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Issuer Choice in Europe

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October 2007

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The authors wish to thank Lucina Berger, Brian Cheffins, Eilís Ferran, Matteo Gatti, Martin Gelter and Amir Licht for helpful discussions about the issues covered in this paper. Opinions expressed in this article are exclusively the authors' and do not necessarily reflect those of Consob. Other usual disclaimers apply, while more comments are welcome.

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Abstract

Unlike the US, the European Union has a tradition of national securities laws significantly differing from each other. Regulatory idiosyncrasies largely remain today despite recent efforts aiming at more comprehensive harmonization. In addition, in important respects, the current conflict of laws rules contained in European Community securities laws bundle the choice of applicable securities laws with the issuer's registered office, while leaving some regulatory aspects to the law of the market where the issuer's securities are admitted to trading. Hence, to the extent that EU companies can choose their state of incorporation and trading location, they can also choose the applicable securities law among those in place in the 27 EU countries.

This paper scrutinizes the policy implications of the conflict of laws rules EC securities regulation has chosen in two scenarios: the present one, in which obstacles to companies mobility across the EU still make regulatory arbitrage in practice unavailable, and a prospective one in which these obstacles are removed.

We consider the bundling of securities laws with the issuer's registered office for conflict of laws purposes overall detrimental when corporate law arbitrage is unavailable. On the other hand, we argue that the impact of such rules is beneficial if companies can transfer their registered office without facing severe obstacles. Yet, we qualify our optimistic assessment by showing that bundling securities regulation and corporate law for conflict of laws purposes may have a negative impact on the dynamics of the market for corporate charters.

For the regulatory aspects that are governed by the law of the affected market (and specifically for securities law aspects of takeover regulation), we argue that already today issuer choice offers a broad variety of options and a separating equilibrium represents the likely outcome.

Keywords: securities laws, securities regulation, harmonization, conflict of laws, corporate law, corporate governance, regulatory competition, legal arbitrage, issuer choice, Financial Services Action Plan

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The authors wish to thank Lucina Berger, Brian Cheffins, Eilís Ferran, Matteo Gatti, Martin Gelter and Amir Licht for helpful discussions about the issues covered in this paper. Opinions expressed in this article are exclusively the authors' and do not necessarily reflect those of Consob. Other usual disclaimers apply, while more comments are welcome.

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I. INTRODUCTION

Regulatory competition is a salient feature of US federalism. The fifty States potentially serve as the rivalling jurisdictions' laboratories breeding constant legislative innovation.[1] The most vivid example of regulatory competition is the market for corporate charters.[2] Its contested impact on corporate law quality has sparked an intense and still lively academic debate at least since the 1970s.[3] The general contro-

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[1] The basic story was sketched out by Charles M. Thiebout, *A Pure Theory of Expenditures*, 64 J. POL. ECON. 416, 419-20 (1956) (devising a model where jurisdiction compete for citizens through the provision of public goods); on the innovative potential of federal structures, *see also* Brian R. Weingast, *The Economic Role of Political Institutions: Market Preserving Federalism and Economic Development*, 11 J.L. ECON. & ORG. 1 (1995). On the underlying idea of competition as a discovery process *see* FRIEDRICH AUGUST VON HAYEK, NEW STUDIES IN PHILOSOPHY, POLITICS, ECONOMICS AND THE HISTORY OF IDEAS 179-190 (1979).

[2] Early accounts of the States' competition for corporate charters can be found in WILLIAM C. COOK, A TREATISE ON STOCK AND STOCKHOLDERS, BONDS, MORTGAGES AND GENERAL CORPORATION LAW AS APPLICABLE TO RAILROAD, BANKING, INSURANCE 1604-5 (3rd ed., 1894); Edward Q. Keasby, *New Jersey and the Great Corporations*, 13 HARV. L. REV. 198, 201-2 (1899).

[3] For various facets of the complex debate see e.g. William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663 (1974) (arguing that Delaware's dominance evidences a race for the bottom); Ralph K. Winter, Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977) (maintaining that Delaware's responsiveness to the demands of incorporators makes for a race to the top); Roberta Romano, *Law As a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1985) (arguing that Delaware dominates the market because it offers an attractive and flexible mix of corporate law rules and also provides a credible commitment that it will continue to supply that mix of rules in the future); Lucian A. Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435 (1992) (arguing that Delaware's dominance accounts for a pro-managerial tilt in U.S. corporate law); Michael Klausner, *Corporations, Corporate Law, and Network of Contracts*, 81 VA. L. REV. 757, 842-47 (1995) (showing that Delaware benefits from positive network externalities like its extensive body of case law, its experienced administration and judiciary etc.); Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525 (2001) (finding that Delaware firms exhibit a higher valuation of 5 percent in terms of Tobin'q); Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679 (2002) (purporting that political and economic barriers prevent States from mounting a serious competitive chal-

versy regarding regulatory competition's merits has more recently extended to other areas of regulation,[4] including the adjacent territory of securities regulation. Here, some scholars have argued in favour of issuer choice of disclosure regulation,[5] while others have advocated upholding a mandatory regime.[6] Whatever the merits of issuer

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lenge to Delaware's monopoly); Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588 (2003) (arguing that Delaware's corporate law legislation and adjudictation was shaped by the permanent threat of Federal preemption); Oren Bar-Gill, Michal Barzuza & Lucian A. Bebchuk, *The Market for Corporate Law*, 62 J. INST. & THEO. ECON. 134 (2006) (devising a model that indicates that a dominant state has incentives to underprice its corporate law package and will favor managers' preferences).

[4] Other ambits of law where regulatory competition was recommended in light of the experience on the U.S. market for incorporations include, among others, bankruptcy law (*cf. e.g*. David A. Skeel, Jr., *Lockups and Delaware Venue in Corporate Law and Bankruptcy*, 68 U. CIN. L. REV. 1243, 1270-79 (2000) (assenting social benefits from liberal bankruptcy venue rules similar to those achieved in charter competition); Lynn M. LoPucki & Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a "Race to the Bottom"*, 54 VAND. L. REV. 231, 232-37 (2001) (arguing that contrary to charter competition forum shopping in U.S. bankruptcy law represents a race to the bottom)) as well as environmental law (*see* Richard L. Revesz, *Rehabilitating Interstate Competition: Rethinking the "Race-to-the-Bottom" Rationale for Federal Environmental Regulation*, 67 N.Y.U.L. REV. 1210 (1992) (advocating federalism in environmental law); Jonathan A. Adler, *Wetlands, Waterfowl, and the Menace of Mr. Wilson: Commerce Clause Jurisprudence and the Limits in Federal Wetland Regulation*, 29 ENVTL. L. 1, 44 (1999) (same); Daniel C. Esty, *Revitalizing Environmental Federalism*, 95 MICH. L. REV. 570, 633-34 (1996) (claiming differences in the mode of operation of competitive forces on the market for incorporations and in environmental regulation).

[5] *See e.g.* Stephen J. Choi & Andrew T. Guzman, *The Dangerous Extraterritoriality of American Securities Law*, 17 NW. J. INT'L L. & BUS. 207, 228-30 (1996) (advocating reduced extraterritoriality of US securities laws in order to allow for maximum regulatory choice of issuers); Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903, 941-45 (1998) (arguing for unrestricted mutual recognition of international disclosure regimes); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2362, 2418 (1998) (proposing that issuers be permitted to opt into both US States' and foreign nations disclosure regimes); Alan R. Palmiter, *Toward Disclosure Choice in Securities Offerings*, 1999 COL. BUS. L. REV. 1, 86-91 (1999) (restricting issuer choice to the selection of a primary market disclosure regime).

[6] Merritt B. Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom?*, 95 MICH. L. REV. 2498, 2582-85 (1997) (recommending a "issuer nationality approach" which would apply the disclosure standards of the issuers' jurisdiction of incorporation mandatorily); James D.Cox, *Regulatory Duopoly in US Securities Markets*, 99 COLUM. L. REV. 1200, 1237-43 (1999) (arguing that sacrificing SEC authority as the sole regulator would reduce its weight in international standard setting and conjure up enforcement deficiencies which loom under a regime of issuer choice); Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice is not Investor Empowerment*, 85 VA. L. REV. 1335, 1345-56 (1999) (holding that the divergence between managers' private benefits and social benefits derived from disclosure rules will induce suboptimal outcomes under a regime of issuer choice); *see also* John C. Coffee, Jr., *Racing Towards the Top?: The*

choice, a long-standing tradition of pre-emptive Federal legislation[7] makes any attempt to change the allocation of regulatory power between the federal government and the states a political non-starter. Similarly, as a practical matter issuer choice represents a rather remote policy option with regard to foreign securities.[8]

The European situation has traditionally looked quite differently. Until recently, regulatory competition in corporate law was basically ruled out in practice, while, unlike the US, securities regulation has always been a matter for the Member States.

After the European Court of Justice (hereinafter: ECJ) rendered its now famous rulings in the *Centros*,[9] *Überseering*,[10] and *Inspire Art*[11] cases, which effectively prescribe mutual recognition of corporations established under the law of a

Impact of Cross-Listings and Stock Market Competition on International Corporate Governance, 102 COLUM. L. REV. 1757, 1827-29 (2002) (arguing for "exitless" competition, i.e. a regime where issuers cannot escape their home jurisdiction's regulation but opt into stricter standards by cross-listing their shares).

[7] *Cf.* Securities Act of 1933, 15 U.S.C. §§77a et seq. (2005); Securities Exchange Act of 1934, 15 U.S.C. §§78a et seq. (2005).

[8] To be sure, already today, reporting obligations under US securities laws contain many exemptions for foreign private issuers. *See e.g.* Rules and Regulations under the Securities Exchange Act of 1934, Rule 13a-16(b), 17 C.F.R. §240.13a-16(b) (2006); Form 6-K sub B, §17 C.F.R. §249.306 (2006) (exempting foreign private issuers from quarterly reporting obligations); Rule 13a-11(b), 17 C.F.R. §240.13-11(b) (2006) (no duty to file current reports of significant events for foreign private issuers). Yet, most of these exemptions do not permit issuer choice. Put briefly, US securities laws generally submit foreign private issuers to a less stringent regime compared to domestic issuers, but this regime is still mandatory. True issuer choice is only permitted within very narrow limits: foreign private issuers can choose to prepare their financial statements in accordance with US Generally Accepted Accounting Principles (GAAP) or can stick with their home country accounting methodology in which case they have to reconcile their financial statements with US GAAP. *See* Form 20-F, Items 17 and 18, 17 C.F.R. §240.220f (2006).

[9] Case C-212/97 *Centros Ltd. v. Erhvervs- og Selskabsstyrelsen*, 1999 E.C.R. I-1459.

[10] Case C-208/00 *Überseering BV v. Nordic Construction Company Baumanagement GmbH*, 2002 E.C.R. I-9919.

[11] Case C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd.*, 2003 E.C.R. I-10155.

Member State of the European Union (hereinafter: EU), regulatory competition is starting to gain ground in EU corporate law as well.[12]

At the same time, notwithstanding recent efforts at more pervasive and effective harmonization at the supranational level, national securities laws still vary considerably across the EU. Further, recent European Community (hereinafter: EC) directives have harmonized conflict of laws rules in securities laws, often linking the applicable securities law regime to a company's registered seat. As a consequence, and leaving aside the still relevant obstacles to reincorporations, in the EU there is now greater room for regulatory arbitrage[13] also in securities law.[14]

Scholars have scrutinized regulatory competition as a general alternative to comprehensive harmonization in the EU.[15] In particular, the prospects for a European race for incorporations and the policy implications of enhanced corporate mobility in the wake of the ECJ judgements have attracted extensive examination.[16] In

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[12] *See e.g.* John Armour, *Who Should Make Corporate Law? EC Legislation versus Regulatory Competition*, *in* AFTER ENRON – IMPROVING CORPORATE LAW AND MODERNISING SECURITIES REGULATION IN EUROPE AND THE US 497 (John Armour & Joseph A. McCahery eds., 2006).

[13] While are aware that the term is sometimes used with a negative connotation to describe a race to the bottom-like outcome of issuer choice (*see e.g.* Amir N. Licht, *Regulatory Arbitrage for Real: International Securities Regulation in a World of Interacting Securities Markets*, 38 VA. J. INT'L L. 563, 567, 636 (1998); Ethiopis Tafara & Robert J. Peterson, *A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework*, 48 HARV. INT'L L.J. 32, 52 (2007)), we use it here in a neutral sense to describe issuers' choosing their securities law environment deliberately to obtain gains from regulation, whether because this allows insiders to extract higher rents to the detriment of outside investors or because, to the contrary, it better protects the latter and allows to reduce issuers' cost of capital. Further, it is worth clarifying that regulatory arbitrage is different from, and does not necessarily coexist with, regulatory competition, because issuers may engage in the former even in the absence of states' competition to attract them with a "better" regulatory environment. *See generally* Stephen Woolcock, *Competition among Rules in the Single European Market*, *in* INTERNATIONAL REGULATORY COMPETITION AND COORDINATION – PERSPECTIVES ON ECONOMIC REGULATION IN EUROPE AND THE UNITED STATES 289, 298 (William W. Bratton et al. eds., 1996).

[14] *See also* EILÍS FERRAN, BUILDING AN EU SECURITIES MARKET 56 (2004) (hinting at a conceivable connection between corporate mobility and securities law arbitrage).

[15] *See e.g.* Jeanne-May Sun & Jaques Pelkmans, *Regulatory Competition in the Single Market*, 33 J. COMMON MKT. STUD. 67 (1995); Woolcock, *supra* note 13.

[16] *E.g.* Klaus Heine & Wolfgang Kerber, *European Corporate Laws, Regulatory Competition and Path Dependence*, 13 EUR. J.L. & ECON. 47 (2002); Klaus Heine, *Regulatory Competition between Company Laws in the European Union: the Überseering-Case*, 38 INTERECON. - REV. EUR.

this paper we contribute to the debate on regulatory competition in securities and corporate law by analyzing recent European securities legislation with regard to the legal arbitrage potentials it contains and the policy consequences that issuers' choice of law decisions may entail.

