rules (as initiated by regulatory competition), and public choice considerations. The implications of this approach will be tested against the background of judge-made law in Europe and United States experiences with private ordering in an international context.

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I. Introduction

1. Why Consider Regulatory Competition and Private Ordering?

It is often overlooked that private ordering contributes significantly to the production of company law[1]. In the European Union (EU), Member States are understood to compete for the most attractive corporate law system as investors shun countries with over-regulation[2]. In this, regulatory competition is still viewed as a modernized version of the traditional law-making process[3]. But when the European Court of Justice (ECJ) opened the floodgates for company mobility, corporate law ceased to be monopolistically supplied by the State[4]. Investors are entitled to choose from a menu of corporate available under various national orders. In fact, private contracting contributes significantly to the production of company law. Jurisdictional competition as unleashed by the ECJ blurs the line between public and private spheres[5]. The regulatory implications of this development have to be ascertained from both, a macroeconomic and a microeconomic perspective[6].

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[1] Cf. *Hadfield/Talley*, On Public versus Private Provision of Corporate Law, J.L. Econ. & Org. 22 (2006), 414; *Easterbrook/Fischel*, The Economic Structure of Corporate Law (1991/Paperback ed. 1996), 35.

[2] In fact, competition among rules includes regulatory competition between national law-makers, regulatory arbitrage by market operators selecting the best location for economic activity, and regulatory emulation of national regulators changing their laws in reaction to competitive threats from abroad: *Woolcock*, Competition Among Rules in the Single European Market, in: Bratton/McCahery/Picciotto/Scott (eds.), International Regulatory Competition and Coordination – Perspectives on Economic Regulation in Europe and the United States (1996), 289 (at p .297 et seq.). See also the assessment by an official of the German Federal Ministry of Justice on the competitive race between the German *GmbH* and the British Private Limited Company, *Seibert*, Close Corporations – Reforming Private Company Law: European and International Perspectives, Eur. Bus. Org. L. Rev. (EBOR) 8 (2007), 83 (86): "The remaining strategy is to face the competition! We take it as a challenge to improve our own product. Since the advantage of the British private limited company seems to be that it is quicker and cheaper to incorporate, the answer is that we are required to make our *GmbH* better, quicker, cheaper and simpler, but still reliable".

[3] *Ventoruzzo*, „Cost-based" and „Rule-based" Regulatory Competition: Markets for Corporate Charters in the U.S. and the EU, Bocconi University – Institute of Comparative „Angelo Sraffa" (I.D.C.) Legal Studies Research Paper No. 14 (October 2006), at p. 2. See generally on regulatory competition within the European Union: *Armour*, Who Should Make Corporate Law? – EC Legislation versus Regulatory Competition, European Corporate Governance Institute, Law Working Paper N°. 54/2005 (June 2005), p. 8 et seq.; *Kieninger*, Wettbewerb der Privatrechtsordnungen im Europäischen Binnenmarkt – Studien zur Privatrechtskoordinierung in der Europäischen Union auf den Gebieten des Gesellschafts- und Vertragsrechts (2002), p. 8 et seq.; *Deakin*, Legal Diversity and Regulatory Competition, Eur. L. J. 12 (2006), 440 (442).

[4] Cf. *Cafaggi/Muir Watt*, The Making of European Private Law: Regulation and Governance Design, available at http://www.eu-newgov.org.

[5] *Muir Watt*, European Integration, Legal Diversity and the Conflict of Laws, Edin. L. R. 9 (2004/2005), 6 (16). This is an important qualification of the *Tiebout* model on the local production of public goods (*Tiebout*, A Pure Theory of Local Expenditures, J. Pol. Econ. 64, 416 (419 et seq.) (1956): see *Bratton/McCahery*, The New Economics of Jurisdictional Competition: Devolutionary Federalism in a Second-Best World, Geo. L. J. 86 (1997), 201 (217).

[6] Cf. *Tjiong*, Breaking the Spell of Regulatory Competition. Reframing the Problem of Regulatory Exit, Preprints aus der Max-Planck-Projektgruppe Recht der Gemeinschaftsgüter, Bonn (2000/13), available at http://papers.ssrn.com/paper.taf?abstract_id=267744; *Stephan*, Regulatory competition and cooperation: the search for virtue, in: Bermann/Herdegen/Lindseth (eds.), Transatlantic Regulatory Cooperation – Legal Problems and Political Prospects (2000), 167 (at pp. 169 et seq., 190 et seq.).

2. A Challenge for Policy-makers

Policy-makers monitor the entry and exit of foreign and pseudo-foreign corporations with some concern. Non-domestic corporations are perceived as a competitive threat to established principles of corporate law[7]. A case of 'cherry-picking' is diagnosed as foreign corporations attempt to reap the benefits of company mobility without paying the price of more restrictive creditor protection rules in their host state[8]. In a way, this rhetoric is both, over-inclusive and deficient. With some justification, it correctly highlights an internalization problem, but it does not address the motivation for opting out of or into national regulatory systems[9].

Regulatory choice is conditioned on private ordering and the freedom of exit. In exiting from a national corporate law system investors reject a public good which they consider as unduly burdensome[10]. Exercising regulatory choice for the benefit of a more attractive foreign rule entails costs for private parties. It may also affect the likelihood of an efficient commons[11], and generate wealth transfers[12]. As corporate law systems have ceased to be all-encompassing regulatory devices there is a need for allocating the spheres of influence of various national laws[13]. Traditional legal terminology classifies this regulatory problem as an issue of whether mandatory law should take precedence over private choice[14]. From a transnational point of view this requires analysis as to what extent the host state may control the internal affairs of a foreign corporation[15]. Ultimately, private international law will have to trench between conflicting national conceptions of corporate law. This implies that private international law itself has undergone evolutionary processes, performing regulatory functions[16]. Private international law rules would have to calibrate conflicting national law con-

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[7] *Seibert*, supra N. 1, Eur. Bus. Org. L. Rev. (EBOR) 8 (2007), 83 (at p. 85 et seq.); *Haas*, Reform des gesellschaftsrechtlichen Gläubigerschutzes, Gutachten E zum 66. Deutschen Juristentag (2006), 9 et seq.

[8] *Schön*, Playing Different Games? Regulatory Competition in Tax and Company Law Compared, Com. Mkt. L. Rev. 42, 331 (337) (2005); cf. the judgment of June 22, 2004 of the Finanzgericht (Tax Law Court) Rheinland-Pfalz, Case No. 2 K 2455/02.

[9] Cf. *Hertig/McCahery*, A Legal Options Approach to EC Company Law, Amsterdam Center for Law & Economics Working Paper N. 2006-01, available at http://ssrn.acle.nl.

[10] Cf. *Hirshman*, Exit, Voice, and Loyalty (1970), 30 et seq.; *Märkt*, Zur Methodik der Verfassungsökonomik – Die Aufgabe eines verfassungstheoretisch argumentierenden Ökonomen, Freiburg Discussion Papers on Constitutional Economics 02/2004.

