How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law

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How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law

Luca Enriques*
Martin Gelter**

The European framework for creditor protection has undergone a remarkable transformation in recent years. While the European Court of Justice’s Centros case and its progeny have given European Union businesses free choice with respect to the state of incorporation, and hence to the substantive corporate law regime, the European Insolvency Regulation has introduced uniform conflict-of-law rules for insolvencies. However, this regime has opened up some forum shopping opportunities for corporate debtors. Both regulatory competition in corporate law and forum shopping in bankruptcy law have been discussed in the United States for years, while they are relatively new territory in the European Union.

This article attempts to pull together the two emerging discussions and analyzes possible consequences for the relationship between shareholders, managers, and creditors in European corporations. We argue that in the absence of evidence of either a race to the top or the bottom, we cannot rule out adverse consequences of either regulatory competition in corporate law or forum shopping in bankruptcy. However, the discussion so far has largely considered only the

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consequences of the first type of regulatory arbitrage while neglecting the second. Hence, the issue of the "insolvencification" of corporate law rules has been brought up in order to enable national policymakers to impose their respective ideas about creditor protection on firms. We suggest that such attempts may be futile.

First, relabeling is possible only to a rather limited degree, and second, while restricting the scope for corporate law arbitrage, relabeling increases the incentives for forum shopping in bankruptcy. Ultimately, relabeling may even backfire, leading to a higher degree of bankruptcy forum shopping to avoid the very rules that have been insolvencified.

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I. INTRODUCTION

The debate about regulatory competition and interaction between different legislative and regulatory levels has a long pedigree in U.S. corporate law scholarship. Scholars have argued for more than thirty years that states vying for incorporations have caused corporate law to race to the top, to the bottom, or to nowhere in particular. Since the early 1990s, following empirical evidence of forum shopping by large corporate debtors, a related debate has developed with respect to

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bankruptcy law. Some scholars suggest that forum shopping between different federal bankruptcy courts has allowed corporate debtors to ensure that bankruptcy proceedings are conducted in the most efficient way possible.\(^4\) The opposing camp argues that forum shopping is essentially destroying the bankruptcy system to the detriment of creditors and to the benefit of the managers who have led firms into bankruptcy.\(^6\)

Good old Europe, as so often, is different. Little was heard about regulatory competition in either field from the other side of the Atlantic Ocean until recently, because the regulatory environment in the European Union (EU) simply did not allow any. However, this has changed drastically during the last few years. In March of 1999, the European Court of Justice's (ECJ) *Centros Ltd. v. Erhvervs-og Selskabsstyrelsen* decision paved the way for corporate law arbitrage within the EU by granting European businesses the right to incorporate in any EU Member State (State or Member State), no matter where their business is run.\(^7\) Correspondingly, the ruling prevents Member States from imposing their own corporate law on such businesses, other than under very limited conditions.\(^8\) In the last few years, newly incorporated businesses have started to take advantage of this new development, choosing English law in relatively high numbers.\(^9\)

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7. See Case C-212/97, 1999 E.C.R. L-1459, 1-1497 to 98; see also infra text accompanying notes 58-61.

8. See *Centros*, 1999 E.C.R. at L-1497 to 98.

9. See John Armour, Who Should Make Corporate Law? EC Legislation versus Regulatory Competition, 58 CURRENT LEGAL PROBS. 369, 386 (2005) (providing data on so-
Independent of this new development, the European Community (EC) adopted an important piece of legislation on bankruptcy law a year after Centros. EC Council Regulation 1346/2000 on insolvency proceedings (EIR).\(^6\) The EIR identifies the Member State that has jurisdiction to open main proceedings having a universal effect (at least within the EU and with some important exceptions) as the place where the debtor has its "centre of main interests" (COMI).\(^7\) Most importantly, it identifies the law applicable to insolvency proceedings as the law of the State of the court opening the proceedings.\(^8\) However, the fuzziness of the COMI standard has allowed some forum shopping, which can be observed in emerging case law on the EIR.\(^9\)

In short, both Centros and the EIR have increased the scope of private parties' free choice in determining the law applicable to companies and their insolvency. By allowing corporate law arbitrage and bankruptcy forum shopping, Europe has become similar to the United States. Yet, there is still one crucial difference. While creditors are a concern of corporate law only to a very limited degree in the United States, EU Member States have traditionally tried to protect corporate creditors through corporate law.\(^10\) And while the U.S. debate on regulatory competition is almost exclusively focused on the relationship between shareholders and managers, the relationship with creditors cannot be ignored in its European analogue. At the same time, because both corporate law and bankruptcy law are concerned with creditors, the two levels of regulatory arbitrage need to be dealt with as two sides of the same coin.

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called "GmbH limited," i.e., German businesses incorporated as English private-limited companies; 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), 2005 EUR. BUS. L. REV. 1534, 1535 (reporting estimates that there are more than 20,000 U.K. limited companies (Ltds) with their real seat in Germany); see also Marco Becht et al., Where Do Firms Incorporate? (European Corp. Governance Inst., Law Working Paper No. 70/2006, 2006), available at http://ssrn.com/abstract=906066 (providing evidence on other Member States businesses' incorporations in the United Kingdom).

11. Id. art. 3.
12. Id. art. 4.
Our Article attempts to pull the two issues together and to analyze how they shape the relationship between corporate debtors and their creditors. In order to do so, in Part II we first sketch out how different jurisdictions may interact with each other in regulating the relationship between companies and their creditors, first in general and then within the EC framework. The emphasis will be on the varying degree of deference to private parties' choices that derives from States’ private international law rules and on its implications for regulatory competition.

We will next show, in Part III, that past efforts at positive harmonization of corporate law by the EC have failed to make EU corporate laws equivalent in terms of creditor protection, so some jurisdictions may be more attractive than others to those who make the (re)incorporation choice. We argue that while some companies may reincorporate in order to exploit some categories of creditors, a race to the bottom is unlikely to develop within the EU and there is currently no conclusive evidence of a race to the bottom or to the top.

We then turn in Part IV to the EIR and its implications for the relationship between EU companies and their creditors. After briefly describing its main provisions, we turn to regulatory arbitrage with respect to insolvency law. We will show that the EIR leaves some possibility for arbitrage, because a switch of COMI by a corporate debtor on the brink of insolvency is not effectively prevented. However, we will also show that because it is most often creditors who file for bankruptcy in the EU, regulatory arbitrage is a weapon in their hands too. Subsequently, we argue that it is unrealistic to expect any EU Member State to supply debtor-friendly insolvency law rules in order to prosper as a bankruptcy venue.

In order to pull the two issues together, in Part V we finally discuss “relabeling”: the idea that by qualifying a corporate law provision as an insolvency law one, it may apply to insolvent companies with a COMI in the relevant jurisdiction no matter where the company is incorporated. We highlight an important implication of relabeling that has been overlooked in the literature so far, which is the fact that it may increase the regulatory surplus to be gained from insolvency forum shopping. We suggest that relabeling may not necessarily be desirable if arbitrage gains are shifted from corporate law to insolvency law. Part VI concludes.
II. REGULATORY INTERACTIONS AMONG JURISDICTIONS

All jurisdictions impose mandatory rules aimed at protecting creditors vis-à-vis their (corporate) debtors. In a multijurisdictional setting, however, it may be possible for private parties to avoid such rules by choosing a different jurisdiction not imposing them whenever it is in their interest. The choice will be made either jointly by debtors and their voluntary creditors or unilaterally by the debtors with the creditors giving tacit consent by agreeing to enter into a relationship with the debtors or by not reserving ex ante the right to veto such a choice. Of course, involuntary creditors and, more generally, nonadjusting creditors can never be said to give consent to this kind of choice. Because they have a credit relationship with the corporate debtor whom they have entered into an agreement with unwillingly or whose terms they are unable or unwilling to renegotiate (in order to react to unilateral moves by the debtor), they can only bear the venue choice’s consequences.

This Part evaluates in general terms the degree to which States may defer to free choice of law in the realm of the creditor/corporate debtor relationship and the various means through which they can limit such a choice. We also briefly outline the implications of multiple jurisdictions’ options with regard to private parties’ choice. Our focus in this Part will be mainly on corporate law, but the analysis can be easily extended to securities regulation and insolvency law. For analytical purposes, we will look first at possible interactions among States in the absence of supranational institutions restraining jurisdictions’ options with regard to substantive regulation and/or conflicts of law. Then we will introduce one such institution, the EC, into the framework.

15. Nonadjusting creditors are those that do not “adjust” the terms of their claims to anticipate or take into account the effects of new developments. See Lucian Arye Bebchuk & Jesse M. Fried, The Uneasy Case for the Priority of Secured Claims in Bankruptcy, 105 YALE L.J. 857, 864 (1996).

16. See id.

17. Needless to say, while tort law is sometimes used as a means to protect creditors (even voluntary ones) against (corporate) debtors’ opportunism, tort law is of no concern here because it makes little sense to talk about free choice with regard to it.

18. See infra Part II.A.

19. See infra Part II.B.
A. Regulatory Interactions in the Absence of Cooperation

Jurisdictions’ attitudes toward choice of law range from absolute negation of free choice to absolute respect for it.\(^{20}\) In the former case, rules are imposed on companies (or transactions) having a meaningful connection to the relevant jurisdiction, no matter what private parties’ choice of law is. In the latter case, there are no restrictions on free choice of law, but for the fact that normally one can opt-out of a single mandatory rule only by choosing another jurisdiction for a whole class of transactions and conducts.\(^{21}\) For example, one can opt out of the German rule on minimum capital for limited liability companies (Gesellschaften mit beschränkter Haftung (GmbHs)) only by choosing a different jurisdiction to regulate the firm as a corporation.\(^{22}\)

1. Choice-Denying Techniques

A jurisdiction can effectively deprive private parties of free choice of corporate law by providing that its own corporate law applies if a corporation has a sufficiently strong connection with it. Most commonly, what counts is where the “real seat” (whatever this means) is located.\(^{23}\) Whenever a corporation’s real seat is within a jurisdiction’s borders, any incorporators’ choice of a foreign law is disregarded, leading to the nonrecognition of the foreign entity.\(^{24}\)

The real-seat doctrine can be symmetric or asymmetric. In the former case, a jurisdiction does not accept a foreign firm’s choice of that jurisdiction’s corporate law unless the firm establishes its real seat within the territory (this is the case, for example, in Germany).\(^{25}\) In other words, the symmetric real-seat doctrine implies a self-imposed

\(^{20}\) See infra notes 23-42 and accompanying text.


\(^{22}\) See id.


\(^{25}\) See Ebke, supra note 23, at 1034-35.
export ban on a jurisdiction’s corporate law. In the latter case, no such export ban is self-imposed and a foreign firm is free to choose the relevant jurisdiction’s corporate law, no matter where their real seat is located (as is the case in Italy).

When the real-seat doctrine governs, the only way to escape the reach of mandatory rules will be to locate (or relocate) the corporation’s real seat in another jurisdiction, which can of course be costly. How costly will, of course, depend on how “real” the real seat must be and on how international the company’s operation is. Moving one’s headquarters implies that at least the human capital needed to direct the firm be moved, while the (re)location will imply that some other laws and regulations from the relocation State will apply to the firm’s headquarters, such as labor and income tax laws.

2. Choice-Restricting Techniques

The asymmetric real-seat doctrine can hardly be distinguished from a pseudo-foreign corporation statute that declares domestic corporate law overall applicable to domestic businesses (however defined) incorporating as foreign companies. Often, however, pseudo-foreign corporation statutes overimpose a subset of domestic rules not comprising the entire corporate law body, the rest deferring to the law of the state of incorporation. Of course, the more

26. See id. at 1036; see also Eva Micheler, § 254, in 2 KOMMENTAR ZUM AKTIENGESETZ cmt. 38 (Peter Doralt et al. eds., 2003) (reporting that in Austria the prevailing opinion is a shareholder resolution to relocate to another country results in the dissolution of the corporation).


28. See Becht, Mayer & Wagner, supra note 9, at 6 & n.10.

29. For instance, in Germany the headquarters only have to be located within its territory; in Italy, Italian corporate law also applies if the principal place of business is in Italy, thus making companies operating mainly in Italy more captive to Italian corporate law than German ones to German law. See Law No. 218 of may 31, 1995 art. 25 (Italy); Seth Chertok, Jurisdictional Competition in the European Community, 27 U. Pa. J. Int’l Econ. L. 465, 482-84 (2006).

30. See Becht et al., supra note 9, at 6 & n.10.


32. Id. at 95. Such was the case with Dutch law on pseudo-foreign corporations the ECJ struck down in its Inspire Art judgment. Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd., 2003 E.C.R. I-10,155 (striking down Wet op de Formeel Buitenlandse Vennootschappen [Law on Formally Foreign Companies] of Dec.
encompassing the subset of domestic rules, the more limited the private parties’ free choice.

A private party’s free choice can also be restricted by making national rules applicable to foreign entities, no matter where their real seat is located.\textsuperscript{33} Although this is uncommon in the corporate law area, it is normally what happens, with due qualifications, in securities regulation and insolvency law. National securities regulation traditionally applies to foreign issuers as long as they offer their securities, or their securities are widely traded, in the relevant jurisdiction.\textsuperscript{34} In a strictly territorialist setting, national insolvency law usually applies to firms having assets in the relevant jurisdiction, no matter what their nationality is or where their real seat is located, but only to assets within the jurisdiction.\textsuperscript{35}

Finally, jurisdictions always reserve the general power to refuse the application of foreign (corporate) law under the public policy exception, which leaves judges the option to apply domestic law if the outcome deriving from application of the relevant foreign law would contrast with fundamental principles and values.\textsuperscript{36}

3. Deference to Free Choice

Jurisdictions may also decide to put no limits on private parties’ free choice. In the corporate law domain, this is the case whenever the choice-of-law rules follow the incorporation doctrine and none of the choice-restricting techniques outlined above are deployed.\textsuperscript{37} The only element of inflexibility derives from the fact that, as already hinted, by incorporating in a given State, companies subject themselves to the State’s whole set of corporate law rules.\textsuperscript{38} In other words, a company

\footnotesize
\begin{itemize}
\item 33. Such is traditionally the case with securities regulation. See infra text accompanying note 34.
\item 34. See Harald Baum, Globalizing Capital Markets and Possible Regulatory Responses, in Legal Aspects of Globalization: Conflict of Laws, Internet, Capital Markets and Insolvency in a Global Economy 77, 90-93 (Jürgen Basedow & Toshiyuki Kono eds., 2000).
\item 37. See supra Part II.A.2.
\end{itemize}
may not engage in “cherry picking,” choosing State A’s corporate law rules on, e.g., minimum net assets and State B’s corporate law rules on, e.g., directors’ liability.

This is less the case, however, with regard to relationships with creditors in two ways. First, because traditionally these rules are in part corporate law and in part insolvency law, as long as conflict-of-law rules differ with regard to the two bodies of law, it might be possible to select one State’s corporate law and another State’s insolvency law.39 Second, a corporation and one of its creditors or classes of creditors might agree that they would be better off if the applicable corporate law were a different one than that otherwise applying to the corporation. They could create a corporate vehicle in the State of their choice and make it the corporate debtor in their relationship. By doing so, they would choose their favorite corporate law without any need to change the corporate law regulating relationships among shareholders, between shareholders and managers, and between shareholders and other creditors. Of course, they will do so only if the advantages of the corporate law of choice more than offset the disadvantages deriving from the fact that only the vehicle will be liable for the corporate debt.40 This may happen only when a viable business is assigned to the corporate vehicle, as the case may be in a conglomerate.

Jurisdictions can defer to free choice to varying degrees, even leaving aside the possibility for the use of the choice-restricting techniques described in Part II.A.2. First, a jurisdiction may opt for geographically-restricted free choice, i.e., limited to one or more other jurisdictions.41 Normally, this will be the outcome of some form of cooperation among States, like a treaty for the reciprocal recognition of companies.42 Second, free choice can be granted either at the incorporation stage only or midstream as well thereby allowing

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39. See infra Part IV.
40. Unless the parent guarantees that debt, in which case of course the corporate law of the parent would come back to the foreground.
41. This is the effective result of the ECJ case law, which allows free choice within the European Economic Area (EEA). See infra Part II.B.
companies to choose a State's law at a later time. In the former case, incorporators are free to choose any given jurisdiction's corporate law. If, however, they choose the domestic one, they cannot change their mind later. If they choose another jurisdiction, they cannot reincorporate as a domestic corporation later. In the latter case, a choice made at the outset can be modified later. It is also possible that restrictions could be placed on outbound, or, less likely, inbound, midstream reincorporations, such as laws granting existing creditors the right to veto reincorporations.

4. Implications for Interjurisdictional Interaction

Let us now briefly comment on whether and to what extent States are affected by each other's choices in regulating the relationships between creditors and corporate debtors.