Our paper is structured as follows. We start by describing the core features of EC securities regulation. In light of this paper's focused objective we confine our analysis to the current EU securities law framework which represents the implementation of the EU Commission's Financial Services Action Plan (hereinafter: FSAP).[17] (Part II). Next, we identify the relevant criteria under the conflict of laws rules contained in the FSAP implementing directives. To facilitate the appraisal of the these rules we initially provide a brief survey of the European international private law rules which governed prior to the implementation of the FSAP. In our main analysis of the recently promulgated directives we show an important parallelism of conflict of laws rules in EU corporate and securities laws:[18] with due exceptions, such rules apply identical criteria in both areas (Part III). Having thus established the basis, we assess the potential for issuer choice in European securities laws thereby distinguishing two scenarios: one in which the transfer of an existing company's registered of-

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ECON. POL'Y 102 (2003); Luca Enriques, *EC Company Law and the Fears of a European Delaware*, 15 EUR. BUS. L. REV. 1259 (2004); Tobias H. Tröger, *Choice of Jurisdiction in European Corporate Law – Perspectives of European Corporate Governance*, 6 EUR. BUS. ORG. L. REV. 3 (2005); Martin Gelter, *The Structure of Regulatory Competition in European Corporate Law*, 5 J. CORP. L. STUD. 247 (2005); Christian Kirchner, Richard W. Painter & Wulf A. Kaal, *Regulatory Competition in EU Corporate Law after Inspire Art: Unbundling Delaware's Product for Europe*, 2 EUR. COMP. & FIN. L. REV. 159-206 (2005); Eva-Maria Kieninger, *The Legal Framework of Regulatory Competition Based on Company Mobility: EU and US Compared*, 6 GERMAN L.J. 740 (2005); Luca Enriques & Martin Gelter, *How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law*, 81 TUL. L. REV. 577 (2007).

[17] Communication of the Commission, Financial Services: Implementing the Framework for Financial Markets: Action Plan, COM (1999) 232 (May 11, 1999).

[18] The relevance of the FSAP implementing directives stretches beyond EU Member States. They are also binding for the Member States of the European Economic Area (E.E.A.) and have to be incorporated into these jurisdictions' domestic law in accordance with the Agreement on The European Economic Area, art. 7, 1994 O.J. (L 1) 3, 9. Terminologically, we do not explicitly refer to

fice is materially impeded, the other where existing firms' can easily engage in company and securities law arbitrage. We also scrutinize legal arbitrage implications where choice of law does not require the transfer of the issuer's registered office, to wit in the context of takeover regulation. (Part IV). Finally, we conclude (Part V).

II. THE EC FRAMEWORK OF CAPITAL MARKET REGULATION

This part provides some background information to allow a reader unfamiliar with EC securities law to better gauge the potentials for legal arbitrage within the EU. After providing a few basic concepts of EC law which account for its still scattered and fragmentary nature, this Part briefly describes the EC achievements in the area of securities law harmonization, focusing on the most recent wave of EC measures.

A. EC Powers and Instruments of Securities Law Harmonization

The EC is competent to harmonize national securities laws of its Member States under the EC-Treaty as a means to further an integrated common market.[19] The instruments at its hand are regulations and directives.[20] While European regulations contain binding law directly applicable in each Member State, directives only prescribe the goals of harmonization but leave the form and method of their implementation to the Member States' discretion.[21]

E.E.A. Member States in this paper, although the substantive content of our deliberations extends to them as well.

[19] Consolidated Version of the Treaty Establishing the European Community, artt. 44(1), 2006 O.J. (C 321) 37, 59 [hereinafter EC Treaty]. Although the procedure for the adoption of specific measures has changed over time, the European legislative was endowed with this competence since the Community's establishment, *see* Treaty Establishing the European Economic Community, Mar. 27, 1957, art 54(2), 298 U.N.T.S. 3. *See generally* NIAMH MOLONEY, EC SECURITIES REGULATION 5-10 (2002).

[20] EC Treaty, art. 95.

[21] *See* EC Treaty, art. 249. To be sure, often directives contain precise and detailed rules, which however Member States still have to translate into national law rules.

Despite these apparent regulatory limits, the earliest steps toward securities law harmonization pointed towards a comprehensively harmonized, unitary European capital market under the supervision of a single supranational authority.[22] Yet, such ambitious plans were dropped after the U.K. joined the EC in favour of an approach which pursued a close integration of national securities markets but upheld their principal autonomy.[23] Accordingly, a patchy European legislation targeted only certain aspects of capital market regulation that seemed particularly critical in approximating Member States securities laws, namely the conditions for admission to the primary market segment of stock exchanges,[24] the information to be published when such listing is sought,[25] the interim reporting duties of companies admitted to such listing,[26] the transparency requirements when significant shareholdings are assembled in listed companies,[27] the obligation to publish a prospectus when securities are offered to the public,[28] and the regulation of insider trading.[29] Most of this initial

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[22] Report of a Group of Experts Appointed by the EEC Commission, The Development of a European Capital Market (Nov. 1966) (Segré Report) *available at* http://ec.europa.eu/economy_finance/emu_history/documentation/chapter1/19661130en382develeurocapitm_a.pdf.

[23] For this change in policy goals *see* RICHARD M. BUXBAUM & KLAUS J. HOPT, LEGAL HAMONIZATION AND THE BUSINESS ENTERPRISE 1-23, 280-83 (1988).

[24] Council Directive 79/279/EEC of 5 March 1979 coordinating the conditions for the admission of securities to official stock exchange listing, 1979 O.J. (L 66) 21-32

[25] Council Directive 80/390/EEC of 17 March 1980 coordinating the requirements for the drawing up, scrutiny and distribution of the listing particulars to be published for the admission of securities to official stock exchange listing, 1980 O.J. (L 100) 1-26 [hereinafter Listing Particulars Directive].

[26] Council Directive 82/121/EEC of 15 February 1982 on information to be published on a regular basis by companies the shares of which have been admitted to official stock-exchange listing, 1982 O.J. (L 48) 26-29.

[27] Council Directive 88/627/EEC of 12 December 1988 on the information to be published when a major holding in a listed company is acquired or disposed of, 1988 O.J. (L 348) 62-65.

[28] Council Directive 89/298/EEC of 17 April 1989 coordinating the requirements for the drawing- up, scrutiny and distribution of the prospectus to be published when transferable securities are offered to the public, 1989 O.J. (L 124) 8-15 [hereinafter Public Offerings Directive].

[29] Council Directive 89/592/EEC of 13 November 1989 coordinating regulations on insider dealing, 1989 O.J. (L 334) 30-32.

legislation was later consolidated into a single directive[30] and soon later largely superseded by more ambitious harmonization measures.

B. The FSAP and its Implementation.

To achieve a higher degree of financial markets integration, in 1999 the European Commission issued a plan to further and more effectively harmonize EU securities laws, the FSAP. The plan was complemented by a new structure in the legislative practice which relies on principal directives promulgated under the traditional, multi-institutional procedure[31] spelling out the central objects of the harmonizing measures but leaving the details to directives devised by the Commission in order to speed up the regulatory process and ensure a higher degree of adaptability of EC provisions.[32] The FSAP was implemented in the first years of this decade through a number of legislative measures regulating or re-regulating financial services, securities markets, and corporate governance.[33] Among them are four core components of the EC securities regulation framework, the Prospectus Directive,[34] the Takeover Bids Directive,[35] the Transparency Directive,[36] and the Market Abuse

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[30] Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on admission of securities to official stock exchange listing and on the information to be published on those securities, 2001 O.J. (L 184) 1-66 [hereinafter Consolidated Admission and Reporting Directive].

[31] The adoption of a directive requires the European Parliament and the Council to consent to the Commission's proposal. *See* EC Treaty, artt. 95, 251.

[32] This regulatory practice draws on the recommendations of an expert group appointed by the European Commssion .*See* The Committee of Wise Men, The Regulation of European Securities Markets: Final Report (2001) [Lamfalussy Report] *available at* http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf; For a detailed description of the regulatory process *see* FERRAN, *supra* note 14, at 61-84.

[33] *See* Luca Enriques & Matteo Gatti, *Is There a Uniform EU Securities Law After the Financial Services Action Plan?* 1-2 (Working Paper, 2007) *available at* http://ssrn.com/abstract=982282 (last visited October 25, 2007).

[34] Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC, 2003 O.J. (L 345) 64-89 [hereinafter Prospectus Directive].

[35] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids, 2004 O.J. (L142) 12-23 [hereinafter Takeover Bids Directive].

Directive.[37] Because our analysis later focuses on these legislative measures, we provide a brief overview of their contents here with particular regard to the arbitrage potentials they leave.

1. The Prospectus Directive. Since the early days of securities law harmonization, EC legislation was inspired by the U.S. approach[38] and regarded transparency requirements in primary markets as a cornerstone of adequate capital market regulation.[39] Yet, the Prospectus Directive together with its implementing measures under the Lamfalussy architecture, with its ambitious goal of maximum harmonization, clearly marks a peak in the EC's regulation of mandatory disclosure to primary markets.[40] The directive leaves Member States with little maneuvering space with regard to the implementation of the Directive's substantive provisions.[41] Yet, despite the maximum harmonization approach, legal arbitrage with regard to primary market

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[36] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, 2004 O.J. (L 390) 38-57 [hereinafter Tansparency Directive].

[37] Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), 2003 O.J. (L 96) 16-25 [hereinafter Market Abuse Directive].

[38] Essentially, § 5 of the Securities Act of 1933, 15 U.S.C. §77e (2005) enjoins issuers from conducting public offerings to U.S. investors prior to filing a registration statement complying with §§ 6, 7 of the Securities Act of 1933, 15 U.S.C. §§77f, 77g (2005) with the SEC.

[39] *See* Listing Particulars Directive, art. 1(1) (prescribing initial disclosure with regard to securities admitted to official stock exchange listing); Public Offerings Directive, art. 1(1) (requiring prospectuses for any public offering of securities). Although the Consolidated Admissions and Reporting Directive, artt. 20-34 still restricted the obligation to publish listing particulars to issuers seeking admission of securities to official stock exchange listing, this was without prejudice to the general prospectus duties applying to any public offering of securities.

[40] Aligned with international disclosure standards (*see* International Organization of Securities Commissions, International Disclosure Standards for Cross-Border Offerings and Inititial Listings by Foreign Issuers (1998) *available at* http://iosco.org/library/pubdocs/pdf/IOSCOPD81.pdf (last visited October 25, 2007)), prospectuses for any kind of security must contain detailed statements about the offered securities, the intended use of the proceeds, the nature and performance of the issuer's business as well as the identity of managers and large blockholders. For details *see* Prospectus Directive, art. 5 and Annex I; Comission Regulation (EC) 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements, artt. 3-28, 2004 O.J. (L 149) 1.

disclosure will continue to play a considerable role with regard to some substantive aspects that are still left to Member States, chief among them the liability regime for false statements in prospectuses.[42] Moreover, significant arbitrage potential follows from national variations in the uniform rules' administration and enforcement.

2. The Takeover Bids Directive. Tender offers represent a critical moment in firm history and create various opportunities to exploit the firm's constituents.[43] Hence, no major jurisdiction leaves the market for corporate control entirely unregulated. As a consequence, leveling the playing field by harmonizing Member States' takeover laws represented a long pursued goal of the EC lawmakers.[44] Yet, with more ambitious attempts to achieve uniformity falling flat in Parliament,[45] the finally adopted version of the Directive leaves important aspects of takeover regulation for the Member States to determine at their discretion. Besides the threshold percentage which determines when a mandatory bid has to be made and its calculation,[46] it is particularly the optional character of the restrictions for the target's board in fending off hostile bids and of the break through-rule that suspends voting caps and transfer restrictions under certain conditions,[47] which allows for significant divergence of Member States' substantive law.[48] As a consequence, existing idiosyncrasies of pivotal parts of Member States' takeover laws still persist, retaining significant potential for legal arbitrage in the field.

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[41] For this assessment *see* FERRAN, *supra* note 14, at 143.

[42] *See* Enriques & Gatti, *supra* note 33, at 10-12 (detailing the various issues that the Prospectus Directive leaves to Member States).

[43] For an overview *see* Roberta Romano, *A Guide to Takeovers: Theory, Evidence, and Regulation*, 9 YALE J. REG. 119 (1992); STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 612-22 (2002).

[44] The Commission first announced its intention to propose a Directive in 1985. *See* European Commission, *Completing the Internal Market: White Paper from the Commission to the European Council*, at 35, COM (1985) 310 (June 14, 1985).

[45] On the reasons for this failure *see* FERRAN, *supra* note 14, at 116-17.

[46] Takeover Bids Directive, art. 5(3)).

[47] *Id.*, art. 9, 11 and 12.

[48] For a more comprehensive overview *see* Enriques & Gatti, *supra* note 33, at 17-19.

3. The Transparency Directive. The Transparency Directive performs the same regulatory function for EU secondary markets that can be attributed to the Prospectus Directive with regard to the Community's primary markets, in a sense mirroring the division of labor familiar from the US Securities Act of 1933[49] and the Securities Exchange Act of 1934.[50] The cornerstones of the Directive's periodic information requirements are issuers' duties to publish annual financial reports[51] as well as half-yearly interim financial reports,[52] and the obligations to disclose the acquisition and disposal of major shareholdings.[53] Yet, while the Prospectus Directive largely preempts Member States' idiosyncratic systems of primary market information, the Transparency Directive only puts up minimum standards which Member States may intensify.[54] Hence, differentiation among Member States with regard to the Transparency Directive's disclosure obligations is still possible. Moreover, private law liability for false or misleading statements, public enforcement of the directives disclosure obligations, and criminal sanctioning do not fall within the scope of the directives program of substantive harmonization.[55]

4. The Market Abuse Directive. The Market Abuse Directive[56] aims at policing manipulative and abusive practices which potentially can be deployed by corporate insiders as well as any other market agent. Hence, not only the prohibition of

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[49] 15 U.S.C. §§77a et seq. (2005).
[50] 15 U.S.C. §§78a et seq. (2005).
[51] Transparency Directive, art. 4.
[52] *Id.*, art. 5.
[53] *Id.*, art. 9.
[54] The important facet of the pertinent rule is that it conforms to the home-state rule of the Transparency Directive's conflict of laws rules (*cf. infra* 2.): only the home Member State, *i.e.* the jurisdiction whose substantive law principally governs, can tighten the ongoing disclosure requirements, while the host Member State has to recognize the incorporation domicile's standards without modification. See Transparency Directive, art. 3.
[55] Enriques & Gatti, *supra* note 33, at 22.
[56] Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse) [Market Abuse Directive], 2003 O.J. (L 96) 16-25.

trading on inside information[57] and the ban on market manipulation[58] but also the preemptive obligation to immediately disclose, under certain conditions, inside information with relevance to the price of an issuer's financial instruments (so-called *ad hoc* disclosures),[59] represent prototypical market regulation. Although the Market Abuse Directive in principle allows Member States to promulgate stricter rules governing their markets, EU implementing regulations[60] narrowed this leeway significantly and effectively rendered the EU framework a maximum harmonization regime. Yet again, national differences survive with regard to the liability regime governing infringements of the directive's proscriptions and its enforcement in general.[61]

C. *Measuring the Room for Securities Law Arbitrage in the EU: A Tentative Assessment*

Our brief survey indicates that, contrary to the US, securities regulation is still chiefly a matter of national law in the EU. In fact, despite ever more far-reaching efforts at harmonizing European capital market regulation that definitely made national laws more similar, the still patchy and incomplete character of EC se-

[57] Market Abuse Directive, artt. 2-4.

[58] Market Abuse Directive, art. 5.

[59] Market Abuse Directive, art. 6. For the Directive's definition of inside information *cf.* Market Abuse Directive, art. 1(1) and Commission Directive 2003/124/EC of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the definition and public disclosure of inside information and the definition of market manipulation, art. 1, 2003 O.J. (L 339) 70.