[11] Cf. *Dagan/Heller*, The Liberal Commons, Yale L. J. 110 (2001), 549 (575 et seq.).

[12] *O'Hara*, Opting Out of Regulation: A Public Choice Analysis of Contractual Choice of Law, Vand. L. J. 53 (2000), 1551 (1584 et seq.).

[13] Cf. *Muir Watt*, Experiences from Europe: Legal Diversity and the Internal Market, Tex. Int'l. L. J. 39 (2004), 429 (452 et seq.).

[14] *Muir Watt*, supra N. 13, Tex. Int'l. L. J. 39 (2004), 429 (443); *Morosini*, Globalization & Law: Beyond Traditional Methodology of Comparative Legal Studies and an Example from Private International Law, Cardozo J. Int'l. & Comp. 13 (2005), 541 (559).

[15] Cf. *Gildea*, Überseering: A European Company Passport, Brook. J. Int'l. L. 30 (2004), 257 (260); and infra sub III.2.b, III.3

[16] Cf. *Muir Watt*, Choice of Law in Integrated and Interconnected Markets: A Matter of Political Economy, Colum. J. Eur. L. 9 (2003), 383 (398 et seq.); *Wai*, Transnational Lift-off and Juridical Touchdown: The Regulatory Function of Private International Law in Era of Globalization, Colum. J. Transnat'l. L. 40 (2002).

cepts, by evaluating the positive and negative externalities that free choice of (foreign) corporate law might bring forth[17].

3. Outline of the Paper

This paper will first outline the regulatory dynamics of corporate law as initiated by the ECJ's jurisprudence. Private companies and start-ups enjoy free regulatory choice, triggering evolutionary processes for established national regulatory concepts in both, national rules of substance and private international law. It will be argued that private corporate law ordering within the EU can best be understood as a mechanism of generating a public good upon private initiative. The implications of this approach will be tested in the light of potential externalities, begging the question whether private parties will be able to internalize the costs of free regulatory choice and contracting. This may affect national redistributive policies. The jurisprudence of US courts and the ECJ will be assessed in order to define the regulatory role of private international law. An outlook on policy implications concludes.

II. Company Mobility and Private Provision of Public Goods Come to Europe

1. The ECJ's Jurisprudence on Company Mobility in a Nutshell

a. Basics

Free regulatory choice characterizes mature markets, undisturbed by interventionist economic policies. Current European policy-making relies on three regulatory alternatives: deregulation as a private market solution, national regulatory devices as an instrument of home country control and harmonizing EU regulation[18]. The ECJ has chosen a deregulatory approach by implementing the freedom of establishment under the EC Treaty[19]. A series of judgments

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[17] Cf. *Stephan*, supra N. 6, at p. 190; *Kerber*, Interjurisdictional Competition within the European Union, Fordham Int'l. L. J. 23 (2000), 217 (249), discussing the need for a legal framework ensuring "both competition between firms for the provision of private goods, and interjurisdictional competition for public goods".

[18] *Kerber*, supra N. 17, Fordham Int'l. L. J. 23 (2000), 217 (243).

[19] The freedom of establishment for corporate organizations is guaranteed by artt. 43 and 48 of the EC Treaty.
Art. 43 of the EC Treaty:
Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of Member States in the territory of another Member Sate shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any other Member State established in the territory of any Member State.
Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of 48, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the chapter relating to capital.
Art. 48 of the EC Treaty:
Companies or firms formed in accordance with the law of a Member State having their registered office, central administration or principal place of business within the Community shall, for the purposes of this chapter, be treated in the same way as natural persons who are nationals of Member States.

guarantees free entry to the host state, thus facilitating corporate relocation decisions[20]. Non-domestic European companies are entitled to access to justice irrespective of whether they have been incorporated under the laws of another Member State. Creditor protection is a valid regulatory policy purpose. But a foreign European company may commence business activities without depositing funds to satisfy potential creditor claims. Conversely, it is illegal to apply specific liability rules to a director of a non-domestic company no longer operative in its country of incorporation. Absent fraud, it is legitimate to circumvent restrictive laws of one Member State and resort to the more liberal company law regime of another[21]. Private companies are entitled to demonstrate mobility by consummating a cross-border merger[22].

The ECJ's rulings on regulatory exit proper are less far-reaching. In the *Daily Mail* case[23] a British statute was upheld which conditioned a corporate relocation decision upon the payment of a de facto exit tax. Since then no tax-related relocation cases have come up to the ECJ[24]. There is, however, some indication, that the ECJ's stance on the tax aspects of company liability may have mellowed[25].

b. Regulatory Policy Implications

It is no coincidence that private companies have become the motor for company mobility and regulatory competition in corporate Europe. National regulatory policies on private companies

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'Companies or firms' means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit making (Consolidated Version of the Treaty Establishing the European Community, O.J. C 325/33 of December 24, 2002).

[20] ECJ judgments of March 9, 1999, Case Nº. C-221/97, Centros Ltd. v. Erhvervs- og Selskabstyrelsen, [1999] E.C.R. I–1459; May 11, 2002, Case Nº. C-208/00, Überseering B.V. v. Nordic Construction Company Baumanagement GmbH (NCC), [2002] E.C.R. I-9919 et seq.; September 30, 2003, Case Nº. C-167/01, Kamer van Koophandel en Fabrieken v. Inspire Art Ltd.; and December 13, 2005, Case Nº. C-411/03, SEVIC Systems AG, [2005] ECR I-10805 et seq

[21] See para. 95 et seq. of the ECJ's judgment of September 30, 2003, Case Nº. C-167/01, Kamer van Koophandel en Fabrieken v. Inspire Art Ltd., "*… The reasons for which a company chooses to be formed in a particular Member State are, save in the case of fraud, irrelevant with regard to application of the rules on freedom of establishment. … (T)he fact that the company was formed in a particular Member State for the sole purpose of enjoying the benefit of a more favourable legislation does not constitute abuse even if that company conducts its activities entirely or mainly in that second State …*".

[22] See ECJ Judgment in the SEVIC case, supra N. 21; Case Note by *Behrens*, CMLR 43 (2006) 1669 et seq.; see also the Directive of the European Parliament and of the Council on cross-border mergers of limited liability companies, O.J. L 310 of December 13, 2005.

[23] ECJ judgment of September 27, 1988, Case Nº. 81/87, The Queen v. H.M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc., [1988] E.C.R. 5483.