If all the relevant jurisdictions adopt the real-seat doctrine, States would face very low constraints on their freedom to design mandatory corporate law rules due to the potentially high costs of reincorporating abroad. Their only concerns could be that domestic businesses might suffer a competitive disadvantage, e.g., a higher cost of debt financing, vis-à-vis businesses from other States or, similarly, that the State would be at a disadvantage in attracting foreign investment. At best, the fact that other jurisdictions better regulate companies can only prompt changes when it is felt that those rules translate into a regulatory environment more conducive to corporate investment or more generally into a more effective and business-friendly set of rules. When this happens, it means that policymakers are genuinely concerned about preserving or enhancing their country's ability to attract investment. They care about "yardstick competition," leading to "regulatory emulation" among the States in some cases.

43. See Ehud Kamar, Beyond Competition for Incorporations, 94 Geo. L.J. 1725, 1731-43 (2006) (describing the various methods European countries have used to attract investment).
44. See id.
To the extent that at least one jurisdiction allows for free choice, and at least one other jurisdiction adopts the asymmetric real-seat doctrine, a market for rules exists. Only States adopting the symmetric real-seat doctrine are totally out of such a market. Those States adopting the asymmetric real-seat doctrine enter the market, but only as suppliers of corporate law rules, impeding access to their own “consumers.” Jurisdictions adopting choice-restricting techniques, in turn, not only enter the market as suppliers of corporate law rules, but also allow their consumers to choose. Nevertheless, their consumers’ choice is constrained, because freedom of choice cannot be used to escape those rules that also apply to (pseudo-)foreign corporations.

The higher the number of jurisdictions that allow choice, the deeper and potentially more dynamic the market. More precisely, the degree of dynamism and competition in a market for rules depends on a number of factors. Examples include: how easy it is to exercise free choice; how relevant the differences among existing jurisdictions are, i.e., how big the regulatory surplus that can be obtained by moving is; whether any jurisdiction and its policymakers are willing and able to attract foreign incorporations; and so on.

When free choice is a real option in practice and no jurisdiction cares about attracting foreign corporations, some form of weak, “defensive” regulatory competition can develop, in which States adapt their laws to the more attractive features of other jurisdictions in order to retain existing, and lure prospective, domestic companies. In the absence of a clear maximand, such as franchise tax revenue in Delaware,\textsuperscript{47} States will take into account the interests of all stakeholders that have some influence on the political process. Hence, any effects regulatory competition may have on the development of the law will be mitigated. Although shareholders, as the group deciding where to incorporate, have a structural advantage over creditors in regulatory competition, legislation beneficial to the former and detrimental to (nonadjusting) creditors need not necessarily ensue if creditors have sufficient political representation or can gain the support of well-organized interest groups, such as trade unions and trade associations.

If one jurisdiction actively engages in attracting (re)incorporations from abroad, a situation very similar to the current situation in the

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United States, as described by Robert Daines, exists: each of the market participants competes with the active jurisdiction (Delaware in the United States) for (re)incorporations of its domestic companies.  

In other words, there is not one single market for incorporations, but rather \( n \) minus one markets, if \( n \) is the number of jurisdictions leaving free choice to their businesses and where there are two suppliers for each market: “Delaware” and the home state.  

Of course, such a multiple-market setting can be very competitive as long as “Delaware” remains active in attracting (re)incorporations. In fact, “Delaware” will not only itself innovate, but it will also respond to any attractive market innovation by one of its competitors; this response, in turn, will prompt a response from each of the other competitors. In such a case, regulatory competition may entail interjurisdictional “externalities,” whereby rules have an effect on constituencies located outside the state, while only groups located within the state are taken into account in the political process. This may have detrimental effects on creditors if they are disproportionately located outside the state of incorporation.

As already seen, defensive regulatory competition in the absence of a “Delaware” can raise no worry about such externalities. States typically have to take the interests of both shareholders and creditors into account and, therefore, “internalize” the effects of any corporate law reform through the political process. Even before that, the interests of relevant stakeholders would be taken into account no less than in any “isolated” corporate law reform effort. However, in the presence of a “Delaware,” jurisdictions may have to sacrifice these interests if they want to retain their corporations by enacting legislation benefiting shareholders and managers, but possibly harming nonadjusting creditors.

Finally, one can imagine a scenario in which various jurisdictions actively compete in order to attract incorporations. Such was the case...

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49. See id. at 1600.
in the United States at the end of the nineteenth century and the beginning of the twentieth.\footnote{See Luca Enriques, The Comparative Anatomy of Corporate Law, 52 AM. J. COMP. L. 1011, 1029-30 n.116 (2004) (reviewing REINER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH (2004)).} For various reasons that are not worth exploring here, the conditions under which this scenario developed in the United States at that time were quite unique, and, therefore, highly unlikely to be reproduced.\footnote{See id.} Intuitively, with multiple competitors acting in the same market, the regulatory environment is most conducive to innovation and rules that most cater to the interests of those who make the decision on where to incorporate.

B. Regulatory Interactions Among Jurisdictions in the Presence of Cooperation: The EU Case

In the previous Subpart we analyzed a scenario of multiple jurisdictions making uncoordinated, unilateral choices with regard to free choice of corporate law. In this Part, we concentrate upon EU Member States and briefly describe how the EC institutions can affect regulatory interactions among jurisdictions with regard to free choice and the substantive regulation of the relationships between creditors and corporate debtors.\footnote{Of course, the EC or an EC-like institution is just one possible form of international cooperation. Other forms include bilateral agreements. For instance, treaties exist requiring the recognition of American companies, e.g., between Germany and the United States, Treaty on Friendship, Commerce and Navigation, art. XXV, U.S.-F.R.G., Oct. 29, 1954, 7 U.S.T. 1839, and between Italy and the United States, Treaty on Friendship, Commerce and Navigation, art. II, U.S.-Italy, Feb. 2, 1948, 63 Stat. 2255. On the effects of these treaties, see BGH Jan. 29, 2003, 153 BGHZ 353 (F.R.G.) (recognizing a foreign corporation's capacity and standing to sue in Germany). See also Jens C. Damann, AMERIKANISCHE GESELLSCHAFTEN MIT SITZ IN DEUTSCHLAND, 68 RABELS ZEITSCHRIFT FÜR AUSLÄNDISCHES UND INTERNATIONALES PRIVATRECHT 607 (2004) (F.R.G.); Tito Ballarino, LA SOCIETÀ PER AZIONI NELLA DISCIPLINA INTERNAZIONALE PRIVATISTICA, IN 9* TRATTATO DELLE SOCIETÀ PER AZIONI 3, 93-94 (G.E. Colombo & G.B. Portale eds., 1994) (Italy). By contrast, the equivalent Austrian Treaty explicitly requires that limited liability companies maintain a central office within the territory of their incorporation. Treaty of Friendship, Commerce and Consular Rights, art. IX, U.S.-Austria, June 19, 1928, 47 Stat. 1876.} The EC introduced a strong form of cooperation into the framework of otherwise unilateral choices with regard to regulatory interactions. We show that cooperation at the EC level can lead to a higher or lower degree of deference toward private parties' free choice (and hence contractual freedom and regulatory competition), depending on whether the EC institutions foster...
companies’ mobility and mutual recognition rather than impose substantive mandatory rules on private parties.

1. Negative Harmonization

Negative harmonization on the basis of the Treaty Establishing the European Community (EC Treaty), which provides for freedom of establishment in article 43, as implemented by the ECJ’s case law, imposes restraints on choice-denying techniques.\(^56\) The Centros-Überseering-Inspire Art triad requires Member States to recognize foreign EU (and European Economic Area (EEA)) corporations’ legal capacity\(^57\) and allows restrictive measures only under very limited circumstances.\(^58\) Any such measures “liable to hinder or make less attractive the exercise” of the freedom of establishment need to satisfy the criteria set out in Reinhard Gebhard v. Consiglio dell’Ordine degli Avvocati e Procuratori di Milano (Gebhard).\(^59\) That is, “they must be applied in a nondiscriminatory 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.”\(^60\) While Member States may take measures to prevent or penalize fraud or abuse,\(^61\) broad-sweeping statutes generally imposing national creditor-protection devices on pseudo-foreign corporations are thus impermissible. Because those imperative requirements are apparently


\(^{60}\) Id. at I-4197 to 98. As an example of the application of the Gebhard factors, see Centros, 1999 E.C.R. at I-1495; Inspire Art, 2003 E.C.R. para. 133.

narrowly construed, Member States are to a large degree forced to allow for free choice among EU corporate laws.

The actual extent of Member States’ discretion is still unclear and possibly will remain so for a long time. What is worth highlighting here is that to the extent that private international law rules have not been harmonized, they are still an issue of national legislation. One could conclude from this that only the result of the conflict-of-law analysis in each particular case needs to be measured against the requirements of primary EC law. However, in Überseering BV v. Nordic Construction Co. Baumanagement GmbH, the ECJ also held that a corporation validly incorporated in the Netherlands is entitled under articles 43 and 48 of the EU Treaty to exercise the freedom of establishment in Germany as a corporation incorporated in the Netherlands. As a result, Member States will have to recognize not only the legal capacity of pseudo-foreign corporations, but also a certain substantive core of the corporate law of the state of incorporation, although it is not clear how far this core extends. Outside of it, the application of the law of the state of incorporation is not imperative. Whether something is considered corporate or insolvency law is largely an issue of the national conception of these fields. Member States may even “relabel” rules as insolvency law if it serves the purpose of being able to apply their own law under the

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63. Case C-208/00, 2002 E.C.R. para. 80.

64. The German *Bundesgerichtshof* recently held that it follows from the recognition of the legal personality of English companies that the liability of managers and shareholders to corporate creditors is determined by the law of incorporation. BGH Mar. 14, 2005, II ZR 5/03, 60 Betriebs-Berater [BB] 1016 (2005) (F.R.G.). But see Gebhard Rehm, *Völker- und europarechtliche Vorgaben für die Bestimmung des Gesellschaftsstatuts, in AUSLÄNDISCHE KAPITALGESELLSCHAFTEN IM DEUTSCHEN RECHT* § 2 cmt. 70, at 39 (Horst Eidenmüller ed., 2004) [hereinafter AUSLÄNDISCHE KAPITALGESELLSCHAFTEN] (explaining that it would be theoretically possible to recognize foreign corporations as such, but to apply certain German law provisions to them). Under the most radical position in German literature, this core shrinks to legal capacity, while German law still applies to all other issues, including the main creditor-protection doctrines. See Holger Altmepen & Jan Wilhelm, *Gegen die Hysterie um die Niederlassungsfreiheit der Scheinauslandsgesellschaften, 57 DB 1083* (2004); Holger Altmepen, *Schutz vor "europäischen" Kapitalgesellschaften, 57 NJW 97* (2004); see also Landgericht Kiel [LG Kiel] [Kiel Trial Court] Apr. 20, 2006, 10 S 44/05, 61 BB 1468 (2006) (qualifying the duty to file for insolvency as corporate law and allowing a damages claim against an English Ltd under German Law).
applicable conflict-of-law rules, as long as the Gebhard criteria are not violated.

We will briefly address the issue of conflicts of law again within the context of the most important creditor-protection mechanisms later in Part III.A and reflect upon "relabeling" strategies in Part V. For now, suffice it to say that Centros and its progeny have reshaped the EU corporate law landscape possibly more than many national reforms in the various Member States and certainly more than any EC positive harmonization effort thus far.

2. Positive Harmonization

With positive harmonization, the EC imposes on Member States an obligation to adopt certain rules (through directives) or directly imposes such rules on EU (and EEA) citizens and firms (through regulations). Positive harmonization can be substantive whenever it defines the content of national corporate laws or it can be procedural and relate to choice of law itself either by promoting or by reducing it. Of course, individual harmonization measures may contain both substantive harmonization rules and choice-of-law-related ones; however, the distinction is useful in order to emphasize the kind of impact harmonization can have on free choice.

Substantive harmonization measures can preempt States' legislative powers to a varying degree. Total preemption occurs in the case of maximum harmonization, while minimum harmonization leaves greater room for States' intervention in the harmonized area.

When maximum harmonization measures are adopted, Member States must adopt the rules devised and may not impose stricter or additional rules. Here, the degree of uniformity achieved is the highest, but the regulatory outcome, of course, is not necessarily the most restrictive. If the harmonizing measures leave some room for contractual freedom, the EC prevents Member States from further

67. See id. The same is also true in the case of optional harmonization. It can take many forms, such as a choice between two mandatory rules that may be given to the Member States or to private parties or to both, or the provision of default rules, or even the requirement that States introduce a regime that private parties will be free to choose through an opt-in decision. See id. at 515.
68. See id. at 508-20.
restricting it. At the same time, the harmonized regime may turn out to be excessively lenient; for example when the compromise-prone outcome of the EC legislative process sets an excessively low level of regulation and, for whatever reason, private parties are unable to bind themselves effectively to a stricter regime by contract or are prevented by the harmonizing measure itself to enter into such kind of agreement. In any event, regulatory competition is banned whether it would take, as is usually the case, the direction of a greater respect for contractual freedom or the opposite one.

With minimum harmonization measures, the EC requires Member States to impose at least the EC-devised rules, but Member States retain the power to impose additional or stricter rules (so-called "goldplating"). When minimum harmonization couples with mutual recognition, the stricter national rules can only apply to domestic firms. In the absence of mutual recognition, Member States may also impose stricter rules on foreign firms’ conduct that is, for whatever reason, caught by national law.

As already hinted, substantive harmonization most often means imposing some mandatory rules across the EU and the EEA, or, more precisely, extending to all Member States rules that are already in place in a majority of them and making them “more” mandatory. This occurs for two reasons. First, there is no escape from the rules other than by incorporating in, or otherwise choosing (if at all possible) a non-EU, non-EEA jurisdiction. Second, repeal of the relevant mandatory rule will be more difficult due to the well-known phenomenon of petrification.

With substantive harmonization, Member States may still deviate from the harmonized outcome, albeit in a disguised, undercover way. Member States may, in fact, fail to properly implement the harmonizing measure, or they may fail to enforce it, or, finally, their judges and enforcers may construe the harmonized measures in line with prior, more (or less) lenient national rules. In other words, Member States have various ways to cheat on the EC regulatory cartel.

69. See id.
70. See Richard M. Buxbaum & Klaus J. Hopt, Legal Harmonization and the Business Enterprise, in 4 INTEGRATION THROUGH LAW 265 (Mauro Cappelletti et al. eds., 1988).
Whenever the EC measures are not purely optional or do not impose purely enabling rules on Member States, not only do they introduce EU/EEA-wide mandatory rules that are more difficult to escape from and to repeal, but they also have an impact on regulatory competition. Their presence reduces the regulatory surplus businesses can gain from (re)incorporation, thereby reducing the dynamism of the market for corporate law rules.\(^72\)

3. Choice-of-Law-Related Harmonization

Positive harmonization can also be more directly related to choice-of-law issues. First, there are measures that aim to remove barriers to freedom of establishment or increase EU companies’ cross-border mobility, thereby enhancing free choice of corporate law.\(^73\) The most prominent example of a choice-enhancing set of rules thus far is Parliament and Council Directive 2005/56/EC (Cross-Border Merger Directive),\(^74\) which can work as a tool for reincorporations.\(^75\)

Second, we have measures that harmonize the procedure to be followed in order to exercise choice of law, such as safeguards for employees or creditors (so-called procedural harmonization).\(^76\) Whenever such measures attach to other measures requiring Member States to introduce new tools for companies’ mobility (as is usually the case), depending on the “proportionality” of the safeguards, they can be viewed either as what is needed in order to avoid opportunistic reincorporations or as the political price to pay for greater choice. If the measures attach to tools for companies’ mobility that are already existing and effective in a sufficient number of Member States, then such measures may restrict rather than enhance free choice.\(^77\)

\(^{72}\) See Stefano Lombardo, Regulatory Competition in Company Law in the European Community: Prerequisites and Limits 193 (2002).


\(^{74}\) Id.

\(^{75}\) In the United States, reincorporations are typically made by merging the parent corporation into a shell subsidiary set up in the reincorporation state. Cf. Ronald J. Gilson, Globalizing Corporate Governance: Convergence of Form or Function, 49 Am. J. Comp. L. 329, 355 & n.90 (2001).

\(^{76}\) Cf. Simon Deakin, Regulatory Competition Versus Harmonization in European Company Law, in Regulatory Competition and Economic Integration: Comparative Perspectives 190, 211 (Daniel C. Esty & Damien Geradin eds., 2001).