[60] For the implementation of the Market Abuse Directive *see* Commission Directive 2003/124/EC of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the definition and public disclosure of inside information and the definition of market manipulation, 2003 O.J. (L 339) 70-72; Commission Directive 2003/125/EC of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest, 2003 O.J. (L 339) 73-77; Commission Directive 2004/72/EC of 29 April 2004 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards accepted market practices, the definition of inside information in relation to derivatives on commodities, the drawing up of lists of insiders, the notification of managers' transactions and the notification of suspicious transactions, 2004 O.J. (L 162) 70-75.

[61] See Enriques & Gatti, *supra* note 33, at 15.

curities law and the fact that its private and public enforcement is almost purely a matter for the Member States mean that differences in national securities law regimes are still significant. Commentators have correctly located the regulatory framework in the EU as settled somewhere in the middle between unimpeded competition and comprehensive harmonization:[62] it exhibits indeed potential for legal arbitrage above the common rules and standards stipulated in the capital market directives.[63] In sum, unless private international law rules or other factors prevent it, the substantive law framework leaves plenty of scope for regulatory arbitrage by issuers. We now turn to conflict of laws rules to understand whether this is the case.

III. The Conflict of Laws Rules in the FSAP-Implementing Measures and their Predecessors

This part describes the conflict of laws rules of the FSAP implementing directives. By introducing the relevant provisions we set the stage for our further analysis of the scope for issuer choice in the EU and the ensuing policy implications. First, however, we briefly review the international private law regime governing European cross-border securities transactions prior to the promulgation of the FSAP-regulatory framework and highlight the shortcomings of this regime. This will help us in the appraisal of the new rules in Part IV.

But why has EC securities law intervened in the field of conflict of laws rules to begin with? National conflict of laws rules in this area are typically a function of

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[62] With particular regard to securities regulation Ferran, *supra* note 14 *at* 54 (noting that from the European perspective, dividing "harmonization and regulatory competition into diametrically opposing camps seems rather wide of[f] the mark"); *see also generally* Sun & Pelkmans, *supra* note 15, at 88 (highlighting the complementary relationship); Woolcock *supra* note 15, at 296 (same).

[63] Obviously, this finding raises an important policy question we will not address here directly: whether EU policy-makers hit the right balance between promulgating mandatory securities law to correct market failures on the one hand and affording sufficient latitude for competitive forces to develop their beneficial functions on the other. Yet, our findings relating to prospective developments under the current legal framework are important as the starting point for a more general assessment which scrutinizes policy alternatives more categorically.

the public nature of securities laws that reflect a certain polity's conception of adequate capital market regulation.[64] Thus, absent coordination, jurisdictions traditionally follow the "affected market" principle, i.e. each of them applies its securities law to transactions having a territorial connection to it (*e.g.* offerings targeted to the state's residents, listings in one of the states' exchanges, and so forth). This has two implications for issuers engaging in cross-border transactions. First, they are required to comply with a plurality of legal regimes, thus raising the costs of such cross-border activity (the multi-jurisdiction problem).[65] Second, the affected market principle potentially hampers the policy goal of unfettered competition between EU securities markets[66] and the envisioned free movement of capital within the common market.[67] In fact, issuers from one Member State cannot conduct transactions in another Member State (*e.g.* offer securities to the public there) without subjecting themselves concurrently to this Member State's legal regime. In other words, issuers from one Member State wishing to tap another Member State's capital market have to buy the pertinent market's legal environment, too, again with higher costs for such cross-border activity (bundling problem).

To the extent that the law is an obstacle to the EC's goal of integrating European securities markets, it is easy to justify harmonized conflict of laws rules tackling the multi-jurisdiction and the bundling problems.

A. The Pre-FSAP Conflict of Laws Rules

Whether explicitly or implicitly, prior to the FSAP-implementing measures, conflict of laws rules with regard to European securities regulation followed the traditional affected market rule: the legal regime of the market being affected most eminently governed the pertinent conduct or transaction. Hence, in the context of

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[64] For this public interest view of securities law-making, *see e.g.* Licht, *supra* note 13, at 565.
[65] *See e.g.* Enriques & Gatti, *supra* note 33, at 2.
[66] EC Treaty, art. 4.

exchange-traded securities, admission to a certain market in principle determined the applicability of the law of the Member State where the exchange was situated as well as its administration by the Member State's securities regulator.[68] As a consequence, the affected market rule gave rise to multiple-jurisdiction problem, i.e. multiple national laws would apply to any transaction conducted in more than one Member State (*e.g*. pan-European IPOs) or to issuers with multiple listings.

On the other hand, issuers wishing to escape their home Member State's securities laws could make their choice of law decision simply by seeking registration of their securities abroad. Yet, such an opt-out made it more difficult for issuers to avoid multi-jurisdiction problems and still openly tap domestic capital markets,[69] arguably the ones where security offerings, due to higher investor recognition,[70] promise the largest success. Generally speaking, issuers could not reconcile multi-market trading with the choice of a single securities law regime. Moreover, issuers in search of a suitable non-legal infrastructure, even if they were willing to limit them-

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[67] EC Treaty, art. 56(1).

[68] For a manifestation of these largely unwritten rules *see e.g*. Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on admission of securities to official stock exchange listing and on the information to be published on those securities, artt. 2(1), 3(1), 11(1), 105 [hereinafter Consolidated Admissions and Reporting Directive] (primary and secondary market disclosure obligations according to the law and administered by the competent authority of the Member State where admission to official listing occurred or is sought); generally on the implicit pre-FSAP conflict of laws rules MOLONEY, *supra* note 19, at 100-102, 159, 160-61, 172, 767.

[69] *See e.g.* Consolidated Admission and Reporting Directive, art. 37 (declaring applicable – for prospectus purposes – the law of the Member State of the registered office in case of simultaneous applications for official listing). The only conceivable way to offer securities admitted to official listing on the issuer's home market without becoming subject to the initial disclosure obligations of the law of the home Member State was under the Directive's safe-harbor provisions. However, these safe-harbours did not concede offering equity-securities to raise fresh capital. *See* Consolidated Admission and Reporting Directive, art. 23. Hence, issuers wishing to avoid multi-jurisdiction problems were compelled to avoid official listing in their home Member State and could sell their securities to domestic investors only by making use of the Public Offerings Directive's exemptions. *See infra* note 116 and accompanying text.

[70] *Cf*. Robert C. Merton, *A Simple Model of Capital Market Equilibrium with Incomplete Information*, 42 J. FIN. 483, 494 (1987) (showing that a firm's investor base is correlated to investors knowing about the security).

selves to transacting only on one market, had to take the selected market's legal institutional environment into account.

Hence, while pre-FSAP conflict of laws rules allowed for some legal arbitrage with regard to securities regulation under the affected market principle, they failed to address the bundling and the multiple-jurisdiction problems.

B. The Prospectus Directive

As a fundamental regulatory principle, administrative competence determines the applicable substantive law, relieving competent authorities of the burden to administer foreign law. Hence, as a general rule, the Prospectus Directive provides that public offerings and admissions to trading (i) are reviewed by the regulator of the Member State where the issuer has its registered office (home State[71]) and (ii) for matters covered by the Directive itself, are subject to the law of their home State,[72] no matter where the offering is conducted, that is, even if the offering is made abroad and no local investor is solicited.[73] However, this rule does not apply with respect to offers of non-equity securities with a nominal value higher than Euro 1,000 and certain derivatives. In this case the issuer can choose to select among the law of its State of incorporation, of the place of listing or of the place where the offer is made to the

[71] Prospectus Directive, art. 2(1)(m)(i).

[72] Prospectus Directive, art. 21(1) requires Member States to concentrate the administrative powers conferred by the Directive in the hands of one competent authority (*see also* Prospectus Directive, recital 37). The designated administrative body has the competence to review the prospectus prior to its publication, Prospectus Directive, art. 13. This regulation of administrative competence implies the pertinent conflict of laws provision, as the competent authority is supposed to automatically apply its domestic law.

[73] The Prospectus Directive's predecessors were more lenient in this respect, *see supra* note 68). Issuers seeking multiple listings or conducting a plurality of offerings outside of the Member State of their registered office simultaneously could choose any of the competent authorities in the Member States where they developed their activities. Hence, the multiple-jurisdiction problem was somewhat attenuated in these cases. *See* Public Offerings Directive, art. 20; Consolidated Admission and Reporting Directive art. 37. In contrast, the Listing Particulars Directive based administrative competence and the choice of applicable law solely on the location of the exchange to which admission was sought. *See* Listing Particulars Directive, art. 24.

public.[74] The "home State" of non-EU issuers of equity or low denomination debt is, on the other hand, the Member State in which the issuer (or the offeror or the person seeking admission to trading) first[75] makes an offer of such securities to the public or first applies for the admission of such securities to trading.[76]

An important qualification has to be mentioned: for purposes of the Prospectus Directive depositary receipts (DRs) are considered non-equity securities.[77] More importantly, the depositary institution – and not the issuer of the underlying shares – will be regarded as the issuer subject to the obligations laid out in the Directive.[78] As a consequence, with relative ease issuers can use DR-facilities for choice of law purposes: depositing shares with an institution registered in the designated Member State and having it offer the receipts to the market will lead to the application of the law on prospectuses and public offerings in force in the depositary's Member State.[79] Hence, a Danish issuer of shares can relatively easily opt for the U.K. regulation of primary markets by depositing shares with a U.K. depositary bank even if the receipts are to be offered only on Danish markets.

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[74] The rationale behind this rule of issuer choice may be seen in positive network externalities. Both London and Luxemburg emerged as the centers of bond and derivative issuance activities in the EU. As a consequence, local supervisory authorities could gain significant expertise in dealing with such issuances which would be inaccessible for foreign issuers if the administrative competence for the pertinent issuances was invariably tied to the issuer's Member State of incorporation. For a critical assessment *see* FERRAN, *supra* note 14, at 174-75.

[75] After the deadline set forth in the Directive of December 31, 2003. *Cf.* Prospectus Directive, art. 2 (1)(m)(ii), 32.

[76] Prospectus Directive, art. 2(1)(m)(ii)(iii).

[77] Prospectus Directive, recital 12.

[78] *See* Committee of European Securities Regulators (CESR), Frequently asked questions regarding Prospectuses: Common Positions agreed by CESR Members, Question No. 30 (Ref. CESR/07-110, Feb 16, 2007) *available at* http://www.cesr-eu.org (last visited October 25, 2007).

[79] DRs should be treated as non-denomination securities covered exclusively by Prospectus Directive, art. 2(1)(m)(i). Yet, our conclusion even holds if the underlying shares' par value – in case they have one – is considered as the DR's "denomination". If DRs thus have a "denomination" above Euro 1,000 the depositary institution will have the choice provided for in Prospectus Directive, art. 2(1)(m)(ii). Hence, even if the DRs are to be offered on the equity markets situated in the Member State where the issuer of the underlying shares has its registered office, the applicability of the law of this Member State can still be avoided by choosing the home state accordingly.

C. The Takeover Bids Directive

The Takeover Bids Directive contains two distinct conflict of laws provisions. This bifurcated approach tries to separate matters relating substantively to corporate law from those relating to securities regulation. It will only lead to a divergence in applicable law if the issuer does not maintain a listing in the Member State where it has its registered office.

On the one hand, certain significant matters in connection with the mandatory bid system, namely the definition of control to be adopted as threshold for the mandatory bid and the safe-harbors and exemptions to the duty to make such bids shall be determined by the law of the Member State in which the target has its registered office.[80] In the same vein, the law of the target's State of incorporation shall apply with regard to the permissible defensive tactics in a takeover situation.[81]

On the other hand, for the transparency-related issues[82] and the procedural duties under the Takeover Bids Directive in general, as well as for the price at which mandatory bids must be made, the EC legislature identified the place of listing as the connecting factor: issuers and market participants are subject to the law of the State where securities are admitted to trading on a regulated market.[83]

In case of tender offers for shares of a European company having multiple listings in Europe, the Takeover Bids Directive makes an offeror subject to the disclosure, procedural and price-related rules of the target company's home Member State if the shares are listed on the home market[84], while, in case shares are not listed on the target's home market, to the rules of the host Member State where the shares

[80] Takeover Bids Directive, artt. 4(2)(e), 5(3).

[81] Takeover Bids Directive, art. 4(2)(e).

[82] The information of the target's employees, however, is subject to the law of the Member State where the target has its registered office, Takeover Bids Directive, art. 4(2)(e).

[83] Once again, the applicability of the pertinent Member States substantive law is a consequence of the competence of its administrative authority. *See* Takeover Bids Directive, art. 4(2)(e) and Takeover Bids Directive, art. 4(2)(a)-(c).

[84] Takeover Bids Directive, art. 4(2)(a) and (e).

were first admitted to trading;[85] in case the multiple listings occurred simultaneously, companies may choose the competent authority on the first day of trading.[86]

D. Transparency Directive

The Transparency Directive contains conflict of laws principles similar to the Prospectus Directive's.[87] Following the allocation of administrative competence,[88] issuers are subject to the law of their home Member State, which for EU issuers of shares or of low denomination (*i.e.* less than Euro 1,000) debt securities is the State of incorporation.[89] For non-EU issuers of equity or low denomination debt securities, the "home State" is determined according to the principles set forth in the Prospectus Directive.[90] An issuer of high denomination debt securities admitted to trading on a EU regulated market is subject to the special regime familiar from the pertinent rules of the Prospectus Directive.[91]

In light of the legal arbitrage potential associated with depositary receipt offerings,[92] it is important to note that it is the issuer of the underlying shares and not the depositary institution that is subject to the reporting duties under the Transparency Directive.[93] Hence, while opting into any Member States' disclosure system at

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[85] Takeover Bids Directive, art. 4(2)(b) and (e).

[86] Takeover Bids Directive, art. 4(2)(c) and (e).

[87] In fact, Transparency Directive, art. 24(1) obliges Member States to designate the administrative authority competent under the Prospectus Directive as responsible body for carrying out the obligations provided for in the Transparency Directive and for ensuring that the provisions adopted pursuant to the Directive are applied.

[88] *Cf.* Transparency Directive, artt. 19(1), 21(1).

[89] Transparency Directive, art. 2(1)(i)(i), first indent.

[90] Therefore, it will be, at the choice of the issuer, the Member State in which it first made (after 31 December 2003) an offer of such securities to the public or first applied for the admission of such securities to trading. *See* Transparency Directive, art. 2 (1)(i)(i), second indent; Prospectus Directive, art. 2(1)(m)(iii).

[91] *See* Transparency Directive, art. 2, (1)(i)(ii) which accords with Prospectus Directive, art. 2(1)(m)(ii). For the reasons of this separate treatment of high-denomination debt *see* FERRAN, *supra* note 14, at 174 (identifying Europe's pre-eminent bond-markets' lobbying efforts as the driving force).