[24] The *X and Y* and *de Lasteyrie du Saillant* cases involve tax liabilities of individuals who held shares of European multinational companies: ECJ judgments of November 21, 2002, Case Nº. C-436/00, X and Y v. Riksskatteverk; March 11, 2004, Case Nº. C-9/02, Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie. See also judgment of March 6, 2007, Case Nº. C-292/04, Meilicke, Weyde and Stöffler v. Finanzamt Bonn-Innenstadt

[25] See the detailed analysis by *Burwitz*, Tax Consequences of the Migration of Companies: A Practitioner's Perspective, European Business Organization Law Review (EBOR) 7 (2006), 589 (at p. 596 et seq.).

and partnerships are less restrictive[26], hence the relative ease for European judges to intervene and foster company mobility. The ECJ's agnosticism towards pseudo-foreign companies has paved the way for free regulatory choice and private ordering. The English Private Limited Company stands to become the major beneficiary of this state of Community law. Investors opt for this type of business organization, continue to have it registered in the United Kingdom (UK), and coordinate their activities from the head office on the European continent[27]. There is no taxable income in the UK and shareholders reap the benefits of English company law which they consider to be of greater appeal than its continental European counterparts[28].

In favoring private companies over listed corporations the ECJ's holdings on company mobility might be thought to be incoherent[29]. But this rather reflects the balance of power between the Member States, the European Commission and the European judges. The corporate law policies of the Member States have tended to establish a non-cooperative equilibrium, foreclosing regulatory choice and interjurisdictional competition to corporations[30]. Although the ECJ has the means to mould Community law, it has attempted to use its discretionary power in a spirit of cooperation in order to avoid alienation with the major regulatory players in the European Union[31]. Member States are still reluctant to bestow free regulatory choice on listed corporations. Rules on stakeholder protection place considerable barriers on

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[26] In the debate on company mobility in the EU the factual settings of the cases before the ECJ are often overlooked: The *Centros*, *Überseering* and *Inspire-Art* rulings, supra N. 20, dealt with close corporations or private companies. See also: *McCahery*, Harmonization in European Company Law: The Political Economy of Economic Integration, in: Curtin/Smits/Klip/McCahery, European Integration and the Law – Four Contributions on the Interplay between European Integration and National Law to celebrate the 25th Anniversary of the Maastricht University's Faculty of Law (2006), 155 (182 et seq.). Cf. *Ribstein*, Why Corporations?, Berkeley Bus. L. J. 1 (2004), 183 (191 et seq.), analyzing the choice between corporation and partnership from a US perspective; and *McCahery/Vermeulen*, Understanding (Un)incorporated Business Forms – Topics in Corporate Finance 12, 9 et seq. (2005), assessing the legal regime for closely held firms.

[27] It is estimated that some 30,000 Private Limited Companies have now moved their headquarters to Germany: *Westhoff*, Die Verbreitung der *limited* mit Sitz in Deutschland, GmbH-Rundschau 97 (2006), 525 (528); *Becht/Mayer/Wagner*, Corporate Mobility Comes To Europe: The Evidence, Working Paper, Université Libre de Bruxelles/Saïd Business School, Oxford University (October 2005); *Rajak*, The English Limited Company as an Alternative Legal Form for German Enterprise, EWS 2005, 539 et seq.

[28] The same practice is observed with respect to Private Limited Companies established in off-shore centers such as the British Virgin Islands or the Cayman Islands. The provisions of the EC Treaty on the freedom of establishment are equally applicable to these companies.

[29] Cf. *Muir Watt*, supra N. 13, Tex Int'l. L. J. 39 (2004), 429 (450).

[30] Cf. *McCahery/Vermeulen*, Does the European Company prevent the 'Delaware-effect'?, Tilburg University, TILEC Discussion Paper DP 2005-10 (March 2005), arguing that "there are few political incentives for lawmakers to pass legislation that might serve to disrupt the EU's non-competitive equilibrium in company law"; and *Kirchner/Painter/Kaal*, Regulatory Competition in EU Corporate Law after *Inspire Art*: Unbundling the Delaware's Product ECFR 2, 159 (176 et seq.) (2005), pointing out to the switching costs an established company would face in migrating from one national legal order to another.

[31] *Cooter/Drexel*, The Logic of Power in the Emerging European Constitution: Game Theory and the Division of Powers, Int'l. Rev. L. & Econ. 14 (1994), 307 (324 et seq.).

the road to exit from one corporate law jurisdiction[32]. Nonetheless, the importance of private companies for listed corporations should not be underestimated. Listed corporations have begun to rely on (more liberal) private company law vehicles to escape the constraints of their domestic corporate law rules. In creating foreign private (holding) companies, merger-like devices are put into effect[33]. There are also signs that competition from private company law[34] and globalization will push national legislators towards reform[35]: Legislative activities of the European Union are designed to extend corporate mobility to listed corporations[36].

The ECJ's rulings on company mobility should not be read as a tacit acknowledgment of congruence between exit and economic markets, or between voice and politics[37]. The ECJ does not openly favor the local production of company law. It is equally difficult to enlist the Court for supporting centralized European rules of company law by way of harmonization. Instead, the ECJ makes an attempt to attack the negative externalities of a public good[38] by emphasizing private choice and the freedom of establishment. In the following, a microeconomic approach towards interjurisdictional competition will be pursued in order to scrutinize private regulatory choice with greater accuracy. This serves to refocus the private international law debate by categorizing conflict of laws as an instrument of regulatory policy. In this, the macroeconomic aspects of private ordering are not to be overlooked. Private ordering has to be evaluated as to whether it is capable of internalizing the spill-over from regulatory differences between the Member States. Against this background, the ECJ adds a caveat to its rulings on company mobility by recognizing 'grounds of imperative national interest' which authorize Member States to derogate from principles of company mobility[39].

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[32] In Germany, e.g., local interest groups heavily defend the country's codetermination laws: See analysis by *Pistor*, Codetermination: A Sociopolitical Model with Governance Externalities, in: Blair/Roe (eds.), Employees and Corporate Governance (1999), 163 et seq.

[33] Foreign holding companies are exempt from German laws on codetermination: BAG (Federal Labor Supreme Court, decision of February 14, 2007 (7 ABR 26/06); OLG (Court of Appeal) Düsseldorf, decision of October 30, 2006 (26 W 14/06 AktE).

[34] Cf. *Timmerman*, Welfare, fairness and the role of courts in a simple and flexible private company law, Eur. Bus. Org. L. Rev. (EBOR) 8 (2007) (forthcoming).

[35] On the international aspects of company law modernization in Europe see the Commission's Action Plan: 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*, COM (2003) 284 final.

[36] See the Directive on Cross-Border Mergers, supra N. 22, and the European Commission Proposal for a Fourteenth European Parliament and Council Directive on the Transfer of the Registered Office of a Company from One Member State to Another with a Change of Applicable Law (XV/D2/6002/97-EN REV.2).

[37] *Easterbrook*, Antitrust and the Economics of Federalism, J. L. & Econ. 26, 23 (33 et seq.) (1983).

[38] This is due to the fact that there is a trade-off between the informational advantages of regional government and the externalization effects of national legal systems: *Laffont/Zantman*, Information acquisition, political game and the delegation of authority, Eur. J. Pol. Econ. 18, 407 (417 et seq.) (2002).

[39] See infra, sub III.3.