\(^{77}\) For instance, suppose that most Member States already allowed for cross-border mergers without requiring any involvement of employees in the process. If the EC requires Member States to involve employees, as the Cross-Border Merger Directive does, then
Finally, we have measures that directly address choice-of-law issues by harmonizing conflict-of-law rules. Depending on the connecting factor chosen for the solution of the conflict, harmonization of this kind can either promote or restrict free choice. In the former case, regulatory arbitrage is imposed from the top, which, to be sure, is almost never the case with EC harmonization. In the latter case, regulatory arbitrage is ruled out or at least restricted within the EU.

4. Prospective Harmonization

The presence of an actor like the EC, with its positive harmonization powers, may have an impact on regulatory competition and free choice no matter whether these powers are indeed exercised, provided that private parties and policymakers at the State level know that the EC may step in to react to any Member State’s move to attract (re)incorporations. In two recent articles, Mark Roe has argued that the threat of federal intervention has shaped the development of U.S. corporate law much more than interstate competition. This was done by creating an incentive for Delaware decisionmakers not to overstep certain boundaries beyond which corporate law would become untenable to federal decisionmakers, who are subject to different kinds of political pressures.

Of course, it is theoretically conceivable that the mere prospect of European harmonization influences decision making at the national level. In quite a different sense than envisioned by Professor Roe, bona fide legislators occasionally implement draft directives before they are adopted. However, it is quite unlikely for a State to be influenced in the way Roe describes. The European legislative process is relatively slow (compared to the United States Congress) and rather impervious to populist pressures, due to the absence of a common European public sphere. The EU legislator has rarely, if ever, been


78. See Roe, Delaware’s Competition, supra note 3, at 591; Roe, Delaware’s Politics, supra note 3, at 2494.

79. See Roe, Delaware’s Competition, supra note 3, at 591; Roe, Delaware’s Politics, supra note 3, at 2494.

80. Cf. Roe, Delaware’s Competition, supra note 3, at 644.

81. See Martin Gelter, The Structure of Regulatory Competition in European Corporate Law, 5 J. CORP L. STUD. 247, 278-79 (2005); see also Luca Enriques, Bad Apples, Bad Oranges: A Comment from Old Europe on Post-Enron Corporate Governance Reforms,
able to gain support from businesses to enact meaningful corporate law.\textsuperscript{82} Generally, Delaware's responsiveness to the threat of federal intervention is owed to its financial dependence on franchise revenue, which creates a powerful incentive against implementing legal rules that might put its unique position among states at risk.\textsuperscript{83} Hence, as long as regulatory competition remains defensive and no European "Delaware" arises, there is no jurisdiction upon which supranational competition can exert significant pressure. The possibility of enacting nontrivial law may even chill nondefensive regulatory competition. One State's attempt to attract incorporations by creating significant rents by means of corporate law could just trigger a reaction by other States, which would push for harmonization.\textsuperscript{84}

5. Summary

We have shown that in a multijurisdictional setting, the degree to which corporate law rules are mandatory depends on the degree of freedom each jurisdiction grants to private actors. States can deny their private parties' freedom of choice in corporate law, restrict it, or, finally, defer to it, with a corresponding decrease in the mandatory character of corporate law rules. This depends, of course, on how easy it is de facto to exercise free choice.

In the EU, under the impulse of the ECJ, Member States can now only restrict their citizens' free choice of corporate law within the somewhat strict boundaries that the ECJ itself has drawn in its freedom of establishment decisions.\textsuperscript{85} This implies a relaxation of the mandatory character of corporate law rules both because at any given time private parties may opt out of local mandatory rules by opting into another State's corporate law and because, from a dynamic point of view, States may have to decrease the level of creditor and investor protection to retain corporations within their borders. Such developments may be less dramatic than they appear, however, due to

\textsuperscript{82} Wake Forest L. Rev. 911, 914-15 (2003) (arguing there is rarely transnational demand to create European-wide corporate law); Marcel Kahan & Edward Rock, Symbiotic Federalism and the Structure of Corporate Law, 58 Vand. L. Rev. 1573, 1583-90 (2005) (viewing populist politics at the federal level as a serious threat to Delaware).

\textsuperscript{83} See Enriques, supra note 71, at 51.

\textsuperscript{84} See Enriques, supra note 3, at 601-07, 644; see Roberta Romano, The State Competition Debate in Corporate Law, 8 Cardozo L. Rev. 709, 721-22 (1987).

\textsuperscript{85} See Enriques, supra note 52, at 1269-70.

See supra notes 57-64 and accompanying text.
existing or prospective positive harmonization measures at the EC level, with regard to substantive law or conflict-of-law rules.

III. PREINSOLVENCY RULES AND REGULATORY COMPETITION IN CORPORATE LAW

We now proceed to investigate the potential for corporate law arbitrage, forum shopping, and regulatory competition in European corporate law with respect to creditor protection. Although we are ready to concede that the distinction is not clear-cut, in this Part we deal with preinsolvency rules. These are rules that operate before the onset of insolvency or, to be more precise, become operational whether the corporation goes bankrupt or not. Examples include minimum asset requirements, limits to distributions, and creditors’ rights to safeguards in the event of specific transactions and disclosure. We also discuss regulatory arbitrage and regulatory competition within the EU and their implications for creditors. Then, in Part IV, we turn to postinsolvency rules, which operate only after a corporation has gone bankrupt. Before proceeding, we would like to stress that our purpose here is not to give a complete taxonomy of each and every creditor-protection instrument currently in use across the EU, but to show what room the current framework leaves for regulatory arbitrage and regulatory competition in Europe.

A. An Overview of the Main Preinsolvency Rules from an Interjurisdictional Perspective

Generally, preinsolvency rules follow the law of incorporation, which means that they factor into the calculus of choosing a particular state of incorporation and that they have an influence on regulatory competition in corporate law. There have been substantial efforts at positive harmonization of these rules. However, these efforts have borne little fruit thus far. First, many of these measures—in particular Council Directive 77/91/EEC (Second Directive)—apply only to public companies such as the Aktiengesellschaft, the naamloze vennootschap, the société anonyme, or the società per azioni but not to private ones. 86 Second, those measures have altered national corporate

law less than one might expect. EC directives relating to corporate law generally leave a variety of options to Member States, where lawyers have frequently understood European law within the context of their respective national legal culture. 87  Those provisions of secondary European law that are mandatory are typically underenforced at the European level, allowing either Member States or corporations to circumvent them with relative ease. 88

Conflict-of-law rules on preinsolvency rules are generally considered well-settled and thus usually considered part of corporate law. Hence, before Centros, the applicable legal regime would depend on either the real-seat theory or the incorporation theory. 89  Member States, especially the ones that were denying or restricting free choice of corporate law, often provided for creditor-protection measures that went far beyond the requirements of EC law. Starting with Centros, negative harmonization by the ECJ has resulted in “defensive regulatory competition,” whereby some Member States have already started to remove rules that were apparently the outcome of isolation from competition. 90

1. Minimum Net Assets

The Second Directive requires public corporations to have a legal capital of at least €25,000, which need not be entirely covered by assets at the time of incorporation. 91  With the Second Directive not applying to private limited companies (Ltds), Member States have

87. See Enriques, supra note 71, at 12-14.
88. See id.
90. See Chertok, supra note 29, at 495-96.
been able to choose freely the amount for this set of corporations. This resulted in a broad variety of regulations, ranging from no such requirement in the United Kingdom, Ireland, and Cyprus to a requirement of €35,000 in Austria.92 *Centros* has already induced France, effectively, to abolish minimum capital for private corporations,93 and even the German Ministry of Justice proposed a reduction from €25,000 to €10,000.94

The effectiveness of minimum capital requirements in actually protecting creditors are highly doubtful for reasons that need not be reiterated here.95 Even some supporters of legal capital requirements concede that their function does not lie in protecting creditors from the risk of substantial losses resulting from an unfavorable business development, but rather in signaling seriousness to the market; thus, this erects a barrier against the creation of dubious corporations with an unreasonable amount of backing by shareholders.96 However, if

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92. Gesetz über Gesellschaften mit beschränkter Haftung [GmbHG] [Limited Liability Company Act] Reichsgesetzblatt [RGBl.] No. 58/1906, §§ 6(1), 10(1) (Austria); see Carsten Frost, *Transfer of Company’s Seat—An Unfolding Story in Europe*, 36 VICT. WELLINGTON L. REV. 359, 372-73 (2005). To be sure, only €17,500 needs to be paid in cash before the corporation is registered (or the lower total amount of cash contributions, which is permissible if there are contributions in kind for which the consideration has to be transferred in full). Limited Liability Company Act, supra, § 10(1).


there are any benefits to this argument, they need to be weighed against the disadvantages of preventing the formation of potentially thriving companies backed by a sound business idea but little or no assets.

The *Centros-Inspire Art* line of decisions has made it impossible for national legislators to impose minimum asset requirements on pseudo-foreign corporations. Thus, the possibilities for corporate law arbitrage in this field are nearly unrestricted. In fact, minimum capital has become one of the most important factors driving the incorporation of continental businesses in the United Kingdom. As already seen, this has prompted some “defensive regulatory competition” across the EU. It is fairly easy to predict that the final outcome of this process will be the practical elimination of minimum capital requirements.

2. Restrictions on Distributions

In the EU, legal rules limiting managers’ discretion over the declaration of dividends or any other way of conveying corporate assets to shareholders are intertwined with the regulation of legal capital. Under article 15(1) of the Second Directive, no distributions to shareholders may be made when net assets are lower or would become lower than subscribed capital plus certain reserves which may not be distributed, except in the case of a reduction of subscribed capital. Even if this does not protect creditors against regular business risk, a public corporation will, in principle, be unable to

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100. Of course, this does not necessarily have to be the case because restrictions on distributions may also be related to balance sheets in the absence of legal capital rules or not be related at all with balance-sheet data, as when a solvency test is required. *See* MODEL BUS. CORP. ACT § 6.40(c) (2002). Even the prohibition of concealed distributions, described *infra* text accompanying notes 108-116, could conceivably apply in the absence of legal capital.

convey funds to shareholders if net assets fall below the subscribed capital, unless shareholders vote to go through a capital-reduction procedure which includes certain safeguards for creditors.\textsuperscript{102} Reduction below the minimum capital is of course ruled out entirely.\textsuperscript{103} As a remedy, article 16 of the Second Directive requires that distributions received must be returned if the corporation proves that these shareholders knew of the irregularity "or could not in view of the circumstances have been unaware of it."\textsuperscript{104}

However, two important caveats need to be mentioned. First, the actual computation of net assets within the meaning of the directive is basically a balance-sheet test on the basis of the last financial year's annual accounts. Thus, the extent of "capital maintenance" depends on the applicable accounting rules. In spite of Council Directive 78/660/EEC (Fourth Directive), which on its face, harmonizes accounting law in great detail,\textsuperscript{105} a considerable number of elective provisions have allowed EU Member States to uphold their national accounting cultures.\textsuperscript{106} However, the recent International Accounting Standards (IAS) regulation gives Member States the choice between an accounting system based on the Fourth Directive, or one on International Financial Reporting Standards (IFRS, formerly known as IAS) for individual accounts.\textsuperscript{107}

\textsuperscript{102} \textit{Id.} arts. 30-39.
\textsuperscript{103} \textit{Id.} art. 34.
\textsuperscript{104} \textit{Id.} art. 16.
Second, as a practical matter, it is not entirely clear to what kind of transactions the prohibition applies. While the Second Directive explicitly speaks only of “distributions,” German commentators generally agree that so-called concealed distributions (verdeckte Ausschüttungen or verdeckte Einlagenrückgewähr) are also prohibited. This term refers to transactions in which corporate funds are conveyed to shareholders indirectly, typically through contracts entered into on unfair terms, such as loans to shareholders with unusually low (or no) interest rates or purchases from shareholders at excessive prices. One argument in favor of such a doctrine uses article 42 of the Second Directive, which requires equal treatment of shareholders under equal conditions. More importantly, if the prohibition is to be effective, it does not matter whether a distribution is made through the official declaration of dividends or in any other way. Naturally, the German understanding of the Second Directive is shaped by the extensive German case law on concealed distributions to shareholders, which, among other things, covers issues such as guarantees for a shareholder’s personal debt by the corporation. However, because the Second Directive only applies to public corporations, German law totally prohibits concealed distributions in Aktiengesellschaften, while in GmbHs concealed distributions are


109. See GRUNDMANN, supra note 91, cmt. 343; MARTHA HABERSACK, EUROPÄISCHES GESELLSCHAFTSRECHT cmt. 167, at 123 (2d ed. 2003); GÜNTER CHRISTIAN SCHWARZ, EUROPÄISCHES GESELLSCHAFTSRECHT cmt. 596, at 379-80 (2000); Peter O. Müllert, Kapitalschutz und Gesellschaftszweck bei der Aktiengesellschaft, in FESTSCHRIFT FÜR MARCUS LUTTER ZUM 70. GEBURTSTAG 535, 545-47 (Uwe H. Schneider et al. eds., 2000).
111. GRUNDMANN, supra note 91, cmt. 343.
112. See Fleischer, supra note 110, at 100 (arguing that the purpose of articles 15 and 16 implies a general prohibition of concealed distributions); Müllert, supra note 109, at 546-47 (same); Wolfgang Schön, Deutsches Konzernprivileg und europäischer Kapitalschutz—ein Widerspruch?, in FESTSCHRIFT FÜR BRUNO KROPPF: AKTIEN- UND BILANZRECHT 285, 294 (Karl-Heinz Forster et al. eds., 1997) (same).
113. See supra note 108 and accompanying text.
115. German commentators typically argue that because article 15(1)(c) of the Second Directive limits distributions to profits, distributions other than through dividends are
permitted as long as they do not reduce net assets below the statutory capital requirement.\textsuperscript{116}

By contrast, under English law a distribution is normally defined as a transfer of assets without consideration.\textsuperscript{117} Still, in a vein similar to the German doctrine, English courts have held the following to be unauthorized returns of capital: excessive remuneration of directors,\textsuperscript{118} undervalued transfers of real property to another corporation owned by the same parent,\textsuperscript{119} and guarantees for other firms within the same group.\textsuperscript{120} However, transactions that are not a complete sham will not be considered a "distribution" at all,\textsuperscript{121} meaning that, other than under German law, a subjective element is required to void a transaction.\textsuperscript{122}

The recent Company Law Reform allows distributions in kind as long as there are sufficient profits available for distributions to cover the difference between the asset's book value and the consideration received, which would not be acceptable under German law.\textsuperscript{123} Given

\begin{footnotes}
\footnotetext[116]{Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, Bundesgesetzblatt, Teil 1 [BGBl. I] at 1089, as amended by Gesetz, Dec. 21, 2006, BGBl. I at 3332, art. 3, § 57, \textit{translated in BUSINESS TRANSACTIONS in GERMANY}, app. 7-1 (Dennis Campbell ed., 2006); GmbHG [Limited Liability Company Act], Apr. 20, 1892, Reichsgesetzblatt [RGBl.] at 477, as amended by Gesetz, Mar. 22, 2005, BGBl. I at 837, art. 12, § 30, \textit{translated in BUSINESS TRANSACTIONS in GERMANY}, supra, app. 6-26; \textit{cf. Marcus Lutter & Peter Hommelhoff, GMBH-GESETZ: KOMMENTAR} § 30 cmt. 3 (Walter Bayer et al. eds., 16th ed. 2004). By contrast, under Austrian corporate law, which usually strongly resembles German law, concealed distributions are generally illegal in both types of corporations. \textit{See AktG BGBl. No. 98/1965, § 52 (Austria); GmbHG RGBl. No. 58/1906, § 82 (Austria); see also Fleischer, supra note 110, at 105-06.}

\footnotetext[117]{See Clydebank Football Club Ltd v. Steedman, 2002 S.L.T. 109 (Sess.) (Scot.); Richard Morris, \textit{Dividends, in 1 PALMER'S COMPANY LAWS} paras. 9.701, 705 (Geoffrey Morse et al. eds., 25th ed. 2002); John Armour, \textit{Avoidance of Transactions as a Fraud on Creditors' at Common Law, in VULNERABLE TRANSACTIONS in CORPORATE INSOLVENCY} para. 7.38 (John Armour & Howard Bennett eds., 2003).}

\footnotetext[118]{\textit{In re} Halt Garage (1964) Ltd, [1982] 3 All E.R. 1016, 1042-45 (Ch.) (Eng.).}


\footnotetext[121]{Armour, supra note 117, para. 7.38.}

\footnotetext[122]{See Fleischer, supra note 110, at 101-02. For a detailed comparison, see Thomas Bachner, Creditor Protection in Private Companies—Anglo-German Perspectives after Centros (2006) (unpublished Ph.D. dissertation, Cambridge University) (on file with author) (see especially chapter 3 on capital maintenance and unlawful distributions).}

\footnotetext[123]{Companies Act 2006, c. 46, § 845 (U.K.).}
\end{footnotes}
that the English case law on this subject is sparse, and, even more importantly, commentators appear not to see a connection with the Second Directive, it is obvious that the understanding of constraints on distributions imposed by EC law differs considerably. On top of that, concealed distributions do not appear to be much of an issue in some other countries.