[92] *Supra* B.

[93] *Cf.* Transparency Directive, art. 2(1)(d).

the initial stage is greatly facilitated by the Prospectus Directive's treatment of DRs, legal arbitrage with regard to disclosure duties in the Transparency Directive typically requires an issuer to actually change its jurisdiction of incorporation.

E. Market Abuse Directive

As a consequence of the nature of the prohibitions and obligations mapped out by the Market Abuse Directive,[94] its conflict of laws rules follow a twofold territorial approach. The applicable law is determined either by the location of the regulated market to which the pertinent financial instruments are or are requested to be admitted[95] or by the location where the relevant action is carried out.[96] Hence, an issuer may have to comply with various Member States' regulations:[97] its actions with relevance under the Market Abuse Directive (*e.g.* its *ad hoc* disclosures under the Market Abuse Directive) will most likely emanate from the Member State where its headquarters are located, and hence be subject to that Member State's law.[98] But they will also be subject to the law of the Member State where the issuer's financial instruments are admitted to a regulated market. As a consequence, any cross-border divergence between headquarter and listing location will lead to the parallel application of different national securities laws. Obviously, this effect of the Market Abuse

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[94] *See supra* II.B.4.

[95] The competent authority of the Member State in which the regulated market is situated or operates can apply the national law implementing the Directive regardless of the location where the pertinent actions are carried out, Market Abuse Directive, art. 10(a).

[96] Market Abuse Directive, art. 10(b), resembling the classical *lex loci commissi delicti*, pays tribute to the fact that certain activities or failures to act can be tracked more efficiently by the competent authorities at the location of their occurrence.

[97] *See* FERRAN, *supra* note 14, *at* 199-200.

[98] Of course, a company may locate its office in charge of *ad hoc* disclosures in another Member State and thus pick that Member State's law on such disclosures instead of the law of the place where its headquarters are located.

Directive's conflict of laws rules is further amplified where an issuer maintains multiple E.U.-listings.[99]

F. Summary

To conclude, the applicable securities laws within the EU are typically determined by the issuer's registered office or the regulated market in which its securities are admitted to trading. With due qualifications, the deliberate choice of a specific Member State's law on (i) disclosure at the IPO stage, (ii) periodic disclosure and disclosure on major holdings later, (iii) mandatory bids (excluding their price) and (iv) on board obligations in a takeover situation requires a transfer of the issuer's registered office.[100] With regard to the traffic rules on takeovers and bid price specifications the choice of listing location governs.[101] Finally, the Market Abuse Directive represents somewhat of an outlier. Its territorial regime with two different connecting factors does not attribute immediate relevance to the issuer's registered office but instead to the location where its relevant actions are carried out, *i.e.*, in the case of ad hoc disclosure rules, its administrative seat or the place where the office in charge of them is located. Given the burdens associated with a transfer of the latter,[102] it seems fair to assume that choice of law considerations regarding securities laws within the substantive scope of the Market Abuse Directive will not play a significant role as far as the second prong of the Directive's conflict of laws rule is con-

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[99] *E.g.* Germany's car manufacturer Volkswagen AG has shares listed not only on Germany's exchanges but also in Luxemburg and London (as well as in New York, Tokyo and Zurich). *See* Volkswagen AG, Share Fact Sheet *available at* http://www.volkswagenag.com/vwag/vwcorp/content/en/investor_relations/share/share_fact_sheet.html (last visited October 25, 2007).

[100] *See supra* at B, C, and D.

[101] *See supra* at C

[102] Obviously, a significant loss of value impends where headquarters, key operations, employees etc. have to be moved. In the conflict of corporate laws setting, it is exactly this cost-factor which renders the real seat doctrine (*siège reel*) a powerful tool to push through legal and social values a polity deems indispensable. *See* Werner F. Ebke, *Centros – Some Realities and Some Mysteries*,

cerned.[103] Issuers will simply have to learn to live with the additional application of the relevant laws in effect at their administrative seat and with their local competent authority's enforcement. On the other hand, insofar as the applicable law depends on the admission to a Member State's regulated market,[104] the realization of choice of law considerations within the regulatory ambit of the Market Abuse Directive is just as easy as the selection of specific traffic rules under the Takeover Directive's conflict of laws rules, although there is no solution to the multi-jurisdiction problem in the former case.

Table 1 summarizes the conflict of laws rules in the FSAP securities law directives that we have previously described. We now move on to assess the FSAP choice of law framework.

Table 1 – Conflict of Laws Rules in Securities Law Directives

Directive	***Conflict of Laws Rules***
Prospectus	Registered office Non-equity securities, debt with denomination higher than Euro 1,000: issuer's choice among State of registered office, State of the place of listing or State of the place where offer is made to the public Issuer's choice for multiple listings by non-EU issuers

48 AM. J. COMP. L. 623, 625 (2000); ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 132-33 (1993).

[103] Market Abuse Directive, art. 10(b).

[104] Market Abuse Directive, art. 10(a).

Directive	***Conflict of Laws Rules***
Takeover Bids	Registered office for defenses, information to employees and rules defining when a bid is mandatory Listing for other issues, including price of mandatory bid, with only one system to apply in case of multiple listings (issuer's choice in case of simultaneous listings)
Transparency	Registered office Non-equity securities, debt with denomination higher than Euro 1,000: issuer's choice among State of registered office or States of the places of listing Issuer's choice for multiple listings by non-EU issuers
Market Abuse	Listing and place where the relevant actions are carried out.

IV. ISSUER CHOICE IN THE EU: AN ASSESSMENT

A. Determinants of issuer choice under FSAP implementing measures

As Part III has shown, the post-FSAP directives contain uniform choice of law rules, meaning that the ground-rules for competition are equal across the European Union, allowing for synchronized legal arbitrage decisions among Member States' securities laws. Hence, a principal objection articulated with regard to the

prospects for global competition in securities regulation does not apply to the subset of EU jurisdictions.[105]

Leaving aside the Market Abuse Directive's reference to the law of the place where the relevant actions have been carried out, for certain aspects European securities laws make the application of a Member State's implementing regulations depend pivotally on the choice of the issuer's listing location, whereas in other respects the selection of the Member State of incorporation becomes critical.

Both factors, in turn, are already the outcome of issuers' choice. Such is the case of listing location, at least since stock exchanges have started to admit foreign issuers to listing.[106] The same is starting to be true for the incorporation seat, as company law arbitrage is becoming more easily available in a post-*Centros* world.[107]

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[105] Frederick Tung, *Lost in Translation: From U.S. Corporate Charter Competition to Issuer Choice in International Securities Regulation*, 39 GA. L. REV. 525, 562-81 (2005) (questioning the adequacy of U.S. charter competition as a model for international securities regulation because a comparable consensus over uniform conflict of laws rules which would duplicate the internal affairs doctrine—the backbone of US charter competition—is unlikely to emerge in a global context).

[106] It was one of the rationales of the Community's first securities law harmonization measures to facilitate the cross-border admission to stock exchange listing in order to "make for greater interpenetration of national securities markets" at a time where stock exchanges enjoyed legal or natural monopolies. *See* Council Directive 79/279/EEC of 5 March 1979 coordinating the conditions for the admission of securities to official stock exchange listing, recital 1, 2 and art. 6, 1979 O.J. (L 66) 21. *See also* Guido A. Ferrarini, *The Regulation of Stock Exchanges: New Perspectives*, 36 COMMON MKT. L. REV. 569, 572-74 (1999) (arguing that the Directive's detailed prescriptions are obsolete and that in an environment characterized by competition among exchanges like today's, European legislation pertaining to admission requirements should be limited to "high level principles" granting exchanges greater discretion in designing admission standards); Guido A. Ferrarini, *Pan-European Securities Markets: Policy Issues and Regulatory Responses*, 3 EUR. BUS. ORG. L. REV. 249, 274 (2002) (same with regard to the Consolidated Admissions and Reporting Directive).

[107] The Court of Justice of the European Communities (ECJ) with its now famous *grands arrêts* established the preconditions for enhanced corporate law arbitrage by *de facto* proscribing those Member States' conflict of corporate laws rules which impeded incorporation of domestic companies under foreign law. See *Centros*, *supra* note 9; *Überseering*, *supra*, note 10; *Inspire Art*, *supra* note 11. These judgments virtually impose a uniform State of incorporation rule in the EU and mandate mutual recognition of the Member States corporate forms. *See e.g.* Thomas Bachner, *Freedom of Establishment for Companies: A Great Leap Forward*, 62 CAMBRIDGE L.J. 47, 49 (2003) (end of real seat doctrine); Kilian Baelz & Theresa Baldwin, *The End of the Real Seat Theory (Sitztheorie): the European Court of Justice Decision in Überseering of 5 November 2002 and its Impact on German and European Company Law*, 3 GERMAN L.J. (2003) (same). For a more nuanced overview of the legal conse-

As an important consequence, the respective choices do not only depend on securities law considerations. Opting for certain regulations by choosing a jurisdiction of incorporation buys the issuer a comprehensive package of securities and corporate law. On the other hand, executing a choice of securities law by seeking admission to a specific Member State's regulated market entails the complex non-legal consequences of having shares traded on that market (*e.g.* changes in liquidity, investor recognition etc.).

With these ramifications in mind, we will now scrutinize the prospects for issuer choice under both conflict of laws rules.

B. Bundling Securities Regulation with the Law of the Registered Seat

Bundling the applicable securities law regime to the incorporation State raises different issues, depending on how easy corporate law arbitrage is. It is still an open question whether in Europe regulatory arbitrage in corporate law is a real possibility not only for start-ups but also for existing companies, in light mainly of tax obstacles.[108] We consider here two scenarios: first, the present one in which regulatory arbitrage by listed companies is extremely rare due to existing obstacles, and, second, the still hypothetical scenario in which, thanks to the *Centros* doctrine, the adoption of the European Company Statute,[109] the Cross-Border Merger Directive,[110]

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quences of the ECJ holdings *see* Werner F. Ebke, *The European Conflict-of-Corporate-Laws Revolution: Überseering, Inspire Art and Beyond*, 16 EUR. BUS. L. REV. 9 (2005).

[108] On the tax-implications of re-incorporation decisions, see *e.g.* Gero Burrwitz, *Tax Consequences of the Migration of Companies: A Practitioner's Perspective*, 7 EUR. BUS. ORG. L. REV. 589-604 (2006).

[109] Council Regulation (EC) 2157/2001 of 8 October 2001 on the Statute for a European company (SE), 2001 O.J. (L 294) 1. On the role of the European Company as a catalyst for company law arbitrage in Europe, *see* Luca Enriques, *Silence is Golden: The European Company Statute as a Catalyst for Company Law Arbitrage*, 4 J. CORP. L. STUD. 77 (2004).

[110] Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies [Cross-border Merger Directive], 2005 O.J. (L 310) 1. A cross-border merger facilitates re-incorporation of existing entities, as they can be merged into a shell corporation established under the law of the favoured jurisdiction. Shortly prior to the adoption of the Directive, the ECJ compelled Member States to permit cross-border mergers even

the amendments to the related tax directive,[111] and possibly other future EC measures,[112] it is easy for listed companies to reincorporate across the EU.

1. With no company law arbitrage available. Assuming, first, that company law arbitrage is *not* a viable option for listed companies, bundling corporate and securities laws has a number of negative implications. First of all, an issuer that, for whatever reasons, wants access exclusively to European capital markets other than its own, will have to comply with their home securities laws and, for certain aspects, with their host ones, with an increase in transaction costs. Second, this bundling makes issuers from "bad" securities law jurisdictions captive, as they may not "opt up" for a better regime to signal their quality. Third, with captive issuers there will be fewer incentives for policymakers and securities regulators in "bad" securities law jurisdictions to improve on their regulatory environment.

Consider that under the pre-FSAP regime, an issuer Alfa from State A wishing to tap foreign EU capital markets was not doomed to incur the multiple jurisdiction problem:[113] by offering its securities exclusively in State B and by having its securities listed in a State B regulated market,[114] only State B securities regulation

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under unharmonized national merger statutes. *See* Case C-411/03, SEVIC Systems AG, 2005 E.C.R. I-10805.

[111] Council Directive 2005/19/EC of 17 February 2005 amending Directive 90/434/EEC 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, 2005 O.J. (L 58) 19.

[112] Currently, the Commission's efforts to propose a 14th Company Law Directive on the cross-border transfer of the registered office of limited companies have been resumed. Commissioner McCreevy declared that the Commission would submit a proposal in 2007. *See* Speech of Charlie McCreevy to the European Parliament JURI Committee (Committee on Legal Affairs) of 21 November 2006, *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/06/720&format=H (last visited October 25, 2007).

[113] See *supra* note 68.

[114] Although some commentators have doubted, that such a complete bypass of an issuer's home market represents a realistic scenario (*see e.g.* Howell E. Jackson & Eric J. Pan, *Regulatory Competition in International Securities Markets: Evidence from Europe in 1999 – Part I*, 56 BUS. L. 653, 679), real-world examples of issuers from countries with small and underdeveloped capital markets exist. *See* Amir N. Licht, *Managerial Opportunism and Foreign Listing: Some Direct Evidence*, 22 U. PA. J. INT'L ECON. L. 325, 336 (2001) (Israeli firms accessing U.S. markets directly).

would apply.[115] Further, State A investors were certainly not precluded from investing in Alfa shares: they could do so through intermediaries having remote access to State B's regulated market. If the domestic capital market was one Alfa wanted to tap while listing abroad, it could sell shares to domestic intermediaries in a private placement and expect them to resell them to local investors, each of the intermediaries taking advantage of the "small number" exemption[116] and/or counting on reverse solicitations by local investors. Alternatively, it could even make an offer to the public at home, circumscribing the multiple jurisdiction problem to the initial public offering stage, after which, in the absence of any listing on a domestic exchange, the home country securities laws would stop applying.

The post-FSAP regime worsens the life of issuers like Alfa, which will typically be those in Member States with smaller and/or less well developed capital markets, *i.e.* those for which market integration matters the most. In fact, not only will they have to deal with their home state securities laws and competent authority for prospectus approval[117] and compliance with Transparency Directive disclosure obligations,[118] and therefore retain local legal counsel for these purposes, but they will also have to obtain advice from lawyers from the country where the public offer or the admission to trading takes place both to conduct the offer to the public or the admission to trading and to comply with the Market Abuse Directive's ongoing disclosure requirements.[119] Intuitively, the interaction between the local counsel and the

[115] *See supra* at III.A.

[116] Public Offerings Directive, art. 2(1)(b).

[117] Unless of course the home state authority transfers the prospectus approval to the host state authority. Note that there is no similar possibility of transferring powers relating to Transparency Directive disclosure obligations.

[118] Consider also that the home state competent authority for prospectus approval, once securities have been admitted to trading on a regulated market, pursuant to Prospectus Directive, art. 21(4)(a) has the power to "require the issuer to disclose all material information which may have an effect on the assessment of the securities admitted to trading on regulated markets in order to ensure investor protection or the smooth operation of the market." In other words, it may interfere with the issuer's disclosure policies even beyond the Transparency Directive's boundaries.