2. Private Provision of Corporate Law through Contracting

a. Company Law in Europe – A Different Perspective

In continental Europe, corporate law is a public good traditionally supplied by national legislators. But corporate statutes and their liability rules are prone to suffer from the tragedy of the commons which is likely to be magnified by federal legal systems. Regulatory protectionism motivates national officials to yield intrajurisdictional efficiency at the expense of interjurisdictional efficiency[40]. US legal analysis on state product liability statutes has established that states have a bias in favor of their own rules, thereby exporting their standards to increase the amount of recovery[41].

Conventional wisdom suggests that the deficiencies a public good might be overcome by regulation. Competitive efficiency dictates that the public good should be privatized, thereby subjecting its provision to the workings of the market mechanism[42]. In Europe, the policy challenge is exacerbated by the multi-layer division of regulatory competences. The ECJ offers a microeconomic way-out of a policy impasse, ignoring the traditional antagonism between the Member States and the European Commission. Negative spillovers of national legal orders are attacked by facilitating private ordering. Empirical studies demonstrate that the English Private Limited Company significantly modernizes the menu of organizational choices available to business people in the Netherlands and Germany[43]. Moreover, private ordering has generated cross-overs between English and German law by establishing Anglo-German partnerships[44]. There is evidence that German courts might integrate foreign companies and cross-overs into the national legal order by harmonizing principles of English company law and the German insolvency statute[45]. *Hadfield/Talley* develop a model of private provision of company law which is applicable to this situation. State officials are unable to re-

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[40] *Issacharoff/Sharkey*, Backdoor Federalization, UCLA L. Rev. 53 (2006), 1353 (1387).

[41] See *Powers*, Some Pitfalls of Federal Tort Law Reform Legislation, Ariz. L. Rev. 38 (1996), 909 (910). A state might be better off by adopting discriminatory rules irrespective of the laws adopted by sister-jurisdictions: *Krauss*, Product Liability and Game Theory: One More Trip to the Choice-of-Law Well, BYU L. Rev. 2002, 782 et seq., using a prisoner's dilemma approach.

[42] Cf. *Engel*, Wettbewerb als sozial erwünschtes Dilemma, Preprints of the Max Planck Institute for Research on Collective Goods (Bonn, 2006/12), available at http://ssrn.com/abstract=902813.

[43] See supra N. 27.

[44] See *Schlichte*, Kapitalerhaltung in der Ltd. & Co. KG, Der Betrieb 59 (2006), 1357 et seq.; *Werner*, Die Ltd. & Co. KG – eine Alternative zur GmbH & Co. KG?, GmbH-Rundschau 96 (2005), 288 et seq.; *Kowalski/Bormann*, Beteiligung einer ausländischen juristischen Person als Komplementärin einer deutschen KG – zugleich Besprechung des Beschlusses AmtsG Bad Oeynhausen vom 15.5.2005 – 16 AR 15/05, GmbH-Rundschau 96 (2005), 1045 et seq.

[45] See BGH (German Federal Supreme Court), Judgment of March 14, 2005, Zeitschrift für Wirtschaftsrecht 26 (2005), 805 (806) (2005); *Goette*, Zu den Folgen der Anerkennung ausländischer Gesellschaften mit tatsächlichem Sitz im Inland für die Haftung ihrer Gesellschafter und Organe, Zeitschrift für Wirtschaftsrecht 27, 541 (544) (2006); *id.*, Krisenvermeidung und Krisenbewältigung in der GmbH – Überblick, Zeitschrift für Unternehmens- und Gesellschaftsrecht 35 (2006), 261 (265); *Schall*, Englischer Gläubigerschutz bei der Limited in Deutschland, Zeitschrift für Wirtschaftsrecht 26 (2005), 965 (974 et seq.).

create market conditions for the efficient production of company law. Private initiative takes over[46] and bypasses deficiencies of national company law systems. This approach is likely to draw criticism from the rent-seeking constituency of non-English lawyers unfamiliar with the Private Limited Company. They will counter foreign competition by alleging that pseudo-foreign companies generate externalities for the host country. But this is a misapprehension of the tragedy of the commons problem. Introducing innovative corporate law models creates positive externalities. To claim the contrary, is to relegate private ordering to a scenario without market conditions. This assumption holds true even if the provider of the public good will not capture the full social value of his efforts[47]. Against this background, corporate law expertise becomes public as cases make their way to the courts. Admittedly, this is a common law approach towards the private provision of company law[48], but it is equally applicable to continental jurisdictions where the English Private Limited Company continues to mesmerize the imagination of the business community and of courts of first instance.

b. New Regulatory Functions for Private International Law

In introducing the Coase theorem to conflict of laws analysis, *Trachtman* has likened governments to owners of property rights in the legislative process. Conflict of laws rules determine which government has the prerogative to supply the relevant rules to a transaction. Conflict of law rules are to minimize transaction costs, maximizing at the same time the amount of transactions which occur under an optimal distribution of the rights to produce law[49]. In an extension to these assumptions, efficiency would then determine the optimal allocation of rights in interjurisdictional conflicts.

As a matter of interpretation technique the ECJ has rather subtly re-calibrated the function of private international law in the legal orders of the Member States[50]. The initial message was that Member States originally in support of the so-called seat theory had to abandon their restrictive regimes on companies from the incorporation states of the EU. Non-domestic European companies must be recognized without re-incorporation in the host coun-

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[46] *Hadfield/Talley*, On Public versus Private Provision of Corporate Law, J. L. Econ. & Org. 22 (2006), 414 (at p. 417 et seq.); see generally on the private provision of public goods *Déprés/Grolleau/Mzoughi*, Fourniture non publique de biens publics: diversité des arrangements, UMR INRA-ENESEAD/CESAER Working Paper 2005/4 (Dijon 2005).

[47] The public goods hypothesis has been tested for intellectual property and cyberspace issues. See: *Lemley*, Ex ante versus Ex post Justifications for Intellectual Property, U. Chi. L. Rev. 71 (2004), 129 (at p. 149 et seq.); *Coyne/Leeson*, Who's to Protect Cyberspace?, J. L. Econ. & Pol'y. 1 (2005), 473 (481 et seq.).

[48] See *Easterbrook/Fischel*, supra N. 1, at p. 35.

[49] *Trachtman*, Conflict of Laws and Accuracy in the Allocation of Government Responsibility, Vand. J. Transnat'l. L. 26 (1994) 975 (at p. 1047 et seq.).

[50] The Rome Convention on the Law Applicable to Contractual Obligations of June 19, 1980, Consolidated Version, O. J. C 27/34 of January 26, 1998, is not applicable to company law matters.

try[51]. Moreover, the legal order of the host country has to respect public policy choices made by the state of incorporation[52]. In pursuing a private ordering approach towards company law the ECJ adds an important qualification to *Trachtman*'s hypothesis. As national legislators cannot be relied upon devising choice-enhancing corporation laws, private parties step in to fill the gap. Ultimately, this is a policy device to contain Member State rent-seeking and opportunistic behavior. It is rendered effective by an evolution of private international law rules which assume a regulatory function[53]. Under the influence of the ECJ national conflict of laws rules are to balance intrajurisdictional and interjurisdictional efficiencies[54], reflecting a trade-off between the interests of various constituencies[55].