Because restrictions on distributions, including concealed distributions, may result in significant cost (e.g., when planning intragroup transactions to avoid violations of such rules) and considerable risk to shareholders if the corporation goes bankrupt, differences in the law may affect corporate arbitrage decisions to some degree. Following Centros and Inspire Art, there appears to be widespread agreement that capital-maintenance rules of the state of incorporation apply, and choice of law with respect to distributions will therefore be possible.


125. For France, see Michel Germain, 1:2 Traité de Droit Commercial 607-09 (G. Ripert & R. Roblot eds., 18th ed. 2002) (discussing the issue of “dividends fictifs” under French Law and ignoring the issue of concealed distributions); see also Fleischer, supra note 110, at 102-04. For Spain, see José Massaguer Fuentes, Utili, Riserve e Dividendi, in 2 Armonie e Disarmonie nel Diritto Comunitario delle Società di Capitale 1115, 1129-32 (Gian Franco Campobasso ed., 2003) (similar to France, but for Spanish law). For Italy, a distinction has to be made between concealed distributions and concealed restitutions of contributions. The former does not appear to be an issue. See, e.g., Giovanni E. Colombo, Il bilancio d’esercizio, in 7* Trattato delle Società per Azioni, supra note 55, at 23, 535-44 (providing a thorough analysis of the Italian provision, Royal Decree, No. 262 of mar. 16, 1942 art. 2433, para. 4, Gazz. Uff., apr. 4, 1942, No. 79, which corresponds to article 16 of the Second Directive, and discussing the relationships between the two, but totally ignoring the problem of concealed distributions). To be sure, until 2002, it was a crime to distribute “in any form” fictitious profits, and the relevant provision was construed as including the case of concealed distributions. C.C. art. 2621. After the 2002 reform, however, the criminal provision was reformulated without the “in any form” clause and, in the absence of case law so far, it is widely construed as not including concealed distributions any more. See, e.g., Valerio Napoliemo, Le disposizioni penali in materia di società e di consorzi, in Codice Commentato delle Nuove Società 1690, 1773 (G. Bonfante et al. eds., 2004). There is, however, some scholarly debate, and a couple of court decisions can be found with regard to concealed restitutions of contributions, a phenomenon partially overlapping with concealed distributions. See, e.g., Marco S. Spolidoro, I conferimenti in denaro, in 1** Trattato delle Società per Azioni, supra note 55, at 247, 349-61 (2004) (not referencing, however, EC law).

126. Cf. Mülbert & Birke, supra note 95, at 720-21 (conceding that creditors may look favorably at rules against concealed distributions that, however, come at a significant cost).

127. E.g., Forsthoft & Schulz, supra note 98, cmt. 32. Contra Altmepen, supra note 64, at 97, 102.
3. Creditors’ Right to Safeguards in the Event of Significant Transactions

Jurisdictions sometimes protect creditors by granting them a right to obtain some form of safeguard in the event the corporate debtor executes a transaction supposedly capable of increasing the risk faced by the creditor. This tool has also been used by EC corporate law with regard to a few transactions, reflecting the fact that some Member States already provided for similar safeguards prior to harmonization.\(^\text{128}\)

First of all, the Second Directive provides that in the event of a reduction of capital,

\[\text{[a]t least the creditors whose claims antedate the publication of the decision to make the reduction shall be entitled at least to have the right to obtain security for claims which have not fallen due by the date of that publication. The laws of a Member State shall lay down the conditions for the exercise of this right.}^{\text{129}}\]

Further, such laws “may not set aside such right unless the creditor has adequate safeguards, or unless the latter are not necessary in view of the assets of the company.”\(^\text{130}\)

Second, “an adequate system of protection” for the interests of creditors has to be devised by Member States in the case of mergers and divisions falling under Council Directive 78/855/EEC (Third Directive) and Council Directive 82/891/EEC (Sixth Directive).\(^\text{131}\) Such provisions also apply to the formation of a European company by merger\(^\text{132}\) and to cross-border mergers.\(^\text{133}\) In many Member States, the system of protection is very similar to the one designed in article 32 of the Second Directive for reductions of capital.\(^\text{134}\)

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\(^{128}\) For instance, in Italy, provisions similar to those on reduction of capital were already present in the 1942 version of the Civil Code. C.C. arts. 2445, 2503 (relating to reductions of capital and mergers respectively). For Germany, see AktG, Sept. 6, 1965, BGBl. I at 1089, §§ 225, 347.

\(^{129}\) Second Directive, supra note 86, art. 32.

\(^{130}\) Id.


\(^{133}\) Cross-Border Merger Directive, supra note 73, art. 2, para. 2.

\(^{134}\) Compare CODE DE COMMERCE [C. COM.] art. L236-14 (Fr.); Umwandlungsgesetz [UmwG], Oct. 28, 1994, BGBl. I at 3210, as amended, Gesetz, Nov. 10, 2006, BGBl. I at 2553, art. 8, § 22 (F.R.G.); C.C. art. 2503 (Italy); CÓDIGO DAS SOCIÉDADES COMÉRCIAIS arts. 101-A, 101-B, Decreto No. 76-A/2006 de 29 de marzo de 2006 (Port.); and art. 243 of the
In general, the relevance of such provisions for creditor-protection purposes can hardly be underestimated. To begin with, as one of the authors has argued elsewhere, all such provisions are either timidly market-mimicking or unimportant.135 These provisions are timidly market-mimicking “with regard to sophisticated creditors, who normally reserve the far more effective right to veto such transactions (usually in broader and more detailed terms) or insert an acceleration clause applying if these transactions are entered into.”136 They are unimportant with regard to other (voluntary) creditors,137 either because these are weak creditors and, hence, lack the negotiating power to exercise their right vis-à-vis the corporation or because they have such power, in which case they do not need a right to obtain safeguards.138

Further, with specific regard to the EC measures, the Third and the Sixth Directives altogether are arguably trivial as long as at least one Member State, namely the United Kingdom, lets its companies execute mergers and divisions under a different set of rules.139

4. Mandatory Disclosure

One of the most important elements, or possibly the dominant element, of EC corporate law is its extensive regime of disclosure.140 Council Directive 68/151/EEC (First Directive) provides for the

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135. See Enriques, supra note 71, at 33-34.
136. Id. at 34.
137. Creditor-safeguard provisions may matter to involuntary creditors, provided that a number of conditions apply. First, involuntary creditors should have no other meaningful relationship with the corporation. Second, legal systems should provide for effective ways for them to become informed about the relevant transaction so as to be able to exercise their right in a timely fashion. Finally, the exercise of such a right must be cheap compared with the expected loss stemming from the increased risk of default following the transaction. In countries where creditors need to act in court in order to obtain the relevant safeguard (as is the case in Italy), and where no means exists to coordinate the efforts of the numerous creditors that, for example, are the victims of a mass tort, the cost of exercising the right is likely to be too high most of the time. See Carlo Santagata, Le fusioni, in 7** TRATTO DELLE SOCIETÀ PER AZIONI, supra note 55, at 3, 527 (2004).
138. Enriques, supra note 71, at 35-36. “[S]uch provisions do not require that the company obtain creditors’ consent to execute certain transactions. They require creditors to activate in order to obtain protection, thus making it less plausible that a bargaining problem connected with an endowment effect will arise.” Id. at 36 n.145.
139. See id. at 33.
disclosure of a variety of corporate data, but mostly for disclosure of data about the corporation’s annual accounts and consolidated accounts. The preambles to both the Fourth Directive and Council Directive 83/349/EEC (Seventh Directive) refer to the interests of third parties (obviously including creditors) to justify mandatory disclosure of accounting information. Mandatory disclosure is of particular significance for small creditors who lack the bargaining power to force the voluntary provision of information and who may even be nonadjusting creditors who are not in the position to alter contract terms depending on risk of default.

However, there are good reasons to doubt whether the enforcement mechanisms of EC law for mandatory disclosure provisions are effective. In 1997 and 1998, the ECJ ruled that Germany had failed to adequately enforce disclosure requirements for small companies. The ruling sparked a German reform act imposing a new regime of sanctions. Nevertheless, recent empirical evidence shows that more than ninety percent of German firms still fail to comply, although the newly enacted law on the electronic commercial register may increase the effectiveness of enforcement.

A related issue, recently tackled by the ECJ in the Berlusconi case, is accounting fraud. Even though there are no explicit provisions addressing the issue in the company law directives, Advocate General (AG) Juliane Kokott sweepingly suggested that community law requires Member States to impose effective, proportionate, and dissuasive penalties. Further, AG Kokott argued that false disclosure is at least as harmful as nondisclosure which is

144. Kapitalgesellschaften- und Co-Richtlinie-Gesetz [KapCoRiLiG], Feb. 24, 2000, BGBl. I at 154 (F.R.G.) (introducing, among other things, penalties imposed upon request by a shareholder, creditor, or the works council).
148. See id. paras. 67-81 (opinion of AG Kokott).
covered by the directives. The ECJ agreed with this assessment in principle, but decided in favor of the defendants on the basis of a rather formalistic understanding of the *nulla poena sine lege* principle, which forms an integral part of community law. Still, European law could, in theory, have an impact on the interests of creditors in that it ensures the accuracy of financial statements.

However, various factors compromise the actual usefulness of disclosure to creditors. Besides the issue of differences in applicable accounting standards and the lack of enforcement of disclosure in some Member States, it is important to note the directives’ failure to provide a specific period after the end of the fiscal year within which disclosure must occur. Member States sometimes prescribe relatively generous filing periods. Examples include: nine months in the United Kingdom for Ltds, twelve months in Germany, nine months in Austria, and seven months in Italy and Spain. At that point, accounting information is, of course, already rather stale.

Thus, at least for small corporations, the European regime of mandatory disclosure may bring fewer benefits than it appears at first glance. Most of the justifications for mandatory disclosure commonly advanced in the literature, which relate to the character of information as a public good and its underproduction and mispricing in an unregulated market, are understandable only within the context of publicly traded firms. For important creditors, such as banks, information provided by mandatory disclosure under the regime of the directives is of little significance because creditors are usually able to gain access directly through the firm’s managers. Trade creditors will often not have the bargaining power to make similar requests. Therefore, they resort to other ways of obtaining information about

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149. See id. For an analysis of that opinion, see Gelter & Siems, supra note 106, passim.
151. See supra Part III.A.2.
155. For Italy, see C.C. art. 2435 in connection with C.C. art. 2365(2). For Spain, see articles 95, 171, and 218 of the L.S.A. (R.C.L. 1989, 1564).
the firm, or they will take out bad-debt insurance, while mandatory disclosure is of little (if any) relevance to them.\textsuperscript{158} The mandatory disclosure regime imposed by the directives may, in effect, be doing as little as ensuring the implementation of unitary accounting systems and standards within the respective country.

Still, accounting and disclosure provisions are a factor potentially influencing regulatory competition. From the perspective of conflict-of-law rules, most authors seem to agree that accounting duties follow corporate law.\textsuperscript{159} For example, an English Ltd should follow U.K. accounting rules. Quite obviously, the ECJ would hardly tolerate a Member State applying its own accounting law to foreign companies, given extensive European harmonization.\textsuperscript{160} This view is confirmed by the new audit directive, which implements the principle of home-country regulation.\textsuperscript{161} The doctrine identifies as the applicable law the one of the Member State in which the auditor is approved and in which the audited entity has its registered office.\textsuperscript{162}

However, accounting is probably one of the few areas (the only one?) where the founders of a corporation will usually not want to opt out of their home state's corporate law regime. This is because drawing up financial statements under a familiar system is easier and less costly and because the home system will be harmonized with the applicable tax law. Apparently, because the Companies House does not investigate the substantive content of financial statements, it has become common practice for English Ltds with their seat of administration in Germany to submit accounts set up under the accounting provisions of the German commercial code.\textsuperscript{163}

\textsuperscript{158} But see id. (claiming without reference that in the United Kingdom disclosed accounts are frequently inspected before a company enters into large business transactions).


\textsuperscript{160} See Gelter, supra note 159, at 135; Markus Rehberg, \textit{Zivil-, Handels- und Verfahrensrecht, in AUSLÄNDISCHE KAPITALGESELLSCHAFTEN}, supra note 64, § 5 cmt. 114, at 165.


\textsuperscript{162} See id. On damages claims against the auditor, see Werner F. Ebke, § 323 HGB, \textit{in 4 MÜNCHENER KOMMENTAR ZUM HANDELSGESETZBUCH} cmts. 148-168 (Karsten Schmidt ed., 2001).

\textsuperscript{163} Westhoff, supra note 159, cmt. 111.
For large listed firms, IFRS/IAS has become the accounting system of choice with the EC “IAS Regulation.”\textsuperscript{164} However, the debate on accounting provisions for small firms is far from over. Accounting standards may, therefore, be one of the factors affecting a corporate law arbitrage decision.

\textbf{B. Corporate Law Arbitrage and Regulatory Competition}

We have seen that the ECJ has largely opened the field to corporate law arbitrage. While there have been efforts at positive harmonization, mostly concerning public corporations, they have remained largely ineffective and therefore do not significantly curb regulatory arbitrage.\textsuperscript{165} As described above, preinsolvency rules are mostly the domain of corporate law, much more so than in the United States where creditor protection is not really an issue for corporate legislators—except for restrictions on dividends, which are mostly meaningless and prone to circumvention.\textsuperscript{166} By contrast, in Europe, creditor protection has long been a concern of corporate law. Hence, it comes as no big surprise that the American discussion on regulatory competition has little to offer on concerns of creditor protection.\textsuperscript{167}

We now proceed to assess the intensity of regulatory competition within the EU today and how it is to be interpreted. Then we analyze how \textit{ex ante} and \textit{ex post} choice-of-law decisions affect creditors. By \textit{ex ante} and \textit{ex post} decisions we mean the decision to incorporate or to reincorporate before or after credit has been extended to the firm.

\footnotesize{\textsuperscript{164} See supra note 107 and accompanying text.  
165. However, the risk that the EC may harmonize a given corporate law issue, making the law of a Member State particularly attractive, may hinder regulatory arbitrage if companies perceive that there is a high chance that a sufficient number of (re)incorporations in that Member State will prompt harmonization, thereby making the choice of that corporate law unattractive \textit{ex post}. See supra note 84 and accompanying text.  
166. \textit{See} ROBERT CHARLES CLARK, CORPORATE LAW 618 (1986) (describing the possibility of increasing surplus by reevaluating assets or changing accounting policies); BAYLESS MANNING WITH JAMES J. HANKS, JR., LEGAL CAPITAL 93 (3d ed. 1990) (“Whether one views it as a blessing or a deficiency of the existing statutory systems, it is at least a fact that the corporation acts do not pursue the implementation of their own scheme with any real seriousness.”). The elimination or vestigialization of legal-capital rules has arguably been the outcome of regulatory competition. Richard A. Booth, \textit{Capital Requirements in United States Corporation Law, in} LEGAL CAPITAL IN EUROPE, supra note 110, at 620, 622, reports that “many observers have suggested that the dilution of substantive rules such as those relating to legal capital may be attributable to destructive competition” among States and suggests that, to the contrary, “it may also be the case that such rules proved to be inefficient and that other more efficient rules have evolved.”  
167. The only exception seems to be Bebchuk, supra note 2, at 1489-90 (discussing involuntary creditors).}
1. Corporate Law Arbitrage and Regulatory Competition So Far

We have seen some regulatory arbitrage with respect to preinsolvency rules is already happening, driven mostly by minimum capital requirements and that possibly can, at least partly, be credited for a trend toward the abolition of minimum capital requirements in some countries. Still, it would probably be premature to infer any long-term trends from this. Of course, legal capital requirements are usually seen as an instrument of creditor protection. However, if minimum capital requirements do not actually help creditors and rational creditors should not care about them, then the changes in the law induced by corporate law arbitrage so far are not really an issue of creditor protection, but rather a removal of administrative slack affecting only the interests of the founders of new companies. If it is true that only one interest group is affected, and this group is affected in a positive way, it seems hard to doubt that the effect of regulatory competition is beneficial as well. Given the minor relevance of this issue from the perspective of creditors, however, this recent development should not be construed as evidence of either a “race to the top” or a “race to the bottom” with respect to creditor protection.

2. Ex Ante Choice of Law

Even in light of doubts about whether each of the current creditor-protection mechanisms implemented by the Member States actually serves the interests of creditors, it is hard to rule out entirely that some of them serve these interests. Conceivably, Member States could also devise new mechanisms that do. Hence, we ask whether regulatory competition is likely to lead to the retention and development of mechanisms creditors actually care about, i.e., whether corporate law arbitrage will be beneficial.