[119] *Cf. supra* at III.E.2.

host country investment bankers might be more cumbersome, thus raising the transaction's costs.

Further, if company law arbitrage is not easily available, bundling securities law with company law carries disadvantages for good quality issuers in States with "bad" regulators (i.e. those doing a bad job at policing securities laws violations).[120] With no escape, such issuers will find it harder to signal their quality by choosing another EU jurisdiction.[121] In fact, if public enforcement of securities regulation mat-

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[120] Not to mention that it is far from clear that a local regulator would have enough incentives to properly monitor the activities of issuers having listing *and* security holders abroad (FERRAN, *supra* note 14, *at* 152 (pointing to the need of cooperative enforcement not easily feasible under the home state rule); *see also* Iris H.Y. Chiu, *Three Challenges Ahead for the New EU Securities Regulation Directives*, 17 EUR. BUS. L. REV. 121, 127 (2006) (exposing enforcement deficits looming under the home state rule). Clearly, the US experience suggests that cross-listings generally account for enforcement shortcomings even if the competent watchdog is the one of the host market. *See* Amir N. Licht, *Cross-Listing and Corporate Governance: Bonding or Avoiding*, 4 CHI. J. INT'L L. 122-41 (2003) (identifying a "hands-off" policy at the SEC with regard to foreign issuers); Jordan Siegel, *Can Foreign Firms Bond Themselves Effectively by Renting U.S. Securities Laws?*, 75 J. FIN. ECON. 319-59 (2005) (neither SEC nor private law enforcement significantly reduces cross-listing Mexican firm's ability to tunnel assets); Donald C. Langevoort, *Structuring Securities Regulation in the European Union: Lessons from the U.S. Experience*, *in* INVESTOR PROTECTION IN EUROPE – CORPORATE LAW MAKING. THE MIFID AND BEYOND 485, 496-501 (Guido Ferrarini & Eddy Wymeersch eds., 2006) (showing reasons for a "home bias" in SEC enforcement actions); but *see also* John C. Coffee, *Racing Towards the Top? The Impact of Cross-Listings and Stock Market-Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757, 1794-96 (2002) (pointing to the deterring effect of high profile cases against foreign private issuers and the statistically distorting effect of silent settlements). Yet, even though host market regulators might perform worse with regard to foreign issuers compared to their enforcement activity vis-à-vis domestic issuers, their incentives to police misconduct that imperils investor confidence in their market are conceivably stronger than those of a competent authority whose home market is not affected at all. Hence, the risk of inadequate enforcement of the Prospectus and Transparency Directives provisions for issuers that do not tap domestic markets is higher under the home state rule.

[121] With the exception of an official listing thanks to the Consolidated Admission and Reporting Directive which still allows for non-discriminatory super-equivalent requirements. *See* Consolidated Admission and Reporting Directive, art. 8(1) and 8(2) as amended by Transparency Directive, art. 32 (4). Yet, if the issuer simultaneously applies for admission of the pertinent securities to official listing in its home Member State, the law of this state, administered by the local competent authority will govern. *See* Consolidated Admission and Reporting Directive, art. 37. Further, even in the case of an official listing, the prospectus will be approved by the home State, whose law will apply also on matters covered by the Transparency Directive.

ters,[122] there will be no way for local issuers to "opt up" for a more effective supervisory authority from another Member State (other than with regard to matters covered by the Market Abuse Directive). To be sure, a limited way-out is offered by the Prospectus Directives' treatment of DRs: even captive issuers can make use of a foreign depositary-facility and thus render applicable another jurisdiction's entire prospectus regime, including its public administration and enforcement, for the subsequent share offering.[123] Yet, this route provides the full scope of bonding opportunities only with regard to initial disclosure, whereas later transparency obligations are inescapably tied to the law of the issuer's home state.[124] Of course, captive issuers still might take advantage of the bonding and signaling mechanisms that another country's market itself makes available, like hiring highly reputed gatekeepers (investment banks, audit firms, law firms) or listing on a given exchange.[125] Further, even without using a DR-facility, by publishing a prospectus in another Member State, they might incur civil prospectus liability according to the general private law rules of the host

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[122] An assumption that, to be sure, a highly cited empirical work has questioned: *see* Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, *What Works in Securities Laws?* 61 J. FIN. 1, 14-23 (2006) (presenting data suggesting that the development of stock markets is strongly related to private enforcement mechanisms sanctioning violations of comprehensive disclosure requirements whereas public enforcements impact is modest at best). *But see contra* Howell Jackson & Mark J. Roe, *Public Enforcement of Securities Laws: Preliminary Evidence* 15-25 (Harvard Law School Working Paper, 2007) *available at* http://ssrn.com/abstract=1000086 (last visited October 25, 2007) (devising a public-enforcement variable based on regulators' staffing and budgets which suggests a correlation between stock market development and public enforcement intensity); John C. Coffee, *Law and the Market: The Impact of Enforcement* 28-50 (Columbia Law School Working Paper, 2007) (arguing that the U.S. unique position of the U.S. in the cross-listing market is due to a staggareing margin not only in private but also in public enforcement of securities laws). Even under the premise that private enforcement indeed represents the first-best institutional arrangement to protect investor interests, depriving high-quality issuers of the opportunity to opt for the superior version *within* the second-best solution of public enforcement leaves issuers with another, independent disadvantage. This is all the more true, where the alleged first best solution is unavailable (*see infra* note 127 and accompanying text).

[123] *See supra* III.B.

[124] *See supra* III.D.

[125] For a survey of the empirical evidence on the signaling value of the described non-legal institutions *see* G. Andrew Karolyi, *The World of Cross-Listings and Cross-Listings of the World: Challenging Conventional Wisdom*, 10 REV. FIN. 99, 121-26, 132-36 (2006).

State[126] and hence be subject to its private enforcement institutions.[127] Alternatively, they could take advantage of the bonding and signalling implications of listing in the US: hardly a good outcome in the perspective of European policymakers or a cheap exercise for European issuers after the post-scandal reforms of US capital markets.[128]

Finally, if company law arbitrage is unavailable, regulators' incentives to improve on their supervisory practices (in terms of time taken to approve prospectuses,[129] paperwork required, flexibility as to financial innovation and regulatory issues not covered by directives, etc.) will be weaker, and reasonably depend on the ability of the Committee of European Securities Regulators (hereinafter: CESR) to exercise some sort of peer pressure.[130] But one may wonder how effective peer pressure can be if regulators do not suffer competition from each other:[131] effectiveness of supervision and public enforcement are essentially a matter of politics and depend

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[126] The Directive does not harmonize Member States' substantive liability rules. This fact warrants the conclusion that it does not touch on conflict of laws rules in this respect either. *See* Enriques & Gatti, *supra* note 33, at 10-11, 13. The applicable rules of international private law will typically lead to the host state's liability rules and standards as the law of the location where investors incurred the relevant losses. *See e.g*. Commission Proposal for a Regulation of the European Parliament and the Council on the law applicable to non-contractual obligations ("Rome II"), art. 3(1), COM (2003) 427 final (July 22, 2003).

[127] Yet, even on Europe's currently most attractive market, private enforcement seems to play no significant role, Eilís Ferran, *Cross-border Offers of Securities in the EU: The Standard Life Flotation* 17-22 (Cambridge University, Centre for Corporate and Commercial Law Working Paper, 2006) (no successful cases under English law).

[128] For evidence of the vanishing attractiveness of U.S. markets as cross-listing venues, *see* Tobias H. Tröger, *Corporate Governance in a Viable Market for Secondary Listings* 7-22 (University of Düsseldorf, Center for Business and Corporate Law Working Paper No. 25, 2007) *available at* http://ssrn.com/abstract=965488 (last visited October 25, 2007).

[129] *Cf.* Committee of European Securities Regulators, CESR's Report on the Supervisory Functioning of the Prospectus Directive and Regulation 31 (CESR/07-25 June, 2007) (reporting that the time period for prospectus approval varies among Member States).

[130] *Cf.* FERRAN, *supra* note 14, at 151-52, 159 (noting that the rigidity of the home State rules "has potential adverse ramifications for the quality of issuer supervision across the EU because it gives national regulators a monopoly over their home issuers and thereby reduces the discipline of competition in that context too").

[131] *Cf.* Frederick Tung, *Passports, Private Choice, and Private Interests: Regulatory Competition and Cooperation in Corporate, Securities, and Bankruptcy Law*, 3 CHI J. INT'L L. 369, 380-86 (2002) (arguing that a territorial regime, even when complemented with a passport arrangement, will

on adequate budgets, presence of qualified and motivated staff and several other socio-economic factors that cannot realistically be expected to be under CESR control, no matter how vigorous its action will prove to be.[132]

To be sure, even without auspicious competition effects directly affecting the private interests of regulators and their dominant constituents – the essence of the public-choice oriented argument – European polities might push for improvements. Even in the absence of competition for corporate charters, the main Member States extensively amended their corporate laws.[133] The stimulus for the observed sweeping law reforms stemmed from the need, embraced at the highest political level, to ameliorate the position of domestic firms in the increasingly vigorous and global competition for investments.[134] It is easy to translate the argument to fit into the securities regulation framework:[135] the higher cost of capital issuers are exposed to when tied inescapably to an inefficient home state regulator represents another disadvantage in their competition for investment. Hence, if the political payoffs that accrue to the successful participants in the international competition for investments are high enough to cancel out the costs of overcoming opposition,[136] powerful political players will push for more efficient structures. However, the envisioned beneficial out-

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not exercise significant competitive pressure on regulators which aim at maximizing the number of firms and transactions under their purview as it ties issuers too strictly to home state regulators).

[132] For a skeptical view *see* Iris Chiu, *supra* note 120, at 128-32 (outlining the various obstacles CESR faces in its strive towards regulatory convergence which is dependent on national regulators' ungrudging cooperation). Generally, on the quintessential role of a (national) regulator, that "has the staff, skill, and budget to pursue complex securities disclosure cases" for the protection of investor interests, *see* Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. REV. 781, 790 (2001).

[133] *See e.g*. Luca Enriques & Paolo Volpin, *Corporate Governance Reforms in Continental Europe*, 21 J. ECON. PERSP. 117, 127-37 (2007) (describing corporate law reforms in Germany, France and Italy since the Nineties).

[134] Ehud Kamar, *Beyond Competition for Incorporations*, 94 GEO. L.J. 1725, 1730-43 (2006).

[135] In fact, many of the reform efforts Kamar (*id.*) draws on to make his hypothesis relate to regulations conventionally classified as securities laws.

[136] Generally on the relevance of interest group opposition to investor-friendly law reforms, Lucian A. Bebchuk & Mark J. Roe, *A theory of path dependence in corporate ownership and govern-*

come and its precise dimension depend on the specific distribution of power, the political dynamics, the yields and costs of higher regulatory efficiency etc., in each Member State. If these factors do not play out well, it might be the case that local issuers will suffer from the higher costs arising from local regulators' sloppiness.

In any event, one important function that legal arbitrage may perform in a context of defensive regulatory competition, i.e. of highlighting deficiencies in the law, will be unavailable in a scenario without corporate mobility.

2. With corporate law arbitrage available. Assuming instead that corporate law arbitrage is easy not only for start-ups, but also for EU listed companies, the bundling of corporate and securities law implies that regulatory arbitrage will become possible in the securities law field as well.[137] In an environment in which the regulatory surplus to be gained by engaging in company law arbitrage is otherwise relatively small, at least for public companies,[138] reincorporations might become popular precisely for the purpose of picking a different securities regulation. Not only are securities regulations across the EU still far from uniform,[139] but, even more importantly, it makes a lot of difference whether the competent authority is an under-

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ance, *in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 69, 82-88, 97-107 (Jeffrey N. Gordon & Mark J. Roe eds., 2004).

[137] *Cf.* Alain Pietrancosta, *The 'Public Offering of Securities' Concept in the New Prospectus Directive*, *in* INVESTOR PROTECTION IN EUROPE, *supra* note 120, 339, 344 (home seat criterion introduces a competitive aspect in the light of *Centros*). FERRAN, *supra* note 14, at 154-55 (hypothesizing a flight to the jurisdictions with the best securities law environment).

[138] Considerable gains could arguably be derived only from escaping co-determination in countries which mandate it. *See* Christian Kersting, *Corporate Choice of Law – A Comparison of the United States and European Systems and a Proposal for a European Directive*, 28 BROOKLYN J. INT'L L. 1, 42 (2002) (noting firms' decreased desire to reincorporate in light of far-reaching uniformity of EU company laws); Enriques, *supra* note 16 at 1268-69 (arguing that uniformity of corporate law leaves Member States less room for regulatory innovations to attract incorporations than New Jersey and Delaware had at the beginning of the U.S. race); for a slightly different view leading to the same conclusion *see* Tröger, *supra* note 16, at 36-41 (suggesting that although differences in Member States' corporate laws exist, no Delaware-like advantages from reincorporation will accrue due to ambiguities in choice of law decisions in a fully developed institutional environment with its resulting complementarities); Gelter, *supra* note 16, at 251-52 (arguing that, unlike in the wake of the U.S. race "no single issue that is only addressed by the law of one state is likely to become that important" in Europe).

funded securities regulator from a country with no tradition in capital market regulation or the skilfully designed authority with a long record of regulating one of the world's most vibrant financial centers.[140] Similarly, it is quite one thing if securities regulation advice is in the hands of a very small circle of local lawyers who are the only ones familiar with the national language, it is quite another if one can choose from a number of top international law firms competing to assist you.

With regulatory arbitrage in corporate law easily available, issuer choice will become a reality in the EU. As a consequence, Member States could find themselves actually competing in the market for securities laws. But will they compete at all? And if so, will the outcome of such competition be a race to the top, a race to the bottom, or neither of them? In order to address these questions in the European context, we briefly discuss Member States' incentives to respond to issuers' demands before we survey the literature debating issuer choice's merits and assess it from a European viewpoint.

a. Incentives to compete. Besides (and logically before) the question of what direction a European race would take, one should ask whether regulators have sufficient incentives to engage in vigorous competition at all.[141] Yet, even if doubts may be warranted that EU regulators have insatiable appetite for increased market shares garnered by national exchanges and trading platforms,[142] with political elites becom-

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[139] *See supra* Part II.

[140] *Cf.* FERRAN, *supra* note 14, at 219.

[141] *Cf.* Cox, , *supra* note 147, at 1232-33 (questioning that the number of potential competitors would suffice for a race); Tung, *supra* note 105, at 587-616 (arguing that established capital market countries lack the incentives to offer popular securities laws while smaller countries lack the means to provide attractive regulation).