III. Externalities of Private Corporate Contracting and Private International Law

1. How to Strike a Balance?

Ideally, private contracting reduces transaction costs at a personal level. From a regulatory policy point of view, parties should be made to internalize the negative effects of their contracting decisions. Under a scenario of private provision of public goods various aspects of externalities have to be balanced. Intuitively, the private provider of a public good should not be allowed to take a free ride on the public goods of another Member State[56]. In a way, this is an observation that remains faithful to its microeconomic origins. Private contracting insinuates that a microeconomic approach might bridge conflicting (macroeconomic) policies by various countries. But this does not adequately address problems of rent-seeking and beggar-thy-neighbor policies. In the EU, the host Member State is not entitled to export its own standards as long as the foreign (private) production of norms does not create serious negative externalities. The inability of a national legal system to internalize the costs of the domestic

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[51] See: *Roth*, From Centros to Überseering: Free Movement of Companies, Private International, and Community Law, I.C.L.Q. 52 (2003), 177 et seq.; *Micheler*, The Impact of the Centros Case on Europe's Company Laws, Comp. Law. 21 (6) (2000), 179 (180 et seq.); *Eidenmüller*, Europäisches und deutsches Gesellschaftsrecht im europäischen Wettbewerb der Gesellschaftsrechte, in: Festschrift Heldrich (2005), 581 (582); *Grundmann*, The Structure of European Company Law: From Crisis to Boom, Eur. Bus. Org. L. Rev. (EBOR) 5 (2004), 601 (611 et seq.).

[52] This is also an issue on how much private choice of foreign norms will be recognized: cf. *Muir Watt*, Aspects Économiques du Droit International Privé, Recueil des Cours de l'Académie de droit international de La Haye, 308 (2004), 25 (at p. 140 et seq.).

[53] Cf. *Muir Watt*, supra N. 16, Edin. L. Rev. 9 (2004/2005), 6 (16).

[54] Cf. *Breton/Salmon*, External Effects of Domestic Regulations: Comparing Internal and International Barriers to Trade, Int'l. Rev. L. & Econ. 21 (2001), 135 (at p. 143 et seq.) and *Kysar*, Sustainability, Distribution, and the Macroeconomic Analysis of Law, B.C. L. Rev. 43 (2001), 1 (at p. 65 et seq.), emphasizing the need to equally consider problems of wealth distribution.

[55] Cf. *Oates/Schwab*, Economic Competition Among Jurisdictions: Efficiency Enhancing or Distortion Inducing?, J. Pub. Econ. 35 (1988), 333 (at p. 345 et seq.); *Brooke Overby*, An Institutional Analysis of Consumer Law, Vand. J. Transnat'l. L. 35 (2001), 1219 (at p. 1232).

[56] See on the externalization aspects of the private provision of local public goods: *Somin*, Revitalizing Consent, Harv. J. L. & Pub. Pol'y 23 (2000), 753 (at p. 799 et seq.).

production of public goods may not serve as a pretense to block the foreign production of public goods. Against this background, private international law has to solve a double cost internalization problem[57]. Private parties have to avoid negative externalities of their contracting decisions. On an intrastate level, government officials have to refrain from rent-seeking[58] which, in turn, evidences regulatory capture strategy by local interests.

In developing a regulatory concept for private international law it is unrealistic to describe the private provision as a mere problem of competing public goods[59]. Member States legitimately pursue their own domestic policies. What is at issue is to what extent private international law rules may be exploited to foster national distributive policies at the expense of foreign competitors. In the following the jurisprudence of US courts on the dormant commerce clause will be studied in order to ascertain whether efficiency or policy considerations dictate the application of conflict of laws rules in the field of corporate law.

2. USA – The Dormant Commerce Clause and Constitutional Economics

a. Basics

According to the theory of the firm private ordering generates search and negotiations costs, but it also imposes monitoring costs on third parties[60]. There is a trade-off between the efficiencies gained by the founders of the firm and the (potential) costs incurred by business partners and non-adjusting creditors. Conventional wisdom holds that the market can be generally be relied upon producing the relevant amount of information so that investors can make an informed judgment[61]. The statutory menu of business organizations is optimal if it maximizes shareholder wealth. For many years the US regulatory debate on business organizations has been dominated by the divide between the mandatory and enabling nature of corporate law[62]. Generally, the market can be relied on producing the relevant amount of information so that investors can make an informed judgment[63]. Government action is required for closing regulatory gaps which have given rise to externalities of private action or to a tragedy of the

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[57] Cf. *Mcgreal* ,The Flawed Economics of the Dormant Commerce Clause, Wm. & Mary L. Rev. 39 (1998), 1191 (at p. 1275 et seq.).
[58] Cf. *Stearns*, A Beautiful Mend: A Game Theoretical Analysis of the Dormant Commerce Clause, Wm. & Mary L. Rev. 45 (2003), 1 (at p. 72).
[59] Cf. *Stearns*, supra N. 58, Wm. & Mary L. Rev. L. Rev. 45 (2003), 1 (at p. 72).
[60] *Vestal*, Not „Like Sailors or Idiots or Infants": Social-Welfare Based Limits on Private Ordering in Business Association Law, Eur. Bus. Org. L. Rev. (EBOR) 8 (2007), 71 (at p. 77 et seq.), discussing the costs of plenary private ordering.
[61] *Easterbrook/Fischel*, supra N. 1, p. 16 et seq.
[62] *Gordon*, The Mandatory Structure of Corporate Law, Col. L. Rev. 89 (1989), 1549 et seq.; *Coffee*, The Mandatory/Enabling Balance in Corporate Law: An Essay on the Judicial Role, 89 (1989), 1618 et seq.; *Easterbrook/Fischel*, supra N. 1, p. 22 et seq.
[63] See *Bainbridge*, Corporation Law and Economics (2002), § 3.7., on the economics of securities markets.

commons situation[64]. Federal systems with multi-layer lawmaking add an important qualification to this analysis. Conventional market failure analysis intersects with the scrutiny of legislative markets[65]: Diverging policy preferences for public goods (including different approaches towards the organization of capital markets and social policy) may result in discrimination towards non-complying firms[66]. In a purely domestic setting these aspects are rarely discussed as an issue of public choice. Rather, they tend to be treated as a variation of the mandatory/enabling nature of corporate law. In federal systems of government, fundamental policy differences have to be accommodated by private international law rules: The right to private ordering has to be protected, but externalities from private contracting, free riding on regulatory differences and conflicting have to be contained as well.