Corporate debtors, especially when the corporation approaches insolvency, have powerful incentives to act in ways that are detrimental to creditors. This incentive arises because shareholders capture most of the potential gains of increased risk, whereas creditors, whose entire benefits are limited to the amount of principal plus interest stipulated ex ante, have to bear most of the risk of failure. To counter this

168. See Miola, supra note 94, at 441-47.
danger, creditors frequently request contractual clauses limiting the opportunism of debtors\textsuperscript{170} or charge a risk-adjusted interest rate.\textsuperscript{171}

Hence, in line with the standard corporate law-and-economics literature, which considers corporate law to be a standard-form contract, the applicable regime of corporate law also needs to be seen as part of the contract of lending.\textsuperscript{172} At least some corporate law creditor-protection tools will affect the creditor’s assessment of shareholder and manager opportunism; to the extent that corporate law reduces this risk, the creditor will charge a lower interest rate or find it unnecessary to add protective covenants to the lending agreement. For example, a rational creditor will take the possibility of veil piercing or equitable subordination into account and adjust the interest rate accordingly, considering the reduced risk, even if only marginally. Similarly, creditors should make some adjustment depending on the ability of managers and shareholders to remove assets from the corporation, thus increasing the likelihood of insolvency and reducing the chances of recovery (called asset diversion). It follows that rules impeding such transactions, including concealed-distribution doctrines or mandatory disclosure rules, should also affect creditors’ decision on the margin. Thus, assuming the ability to accurately assess risk of default and to adjust prices and conditions accordingly, creditors should be getting precisely what they bargained for in terms of \textit{ex ante} expectations.

A creditor may want a corporate debtor to observe a specific Member State’s creditor-protection regime. A powerful institutional lender could theoretically even have the bargaining power to induce a firm to submit itself to a particular regime.\textsuperscript{173} From this discussion, considering firms’ \textit{ex ante} incorporation choice, both debtors and


\textsuperscript{171} See LOMBARDO, supra note 72, at 166 (discussing rational behavior by creditors who reward incorporation in a Member State that has good law).


\textsuperscript{173} As described above in Part II.A.3, an adjusting lender could select a given corporate law by asking the borrower to set up a subsidiary in the desired legal system in which the loan is given, and the subsidiary would then enter into a nonreincorporation covenant, while the parent guarantees the loan. However, this will work only if the subsidiary is endowed with a sufficient amount of assets to repay the loan; otherwise, the lender will have to call upon the guarantee, in which case the corporate law governing the parent corporation will be of primary importance again.
lenders should have an incentive to lobby states to implement creditor-protection rules which are beneficial to lenders (and borrowers).

However, the analysis so far ignores nonadjusting and partially adjusting creditors. Most of all, tort claimants will not be able to adjust their claims. Small, less sophisticated creditors (e.g., suppliers) will be unable to determine exactly the risk involved and will find it too costly to draft an agreement precisely reflecting the risk of the borrower. It is for these creditors that a boilerplate-contract corporate law will be insufficient. Hence, in the presence of nonadjusting creditors, a “race to the bottom” is theoretically possible, because those creditors will not adequately react to the choice of a suboptimal corporate law.

An obvious objection is that nonadjusting creditors may free ride on the bargaining power of large lenders. Within certain limits, this is likely to happen, namely in those cases where the law of a specific jurisdiction is beneficial to creditors as a group. However, free riding will not work if the choice of law involves a conflict of interest between different groups of lenders, e.g., where bank loans are collateralized, while trade creditors do not possess such protection. Choice-of-law opportunities may therefore be detrimental to nonadjusting creditors (in particular, tort creditors) vis-à-vis adjusting creditors.

3. *Ex Post* Reincorporation

So far, only newly founded companies have taken advantage of corporate law arbitrage within the EU. Once a specific regime has been chosen, firms are locked into a particular system of creditor protection. This is due mostly to the costs of moving: firms may need to resort to complicated constructions in order to switch to a new

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175. See Bebchuk, supra note 2, at 1489-90.
176. See Gelter, supra note 81, at 276.
regime. Furthermore, they face severe obstacles resulting from taxation.

The first problem has been alleviated, at least to some degree, by the recently enacted Cross-Border Merger Directive and the ECJ's recent opinion in In re SEVIC Systems AG. In SEVIC, the ECJ found that the German law's failure to allow for cross-border mergers violates articles 43 and 48 of the EU Treaty. The second issue should have been partly resolved by Council Directive 90/434/EEC (Directive on the Taxation of Mergers), which prohibits the taxation of hidden reserves in cross-border mergers subject to certain conditions. However, presently it remains unclear whether other types of reincorporation will be possible without resulting in deterrent tax consequences. Where reincorporation entails a change in the firm's tax residence, which will not necessarily be the case if no assets are relocated, it will often trigger exit taxation of unrealized gains. In Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie, the ECJ found that this was not permissible under the freedom of establishment when a natural person moved to another Member State. There are good reasons to believe that this reasoning also applies when a corporation reincorporates or moves to another


Member State, although it remains to be seen where exactly the ECJ will draw the line.\textsuperscript{183}

Midstream or \textit{ex post} corporate law arbitrage (i.e., during the later life of the corporation) adds another dimension to the analysis. Once firms are no longer locked into a particular legal regime, it may be in the interest of both parties to commit \textit{ex ante} to stay in a particular legal system to which creditors have adjusted. In this case, contractual creditors need to deal only with the law of one jurisdiction and should be able to adjust and penalize bad law with relative ease, assuming there are no information asymmetries about the content of the particular law. The possibility of implicitly altering the terms of the lending agreement by reincorporating compares to the U.S. debate on mandatory rules in corporate law, which focuses on the relation between shareholders and managers. The usual justification given for making some rules mandatory in the midstream stage is managerial opportunism.\textsuperscript{184} Even if the charter terms were fair when the corporation first went public, the argument goes, management can push through charter amendments which are not necessarily in shareholders’ interest because shareholders are rationally ignorant and subject to collective-action problems and because charter amendments need to be proposed by the board of directors in the United States.\textsuperscript{185} This precludes charter amendments that will benefit shareholders but

\textsuperscript{183} See, e.g., Jens Kleinert & Peter Probst, \textit{Endgültiges Aus für steuerliche Wegzugsbeschränkungen bei natürlichen und juristischen Personen}, 57 DB 673, 674 (2004); Tröger, supra note 52, at 17. Contra Wolfgang Schön, \textit{Playing Different Games? Regulatory Competition in Tax and Company Law Compared}, 42 COMMON MKT. L. REV. 331, 359-60 (2005) (highlighting the implications of broad sweeping a holding like the one in \textit{Lasteyrie du Saillant} for corporations); Rock, supra note 181, at 21-25 (similarly doubting that, unless corporate income tax is federalized, Member States would accept that corporations can reincorporate without paying taxes on hidden reserves). But see Gilbert Parleani, \textit{Relocation and Taxation: The European Court of Justice Disallows the French Rule of Direct Taxation of Unrealised Gains}, 1 EUR. COMPANY & FIN. L. REV. 379, 381 (2004) (waiting for a legislative solution). In particular, in the case of mere reincorporation without a relocation of assets, it seems hard to conceive how a taxation of reserves could be justified in light of the EC case law, as the ability to tax those reserves later will not be lost. See Andreas Engert, \textit{Steuerrecht, in AUSLÄNDISCHE KAPITALGESELLSCHAFTEN}, supra note 64, § 8 cmt. 111 (arguing that German exit taxation should not apply in such cases in light of European law); Franz Wassemeyer, \textit{Steuerliche Konsequenzen aus dem EuGH-Urteil “Hughes de Lasteyrie du Saillant,”} 95 GMBHR 613, 615-16 (2004) (same); see also Case C-446/03, Marks & Spencer plc v. Halsey, 2005 E.C.R. I-10837 paras. 27-59 (applying a test of proportionality to the question of whether a Member State may permit the offsetting of profits made by a subsidiary in the same State while prohibiting the offsetting of profits made elsewhere).


\textsuperscript{185} See id.
be to the detriment of management.\textsuperscript{186} Therefore, it may be beneficial if company managers’ hands were tied with respect to charter amendments.\textsuperscript{187}

Similarly, it may be beneficial if a firm is committed to the terms of a lending agreement, as implied by the corporate law regime of its state of incorporation. However, if the debtor is not committed to a particular system, or if such a commitment is impossible or prohibitively costly, the opportunity to move to a less creditor-friendly jurisdiction creates a new moral-hazard problem vis-à-vis creditors.\textsuperscript{188}

Under the regime created by recent ECJ case law, shareholders may unilaterally decide to change the firm’s charter or to reincorporate in another jurisdiction without creditors’ approval.\textsuperscript{189} This moral-hazard opportunity raises information costs for creditors who need to deal with the laws of the multiple states in which a corporation might reincorporate.

With time, sophisticated creditors would probably learn how to deal with this and, at the very least, adjust interest rates accordingly. Conceivably, a lending contract or a bond covenant could require the debtor to stay within one particular legal system. In most cases, creditors theoretically will be in the position to protect themselves against this particular type of moral hazard. Even today, loan agreements with banks often stipulate the acceleration of the loan in the case of significant transactions, such as mergers. Similarly, contracts might penalize reincorporations by raising interest rates in

\begin{footnotes}
\item[186] See id.
\item[188] See LOMBARDO, supra note 72, at 181-82.
\item[189] To be sure, the ECJ’s opinion in Case 81/87, The Queen v. H.M. Treasury (Ex Parte Daily Mail), 1988 E.C.R. 5483, allows Member States to impose an export ban on the firms incorporated under their respective law, is frequently still considered good law. See, e.g., Bayerisches Oberstes Landesgericht [BayObLG] [Court of Appeals for Selected Matters in Bavaria] Feb. 11, 2003, 2004 Entscheidungen des Bayerischen Obersten Landesgerichts in Zivilsachen [BayObLGZ] 24 (F.R.G.); Frank Woolridge, Überseering: Freedom of Establishment of Companies Affirmed 14 EUR. BUS. L. REV. 227, 231-32 (2003); Eva Micheler, Current Development, Recognition of Companies Incorporated in Other EU Member States, 52 INT’L & COMP. L.Q. 521, 524 (2003); cf Wolf-Georg Ringe, Anmerkung, 58 DB 2806, 2807 (2005) (arguing that Daily Mail is still good law in light of the ECJ’s SEVTC judgment, which dealt with an inbound case); Wulf-Henning Roth, From Centros to Überseering: Free Movement of Companies, Private International Law, and Community Law, 52 INT’L & COMP. L.Q. 177, 197 (2003) (stating that Member States will have to reconsider their position on moving out as well). However, following the Lasteyrie du Saillant opinion, there are good reasons to believe that this is no longer the case.
\end{footnotes}
such a case. These clauses may be a sufficient deterrent in many cases, at least as long as bankruptcy is not imminent.

Even when a "commitment" clause is in place, it is shareholders who need to initiate a reincorporation, even though creditors need to approve it. The ensuing distribution of powers between shareholders and creditors is analogous to that between managers and shareholders in the United States. One could argue that in the theoretical case where a move will increase the total value of the firm by improving the position of creditors, but will take away some value from shareholders, a reincorporation will not be implemented.

As before, the crucial question is how well creditors are able to deal with the issue on their own, in particular by contracting for a commitment clause ex ante. Tort creditors are of course unable to adjust, although a reincorporation to escape tort claims will not be possible given that the private international law of torts typically follows the lex loci commissi delicti, meaning the law applied is the law of the country in which the tort was committed. With respect to claims against the corporation, tort creditors will in most cases be primarily interested in postinsolvency rules. However, reincorporation may sometimes be a way to escape veil piercing.

190. Cf. Bebchuk, supra note 2, at 1470 (explaining that due to managerial veto power over reincorporations, moves enhancing shareholder value will not ensue if they hurt managers).

191. Of course, if lending is concentrated and negotiations can take place between creditors and managers or controlling shareholders, leaving aside the possibility of bargaining breakdowns, such a reincorporation may take place. Typically, sophisticated adjusting creditors, such as the firm's main bank, will be able to stimulate the other groups to initiate a negotiation. However, the benefits of Coasian bargaining are limited as it will probably be used only to the benefit of adjusting creditors. On the other side of the bargaining table, it seems also likely that only large shareholders and managers, but not the minority, will be primary beneficiaries of the negotiations.

192. A theoretical case where corporate law could become relevant would be the implementation of unlimited shareholder liability for corporate torts in at least one country, as famously proposed by Henry Hansmann & Reinier Kraakman, Toward Unlimited Shareholder Liability for Corporate Torts, 100 Yale L.J. 1879, 1880-81 (1991). Shareholders would have an incentive to reincorporate if the firm is facing a mass tort claim.

193. See Stefan Leible, Rechts- und Geschäftsfähigkeit. Kaufmannseigenschaft, in Grenzüberschreitende Gesellschaften, supra note 98, § 10 cmt. 25 (stating that veil-piercing claims for undercapitalization or commingling of assets are qualified as corporate law by German courts and authors); Schall, supra note 9, at 1552 (suggesting that veil piercing is to be considered corporate law); see also Amtsgericht Bad Segeberg [AG Bad Segeberg] [Bad Segeberg District Court] Mar. 24, 2005, 17 C 289/04, 95 GMBHR 884 (2005) (F.R.G.) (rejecting a veil-piercing claim for undercapitalization against an English Ltd because English law does not require private companies to have any capital). However, this case was decided differently on appeal. See LG Kiel Apr. 20, 2006, 10 S 44/05, 61 BB 1314

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Furthermore, typically commitment clauses or acceleration clauses will be stipulated only to the benefit of large adjusting creditors. Again, sophisticated creditors may cooperate with shareholders and managers to the detriment of less sophisticated ones, namely by agreeing to a reincorporation in a jurisdiction where, for example, tort creditors are treated badly but creditors whose claims are collateralized are treated well.

Of course, Member States or the EC itself may provide for creditor-protection tools in the event of a reincorporation provided, in the former case, that they satisfy the Gebhard criteria. A reincorporation is now possible (or soon will be) either through a cross-border merger or through the creation of a European company, in both cases by merging the operating corporation into a wholly owned shell corporation created in the reincorporation State. Irrespective of which of the two methods is selected, national rules providing "an adequate system of protection of the interests of creditors" pursuant to the Third Directive apply to such transactions. Hence, one may argue that all creditors are protected against the risk of opportunistic reincorporations. However, as argued above, while sophisticated creditors do not need such a system of protection, other creditors will normally be unable to take advantage of it, with the possible exception of tort creditors.

(2006); see also BGH Mar. 14, 2005, II ZR 5/03, 60 BB 1016 (2005) (rejecting a claim against shareholders of an English company by analogy to the German rules about companies prior to registration); cf. Horst Eidenmüller, Gesellschaftsrecht, in AUSLÄNDISCHE KAPITALGESELLSCHAFTEN, supra note 64, § 4, at 85, cmts. 21-26, at 92-94 (arguing that the German doctrine of Existenzvernichtungshaftung—liability to creditors for endangering the corporation’s existence—follows corporate law); Gerald Spindler & Olaf Berner, Gliübigerschutz im Gesellschaftsrecht nach Inspire Art. 50 RECHT DER WIRTSCHAFT: BETRIEB-BERATER INTERNATIONAL 7, 11 (2004) (F.R.G.) (same).
194. See Case C-55/94, Reinhard Gebhard v. Consiglio dell’Ordine degli Avvocati e Procuratori di Milano, 1995 E.C.R. 1-4165; cf. Schall, supra note 9, at 1553 (suggesting that even those German creditor-protection mechanisms cannot apply to U.K. companies under the freedom of establishment).
197. See supra Part III.A.3.
198. But see discussion supra note 137.
4. Conclusion

As we have seen, EC corporate law offers considerable leeway for regulatory arbitrage vis-à-vis creditors. On the positive side, regulatory competition is likely to remove mere slack, such as minimum capital, from which creditors derive no actual benefit. However, the outcome with respect to rules creditors actually may have an interest in depends on whether creditors are able to adjust to differences in the creditor-protection mechanisms of corporate law. For adjusting creditors, reincorporation and other types of moral hazards may be solved by covenants. This is not necessarily so for others, and certainly not for tort creditors. The position of large, sophisticated creditors who are able to adjust may actually be enhanced by regulatory arbitrage, to the detriment of nonadjusting groups of creditors.