[142] But see William E. Decker, *The Attractions of the U.S. Securities Markets to Foreign Issuers and the Alternative Methods of Accessing the U.S. Markets: From the Issuer's Perspective*, 17 FORDHAM INT'L L.J. 10, 22-23 (1994) (purporting that the SEC has been hospitable with regard to U.S. exchanges' interest to attract international secondary-listings). The recently promulgated alleviations for foreign private issuers seeking escape from continuous reporting duties under the Securities Exchange Act of 1934 can also be seen as an instance where the SEC was at least not averse to business interests of US exchanges. *See* Termination of Foreign Private Issuer's Registration and Duty to File Reports, Securities Exchange Act Release No. 34,55540, 72 Fed. Reg. 16,934 (April 5, 2007). If

ing more and more aware of the essential role viable capital markets play in fostering economic prosperity, there should be sufficient incentives to at least retain the critical mass of issuers on domestic markets to secure sufficient depth and liquidity, institutional infrastructure etc.[143] If the potential for legal arbitrage for issuers proves sufficiently large, as we suggest, we will see in securities regulation too at least what one of us, with regard to developments in corporate law, termed "defensive regulatory competition."[144] Hence, it is not a thought experiment remote from reality if we explore now whether such competition will drag regulatory quality up or down in the European context.

b. The issuer choice debate. Our assessment of the impact of regulatory competition in European securities laws can dwell on the extensive debate regarding issuer choice's merits.

The optimistic view assumes that issuers are typically in search of a regulatory regime that best serves investor interests, because such a regime will reduce the risk premiums investors charge and hence will lower issuers' cost of capital. As a consequence, a race to the top will ensue, ultimately leading to socially desirable institutional arrangements.[145] As a variation on the theme of an upward trajectory, others argue that the outcome of regulatory competition would be a separating equilib-

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issuers indeed were chilled from tapping US capital markets by the cumbersome process of SEC deregistration (see *id*. at 16934-5), their absence from U.S. markets did not so much constrain US investors' ability to acquire the pertinent securities through their brokers with remote-access to foreign markets (*cf. e.g*. Choi & Guzman, *The Dangerous Extraterritoriality*, *supra* note 146, at 221) as deprive U.S. exchanges and market intermediaries of valuable business.

[143] *Cf.* Ehud Kamar, *supra* note 134, at 1730-43 (2006) (arguing that competition for investments is the driving force behind corporate and securities law reforms in Europe).

[144] Enriques, *supra* note 16, at 1273. *See also infra* note 189.

[145] Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359, 2366-67, 2383-88 (1998) (invoking evidence from the competition for corporate charter in the U.S. to validate her thesis); Roberta Romano, *The Need for Competition in International Securities Regulation*, 2 THEORETICAL INQUIRIES L. 387, 390, 493 (2001) (same); Steven Huddart, John S. Hughes & Markus K. Brunnermeier, *Disclosure Requirements and Stock Exchange Listing Choice in an International Context*, 26 J. ACCT. & ECON. 237, 260 (1999) (exchanges' incentives to

rium:[146] in this view, the survival of high-quality and lower-quality legal regimes represents a result, brought about by deliberate issuer choice, which enhances social welfare. Lower-quality legal regimes persist, typically as the law of regional exchanges catering to purely domestic issuers, because some firms have financing needs which do not warrant the costs of compliance with high-quality securities laws governing the world's principal exchanges.

Conversely, putting the emphasis on conceivable market failures makes the effect of regulatory competition look rather murky, with a race to the bottom representing the plausible worst case scenario. Incentives to opt for suboptimal securities laws are conceivable because managers or large blockholders (those effectively exercising issuer choice) fully bear the costs of high-quality securities laws, but have to share its benefits with outside investors. Hence, they will either opt for incrementally lower quality regulation or constantly lobby for diminished standards, as long as investors are unable to detect and punish such rent-seeking.[147]

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maximize trading volume will induce them to raise reporting requirements because trading concentrates on markets with high disclosure standards).

[146] Stephen J. Choi & Andrew T. Guzman, *National Laws, International Money: Regulation In A Global Capital Market*, 65 FORD. L. REV. 1855, 1876-79 (1997); Stephen J. Choi & Andrew T. Guzman, *The Dangerous Extraterritoriality of American Securities Law*, 17 NW. J. INT'L L. & BUS. 207, 223, 227 (1996); John C. Coffee, *Racing Towards the Top: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757, 1814-17 (2002).

[147] Merritt B. Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom?*, 95 MICH. L. REV. 2498, 2626-27 (1997) (arguing that political pressure will induce regulators to reduce disclosure standards to garner trading volume); James D.Cox, *Regulatory Duopoly in US Securities Markets*, 99 COLUM. L. REV. 1200, 1233-36 (1999) (same); Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice is not Investor Empowerment*, 85 VA. L. REV. 1335, 1410 (1999) (purporting that issuers would "choose a regime requiring a level of disclosure well below what is socially optimal for it"); Robert Bloomfield & Maureen O'Hara, *Can Transparent Markets Survive?*, 55 J. FIN. ECON. 425, 448-452 (2000) (showing a preference of influential market participants for reduced transparency, because low transparency dealers are capable of outperforming more transparent competitors).

The direction of the potential race depends crucially on investors' ability to appraise the merits and deficits of specific securities regulations correctly.[148] Only under this condition will informed investors be in a position to charge "bad law"-adjusted risk premiums and make issuers fully internalize the heightened threat of expropriation for securities holders in an inferior legal environment. Clearly, the conditions necessary to warrant a perfectly accurate assessment of any particular securities law regime will never be present in reality, and certainly not with regard to each and every retail investor. Yet, the empirical literature suggests that changes in an issuer's institutional environment are reflected in share prices, with no compelling evidence indicating that the relevant valuations are systematically biased.[149] These findings warrant the conclusion that markets are generally capable of assessing accurately the securities law regime a specific issuer is subject to. Although one can be sceptical with regard to even sophisticated investors' ability to precisely gauge the merits of a complex set of securities laws, there is reason to believe that investors' general assessment of specific securities laws, mainly based on their overall reputation, is correct. As a consequence, legal arbitrage decisions should generally be re-

[148] *Cf.* Joel P. Trachtman, *Regulatory Competition and Regulatory Jurisdiction in International Securities Regulation*, *in* REGULATORY COMPETITION AND ECONOMIC INTEGRATION 289, 293-94 (Daniel C. Esty & Damien Gerardin eds., 2001) (questioning that if the conditions for informed investor choice are met there is a need for regulation at all); Cox, *supra* note 147, at 1234 (demanding clear evidence for investor's ability to assess securities law regimes).

[149] Darius P. Miller, *The Market Reaction to International Cross-Listings: Evidence from Depositary Receipts*, 51 J. FIN. ECON. 103-23 (1999) (finding higher positive abnormal returns for US exchange cross-listings compared to private placements or OTC-offerings); Craig Doidge, G. Andrew Karolyi & René M. Stulz, *Why Are Foreign Firms that Are Listed in the U.S. Worth More?*, 71 J. FIN. ECON. 205-238 (2004) (approximately 16 percent valuation premium in terms of Tobin's q analysis for the year 1997 in a worldwide sample of 712 issuers cross-listing in the US relative to a global benchmark sample of 4078 publicly traded firms); Craig Doidge, G. Andrew Karolyi & René M. Stulz, *Has New York Become Less Competitive in Global Markets? Evaluating Foreign Listing Choices over Time* 31-32 (Ohio State University, Dice Center working paper No. 2007-9, 2007) *available at* http://ssrn.com/abstract=982193 (last visited October 25, 2007) (finding a persistent premium for U.S. cross-listings in terms of Tobin's q of 17.4 percent for the period between 1990 and 2001 and of 14.3 percent between 2002 and 2005). For further evidence from bond indenture and corporate charter contexts*, see* Romano, *Empowering Investors*, *supra* note 145, at 2367. *See also infra* note 158 and accompanying text.

flected in share prices, making opportunistic choices of controlling insiders less likely.

c. Issuer choice in the EU: race to the bottom or separating equilibrium? Against this backdrop, should we expect a race to the bottom, once regulatory arbitrage in company law, and thus securities law, becomes available?

i. Distorting impact of non-legal institutions? An initial concern centers upon conceivable distortions issuer choice in Europe would face. Certain markets today exhibit a degree of maturity and development which will give them a tremendous head-start in any race. Particularly from an investor's perspective, the historical disparities with regard to market depth, liquidity etc. might easily even out any detrimental effects from worse legal institutions.[150] Why forgo the benefits of one of the world's deepest and most liquid capital markets with mature non-legal institutions only to be better protected from expropriation under the laws governing a tiny, illiquid market where no sophisticated investment banks, analysts etc. accompany market transactions? By tying applicable law in important respects to the issuer's registered office instead of its trading venue, European conflict of securities laws rules disen-

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[150] Where institutional factors and network externalities figure in regulatory arbitrage, they are apt to lead to socially suboptimal outcomes. The advantages unrelated to substantive law's content give providers of regulation the leeway to cater to rent-seeking interests of those in control of the arbitrage decision. Those making choices can seek private benefits as long as deviations from optimal solutions are surpassed by advantages resulting from informal institutions or positive network externalities. *See* Oren Bar-Gill, Michal Barzuza & Lucian A. Bebchuk, *The Market for Corporate Law*, 62 J. INSTITUTIONAL & THEORETICAL ECON. 134, 145, 149-50 (2006) (showing that a dominant state in the competition for corporate charters has incentives to cater to managers' interests and that shareholders are willing to acquiesce to a suboptimal incorporation decision as long as they reap an overall benefit from it). Structurally, the outcome in securities law arbitrage could be distorted by a bundling of legal and non-legal determinants similar to the one that, as some argue, impedes the US race for corporate charters today. *See* Klausner, *supra* note 3, at 842-847 (arguing that Delaware's preponderance in the charter-market is due to its extensive body of case law, its experienced administrative and judicial system etc.); Lucian A. Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553, 585-95 (2002) (holding that due to network externalities and prior investments in its institutional framework Delaware is largely protected from potential challengers by significant entrance barriers). *See also* Licht, *supra* note 13, at 609-35 (arguing that the bundling of various legal rules alone renders accurate pricing difficult).

tangle legal and non-legal institutions and thus create a basis for largely undistorted regulatory competition.[151] Under such rules, with the qualifications highlighted in Part III, issuers may choose their securities law by registering the company in State Alpha that ideally fulfils their legal demands and simultaneously benefit from State Beta's superior non-legal infrastructure by having equities traded on its deep and liquid markets, where the best intermediaries offer their services etc.

ii. Emergence of a separating equilibrium. For the time being, there seems to be at best only anecdotal evidence that the highest-quality markets (and their regulators) have lowered the applicable standards to compete with other jurisdictions.[152]

The UK experience is a case in point. Continuous and well-considered amendments of the British law governing capital markets rather tightened than slackened issuers obligations[153] and finally seem to have paid off with the London Stock Exchange becoming an increasingly attractive trading venue for international issuers in recent years.[154] To be sure, we are not suggesting here that the regulatory regime governing UK markets is as stringent as those applying to issuers at other successful trading venues, most notably the one issuers become subject to by tapping the US

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[151] Undistorted issuer choice hence is the flipside of the FSAP-directives' solution to the bundling problem which occurred under the traditional European conflict of securities laws rules. *See supra* text following note 67.

[152] But *see* Bloomfield & O'Hara, *supra* note 147, at 426 (reporting that the London Stock Exchange (LSE) successfully lured away trading volume from the Paris Bourse when it allowed large block trades to remain unreported for several days, a success that ultimately compelled the Paris Bourse to adopt the LSE rules). Yet, the generally conclusive empirical evidence produced to validate the basic propositions of the legal bonding hypothesis articulated in the finance and legal literature (*infra* note 158) vindicates at least some issuers' alleged strive for better securities laws and hence is apt to thwart the notion of a general race to the bottom.

[153] Most notably, the post-Enron reforms in the U.K. have been hailed for rectifying existing drawbacks but were largely free of panic-driven overreaction. *See* Paul Davies, *Enron and Corporate Governance Reform in the UK and the European Community*, *in* CORPORATE GOVERNANCE IN CONTEXT CORPORATIONS, STATES, AND MARKETS IN EUROPE, JAPAN, AND THE US 163, 190 (Klaus J. Hopt et al. eds., 2005).

[154] For a survey of the empirical evidence on the LSE's attractiveness *see* Tröger, *supra* note 128, at 7-21.

securities market.[155] The pivotal aspect for our analysis is that the success of UK markets cannot be attributed to a relaxation of regulatory standards, at least vis-à-vis other EU jurisdictions. Quite the contrary, the UK today once again contemplates further tightening the rules, particularly those applying to companies listed on the Alternative Investment Market (AIM).[156] In light of this, a more plausible scenario in a world with more freedom to engage in regulatory arbitrage is one in which issuers divide into three groups.[157]

A first group would comprise high-quality issuers, *i.e.* those ready to comply with strict rules and to deal with tough regulators, if that is the price to pay to get access to cheaper capital: in this category fall several national champions from many countries, which, during the 1980s and the 1990s, listed on the New York Stock Exchange, and self-confident emerging businesses that joined the NASDAQ to reap the benefits of the deep and liquid U.S. market and, according to some, of bonding to a high-level investor protection system.[158]

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[155] Several studies have pointed to the fact that UK securities regulation for various reasons takes a smoother stance vis-à-vis foreign issuers. *See e.g.* John C. Coffee, John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement* 11 n17 (Columbia Law and Economics Working Paper No. 304, 2007) *available at* http://ssrn.com/abstract=967482 (last visited October 25, 2007) (maintaining that pivotal parts of U.K. capital market regulation do not apply to foreign issuers); Doidge, Karolyi & Stulz, *supra* note 149, at 9-10 (same); Tröger, *supra* note 128, at 49-101 (comparing UK and US securities laws applying to foreign issuers and finding that UK regulation offers more latitude to overseas companies and is less rigidly enforced).

[156] The new AIM rulebook introduced in February 2007 has increased transparency requirements for listed companies and tougher standards for nominated advisors, *i.e.* persons guiding the would-be AIM issuer through the admission process and responsible for the issuer's compliance with market regulations thereafter. For details of the amendments *see* London Stock Exchange plc., AIM Notice 27 (Feb 20, 2007), *available at* http://www.londonstockexchange.com/NR/rdonlyres/EEB85E9E-6592-46E0-9880-0A142618ABEA/0/AIMNotice27.pdf (last visited October 25, 2007).

[157] *See also* Choi & Guzman, *supra* note 146, at 1876-79 (identifying two groups of issuers – in short, the good and the bad ones – demanding for securities law regimes of different quality); Coffee, *supra* note 146, at 1814-17.

[158] The bonding hypothesis suggests that, besides the liquidity effects of tapping deeper and more liquid capital markets, it is mainly the corporate governance related changes in an issuer's environment that drive cross-listing decisions. By decreasing the chances to expropriate investors ex post, firms can lower their costs of capital because market participants will charge lower risk premiums. For the earliest articulations of the bonding-hypothesis *see* René M. Stulz, *Globalization, Corporate*

A second, large group would comprise local issuers, *i.e.* those for which domestic markets would constitute the only option in practice. This will be the case for both mid- and small-size "good natured" issuers, raising an amount of capital too low to justify the cost of listing abroad, and large, average-quality issuers that are afraid of enhanced investor protection (*e.g.* because the founding family wants to continue to extract its moderate amount of private benefits) or simply content with the money they have raised at the IPO stage and not even considering the idea of raising new equity on the market.