Art. I, section 8 of the United States Constitution empowers Congress "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes". Art. IV, section 4 entitles "[t]he Citizens of each State … to all Privileges and Immunities of Citizens in the several States"[67]. The 'dormant commerce clause' is intended to promote cooperation among the states by stigmatizing a regime of mutual defection[68]. US constitutional economics illustrates how state politicians might find it more rewarding to implement their own 'domestic' policies than paying heed to the principles of comity towards other states or the Union. Nonetheless, states are unlikely to disrupt 'foreign' policies if they stand to face retaliation towards their own citizens. A prisoner's dilemma explanation fails to accommodate rent-seeking state policies at the expense of other states. In the jurisprudence of the US Supreme Court controversial cases appear to be instructed by game-theoretical insights on the Nash equilibrium. State policies disrupting benign multiple Nash equilibrium games are illegal[69]. There are, however, policy strategies where several Nash equilibriums are conceivable[70]. The implications of this observation will be tested in the context of the 'internal affairs rule' for corporations.

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[64] *Wai*, supra N. 16, Col. J. Transnat'l. L. 40 (2002), 209.
[65] Cf. from a European perspective: *Van den Bergh*, Regulatory competition or harmonization of laws? Guidelines for the European regulator, in: Marciano/Josselin (eds.), The Economics of Harmonizing European Law (2002), 27 (at p. 34).
[66] *Charny* ‚Competition among Jurisdictions in Formulating Corporate Law Rules: An American Perspective on the „Race to the Bottom" in the European Communities, Harv. Int'l. L. J. 32 (1991), 423 (at p. 453).
[67] U.S.C. Const. Artt. I, IV.
[68] See *Metzger*, Congress, Article IV, and Interstate Relations, Harv. L. Rev. 120 (2007), 1468 (1473 et seq.); *Stearns*, supra N. Wm. & Mary L. Rev. 45 (2003), 1; cf. *Wilson*, The Fate of the Dormant Commerce Clause after Garamendi and Crosby, Colum. L. Rev. 107 (2007), 746 (749 et seq.).
[69] *Stearns*, supra N. 58, Wm. & Mary L. Rev. 45 (2003), 1 (at p. 116 et seq.).
[70] *Stearns*, supra N. 58, Wm. & Mary L. Rev. 45 (2003), 1 (at p. 142 et seq.).

b. Corporate Law – The Internal Affairs Doctrine

In fleshing out US constitutional law courts have developed a specific conflicts rule on the internal affairs of this corporation: The internal corporate relationships are to be governed by the laws of the forum on incorporation[71]. While the general principle is greeted with unanimity, there is considerable disagreement on whether states are entitled to pursue specific policy goals, potentially clashing with the free movement of corporations in the US. In fact, this is a legal dispute fought mostly between California and Delaware. California has legislated on pseudo-foreign corporations not listed at the New York Stock Exchange or the American Stock Exchange and do not have outstanding securities qualified for trading at the Nasdaq Stock Market[72]. If more than one half of the outstanding shares of a pseudo-foreign corporation are owned by California citizens, specific corporate governance and capital market standards are to replace the law of the jurisdiction of incorporation. A closer look at the jurisprudence of California courts suggests that consumer and investor protection decide on whether to overrule a non-domestic corporation statute[73]. Although California courts readily acknowledge that the intra-corporate affairs of a foreign corporation should not be interfered with[74], California cumulative voting rules have been applied to pseudo-foreign corporations when capital market concerns were likely to be affected. Moreover, California courts have accepted (additional) domestic liability rules sanctioning fraudulent director behavior. While this appears to be clear case of calibrating freedom of contract against local regulatory policies, it should not be overlooked that additional liability has the potential to affect internal decision-making structures, making directors more risk-averse and reassessing investment decisions from an *ex post* perspective.

Delaware courts view California's legislative policy as an encroachment on corporate planning in flat rejection of the internal affairs doctrine. "[The internal affairs doctrine] serves the vital need for a single, constant and equal law to avoid the fragmentation of continuing, interdependent relationships"[75]. Host state laws redefining directors' duties under the business

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[71] Nagy v. Riblet Products Corporation, 79 F. 3d 572 (at p. 576) (7th Cir., 1996); Newell Co. v. Petersen, 758 N.E. 2d 903 (at p. 523 et seq.) (Ill. App. 2nd Dist., 2001), analyzing US case law.

[72] Cal. Corp. Code § 2115.

[73] Western Air Lines, Inc. v. Sobieski, 191 Cal. App. 2d 399 (410 et seq.) (Cal. App. 2nd Dist., 1961); Wilson v. Louisiana-Pacific Resources, Inc., 187 Cal. Rptr. 852 (859 et seq.) (Cal. App., 1982); Friese v. The Superior Court of San Diego County, 36 Cal. Rptr. 3d 558 (568 et seq.) (Cal. App. 4th Dist., 2005). See also the cases decided under New York conflict of laws rules: Broida v. Bancroft, 478 N.Y.S. 2d 333 (336 et seq.) (N.Y.A.D. 2nd Dept., 1984), emphasizing access to justice aspects); Berger v. Spring Partner L.L.C., 2005 WL 2807514 (N.Y. Sup., 2005), applying the law of incorporation for determining the standards for a breach of duty claim.

[74] State Farm Mutual Automobile Insurance Company v. The Superior Court of Los Angeles County, 8 Cal. Rptr. 3d 56 (at p. 66 et seq.) (Cal. App. 2nd Dist., 2003); cf. In re Flashcom, Inc. v. Sachs et al., 308 B.R. 485 (490 et seq.) (Bkrtcy. C.D. Cal., 2004).

[75] McDermott, Inc. v. Lewis, 531 A. 2d 206 (216) (Del., 1987): "… The policy underlying the internal affairs doctrine is an important one, and we decline to erode the principle: Under the prevailing conflicts practice, nei-

judgment rule, their liability for acts undertaken in their capacity as corporate officers or internal voting mechanisms are incompatible with the internal affairs doctrine. Judge *Easterbrook* has emphasized the freedom of contract implications of this conflict of laws rule[76]. US Supreme Court cases on the dormant commerce clause indicate that regulatory policy considerations promoting the goal of a political rather than an economic union may ultimately tilt the scales towards unrestricted private ordering and company mobility[77]. This would indicate that European Community might favor a comparable strategy.