Of course, the analysis of potential results of regulatory competition depends to a considerable degree on whether Member States actually have incentives to change their laws to attract (re)incorporations, as Delaware does. About this, we remain skeptical.\footnote{See Enriques, supra note 52, at 1266-73 (providing arguments for the implausibility of a Delaware-like scenario within the EU); Gelter, supra note 81, at 259-64 (same).} Admittedly, the fact that the U.K. Companies House accepts financial statements drawn up under non-U.K. law for purposes of the legal filing requirement may be taken as evidence that it is actively engaging in regulatory competition.\footnote{See Westhoff, supra note 159, § 17, at 493.} However, other actors such as legislators and courts have a more important role in shaping future law, and it remains to be seen whether they will actively seek to attract foreign incorporations.

IV. POSTINSOLVENCY RULES AND BANKRUPTCY FORUM SHOPPING

The increasing room for regulatory arbitrage in corporate law that follows, or will follow, EC negative and positive harmonization initiatives raises the issue of how corporate law and insolvency law interact in situations where the two bodies of law to be applied are from different Member States. There are in fact strong complements between the two.\footnote{See Schön, supra note 183, at 353-54.} If companies were free to choose the applicable corporate law and insolvency law, rules “could be selected that best fit
the needs of shareholders and managers but not necessarily those of creditors ('cherry-picking').\textsuperscript{202} This is also true, albeit to a lesser degree, if free choice is possible with regard to corporate law only; in this case, corporate decision makers may choose the corporate law that in the event of insolvency provides the best combination with the relevant insolvency law from the point of view of managers and shareholders. If reincorporation is an available option, the prospect of more favorable treatment in bankruptcy, irrelevant as it might have been at the incorporation stage, will become the main driver of reincorporation decisions for companies on the brink of insolvency.

This Part inquires into the interactions between corporate and insolvency law within the EU, providing an introduction to the most relevant conflict-of-law rules. We subsequently reflect upon the implications of bankruptcy forum shopping in Europe.

A. Postinsolvency Rules

In order to analyze the interactions between corporate law and bankruptcy law in the post-\textit{Centros} world, we first sketch out the private international law framework for insolvencies within the EU. The central piece of legislation in this area is now the EIR,\textsuperscript{203} but attention will be given more specifically to two legal tools for creditor protection particularly relevant for our analysis: fraudulent conveyance laws and equitable subordination. The former can act as a substitute for the legal-capital doctrine where, like in the United States, such doctrine has been vestigialized.\textsuperscript{204} Hence, to the extent that legal capital becomes less central in the EU as well, this tool may come to the foreground. The latter provides a good example of a corporate law doctrine that Member States may relatively easily relabel as an insolvency law tool.


In sharp contrast to the U.S. experience, where bankruptcy law is federal, insolvency law is still a matter of national law within the EU: no relevant substantive harmonization of EU insolvency rules has ever

\textsuperscript{202} Eidenmüller, \textit{supra} note 13, at 435.
\textsuperscript{203} EIR, \textit{supra} note 10.
\textsuperscript{204} See generally Enriques \& Macey, \textit{supra} note 14, at 1185-95.
been adopted (nor attempted) at the EC level. However, in 2000, the EIR was passed in order to enhance cooperation among jurisdictions in insolvency proceedings by harmonizing conflict-of-law issues relating to insolvencies.

The EIR identifies the Member States having jurisdiction to open insolvency proceedings by introducing a distinction between main proceedings, which have a universal effect (at least within the EU), and secondary proceedings, which can be opened if the debtor has an establishment and if the effects of the proceedings extend to assets situated in the territory of the establishment’s Member State. The EIR identifies the law applicable to insolvency proceedings as the law of the State of the court opening the proceedings, with a number of exceptions. It also introduces the principle of mutual recognition of insolvency proceedings and provides rules for the coordination of main and secondary proceedings. Finally, the EIR contains rules on information for creditors and on lodging of their claims. What is relevant here are the rules determining the competent court and, hence, the applicable insolvency law and its scope.

In general it can be said, at least it was the drafters’ intention, that the EIR displays a strong disfavor for regulatory competition in insolvency law. As the preamble to the EIR puts it: “It is necessary for the proper functioning of the internal market to avoid incentives for the parties to transfer assets or judicial proceedings from one Member State to another, seeking to obtain a more favourable legal position (forum shopping).” As we shall see, the regulatory framework is only partly consistent with such an objective. However, it is apparent that if doubt arises in the interpretation of the EIR, the preamble provides an important guideline against any interpretation favoring parties’ free choice of the insolvency regime.

The core provisions in the EIR are articles 3 and 4 on international jurisdiction and applicable law, respectively. According

205. For an account of the few substantive harmonization measures in the insolvency law field, see MIGUEL VIRGÓS & FRANCISCO GARCIMARTÍN, THE EUROPEAN INSOLVENCY REGULATION: LAW AND PRACTICE 9 (2004).
206. See EIR, supra note 10.
207. See id. art. 3. Article 2(h) defines an establishment as “any place of operations where the debtor carries out a non-transitory economic activity with human means and goods.” On this notion, see, e.g., VIRGÓS & GARCIMARTÍN, supra note 205, at 158-62.
208. See EIR, supra note 10, arts. 4-15.
209. Id. arts. 16-38.
210. Id. arts. 39-42.
211. Id. pmbl., para. 4.
to article 3, jurisdiction for main proceedings is identified according to the COMI criterion, while secondary proceedings can be opened where the debtor has an establishment.212 Under article 4, “the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened” (lex fori concursus).213 The EIR further provides a nonexhaustive list of matters included in the lex fori concursus, ranging from “the conditions for the opening of the proceedings” to “the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors.”214 However, it contains a number of exceptions to the lex fori concursus, such as those concerning third parties’ rights in rem and contracts of employment, including an important qualification with regard to detrimental acts.215

Despite COMI’s key role in determining jurisdiction and in solving conflict-of-law issues in insolvency, there is surprisingly no definition of COMI in the text of the EIR. Instead, there is a rebuttable presumption that for companies and legal persons, “the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary.”216 The rationale for this presumption is that a corporation’s head office is usually situated where the corporation has its registered office.217 This presumption is by no means evidence of the lawmakers’ willingness to favor debtor’s choice in insolvency matters.218

A definition of COMI can, however, be found in the preamble to the EIR, where it states: “The [COMI] should correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties.”219 Legal scholars and courts across the EU agree that what counts is where the

212. Id. art. 3, paras. 1-2.
213. Id. art. 4, para. 1.
214. Id. art. 4, paras. 2, 2(m). On the rules relating to the voidness, voidability, or unenforceability of legal acts, see infra Part IV.B.
215. EIR supra note 10, arts. 5-15; see infra Part IV.B.
216. EIR supra note 10, art. 3, para. 1.
218. But see Armour, supra note 9, at 407-08 (arguing that the presumption created by EIR article 3(1) should be “a strong one”).
219. EIR, supra note 10, pmbl., para. 13. According to Virgós and Garcimartín, for various reasons this definition has “the same value as the definitions contained in Article 2.” VIRGÓS & GARCIMARTÍN, supra note 205, at 39-40.
“head office functions are carried out” on a regular basis, rather than where the head office is located.220

A thorough investigation into the meaning of COMI is unnecessary here. Suffice it to say, despite the emphasis in the preamble and in commentaries on the EIR on the fact that “transparency and objective ascertainability are dominant factors” in determining COMI,221 it is unquestionable that COMI is a highly ambiguous and manipulative concept that requires subjective and fact-intensive evaluation by judges.222 As a consequence, not only insolvent companies with international operations, but also their creditors, are able to some degree to select the forum (and hence the law) of their choice. This is especially true with regard to subsidiaries within a group of companies. As a number of precedents already show, it is both easy for the court where the subsidiary has its administration (and registered seat) and for the court where the parent has its COMI to claim jurisdiction over the subsidiary’s insolvency.223

Because it is the filing time that determines COMI, debtors may shop for friendlier insolvency laws also by switching COMI when


223. For a survey of the relevant cases, see Bob Wessels, International Jurisdiction To Open Insolvency Proceedings in Europe, in Particular Against (Groups of) Companies 16-23 (2003), http://www.iiglobal.org/country/european_union/InternJurisdictionCompanies.pdf. See also Franken, supra note 222, at 250-53.
insolvency is near. Of course, the switch of COMI immediately prior to the filing will not pass the test of continuity that is implied in the phrase “on a regular basis.” However, for switches taking place with some anticipation, it might be difficult not to recognize the new COMI, provided that the longer the time lag between the switch and the filing, the more difficult to resort to general abuse or fraud exceptions to disregard it.

Incentives for forum shopping also derive from the EIR’s solution to the problem of conflicting decisions on the opening of main proceedings. Based on the idea of mutual trust between EU courts, the criterion is purely temporal. Once a main proceeding has been opened by a court, other courts have to defer to that decision, only limited by the public policy exception. As courts have a tendency to recognize their own jurisdiction over insolvency proceedings, if only to protect local creditors’ interests, this temporal criterion implies that debtors and creditors may engage in a race to file in order to place the case

224. Incidentally, this creates an internal inconsistency in the EIR. If it is true that the perspective determining where the COMI is located should be that of potential creditors, then by identifying COMI with respect to potential creditors’ hypothetical determinations at the time of filing, in the case of a switch of COMI, the court will necessarily have to disregard any prior determination about COMI by creditors predating the switch. See Virgós & Garcimartín, supra note 205, at 42. Of course, one may reason that existing creditors who failed to contract for a covenant preventing switches of COMI accepted the risk of such a switch and, hence, can be disregarded in determining COMI. This sounds like a fairly groundless assumption with regard to unsophisticated creditors, however.

225. See Virgós & Garcimartín, supra note 205, at 41, 50; see also Case C-1/04, Staubitz-Schreiber, 2006 E.C.R. I-701 (finding that the Member State where a request to open insolvency proceedings is filed retains jurisdiction even if the debtor moves its COMI to another Member State subsequently).


227. See Wessels, supra note 222, at 503 n.39.

228. EIR, supra note 10, art. 26; see also In re Eurofood IFSC Ltd, [2005] B.C.C. 999 (Ir.) (deferring to the ECJ the question of whether Irish courts may refuse recognition of a Parma court’s decision made after failure to grant the temporary administrator of an Irish company the right to a fair hearing before it).

before a given (and supposedly friendlier) court and, hence, to obtain the most convenient applicable law.230 To the extent that the EIR leaves some room for regulatory arbitrage in insolvency law, it is worth dealing briefly with the scope of the *lex fori concursus* as a useful introduction to the discussion in Part IVB on whether “relabelling” corporate law rules as insolvency law rules can be a viable strategy for Member States. Without going into the details of the matters mentioned in article 4 and of the carve-outs in articles 5 through 15, it is again in the preamble that we find a general criterion to determine what issues are covered by the *lex fori concursus*.231 Paragraph 6 of the preamble provides: “In accordance with the principle of proportionality this [r]egulation should be confined to provisions governing jurisdiction for opening insolvency proceedings and *judgments which are delivered directly on the basis of the insolvency proceedings and are closely connected with such proceedings*.232 This criterion is clearly reminiscent of ECJ case law regarding Council Regulation 44/2001 (Brussels Regulation) on civil jurisdiction and, more precisely, on the scope of article 1(2)(b), which declares the Brussels Regulation inapplicable to bankruptcy.233 The case law had in fact clarified that this provision extends to all actions deriving directly from the bankruptcy proceeding; i.e., whose outcome depends upon insolvency law, and closely connected to it, from a procedural point of view.234 In *Gourdain v. Nadler*, the ECJ concluded that the French *action en comblement du passif* is part of bankruptcy law after conducting an independent characterization of the relevant French provisions and giving, of course, no weight to the “label” of the relevant provisions, i.e., whether they were located in French insolvency statutes or elsewhere.235 The Court gave weight instead to the following: (1) the only competent court was the insolvency court; (2) only the liquidator could bring suit; (3) the rules on the burden of

230. A race to file is facilitated by the ECJ’s opinion in the *Eurofood* case. The ECJ affirmed that once any Member State has opened insolvency proceedings, the other States do not have the power to review the decision. Case C-341/04, Eurofood IFSC Ltd, 2006 E.C.R. I-03813, paras. 111-112; see Thomas Bachner, *The Battle over Jurisdiction in European Insolvency Law*, 3 EUR. COMPANY & FIN. L. REV. 310, 316-19, 325-27 (2006) (criticizing the ECJ’s reference to mutual trust).
232. Id. pmbl., para. 6 (emphasis added).
235. Case 133/78, 1979 E.C.R. 733, 743. The legal basis for this type of lawsuit is C. COM. art. L624-3 (Fr.).
proof derogated from the general ones under the law of liability; (4) the statute of limitations was linked to a certain stage of the insolvency proceeding; (5) if the action succeeded, it would be the general body of creditors that would benefit; and (6) managers could be declared insolvent in case they did not discharge their liabilities toward the creditors without inquiring into whether the relevant requisites for their declaration of insolvency existed.236

2. Fraudulent Conveyance

All EU jurisdictions have rules against fraudulent conveyance (or fraudulent transfers) and preferences for certain creditors, permitting recovery of funds from the recipients of such conveyances.237 Similarly, most states in the United States enacted either the older Uniform Fraudulent Conveyances Act or the newer Uniform Fraudulent Transfers Act238 and the federal Bankruptcy Code includes an equivalent statute on transfers239 and another one on preferences.240 Those statutes cover transactions in which the debtor did not receive "reasonably equivalent value in exchange for the transfer" and "for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction."241 The provision is interpreted widely to include also dividends and share repurchases.242 Because the applicable fraudulent-transfer law does not depend on the state of incorporation, corporations are not subject to regulatory competition (between different corporate law regimes) in the United States.243

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237. See VIRGÓS & GARCIMARTÍN, supra note 205, at 134.
240. Id. § 547.
243. See Gelter, supra note 81, at 281; Kahan, supra note 242, at 148.
theory, fraudulent-transfer laws could take the function of provisions on legal capital-limiting dividends in Europe and of the concealed-distribution doctrines used in some countries.\textsuperscript{244}

The EIR does not apply to statutes on conveyances and preferences outside bankruptcy. In that context, the only restraint on Member States is primary EC law.\textsuperscript{245} However, any rule of this kind is superseded by the EIR once the corporation enters into bankruptcy, meaning that any conflict-of-law rules applied by Member States outside bankruptcy will be of very limited significance. Under the EIR, as a general rule, the law of the state opening insolveney proceedings determines "the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors."\textsuperscript{246} The EIR, however, also provides for an important exception to this rule, which may even allow for some "separate" forum shopping concerning preferences. The general rule does not in fact apply when the person benefiting from the act proves: (1) the "act is subject to the law of a Member State other than that of the State of the opening of proceedings," and (2) "that law does not allow any means of

\begin{footnotesize}

245. For example, the respective German statute states that a legal act will be evaluated under the law applying to its effects (\textit{Wirkungsstatut} or \textit{lex causae}). \textit{AnG} § 19. Apparently, the majority opinion in Germany interprets this as the law governing the contract or, in the more important case where a creditor seeks to rescind a transfer of title, the \textit{lex rei sitae} (i.e., the location of the property in question). See Ulrich Huber, \textit{Das für die anfechtbare Rechtshandlung maßgebende Recht, in Festschrift für Andreas Heldrich} 695, 701 (Stephan Lorenz et al. eds., 2005) (summarizing and criticizing the prevailing opinion). Similarly, Austrian courts have subjected conveyances to Austrian law if the property in question was located in Austria. Oberster Gerichtshof [OGH] [Supreme Court] May 23, 1984, 3 Ob 507/84, 27 \textit{ZEITSCHRIFT FÜR RECHTSVERGLEICHUNG} 290 (1986) (Austria). \textit{But see OGH} Apr. 27, 2006, 2 Ob 196/04v, 129 \textit{JURISTISCHE BLÄTTER} [JBl] 61 (2007) (holding that the most important factor in determining the applicable law is in which country the reduction of funds available for creditors took place). For Italy, compare Corte di cassazione [Cass.] [Court of Last Appeal in Civil and Criminal Matters], sez. un., 7 may 2003, n.6899, 2004 \textit{RIVISTA DI DIRITTO INTERNAZIONALE PRIVATO E PROCESSUALE} 635, 640-44 (finding that Italian judges have jurisdiction on a fraudulent-conveyance action on the basis of \textit{lex contractus}). For France, see \textit{Yvon Louisquern et al., DROIT INTERNATIONAL PRIVE} 514 (8th ed. 2004) (concurring in the scholarly opinion that \textit{lex contractus} applies to \textit{actio pauliana}).