Finally, a third group would comprise "rogue issuers," *i.e.* those keen on exploiting weaknesses and loopholes in the jurisdictions with the most lenient securities regulation.

While unquestionably no Member State will deliberately cater to the interests of rogue issuers,[159] EU members will rationally vary with regard to the incentives spurring their legislatory efforts in designing securities laws. Depending on the num-

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Finance, and the Cost of Capital, 12 J. APPLIED CORP. FIN. 8-25 (1999); John C. Coffee, *The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications*, 93 NW. U. L. REV. 641, 683-91 (1999); for empirical assessments *see* William A Reese, Jr. & Michael S. Weisbach, *Protection of minority shareholder insterests, cross-listings in the United States, and subsequent equity offerings*, 66 J. FIN. ECON. 65, 80-104 (2002) (finding issuers from jurisdictions with – according to the LaPorta et al. index – weak investor protection to be more likely to cross-list in the United States and conducting equity offerings after cross-listing significantly more frequently, the latter findings being even more conclusive for issuers whose home jurisdictions offered poor protection of minority shareholders); but compare Licht, *supra* note 120, at 160-61 (arguing that the Reese & Weisbach findings in fact suggest that foreign issuers try to avoid stringent U.S. securities regulation because their subsequent equity offerings are conducted primarily on their home markets); see also *supra* note 149. For a recent explanation of cross-listings which departs completely from the functionalist, cost of capital-oriented approaches *see* Jordan I. Siegel, Amir N. Licht & Shalom H. Schwartz, *Egalitarianism and International Investment* (Working Paper, 2007) *available at* http://ssrn.com/abstract=899092 (last visited October 25, 2007) (devising a measure for societies' attitudes towards egalitarian ideals, i.e. their disapproval of the abuse of economic and political power, and finding it more robustly related to cross-national investment flows of equity than comparable indicators of competing explanations).

[159] However, the strong terminology is apt to distract from the variations within the set of rogue issuers, which comprises cold-blooded fraudsters who operate deliberately outside the borders of legality as well as less hardboiled agents that aim at relatively slight overstatements of their represented value as permitted under lax securities laws. The latter kind of opportunism is at least tacitly tolerated by regulators that make do with more lenient disclosure regimes.

ber and relative importance of high-quality issuers in the Member States, the pressure to constantly improve the regulatory framework will vary. Moreover, under the post-FSAP choice of law rules, high-quality issuers can opt into adequate regulation by reincorporating abroad. Together with the fact that they can piggy-back on foreign markets' non-legal institutions by seeking admission to exchanges abroad,[160] this will further reduce the pressure on national regulators to improve their securities laws. Hence, some Member States find themselves in a position where it is rational to cater mainly to the demands of local issuers, and some might even consider it dispensable to autonomously improve their capital market regulations at all. As a consequence, within the band sketched out by the EU's harmonizing measures, we would have good, average and bad quality securities laws across the EU, serving the interests of different types of issuers and catering to investors with diverging attitudes toward the risk of expropriation.

Is this scenario dreadful? Definitely so, if one covets the ideal of an integrated, high-standard single EU securities market deserving investors' unreserved and undiscriminating confidence and allowing issuers from any EU jurisdiction to reduce their cost of capital uniformly.

This ideal, however, is unattainable in the real world and, so long as the EC plays a role in the regulation of securities markets, the above scenario appears to be almost the best one can get. First of all, EU securities regulation cannot ensure uniformity in the level of investor protection under the current institutional framework. Even a comprehensive set of EC rules would not be enough as long as enforcement is decentralized and national under-enforcement hard to detect and punish. On the other hand, it is difficult to tell whether centralization of enforcement at the EC level

[160] Besides the market's depth and liquidity, pivotal factors in this respect are *e.g.* the presence of reputed investment banks and other gatekeepers, the close following by sophisticated analysts, an overall good informational environment, and the presence of actively monitoring institutional investors. *Cf. also supra* note 125 and accompanying text.

would make EU capital markets more efficient: a U.S. SEC-like, single European regulator would potentially suffer from diseconomies of scale and could exhibit an increased tendency to abuse its EU-wide monopoly power in the form of over-regulation.[161] Moreover, on a global scale, the lower number of competitors could even facilitate reaching tacit anticompetitive conformity with the SEC.[162]

Further, a reduction in the cost of capital should be easier and quicker to attain if issuers can immediately choose the most efficient EU securities regulation at relatively low cost than if they have to rely on evolving investor confidence as a long term outcome of the cumbersome efforts for uniformity. Finally, as to investor confidence, why assume that markets are unable to distinguish among good-quality, average and bad quality securities law regimes, price securities accordingly and therefore avoid systematic investor expropriation?[163] We have already expressed our view that empirical evidence indeed fosters the conclusion that in general markets reflect the merits of a specific legal framework accurately.[164] Issuer choice and the ensuing

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[161] *Cf.* Jonathan R. Macey, *Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty*, 15 CARDOZO L. REV. 909, 914 (1994) (delineating bureaucracies' incentives to overregulate). For a far more favourable assessment of SEC-style regulators *see* Robert A. Prentice, *The Inevitability of a Strong SEC*, 91 CORNELL L. REV. 775 (2006) (arguing that a strong-SEC model best facilitates capital market development and economic growth).

[162] Obviously, we are not suggesting the appearance of open cartelization but a general tendency to substitute informal coordination for regulatory competition. That the SEC and CESR have during recent years intensified and institutionalized their dialogue on various regulatory issues can be seen as evidence of this. *See* SEC press release No. 2004-75, SEC and CESR Set Out the Shape of Future Collaboration (June 4, 2004) *available at* http://www.sec.gov/news/press/2004-75.htm (last visited October 25, 2007).

[163] *See* Romano, *Empowering Investors*, *supra* note 145, at 2367-68; Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903, 942 (1998).

[164] *See supra*, at footnote 149 and accompanying text. To be sure, one of us has argued elsewhere that capital markets are unable to translate specific securities laws' merits or shortcomings into precisely metered premiums or discounts if the jurisdictions involved both represent high-quality suppliers. *See* Tröger, *supra* note 128, at 116-19 (comparing U.S. and U.K. markets and finding a palpable difference reflected in share prices only with regard to enforcement levels). This, however, is not inconsistent with the argument advanced here which rests on the far less ambitious assumption that market participants are capable of correctly reflecting the overall reputation of significantly diverse regulatory environments in share prices.

separating equilibrium should leave investor confidence in the overall efficiency of European capital markets unscathed.

If all that sounds Panglossian, consider the alternatives: with harmonization necessarily imperfect, one could think of bundling securities law with the real seat, as Professor Merritt Fox has suggested.[165] But, quite apart from the proposal's own merits,[166] this connecting factor would not rule out the possibility that certain jurisdictions continue to provide weak investor protection. In fact, this conflict of laws rule would not significantly alter Member States' incentives in securities lawmaking outlined above. However, it would strip high-quality issuers of the opportunity to opt for better securities laws.

Admittedly, at the margin, with national champions deprived of the possibility of an easy European opt-in, some Member States might deem it worthwhile to provide better securities laws at an earlier stage than they would have in a scenario where their existing high-quality issuers had the opportunity to escape inferior domestic securities laws lightly. Yet, this conceivable long-term social benefit arguably does not offset the immediate individual disadvantage an inescapable home State rule would entail.

Other connecting factors, like the place where most of the securities have been sold or where they have first been admitted to trading would be very easy to manipulate, thereby opening the same opportunities for securities law arbitrage existing under the current regime. The only real alternative to the current framework would be to abandon the idea of mutual recognition altogether and leave Member

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[165] Fox, *Securities Disclosure in a Globalizing Market*, *supra* note 147, at 2506, 2628 (proposing to apply U.S. securities laws "only to those issuers that have their economic center of gravity in the United States" as behaviour of these issuers most affects social welfare in the U.S.).

[166] For critical assessments *see* Choi & Guzman, *Portable Reciprocity*, *supra* note 163, at 948-50 (arguing that Fox's "issuer-nationality" model undermines international capital mobility and cancels regulatory competition completely); Romano, *Empowering Investors*, *supra* note 145, at 2408-09 (arguing that welfare gains resulting from rather minor improvements in an issuer's legal

States free to regulate transactions with a sufficiently close connection to their territory, or in other words, since at this point harmonization would be harder to justify, dismantle existing EC securities regulation altogether or limit its future contents to uniform conflict of laws rules.

iii. Deterioration of EU securities laws in the absence of credible commitment devices? If race-to-the-bottom concerns under the current system are misplaced, a plausibly more serious problem is that, with the regulatory arbitrage option open, effectively no firm would be making a credible commitment to any (high-quality) securities law for indefinite time in the future, which is, according to a leading US scholar, the ultimate function that securities law serves (in particular for IPO firms and foreign issuers seeking to tap more liquid markets) and a function that private contracts are unable to perform as efficiently.[167] In other words, if firms were free to engage in midstream reincorporations, there is a chance that some will opportunistically make an IPO in a high-quality jurisdiction only to run to a sloppy one after taking the money. If we consider that these midstream reincorporations can be driven by the goal of making the company more takeover-proof (arguably a corporate law matter, which, however, plays a very significant role in incorporation choices at the IPO stage in the U.S.),[168] now that regulation of takeover defenses

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environment would be foregone if opting for better law required physical and human capital to be moved).

[167] Edward B. Rock, *Securities Regulation as Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure*, 23 CARDOZO L. REV 675, 684-91 (2002) (explaining the – until very recently – extremely restrictive rules governing the exit of foreign private issuers from the system of continuous disclosure under U.S. securities laws as a credible commitment device). Although some backfiring consequences of the traditional U.S. system may weaken Professor Rock's explanation with regard to the U.S. (*cf.* Reproposal Termination of Foreign Private Issuer's Registration and Duty to File Reports, Exchange Act Release No. 34-55005, 72 F.R. 1384, 1391 (proposed Dec. 22, 2006) (reporting that quite many foreign private issuers terminated ADR facilities as a preparatory measure in order to escape the disclosure duties under the Securities Exchange Act of 1934 and thereby triggered materially detrimental consequences for U.S. investors)), Rock's fundamental insights remain valid.

[168] On protection from takeovers as a powerful force in the market for corporate law, *see* Lucian A. Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race to Protect Managers*

highly differs throughout the EU (because Takeover Directive's art. 9 leaves Member States enough latitude to custom-tailor their takeover regulation to fall somewhere in between mandating board-passivity and permitting just-say-no-defense strategies),[169] this scenario looks less theoretical than one may initially think.

Even worse, markets will anticipate that issuers may reincorporate in lower-quality jurisdictions and will discount the securities for the potential opportunism.[170] With no device available to facilitate an ex ante credible commitment to high investor protection standards, even truly domestic issuers would thus be unable to take full advantage of their home country good-quality securities law.

Interestingly, this is an issue that EC securities regulation almost completely ignores,[171] perhaps because the FSAP directives drafters had not envisaged the possibility of post-*Centros* company law arbitrage. Even worse, it appears that the conflict of laws rules in the FSAP directives themselves would prevent Member States from imposing their securities laws to issuers that have reincorporated elsewhere; at the same time, the possibility of cross-border mergers established under EC law[172] enjoins Member States from impeding reincorporations outright; and freedom of establishment sets tight limits on any attempts Member States may undertake in order

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from Takeovers, 99 COL. L. REV. 1168, 1172-77 (1999) (outlining the importance of manager's preference for takeover protection in incorporation decisions); Lucian A. Bebchuk & Alma Cohen, *Firms' Decisions Where to Incorporate*, 46 J.L. & ECON. 383, 404-11 (2003) (presenting empirical evidence from the 1990s). On Member States' leeway in defining the rules for takeover contests *see* Matteo Gatti, *Optionality Arrangements and Reciprocity in the European Takeover Directive*, 6 EUR. BUS. ORG. L. REV. 440, 564-68 (2006).

[169] On Member States' leeway in defining the rules for takeover contests *see* Matteo Gatti, *Optionality Arrangements and Reciprocity in the European Takeover Directive*, 6 EUR. BUS. ORG. L. REV. 440, 564-68 (2006).

[170] *See* ROBERTA ROMANO, THE ADVANTAGE OF COMPETITIVE FEDERALISM FOR SECURITIES REGULATION 127-28 (2002).

[171] A provision very weakly addressing the issue is the Transparency Directive's one providing that third countries issuers' choice of a given Member State as their home State "shall remain valid for at least three years unless its securities are no longer admitted to trading on any regulated market in the Community" (Transparency Directive, art 2(1)(i)(ii)).

[172] See *supra* note 110.

to hamper corporate mobility indirectly.[173] Note also that the restrictions on delisting, the typical safeguards Member States rely on to counter post-IPO opportunism in the form of evading stringent securities laws the issuer originally pledged to comply with,[174] are pretty worthless in the context scrutinized here. To facilitate a change in applicable law under the Transparency Directive's continuous disclosure requirements or the pertinent parts of the Takeover Directive, opportunistic issuers can, without turning a hair, maintain their listing on any Member State's regulated market because the conflict of laws rules depend critically on the issuer's registered office.[175]

As a consequence, the quality of securities regulation across the EU could inexorably fall, because its costs would not be justified any more. Yet, the take-the-money-and-run kind of opportunistic strategy outlined above is only available for prototypical rogue issuers that do not intend to approach capital markets again, at least not in the short or medium term. Investors would certainly red-flag any issuer once it reincorporated opportunistically. The augmentations in the firm's future costs of capital[176] such reputational damage would entail will arguably chill long-term oriented issuers from pursuing such strategies in the first place, *i.e.* high-quality and domestic issuers are deterred from this conduct ex ante by market sanctions. The reliance on these costs of capital effects seems more plausible in the European context than skeptics about the merits of regulatory competition regard it in the U.S. market

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[173] Consolidated Version of the Treaty Establishing the European Community, art. 43, 48, 2006 O.J. (C 321) 37, 59, 61-62. On the freedom of establishment's consequences for reincorporation restrictions *see* Tröger, *supra* note note 16, at 51-56.

[174] Regulators so far have obviated the relevant kind of opportunism by complicating delisting. For details *see infra* note 183.

[175] *See supra at* III.B.2; III.C.2.

[176] Even if investors will generally charge a risk-premium from spotless issuers adjusted to the overall probability of ex post opportunism, issuers with an opportunistic record will have to live with an additional charge.

for corporate charters.[177] According to Lucian Bebchuk, managers can use Delaware's unique institutional advantages and network externalities (*i.e.* its elaborate body of case law, its experienced and efficient administration and judiciary) to camouflage the opportunistic streak of their reincorporation decision.[178] In the EU securities law context, if an issuer reincorporated opportunistically to capitalize on less stringent securities laws, no provider of lower quality regulation in the EU appears to be able to offer comparable positive network externalities to conceal the true character of the pertinent choice of jurisdiction.