3. The ECJ and National Policy Reasons of Imperative Interest

In the EU, national policymakers may be tempted to derive general control benefits by fostering intrajurisdictional efficiency. It is unclear though, how corporate law-making translates into direct (personal) benefits for legislators[78]. For the individual Member State, openly discriminatory policies are not a viable policy option as there are severe policy and Community law constraints. European Community Law declares it illegal to impose a franchise fee on corporations relocating from one Member State to another. National corporate law policies operate under a 'cost externalization constraint'[79] which is tantamount to a prohibition to beggar-thy-neighbor policies in corporate law. Current private company law reforms in Germany and the Netherlands[80] illustrate that the 'cost externalization constraint' operates as a powerful incentive to modernize corporate statutes if regulatory competition increases. It is perhaps premature to invite the ECJ to openly endorse a European equivalent to the 'internal affairs

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ther the courts, nor legislatures have maximized the imposition of local corporate policy on foreign corporations, but have consistently applied the law of the state of incorporation to the entire gamut of internal corporate affairs. … The lex incorporationis, … , is not a rule merely based on the a priori concept of territoriality and on the desirability of avoiding forum-shopping. It validates the autonomy of the parties in a subject where the underlying policy is enabling. It facilitates planning and enhances predictability." (quoting from *Kozyris*, Corporate Wars and Choice of Law, 1985 Duke L. J. 1); accord: Paul Gardner Defined Plan Trust v. Draper et al., 1993 WL 125517 (Del. Ch., 1993); Vantagepoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 318 (at p. 324 et seq.) (Del. Ch., 2005), aff'd. 871 A. 2d 1108 (at p. 1110 et seq.) (Del. 2005)

[76] "… [T]he corporate charter is a species of contract, and selecting a state of incorporation then is no different from putting a choice-of-law clause in a complex commercial contract. States compete to provide better rules of corporate law, from which the entrepreneurs may choose. Indiana enforces choice-of-law clauses and therefore should apply the internal affairs doctrine too" (in: Nagy v. Riblet Products Corporation, 79 F. 3d 572 (at p. 576) (7th Cir., 1996), analyzing Indiana law).

[77] *Stearns*, supra N. 58, Wm. & Mary L. Rev. 45 (2003), 1 (at p. 155). Cf. *Stiglitz*, The Theory of Local Public Goods Twenty-Five Years after Tiebout: A Perspective, National Bureau of Economic Research Working Paper No. 954 (August 1982), emphasizing that – in the process of individual choice among communities – Pareto optimality will only obtain under very special and unreasonable assumptions.

[78] Cf. *Barzuza*, Price Considerations in the Market for Corporate Law, Cardozo L. Rev. 26 (2004), 127.

[79] See *Schwartz*, Statutory Interpretation, Capture, and Tort Law: The Regulatory Compliance Defense, Am. L. & Econ. Rev. 2 (2000),1 (21 et n. 26).

[80] *Seibert*, supra N. 1, Eur. Bus. Org. L. Rev. (EBOR) 8 (2007), 83 et seq. (Germany); *De Kluiver*, Private Ordering and Buy-Out Remedies Within Private Company Law: Towards a New Balance Between Fairness and Welfare?, Eur. Bus. Org. L. Rev. (EBOR) 8 (2007), 103 et seq. (The Netherlands).

doctrine'. But the cases on company mobility can nonetheless be read as tacitly accepting the underlying constitutional economics of the 'internal affairs doctrine'.

For practical matters European Community law has brought forth a policy solution to contain Member State rent-seeking and opportunistic behavior. The so-called country of origin principle is to calibrate conflicting national policies: Business activities that were lawful in the country of origin may not be sanctioned by the host state as long as they are in accordance with the laws of the former[81]. A qualification with private international law implications has been added has been added to this rule. If the national rules of the host state are more favorable than those of the country of origin the latter may be disregarded[82]. There is a clear policy choice behind this approach: Intra-community trade shall not be impeded by Member State legislation. The application of the country-of-origin principle is not dictated by grounds of efficiency as it does not systematically allow for free regulatory choice. In applying the least onerous rule it is equally unclear how cost internalization aspects might enter into the analysis. Regulatory aspects are neglected. Thus, it remains an unresolved question to what extent the host Member State may pursue domestic distributive policies.

In the *Gebhard* case the ECJ proposed a four criteria-test that decides under what circumstances a host Member State may disregard the choice of law of non-domestic, relocating company. A Member State may derogate from the freedom of establishment by imposing its own mandatory laws, if these are (i) applied in a non-discriminatory manner, (ii) justified by imperative requirements of the public interest, (iii) suitable to attain their objective, and (iv) compatible with the principle of proportionality[83]. This is not a test that specifies when private international law rules should be utilized to make non-domestic parties internalize their own costs. The ECJ does not reach out for an explanation that goes beyond the traditional macroeconomic rhetoric typical for public policy analysis. Nonetheless, the Court does not openly reject efficiency analysis or overlook the potential for externalities. The concept of proportionality is broad enough to include a cost-benefit analysis of restrictive national measures[84].

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[81] See the detailed analysis by *Michaels*, EU Law as Private International Law? – Reconceptualizing the Country-of-Origin Principle as Vested Rights Theory, Duke Law School Research Paper N°. 122 (August 2006), available at http://ssrn.com/abstract=927479.

[82] *Basedow*, Conflicts of Economic Regulation, Am. J. Comp. L. 42 (1994), 423 (at p. 447).

[83] ECJ judgment of November 30, 1995, Case Nº. C-55/94, Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano, [1995] I – 4165 et seq.; 14.

[84] See *Broke Overby*, supra N. 55, Vand. J. Transnat'l. L. 35 (2001), 1219 (at p. 1246), reflecting on consumer law in the European Union.

The ECJ's silence on the private provision of public goods should not be taken as to deny the emergence of a market for regulation[85]. The jurisprudence on company mobility is decidedly based on an individualistic, microeconomic regulatory model that questions the underlying rationale of the country-of-origin principle. In this, the ECJ recognizes that under the current state of European Community law private international law rules are to accommodate externalities of private ordering[86]. From a practical point of view, the proportionality test is broad enough to scrutinize the implications of private ordering in the context of private provision of company law. As a matter of principle Member States are authorized to police externalities of private ordering under a legal order different from the one the foreign corporation was incorporated under. But this authorization is less generous than it looks as it should not amount to a complete rejection of the market mechanism. The ECJ instructs legislators only to step in when there is no information on the marketplace. Thus, information on the 'foreignness' of a corporation should be sufficient to alert creditors to the specific risks of trading with a non-domestic corporate body. Private international rules may be instrumentalized to pursue national (distributive) policy objectives, but they should not thwart the goal of integration within the EU. The ECJ's current regulatory approach comes close to *Stearns*' analysis of the jurisprudence of the US Supreme Court on the dormant commerce clause[87]. The ECJ's cases on company mobility *de facto* protect the internal affairs of a foreign corporation, but there is very little evidence that the ECJ's considerations are motivated by a rigorous efficiency analysis. This would confirm findings by *Van den Bergh/Camesasca* on European competition policy who demonstrate that neither the ECJ nor European authorities strive to implement a Pareto or Kaldor-Hicks efficiency model of competition. Rather, the ECJ insists on implementing a concept of workable (regulatory) competition that bears in mind the specific challenges of European integration[88].

IV. Outlook

The ECJ's rulings on company mobility are both, encouraging and sobering. They have to the potential to trigger evolutionary processes that reshape national corporate and private inter-

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[85] See: *Muir Watt*, supra N. 13, Tex. Int'l. L. J. 39 (2004), 429 (438) :"… There is a new awareness in Europe, that a market for regulation is an inevitable consequence for the free movement of goods, services, and factors of production (capital and work-force)."