246. EIR, supra note 10, art. 4, para. 2(m). The German and French versions of the text lend themselves to the conclusion that it need not be shown that each individual creditor was harmed, but that the language actually means the general body of creditors. Gabriel Moss & Tom Smith, \textit{Commentary on Council Regulation 1346/2000 on Insolvency Proceedings, in EIR COMMENTARY, supra note 217, at 155, para. 8.80, at 180.}
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challenging that act in the relevant case. As a result, the more lenient of the two provisions always applies if the beneficiary satisfies the burden of proof. The crucial question is, of course, which country’s law applies to the relevant act. The literature generally seems to imply that the law applicable to the transaction under the conventional rules of the private international law of contract apply.

This may allow the parties entering into a contract to choose a relatively lenient fraudulent-transfers regime independently from where insolvency proceedings are carried out, most obviously by a choice-of-law clause.

In light of this, conveyances will take part in “general” forum shopping and in regulatory competition for insolvency law, if there is any. To conclude, article 13 leaves open some limited room for forum shopping independent of bankruptcy.

3. Subordination

Several European jurisdictions have statutes or doctrines under which loans given by shareholders to the corporation under certain circumstances are subordinated to other debt in bankruptcy. The economic rationale for such doctrines is that risk enhancement resulting from the continued operation of the firm is detrimental to third-party creditors because the proceeds available in liquidation will typically be lower if the firm continues to operate because of the loan. On the other side, shareholders will capture most of the

247. EIR, supra note 10, art. 13; see Insolvenzordnung [InsO], Oct. 5, 1994, BGBI. I at 2866, as amended, Gesetz, Nov. 10, 2006, BGBI. I at 2553, art. 12, § 339 (F.R.G.) (similar text to the EIR applying the same criteria to cross-border insolvencies with non-EU countries).


250. Isaacs et al., supra note 249, cmt. 6.127, at 127. To be sure, at least in some cases, courts might consider this kind of transaction planning fraudulent or abusive. See Duursma-Kepplinger, supra note 249, cmt. 16, at 324; Huber, supra note 245, at 711.

251. See infra notes 254-261 and accompanying text.

benefits of continued operations because a successful turnaround of the business will result in increased shareholder wealth, while the gains creditors can make are typically only minute.253

The best known example is the German Kapitalersatzrecht, which covers not only loans given in times of crisis (not necessarily insolvency, but under circumstances where only shareholders would have extended a loan), but also loans not withdrawn at the onset of a crisis.254 Similar doctrines exist in Austria,255 Italy,256 Slovenia,257 and other countries.258 Similarly, U.S. courts developed the doctrines of equitable subordination,259 which found statutory recognition in § 510(c) of the Bankruptcy Code of 1978,260 and the more recent recharacterization doctrine.261 Other than the German doctrine, which

prohibits repayments while the corporation remains uncreditworthy, the American doctrines apply only in bankruptcy. However, the crucial point for issues of regulatory competition is that the equitable-subordination doctrine, as part of the bankruptcy code, does not share in regulatory competition for corporate law.

B. Forum Shopping for Insolvency Law

It is sometimes suggested that EU bankruptcy law as it implements a uniform system of conflict-of-law rules is not quite unlike the real-seat theory. The EIR, at first glance, seems to imply that a specific COMI can be determined for each individual firm. However, the practical experience with the EIR during its first years lends itself to a partly different conclusion. For firms active in one country only, COMI is unambiguous, leaving no option for forum shopping as far as different insolvency law regimes are concerned. By contrast, firms with operations in different countries, and above all international groups, have leeway to engineer insolvency proceedings in one of the countries in question. The substantive rules of bankruptcy are not a matter of federal law in Europe like they are in the United States, and therefore one might speculate whether the result will not be mere forum shopping, but actual regulatory competition, which implies states adapting their law to attract insolvency filings.

There is little doubt that forum shopping has potential benefits. In the United States, even though bankruptcy law is federal law, courts have some discretion in the application of procedural and substantive rules. Proponents argue that forum shopping has enabled bankrupt firms to choose venues where judges are predictable, fast, and competent in handling the reorganization of large firms. In other words, incumbent managers may have been able to choose the forum maximizing the total value of the reorganized firm (typically the New York and Delaware courts). Ex post value maximization may, in some cases, harm creditors to the benefit of other interest groups (such as shareholders and employees benefiting from continued operation), which is efficient if the benefits to those groups exceed the harm to creditors. Potential harm to creditors because of the evasion of

262. See Cole, supra note 5, at 1859-76; Ayotte & Skeel, supra note 5, at 15-17.
263. See Cole, supra note 5, at 1859-76; Ayotte & Skeel, supra note 5, at 15-17.
creditor-protection mechanisms therefore needs to be weighed against the benefits of *ex post* maximization.

Likewise, gains from regulatory arbitrage can be made by shopping between different European bankruptcy regimes.\(^{264}\) The possibility of secondary insolvency proceedings concerning the debtor’s assets in another State mitigates these gains, but does not eliminate them. In some cases, secondary procedures will not be an option. First, the debtor needs to have an establishment in the country where secondary proceedings are to take place.\(^{265}\) Second, proceedings will typically not be opened where the very limited assets in the relevant State are unlikely to cover costs.\(^{266}\) Third, secondary proceedings will always result in the liquidation of assets, meaning that it will matter a lot to creditors in which country a reorganization procedure is initiated.\(^{267}\) Furthermore, the law of the Member State will typically apply to certain procedures relating to insolvency, such as the claims against directors.\(^{268}\) The particular powers of the liquidator of the main proceedings and the obligation to transfer any remaining assets to him may also make a difference.\(^{269}\) Finally, as a practical matter, the race to file is a reality, as *Eurofood IFSC Ltd.*\(^{270}\) illustrates.\(^{271}\)

In the subsequent analysis, we look exclusively at the possibility of harm to creditors resulting from forum shopping. We first describe the commitment problem resulting from COMI and then point out some important differences from forum shopping for bankruptcy law in the United States. We analyze who may act as “case placers,” and


\(^{265}\) EIR, *supra* note 10, art. 3, para. 2.


\(^{267}\) EIR, *supra* note 10, art. 27 (referring to annex B of the EIR).

\(^{268}\) See Marc-Philippe Weller, *Forum Shopping im Internationalen Insolvenzrecht?,* 24 *PRAXIS DES INTERNATIONALEN PRIVAT- UND VERFAHRENSRECHTS* 412, 415 (2004); see also *infra* notes 297-300 and accompanying text.

\(^{269}\) See EIR, *supra* note 10, arts. 29, 33, 35.

\(^{270}\) Case C-341/04, 2006 E.C.R. I-3813.

\(^{271}\) See *infra* note 281 and accompanying text.
what consequences this may entail. Finally, we speculate whether States will have any incentive to attract insolventies.

1. Basic Structure

There are, of course, a number of notable differences between insolvency and corporate law arbitrage. To begin with, the decision about the applicable legal regime is not made at the stage of incorporation, but rather when insolvency proceedings are to be initiated. This compares to the situation described in Part III.B with the crucial difference that the borrower is unable to commit to a particular legal system. In fact, other than by avoiding transnational activity that may result in an unexpected COMI altogether, firms cannot commit to insolvency proceedings in a particular jurisdiction to their creditors. The possibility of ex post forum shopping obviously reduces ex ante predictability for creditors and therefore increases the agency cost of debt.272 However, only a limited number of jurisdictions will be an available option; even though an outsider may not be able to determine the COMI ex ante and managers have some opportunity to manipulate it, sophisticated creditors may be able to narrow down the available options.273 To be sure, predictability may not be perfect, as the approach taken by English courts with regard to the COMI highlights: their COMI decisions have been criticized as being hard to predict by outsiders.274

Second, the choice-of-law decision is not necessarily taken by the insolvent corporation. A striking difference from the United States, where involuntary bankruptcies are rare, lies in the persons who petition for bankruptcy proceedings—the case placers.275 Bankruptcy systems can be characterized as either manager-driven or manager-

272. See Franken, supra note 222, at 236.
274. See Franken, supra note 222, at 248-54. This lack of predictability is the reason why several authors have suggested that ex ante free choice should be adopted; this would both allow firms to choose the regime most appropriate to their governance structure and to commit to a particular regime that can be ascertained by creditors. See, e.g., Franken, supra note 222, at 242-46; Robert K. Rasmussen, A New Approach to Transnational Insolvencies, 19 MICH. J. INT'L L. 1, 32-33 (1997); Robert K. Rasmussen & Randall S. Thomas, Timing Matters: Promoting Forum Shopping by Insolvent Corporations, 94 NW. U. L. REV. 1357, 1403 (2000). Others suggest that the bankruptcy forum should be bundled with corporate law. See, e.g., Armour, supra note 9, at 407-08; Eidenmüller, supra note 13, at 438-40.
displacing.\textsuperscript{276} The U.S. bankruptcy system is the paradigmatic example of a manager-driven system, with executives having powerful incentives to file for chapter 11, which allows them to attempt a turnaround of the corporation while staying in charge.\textsuperscript{277} By contrast, European bankruptcy proceedings, including British ones, are manager-displacing, as the corporation is typically liquidated or sold piecemeal by an administrator.\textsuperscript{278} Directors are not rewarded with the carrot of prolonged control over the corporation, but threatened with the stick of liability in the case of a late filing. However, it appears that this stick does not work effectively, because the case placers are usually creditors.\textsuperscript{279}

2. Conflicts of Interest on the Demand Side

Let us consider what happens when a corporation approaching insolvency could make a case for its COMI in jurisdictions \textit{A} and \textit{B}. Assume both systems are manager-displacing. Managers will fear displacement and usually delay bankruptcy filings as long as possible. If creditors are a homogeneous group, they will submit a petition for bankruptcy in the jurisdiction maximizing the expected value accruing to creditors, which is not necessarily the jurisdiction maximizing total value.\textsuperscript{280}

If creditors are heterogeneous, and the law of jurisdiction \textit{A} is favorable to Group 1 (e.g., secured lenders), while jurisdiction \textit{B} is favorable to Group 2 (e.g., unsecured lenders, employees, and so on),\textsuperscript{281}
a race to file between creditors may develop.\textsuperscript{282} Its outcome may depend on pure chance, but also on different prerequisites for bankruptcy in different jurisdictions,\textsuperscript{283} or even on the procedural rules and safeguards for the debtor's right to a fair hearing.\textsuperscript{284} If one jurisdiction allows a petition for (involuntary) bankruptcy earlier than the other, the group of creditors favored by this jurisdiction will prevail.

The prospect of forum shopping by creditors may create an incentive for managers to file for bankruptcy. If jurisdiction $A$ favors creditors and jurisdiction $B$ favors managers and shareholders, e.g., because rules on directors' liability and veil piercing are lenient, the latter may have an incentive to file in $B$ before creditors file in $A$, using their information advantage. Again, the group favored by the jurisdiction allowing the earlier onset of bankruptcy proceedings will win. Note that the costs to managers will be not only monetary, but also include the stigma of having run the corporation into bankruptcy. This may mean that managers will sometimes still delay bankruptcy, even though the bankruptcy proceedings of jurisdiction $B$ favor them in purely financial terms. Also, creditors will often prefer bankruptcy

\textsuperscript{282} The difference between the two groups may stem from securitization or from a preference for a specific location, as involvement in insolvency proceedings in a distant country may be costly.

\textsuperscript{283} In some jurisdictions, bankruptcy can only be declared after finding that the company is unable to pay debts as they become due. See, e.g., C. COM. art. L621-1 (Fr.); Royal Decree No. 267 of mar. 16, 1942, art. 5, para. 2, Gazz. Uff., apr. 6, 1942, No. 81 (Italy); Faillissementswet [F] [Bankruptcy Law] art. 1 (Neth.); Prawo upadłościowe i naprawcze [Law on Bankruptcy and Rehabilitation] 2003, No. 60, poz. 535 Dziennik Ustaw [Dz. U.] (Pol.); Art. 2 of the Bankruptcy Act (Boletin oficial del Estado [B.O.E.] [Official Gazette] 2003, 164) (Spain); Konkurslag [KonKL] [Bankruptcy Code] 1:2 (Swed.). By contrast, the insolvency laws of other countries include overindebtedness as an additional, alternative criterion for limited liability associations only. In its most basic form, it is fulfilled when total debt exceeds total assets. See, e.g., Konkursordnung [KO] [Bankruptcy Code] No. 337/1914, as amended, § 67 (Austria); InSO, Oct. 5, 1994, BGBl. I at 2866, as amended, Gesetz, Nov. 10, 2006, BGBl. I at 2553, art. 12, § 19; zákon [statute] č. 7/2005 Zbierka zákonov [Zb.] [Collection of Statutes] (Slovk.); Zakon o finančnom poslanju podjetij [ZFPPod] [Financial Operations of Companies Act] § 54/1999 Ulrl. RS §§ 12-13 (Slovn.). Needless to say, the interpretation of the criterion varies among jurisdictions.

\textsuperscript{284} This is also an area where Member States can be creative in anticipating the date of an insolvency proceeding's opening. See discussion supra note 230.
proceedings in, or close to, the state of their own residence and consider bankruptcy proceedings abroad more costly.\footnote{285} However, in many cases, it will be possible to solve this problem by opening secondary insolvency proceedings.\footnote{286}

Generally, there are still good reasons to believe that managers/shareholders will usually beat creditors in the race to file. As insiders, they possess a considerable information advantage, allowing them to assess whether the corporation is eligible for bankruptcy and possibly to win the race for filing because creditors do not know yet that illiquidity is impending. Furthermore, managers/shareholders will know better than creditors in which countries a good case for COMI can be made, and what options are available. Rational managers with sophisticated counsel should be able to use forum-shopping opportunities to their advantage. However, whether insiders will prevail in the way described, to some extent depends on who the particular creditors are. If the corporation is tightly supervised by a financial institution, the advantage may be close to nonexistent. There are also reasons to believe that certain groups of creditors will typically win over other groups in a race. In many cases, sophisticated, secured creditors will be better informed both about the financial situation of the debtor and about forum-shopping opportunities. They may even enter coalitions with managers to the detriment of nonadjusting creditors.

Most likely, forum shopping will be to the detriment of tort creditors, who are unable to adjust their claims. A firm might move to reincorporate, with the assent of large lenders protected by an acceleration clause, in a jurisdiction where the position of tort creditors is particularly bad, and establish a COMI there on the basis of the presumption in article 3 of the EIR.

Note that a slight slant in favor of management may not necessarily be detrimental in principle. Besides management, there

\footnote{285. This was probably the issue in a recent case concerning a conflict of competence between Czech and German courts. Czech creditors submitted a petition for bankruptcy in Prague while the debtor, an unincorporated German entrepreneur, filed for bankruptcy in Hamburg. Městský Soud [MS] [Circuit Court in the City of Prague] Apr. 26, 2005, čj. 78 K 6/05-127, 26 ZIP 1431 (2005); LG Hamburg Aug. 18, 2005, 326 T 34/05, 26 ZIP 1697 (2005).

286. Cf. Franken, supra note 222, at 255 ("[I]f creditors of an establishment located in another Member State have statutory priority rights that do not have equivalents under the home-country law, they can protect their priority position by filing for a secondary bankruptcy proceeding.")}
may be other stakeholders with an interest in keeping the corporation going, such as employees whose human capital is to some degree tied up in the firm and not protected by complete contracting. To be sure, Lynn LoPucki, the leading academic critic of bankruptcy forum shopping in the United States, argues that forum shopping has hurt the bankruptcy system by allowing bad management to stay in office and by letting many prepackaged bankruptcies go through where the insolvent corporation needs to refile within a few years. This may indicate that forum shopping has allowed the U.S. system to tilt too strongly in favor of reorganization.

3. Supply Side

On the supply side of the market for bankruptcy law, Member States could theoretically offer postinsolvency rules catering to the interests of any group. Among the strategies available, it may be most promising to cater to managerial interest, given the managerial head start in information. Because Member States have different substantive bankruptcy laws, a State might even implement manager-driven bankruptcy proceedings in order to attract filings.

It seems interesting to consider what strategies Member States engaging in regulatory competition could take or, to put it differently, what kind of law would attract case placers. The most obvious example is a law providing strong managerial control in bankruptcy, along U.S. lines. If managers and controlling shareholders with them stay in control of the firm during bankruptcy by filing in a particular country, it would give them a considerable ex post advantage over creditors. Furthermore, states allowing early filings or petitions for bankruptcy would also be attractive, at least to the group favored by bankruptcy proceedings in that particular state. The favored group, be it managers or a particular segment among creditors, could seize the opportunity to initiate filings. The supply of a bankruptcy law

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287. See LoPucki, supra note 6, at 97; LoPucki & Kalin, supra note 6, at 270-71.
288. For a more positive assessment of bankruptcy venue choice in the United States, see Cole, supra note 5, at 1859-76; Rasmussen & Thomas, supra note 5, at 1396-406; Skeel, Bankruptcy Judges and Bankruptcy Venue, supra note 5, at 27-29; Skeel, What's So Bad About Delaware?, supra note 5, at 326-28; Ayotte & Skeel, supra note 5, at 1517.
289. For example, under section 123 of the U.K. Insolvency Act, default on an undisputed debt over £750 is sufficient to prove insolvency, whereas in Germany, the creditor needs to show that the debtor is unable, and not merely unwilling, to pay. See Schall, supra note 9, at 1538. The leading English case is Cornhill Insurance plc v Improvement Services Ltd, [1986] W.L.R. 114 (Ch.) (Eng).
favorable to any particular group should thus be made more attractive by allowing that group to file early before an interested group launches a petition in another state.