[86] Cf. *Muir Watt*, Integration and Diversity: The Conflict of Laws as a Regulatory Tool, in Cafaggi (ed.); the Institutional Framework of Private International Law (2006), 107 (at p. 137 et seq.).

[87] See *Stearns*, supra N. 58.

[88] *Van den Bergh/Camesasca*, European Competition Law and Economics (2nd ed. 2006), at p. 40 et seq.; see also *Mokal*, Contractarianism, Contractualism, and the Law of Corporate Insolvency, [2007] Singapore J. Leg. Stud. (forthcoming), available at http://ssrn.com/abstract=946403, rejecting the Pareto and Kaldor-Hicks versions of efficiency on grounds of specific corporate insolvency issues.

national law rules. But corporate planners still have to choose a bifurcated approach towards devising the optimal business strategy. Company mobility is assured for private companies and partnerships whereas national laws on tax, creditor protection and stakeholder rights discourage listed corporations from exiting from an overregulated corporate law jurisdiction. In exercising its judicial powers the ECJ refrains from overstretching Member State tolerance for integrationist rulings. Thus, national policies on listed corporations are more likely to experience rent-seeking and regulatory capture.

In reaction to the ECJ's jurisprudence private companies have resurfaced, occupying the attention of politicians and corporate strategists who are looking for a flexible type of business organization for start-ups and investment vehicles. Depending on the interest represented, jurisdictional competition is either enthusiastically welcome or greeted with forebodings about its fall-out. There is less awareness about the shifting role of private international law under conditions of unrestricted private ordering. Rather subtly, the ECJ has begun to transform established beliefs about private international law and the monopolistic functions of national corporate law statutes. Member States are required to recognize non-domestic European companies and treat pseudo-foreign corporations with greater leniency. This assigns a regulatory function to private international law as judges will have to decide to what foreign corporate law concepts will prevail in a domestic court.

In emphasizing the freedom of establishment the ECJ embarks on a microeconomic analysis of interjurisdictional competition, favoring private ordering over government intervention. The freedom of corporate contracting is of vital importance for the private provision of a public good, i.e. company law. As the private provision of company law adds to the menu of choices available under the legal orders of the Member States issues of externalities have to be addressed. Companies relocating from one Member State to another are expected to internalize the costs of their activities. The ECJ prefers disclosure as a mechanism to internalize cost and to divulge private information about a non-domestic company. But there are also European Community Directives specifying Member State powers to police private externalities[89].

European Community law as it stands does not require Member States to completely renounce distributive policies of their own. If a case of an overriding national interest can be established, a derogation from the freedom of establishment is compatible with EC law, subject to a cost-benefit analysis under a proportionality test. The ECJ's approach towards conflicting national policies is not instructed by efficiency considerations. Several Nash equilib-

[89] Cf. *Schön*, Zur "Existenzvernichtung" der juristischen Person, Zeitschrift für das gesamte Handels- und Wirtschaftsrecht 168 (2004), 268 (293).

riums are conceivable. In insolvency law[90], some Member States pursue an *ex ante*-concept of creditor protection whereas the UK favors a regulatory philosophy of *ex post*-rules on director liability. Under English law, the individual creditor has no right of action against the director for wrongful trading[91]. Under Dutch and German laws, the individual creditor may directly sue the director[92] even if this curtails the amount of recovery available to the whole class of creditors on a *pro rata* basis. If such an insolvency case would make its way up to the ECJ, it is likely that the Court would favor an argument about the political integration of the EU over an efficiency-instructed argument.

This paper has argued a case for unlimited private ordering and regulatory competition in corporate Europe, as private international law is suited for calibrating conflicting national policies and balancing the microeconomic and macroeconomic aspects of private ordering. Private international law should not be used as an instrument to deliberately generate harmonized, common standards[93]. This would counteract the very essence of privately produced in the Community: comparative advantage which, in turn, might initiate processes of convergence[94]. In the face of globalization, a policy debate is needed on how strike the balance between efficiency, welfare and enhancing choice[95].

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[90] It is beyond the scope of this paper to investigate whether the choice of law rules of the European Insolvency Regulation convincingly balance microeconomic aspects of company mobility with concerns for consumer protection (see: *Whincop/Keyes*, Policy and Pragmatism in the Conflict of Laws (2001), p. 179 et seq., defending the current regime, and *Eidenmüller*, Free Choice in International Company Insolvency Law, Eur. Bus. Org. L. Rev. (EBOR) 6 (2005), 424 (429 et seq.), arguing for free choice. But it is noteworthy that the courts have begun to play cooperative games in allocating power at the occasion of transnational insolvencies: See Hans Brochier Holdings Ltd. v. Exner, [2006] EWHC 2594 (Ch D); In the Matters of Collins & Aikman Europe SA and Others, [2006] EWHC 1343 (Ch) and decisions of the AG (Magistrate's Court) Nürnberg of August 15, 2006 (8004 IN 1326 – 1331/06) and of October 1, 2006 (8034 IN 1326/06).

[91] *Davies*, Directors' Creditor-Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency, Eur. Bus. Org. L. Rev. (EBOR) 7 2006), 301 (329 et seq.).

[92] See *Seibert and De Kluiver*, supra N. 80.

[93] In a European context, harmonization as a regulatory device to cut down on transaction costs is unconvincing and may be the result of regulatory capture: *Van den Bergh*, Economic Criteria for Applying the Subsidiarity Principle in the European Community: The Example of Competition Policy, Intl'l. Rev. L. & Econ. 16 (1996), 366 et seq.; see also the scepticism by *Enriques/Gatti*, The Uneasy Case for Top-Down Corporate Law Harmonization in the European Union, U. Pa. J. Int'l. Econ. L. 27 (2006), 939; and the cautious, cost-motivated approach towards harmonizing laws in the European Union advanced by *Ogus*, Competition between National Legal Systems: A Contribution of Economic Analysis to Comparative Law, I.C.L.Q. 48 (1999), 405 (at p. 415 et seq.). A consumer-protection argument is advanced by *Muir Watt*, supra N. 13, Tex. Int'l. L. J. 39 (2004), 429 (439).

[94] Cf. on the function of private international law rules in facilitating convergence: *Buxbaum*, Conflict of Economic Laws, Va. J. Int'l. L. 42 (2002), 931 (at p. 972 et seq.).

[95] In this context, an externality-oriented analysis has been undertaken by: *Bebchuk*, Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law, Harv. L. Rev. 105 (1992), 1435 (at p. 1505 et seq.). *Bebchuk/Ferrell*, A New Approach to Takeover Law and Regulatory Competition, Va. L. Rev. 87 (2001), 111 (at p. 150 et seq.), pursue a choice-enhancing argument, advocating federal takeover rules which shareholders could opt into in order to escape the shortcomings of state legislation.