As in regulatory competition for corporate law, any influence on the development of the law as such hinges on whether its suppliers have an incentive to cater to the interests of decision makers. Only if there is such an incentive will the development of the law itself be influenced, turning mere forum shopping into actual regulatory competition. The biggest problems for regulatory competition are incentives on the supply side, which are often idiosyncratic and hard to predict. According to Lynn LoPucki, judges are motivated by the glamour of handling “celebrity” bankruptcies and their increased standing in the community resulting from it.\textsuperscript{290} While this may have been the original incentive for the individual judges who started attracting cases to New York and Delaware, pressure from local bankruptcy bars that wanted to avoid losing business to Delaware, seems to have become an important factor later.\textsuperscript{291} Still, even this has not become a universal incentive for other courts to adapt their procedures.\textsuperscript{292}

Although there is little doubt that the potential rents to be gained from forum shopping are bigger if not just minor differences in the interpretation of a single bankruptcy code (as in the United States), but a variety of bankruptcy laws are at issue,\textsuperscript{293} it is too early to conclude that legislators will enter regulatory competition under the EIR regime. First, the gains to be made are probably limited to a considerable degree by secondary insolvency proceedings. Second, the number of firms where gains are possible is relatively small. To be sure, this may be true also in the United States, where forum shopping for chapter 11 “prepacks” seems to be an option mainly for large borrowers. Similarly, the COMI standard grants forum-shopping opportunities only to firms with considerable international activities and, by means of the presumption of COMI in the state of incorporation, to pseudo-foreign companies. However, COMI allows case placers to choose among a limited selection of venues; while in the United States, “large

\textsuperscript{290} LoPucki, supra note 6, at 19-20.
\textsuperscript{291} See id. at 124-28.
\textsuperscript{292} See id. at 21-24 (discussing Boston judges’ refusal to enter the competition).
\textsuperscript{293} See id. at 207.
public companies [are] free to file their bankruptcies pretty much anywhere they [choose]."

These two factors combined make it rather unlikely that local bankruptcy lawyers in Europe will have to fear loss of large portions of their business. It is hard to see why Member States should allow themselves to be pressured into changing their bankruptcy laws in ways that give rent-seeking opportunities to managers or other groups. Given that Member States themselves can hardly gain financially from handling bankruptcy proceedings, the crucial issue probably is to what extent particular groups (bankruptcy lawyers in particular) will be able (and have an incentive) to influence legislators, or possibly judges, to change the law or its interpretation to generate revenue for the bar.

4. Conclusion

The EIR offers ex post forum-shopping opportunities that European bankruptcy systems will have to address. Although an ex ante commitment to a particular bankruptcy system would likely be beneficial, COMI and its ambiguities for multinational groups and companies are here to stay. Consequently, at least some creditors are likely to be hurt by forum shopping. That said, we can reasonably predict that states will not actively compete to attract bankruptcies.

V. THE “RELABELING” OF CORPORATE LAW RULES AS INSOLVENCY LAW RULES: LIMITS AND IMPLICATIONS

Shortly after Centros opened the door for regulatory arbitrage in the corporate law field, the Council adopted a regulation which seemingly ruled out forum shopping and regulatory arbitrage in the bankruptcy law field. While we have seen that such objective was far from attained by the EIR, it is also true that whatever State succeeds in opening the insolvency proceedings will be able to apply its own insolvency law rules, even to foreign entities, with due exceptions and qualifications. Hence, States (and legal scholars before them) may be tempted to requalify corporate law rules as insolvency law rules so as to apply their domestic law to foreign entities, as though Centros did not exist. With respect to postinsolvency corporate law rules, i.e., those that de facto operate only if a corporation becomes insolvent, the

294. Id. at 15.
outcome of such a relabeling would be practically the same as prior to Centros.

As a matter of fact, various commentators do consider insolvency law (and tort law) to be a sort of safe haven protecting domestic provisions from review by the ECJ.  However, two caveats need to be made.  First, secondary EC law (like the EIR) can hardly mend a violation of primary law by a Member State.  Second, it is not evident why the ECJ should take a formalistic perspective and bother to consider in which field of national law a creditor-protection mechanism falls if its effects are identical.  In fact, as we have seen in Part IVA, the ECJ’s criteria for the qualification of rules as insolvency law are autonomous from national laws and are strictly related to substantive and procedural features of bankruptcy law.

In light of Gourdain, for instance, commentators tend to exclude claims that can be brought irrespective of whether a corporation goes bankrupt, like claims against directors for breach of their ongoing duties, that are among those covered by the lex fori concursus.  Of course, actions based on English provisions on wrongful trading would certainly be included among those covered by the English lex fori concursus, should a proceeding be opened in England.  Similarly, claims against directors arising from breach of the duty to file for insolvency are also held to be covered by the lex fori concursus.

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295. See, e.g., Christian Kersting & Clemens Philipp Schindler, The ECJ’s Inspire Art Decision of 30 September 2003 and Its Effects on Practice, 4 GERMAN L.J. 1277, 1290 (2003) ("Existenzvernichtungshaftung . . . or liability for undercapitalization can only be applied to foreign companies if they are understood as institutes of the law of torts or of insolvency law"); Hanno Merkt, Creditor Protection and Capital Maintenance from a German Perspective, 15 EUR. BUS. L. REV 1045, 1057 (2004) ('[A] tort law based solution would, as a general legal principle, be immune to findings that it violates the principle of freedom of establishment.'); Ulmer, supra note 62, at 1207.


298. See Schall, supra note 9, at 1549.

299. See VIRGÓS & GARCIMARTIN, supra note 205, at 82; Horst Eidenmüller, Insolvenzrecht, in AUSLANDISCHE KAPITALGESELLSCHAFTEN, supra note 64, § 9, at 310, cmts. 25-33, at 317-18; see also Gerd Leutner & Olaf Langner, Durchgriffshaftung bei Scheinauslandsgesellschaften, 2005 ZInsO 575, 577 (suggesting that German Insolvenzverschleppungshaftung should apply when an insolvency proceeding is opened in
However, this view is not uniformly held; some authors and recently one lower court have in fact argued that issues of liability for late filing should be decided according to the law of incorporation,\(^\text{300}\) although this case was decided differently on appeal.\(^\text{301}\)

Hence, the relabeling of corporate law provisions as insolvency law may only work provided that these provisions are properly "insolvencified," i.e., as long as a sufficient number of features linking them to the insolvency proceeding and its objectives are introduced. As a consequence, in most cases insolvencification cannot be the product of scholarly or judicial interpretation. Instead, an intervention by national lawmakers and a profound revision of existing legal doctrines will be needed for relabeling to be successful.

Further, insolvencification may prove to be useless for extending the scope of domestic laws to entities incorporated in other Member States. Whenever insolvency law rules may be held to have a more than indirect and uncertain impact upon the exercise of freedom of establishment, they also must be consistent with the Gebhard criteria.\(^\text{302}\) Admittedly, insolvency law or tort law rules will typically apply without regard to the particular legal form, meaning that one of the Gebhard criteria—application in a nondiscriminatory manner—will be met more or less automatically, which is in stark contrast to pseudo-foreign corporation statutes.\(^\text{303}\) But no such automatism will work with regard to the other criteria.

Germany and citing Gourdain as an important argument); Rouven Redeker, Die Fortführung insolvenzreifer Gesellschaften nach "Inspire Art," 2005 ZInsO 1035, 1037 (same); Friedrich Rüffer, Die Behandlung von Scheinauslandsgesellschaften, 2 GeS 411, 416-17 (2005) (same); Philipp Ungan, Gläubigerschutz nach dem EuGH-Urteil in "Inspire Art"—Möglichkeiten einer Sonderanknüpfung für die Durchgriffshaftung in der Insolvenz?, 104 ZEITSCHRIFT FÜR VERGLEICHENDE RECHTSSPRACHEN 355, 368 (2005) (same).

300. See, e.g., Spindler & Berner, supra note 193, at 12; Sebastian Mock & Charlotte Schildt, Insolvenz ausländischer Gesellschaften mit Sitz in Deutschland, in GRENZÜBERSCHREITENDE GESELLSCHAFTEN, supra note 98, § 16 cmts. 43-48; see also AG Bad Segeberg Mar. 24, 2005, 17 C 289/04, 95 GmbHR 884 (2005) (rejecting a claim for damages on the grounds that English law applies and German law cannot be superimposed in light of ECJ case law).

301. LG Kiel Apr. 20, 2006, 10 S 44/05, 61 BB 1314 (2006) (qualifying the duty to file for insolvency as corporate law and allowing a damages claim against an English Ltd under German law and arguing that this was compatible with EC law).


303. Gebhard, 1995 E.C.R. at I-4165; see Schanze & Fütter, supra note 62, at 668 (pointing out that general laws of commercial traffic—allgemeines Verkehrsrecht—will usually not violate primary law); Schmidt, Publizität, supra note 296, at 25-26 (pointing out
As previously hinted in Part IV.A, at least in theory fraudulent conveyance could be one of the areas where insolvency could, i.e., the introduction of rules that are functionally equivalent or similar to rules previously found in corporate law, may work out within the EU. Fraudulent-conveyance rules can in fact tackle opportunistic behavior in the form of asset diversion similarly to corporate law’s limits on distributions. The problem is that EIR’s article 13 opens the door to regulatory arbitrage with regard to these kind of rules. Because, of course, insolvency could not take place on a discriminatory basis, it would mean opening the door for regulatory arbitrage for domestic as well as foreign companies. If companies started to engage in concealed distributions through contracts for which parties chose the law of a Member State not allowing for any means of challenging them, the relabeling of rules limiting distributions as fraudulent transfer might hinder the effectiveness of rules aimed at preventing asset diversion in jurisdictions where concealed distributions are now covered by corporate law.

Finally, we have seen that at least in some countries, like Germany, the qualification of the equitable-subordination doctrine is disputed.\textsuperscript{304} In light of the discussion of ECJ case law on bankruptcy above, which is construed narrowly to refer only to “judgments which are delivered directly on the basis of the insolvency proceedings and are closely connected with such proceedings,”\textsuperscript{305} it seems clear that a subordination doctrine such as the German one that becomes applicable before insolvency and can result in a duty of shareholders not to recall the loan even if the corporation does not go bankrupt, does not necessarily fall under the scope of the EIR.\textsuperscript{306} The question of

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\item[304.] See Eidenmüller, supra note 299, cmts. 42-43 (qualifying the rules as corporate law); Forsthoff & Schulz, supra note 98, cmts. 40-47. But see Ulrich Huber, \textit{Gesellschafterdarlehen in der Inlandsinsolvenz von Auslandsgesellschaften, in EUROPÄISCHE AUSLANDSGESELLSCHAFTEN IN DEUTSCHLAND}, supra note 296, at 131-221 (arguing only the statutory rules (\textit{Novellen-Regeln}), but not the independent case law (\textit{BGH-Regeln}), should apply to foreign corporations); Ulmer, supra note 62, at 1207 (same); Weller, supra note 268, at 414 (same); Zöllner, supra note 94, at 6 (same). For Austria, see Sabine Donnmes et al., \textit{Die englische Private Company Limited in Österreich—Gesellschaftsrechtliche Fragen}, 15 \textit{STEUER UND WIRTSCHAFT INTERNATIONAL} 477, 484 (2005).
\item[305.] EIR, supra note 10, pmb., para. 6.
\item[306.] However, the German Ministry of Justice has recently proposed an amendment to German corporate and insolvency law that would make subordination an insolvency concept. This would (if implemented) apply to all business associations that do not have a personally
whether a Member State can apply such a provision to foreign corporations would have to be decided under the Gebhard criteria. In any case, it seems safe to say that certain rules could be recast to fall under the reach of the EIR directly by establishing a reasonable connection to insolvency proceedings, while the main thrust of the rule remains the same.

But where effective relabeling is feasible, is it truly desirable from the perspective of a Member State intending to implement its own policies for creditor protection? The above discussion of forum shopping in European bankruptcy law casts serious doubts on this proposition. The better relabeling works and the larger the field covered by bankruptcy law, the smaller the opportunistic gains that can be made by regulatory arbitrage in corporate law. However, on the flipside of the coin, the reduced significance of corporate law shopping increases the incentive to engage in ex post forum shopping in bankruptcy because shareholders and managers placing the case will have more to gain later on. In some situations, this may even be worse from the creditors’ point of view. Opportunistic bankruptcy forum shopping under the EIR may be more difficult to predict than corporate law shopping and cannot be prevented by contract. If such can be the outcome of relabeling, then one may question whether it is at all wise for policymakers to engage in it. It may even be detrimental to the position of creditors and thus raise the capital costs of firms. At the very least, advantages and disadvantages of ex post choice-of-law decisions in the two fields will need to be weighed against each other with respect to particular issues.

VI. CONCLUSION

Following Centros, all Member States now must essentially defer to private parties’ choices with regard to corporate law. This has

liable member who is a natural person. See MoMiG, supra note 94, at 20-21 (proposing InsO § 39(4)).

307. Creditors may sometimes be able to contractually reserve the right to replace the board of directors if certain specified events occur and then eventually take full control of the corporation, or they may practically have that power without a legally enforceable stipulation to this effect, which will prevent forum shopping ex ante. See Douglas G. Baird & Robert K. Rasmussen, Essay, Private Debt and the Missing Lever of Corporate Governance, 154 U. Pa. L. Rev. 1209, 1213-23 (2006). Needless to say, most creditors will be quite reluctant first to reserve and then to exercise this form of protection. Furthermore, where such a protection is exercised, this will benefit large financial creditors, whose interests may not coincide with other creditor groups.

308. See supra notes 56-64 and accompanying text.
already prompted regulatory arbitrage at the incorporation stage and, following positive harmonization efforts by the EC, may soon make it possible for existing companies as well. At the same time, the EIR has deeply affected regulatory interactions in the realm of insolvency law by increasing the opportunities for forum shopping. These two developments together have significantly reshaped the regulatory environment for the relationships between corporate debtors and their creditors.

This Article has provided a picture of such a post-Centros, post-EIR environment. We have shown that despite the positive harmonization efforts by the EC, creditor-protection regimes still differ across the EU, so that the regulatory surplus to be gained from (re)incorporations is still large enough. Regulatory arbitrage at the incorporation stage in order to escape minimum capital rules cannot yet be taken as evidence for a race to the bottom because such rules are outdated and provide no meaningful protection for creditors. We cannot rule out the possibility that companies engage in midstream reincorporations in order to exploit unsophisticated and nonadjusting creditors. However, in the absence of a European Delaware, the odds are against a U.S.-style, intense regulatory competition in this area of law.

While the incorporation doctrine has been imposed upon Member States with respect to corporate law, the EIR has de facto harmonized conflict-of-law rules in the insolvency domain by picking something close to the real-seat doctrine, i.e., the fuzzy COMI standard. When a corporation incorporated abroad to take advantage of more attractive corporate law rules goes bankrupt, the COMI's insolvency law will have to apply together with the incorporation State's corporate law. The EIR, with its emphasis on pure temporal priority for the opening of the main proceedings, provides incentives for a race to file between the corporate debtor and its creditors. This, in turn, might prompt some Member States to reform their insolvency laws so as to make them more favorable to managers and shareholders in order to attract insolvency business. In light of the relevant interest groups in action, we doubt that any Member State will have sufficient incentives to engage in broad-scope regulatory competition.

Still, the policy goal of protecting creditors prevalent in many Member States may tempt legislators to relabel corporate law rules so as to make them applicable to pseudo-foreign entities. However, relabeling requires insolvencification of the relevant doctrines, meaning that they will have to apply only within the insolvency
context and in close connection with the proceeding. Member States will then have to decide whether the benefits of having those doctrines (possibly duly tamed in order to pass the Gebhard test) applied to bankrupt foreign entities outweigh the costs (if any) of not being able to apply them to nonbankrupt domestic entities. Finally, as long as the EIR does allow forum shopping and hence insolvency law arbitrage, relabeling may increase the regulatory surplus a corporation can derive from forum shopping through an opportunistic switch of COMI. This may even increase the exposure of creditors to opportunistic conduct by shareholders and managers and thus increase the cost of debt for all companies with international operations. It is therefore doubtful whether relabeling is actually desirable from the Member States’ perspective.