Taking market sanctions into account, the only field where EU securities laws provide no guidance for investors is when it comes to identifying rogue issuers: while inescapable, stringent securities laws make it less likely that rogue issuers will enter the system, no such prediction is warranted where ex post opportunism remains possible. If the lobster-trap metaphor in its strongest form did capture the core function of securities regulation,[179] the current EC conflict of laws framework would make securities regulation worthless, once company law arbitrage becomes easily available. In the worst case scenario, investors who could not discriminate between rogue and innocuous issuers would lose confidence in the markets and refrain from investing in equity shares altogether.[180]

Yet, it should not be overlooked, that despite the absence of a lobster-trap kind of regulation,[181] European exchanges went through a significant upswing re-

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[177] *See especially* Bebchuk, *supra* note 3, at 1458-84 (1992) (outlining controllers' ability to exploit informational asymmetries at the IPO stage in the US).

[178] *See also supra* note 150.

[179] *See supra* note 167.

[180] As a result of the informational asymmetry, capital markets which do not offer a signaling device would represent a prototypical market for lemons. *See generally* George A. Akerlof, *The Market for Lemons: Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970).

[181] Remarkably, issuers could – and still can – terminate the applicability of high-quality, secondary market securities laws simply by delisting their securities. *See e.g.* Consolidated Admission and Reporting Directive, art. 2(1); Takeover Bids Directive, art. 1(1); Transparency Directive, art. 1(1) (all requiring the securities to be admitted to official listing or a regulated market). Clearly, a comparable option was always unavailable under U.S. securities laws where the termination of the

cently, at least one of them becoming a serious competitor of U.S. exchanges.[182] Obviously, investors did not perceive EU exchanges as lemon markets. The reason for this persistent investor confidence is that high-quality jurisdictions indeed had safeguards in place at all times that were apt to prevent the easy execution of opportunistic choice of law decisions although they were certainly less incisive than the US-style lobster trap. The current protections rely on shareholder consent prior to the execution of delisting schemes.[183] In essence, they resemble or are even less restrictive than those that will make malign re-incorporations more cumbersome. Typically a re-incorporation will be instituted through a cross-border merger, which requires not only shareholder consent but also compliance with several other preconditions designed to protect, among others, minority shareholders.[184] Delistings and reincorporations at the outset offer only alternative routes for rogue issuers to achieve their opportunistic ends. Hence, it is unlikely that introducing another, at least similarly cumbersome method for an opportunistic escape from stringent securities laws will lead to a melt-down of EU capital market regulation if another method, since long available, did not. While it is unlikely that deep and liquid securities markets will

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exchange listing has no immediate influence on the pivotal registration of the securities with the SEC. *Cf.* Rules and Regulations under the Securities Exchange Act of 1934, Rule 12g-2, 17 C.F.R. 240.12g-2 (2006).

[182] *Cf.* Tröger *supra* note 128 *at* 31-33 and 47-49.

[183] *See e.g.* U.K. Listing Authority, Listing Rules 5.2.5(2) (requiring approval by 75% of the shareholder votes cast in a general meeting); Bundesgerichtshof [BGH] [Federal Court of Justice] Nov 25, 2002, 153 Entscheidungen des Bundesgerichtshofs in Zivilsachen [BGHZ] 47 (53-59) (F.R.G.) (requiring simple majority shareholder consent in a general meeting and establishing a shareholder appraisal right).

[184] *See* Cross-border Merger Directive, art. 5-9 (mandating shareholder approval on the basis of a detailed document containing the terms of the transaction, a management report and an independent expert report). Importantly, the Directive only provides a framework of minimum standards, allowing Member States to retain stricter requirements set by domestic merger statutes. *See e.g.* Companies Act 2006, 2006, c.46, § 907 (Eng.) (supermajority of 75% in value, of each class of members of each of the merging companies, present and voting either in person or by proxy at a meeting); Umwandlungsgesetz [UmwG] [Merger Statute], Oct 28, 1994, BGBl. I at 3210, last amended by Gesetz, April 19, 2007, BGBl. I at 542, §§ 13, 50, 65 (F.R.G.) (supermajority of 75% of the votes cast in shareholder meeting for each class of shares).

develop in the absence of special mandatory legal institutions,[185] it is probably sufficient to complement non-legal safeguards with some legal hooks, like supermajority requirements, to shut the lobster-trap effectively.[186]

Moreover, the alternative of walling-in issuers once they have made their choice comes at a cost, too, because it eliminates the upside of issuer choice – the opportunity for high-quality issuers to opt for another provider of even better regulations later down the road, in case such a provider should emerge. Put pointedly, meeting the race to the bottom concerns also deletes the prospects of a race for the top. If one accepts that market forces, reputational mechanisms and legal safeguards enable issuers to commit to high-quality standards,[187] albeit less tightly than inescapable mandatory law would, the question becomes a quantitative one: will the losses caused by less credible bonding be offset by the gains associated with "better law" opt-in opportunities? It should be recalled that opportunistic re-incorporations in our context require rogue issuers to submit to good securities laws and other efficient non-legal institutions of investor protection at the initial stage in order to allow for noteworthy arbitrage gains. If so, however, the chances that effective gatekeepers,[188] analysts, lawyers, and underwriters can detect these issuers' malevolent intentions are as high as it gets. This fact, together with the additional safeguards established through common standards in the EU's harmonizing measures, results in an institu-

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[185] *E.g.* Black, *supra* note 132, at 789-99; Andrei Shleifer & Daniel Wolfenzon, *Investor Protection and Equity Markets*, 66 J. FIN. ECON. 3 (2002); for empirical evidence *see* La Porta, Lopez-de-Silanes & Shleifer *supra* note 122; for a critique of the La Porta et al.'s methodology *see* Mathias M. Siems, *What Does Not Work in Comparing Securities Laws: A Critique on La Porta et al.'s Methodology*, 2005 INT'L CO. & COM. L. REV. 300 (2005).

[186] *See also* Romano, *The Need for Competition*, *supra* note 145, at 411-14 (arguing that management self-interest complemented with shareholder approval requirements will prevent a good deal of midstream opportunism).

[187] On the possibility and significance of reputational bonding on international capital markets *see* Siegel, *supra* note 120; Larry E. Ribstein, *Cross-Listing and Regulatory Competition*, 1 REV. L. & ECON. 97, 112-13 (2005).

tional framework which makes it a maintainable policy choice to accept the remaining losses due to issuer midstream opportunism. In sum, allowing for issuer choice within the EU and its groundwork of harmonizing directives should enable market participants to fetch most of the benefits of securities law arbitrage without incurring exceeding costs.

d. Toward a more vibrant EU market for company law? The bundling of company and securities law for conflict of laws purposes may have important consequences also for the market for corporate law itself. Let us not forget that today some regulatory arbitrage is *already* taking place in Europe. A high number of German small and medium firms are in fact flocking to the UK to take advantage of the lower incorporation costs for private limited liability companies.[189] At least some of the German "GmbH Limited" founded these days will be among tomorrow's IPO companies. Once they are organized under English law, these firms might avoid an offer to the public and admission to trading on a German market, to take advantage of the UK market and avoid remaining double jurisdiction problems altogether.[190] To be

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[188] *See* Thomas Chemmanur & Paolo Fulghieri, *Investment bank reputation, information production, and financial intermediation*, 49 J. FIN. 57-79 (1994) (analyzing incentives of investment banks and underwriters to perform their certifying function efficiently).

[189] Marco Becht, Colin Mayer & Hannes F. Wagner, *Where Do Firms Incorporate?* (Centre for Economic Policy Research (CEPR) Research Paper No. 5875, 2006) *available at* http://ssrn.com/abstract=953820 (last visited October 25, 2007) (naming minimum capital requirements and delays in registration as main determinants for the observed outpour). As predicted (*see* Tröger, *supra* note 16, at 50; Gelter, *supra* note 16, at 263) affected Member States respond by amending their corporate law, in order to rectify the deficits exposed by corporate migration. *See* the German Ministry of Justice proposal to amend the Private Limited Liability Company Statute (Entwurf eines Gesetzes zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen [Proposal of an Act Modernizing the Law of Private Limited Liablity Companies and Combating Abuses] *available at* http://www.bmj.bund.de/media/archive/1236.pdf (last visited October 25, 2007)). In corporate law, defensive regulatory competition is well under way.

[190] Yet, if our German "GmbH Limited" does business exclusively or mainly in Germany, the prospects for success of a U.K. IPO may be questionable: empirical evidence indicates a relation between investors' familiarity with an issuer's product and the outcome of share offerings. *See* Sergei Sarkissian & Michael Schill, *The Overseas Listing Decision: New Evidence of Proximity Preference*, 17 REV. FIN. STUD. 769-809 (2004) (finding the success of cross-listings to depend significantly on the connection between the home and host state's product markets and attributing this finding to the importance of investor familiarity).

sure, offering shares to the public for the first time represents a stage in a firm's history where its dominant decision makers have to reconsider and adjust the organizational framework governing the firm's operations anyway, making reincorporation more plausible.[191] But, transforming an English Ltd. into a plc. should work more smoothly than converting it into a German stock company.[192] Clearly, the thus created path dependency is amplified where sticking to English corporate law liberates the firm from reconciling its organizational law with foreign securities regulations in the future. As an outcome, the bundling of company and securities laws will have a negative impact on the German securities industry. With time, this should raise the stakes of having attractive company laws, *i.e.* provide further incentives for defensive regulatory competition within the EU.

Further, there can be few doubts that the main candidate to the position of a European Delaware – if any such exists at all – is the UK itself.[193] With securities regulation tied to company law, (re)incorporating in the UK will become even more attractive: in fact, as already hinted, this choice lowers the securities law-related costs for issuers that wish to list their securities on a British market. Further, if there are synergies between a country's corporate and securities laws or, in other words, if each of them "works better" when applied together with the other than with that of another jurisdiction,[194] bundling the two will allow issuers to take advantage of such

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[191] It is exactly this moment in which U.S. corporations feel the most intense stimulus to re-incorporate. *See supra* note 168.

[192] A secure way to accomplish the latter would be to merge the English limited into a German shell-stock company, hardly a transaction cost-saving endeavor.

[193] *See* John Armour, *Who Should Make Corporate Law? EC Legislation versus Regulatory Competition*, *supra* note 12, at 510-18. Even before *Centros*, *see* BRIAN R. CHEFFINS, COMPANY LAW: THEORY, STRUCTURE AND OPERATION 426-430 (1997). The U.K. would resume a position it already occupied during the second half of the nineteenth century. *See* Elvin R. Latty, *Pseudo-Foreign Corporations*, 65 YALE L.J. 137, 166 n130 (1955).

[194] *See* Reinhard H. Schmidt & Gerald Spindler, *Path Dependence, Corporate Governance and Complementarity*, 5 INT'L FIN. 311 (2002) (formalizing complementarities between corporate law and neighboring fields of law).

synergies.[195] Finally, reincorporating in the UK is the most straightforward way to associate with the UK's "good-quality securities regulatory supervisory regime."[196]

If bundling reinforces the dominant player's position in the market, then, no matter what view one takes on regulatory competition in corporate law, the outcome is negative for its dynamics: for opponents of regulatory competition, the fact that a European Delaware would become even more attractive is obviously bad. On the other hand, a regulatory competition supporter would not be fond of a market in which, willy-nilly, the EC legislature has favored one jurisdiction by raising the entry costs for potential competitors. In fact, entering the market for corporate law itself requires an investment by the relevant jurisdiction, especially if a well-established corporate law supplier exists.[197] The investment needed to be attractive to the listed companies segment will be higher, because the relevant jurisdiction will have to make its securities regulation attractive as well. And this may not even be enough, because the UK will still retain the advantages of a deep, liquid and efficient capital market, which might make listing in the real seat country irrelevant, so that the costs of dealing with two jurisdictions under the post-FSAP framework will not

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[195] *See* ROBERTA ROMANO, THE ADVANTAGE OF COMPETITIVE FEDERALISM FOR SECURITIES REGULATION 123 (2002) for some examples of synergies between corporate and securities laws, that would stem from adopting the incorporations state approach as the conflict of laws criterion for securities law (better integration of fiduciary and disclosure duties; a single set of rules for hostile bids and shareholder meetings; lower litigation costs). *See also* Ribstein *supra* note 187 *at* 115-16 (discussing the additional bonds a U.S. incorporation creates, *e.g.* shareholder governance powers in board election, significant transactions etc., adjudication by reputed U.S. courts, protection in takeover situations). With regard to the U.K. in particular, it is important to note that many institutions frequently regarded as critical for investor protection originated from and thus are sometimes still located in company law, making them unavailable to issuers merely listing their shares on a UK regulated market but retaining their registered office abroad. *See* Tröger *supra* note 128, at 73-74, 82 (showing that the strict disclosure duties with regard to significant holdings and the takeover regulation of the City Code until very recently required a U.K. incorporation as a prerequisite of their application).

[196] FERRAN, *supra* note 14, at 155.

[197] To gauge the potential magnitude, it should be recalled that leading US scholars have argued that Delaware today is in a position to successfully chill potential competitors by artificially raising entry costs. *See* Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STAN. L. REV. 679 (2002); Lucian A. Bebchuk & Assaf Hamdani, *Vigorous Race of Leisurely Walk: Reconsidering Competition over Corporate Charters*, 112 YALE L.J. 553 (2002).

have to be incurred. The same will not be true for the majority of other Member States and especially, with one exception to which we now turn, for smaller countries, i.e. the most likely candidates to compete in the market for corporate law.

One may speculate whether the new conflict of laws rules might have an impact on Luxembourg, which is often dubbed as a potential European Delaware[198] and which also happens to have one of the most vibrant capital markets in the world. Like the UK, Luxembourg may become more attractive as the incorporation State for EU issuers wishing to list their securities on its exchange. One might even speculate that the link between issuer choice and company law might finally prompt Luxembourg actively to seek for reincorporations from other Member States, because a more attractive corporate law would make Luxembourg's securities markets even more attractive than they are already.

It is highly doubtful, however, whether Luxembourg's sleepy attitude toward the market for corporate law[199] is going to change: apart from any possible corporate law-specific reasons why Luxembourg is likely to remain passive,[200] it is Luxembourg securities market's specialization that makes this scenario unlikely: Luxembourg is a leading market for mutual funds (Undertakings of Collective Investments, or UCIs) and debt securities.[201] The former are out of the scope of the post-FSAP

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[198] Jens C. Dammann, *Freedom of Choice in European Corporate Law*, 29 YALE J. INT'L L. 477, 528-30 (2004); Gérard Hertig & Joseph A. McCahery, *Company and Takeover Law Reforms in Europe: Misguided Harmonization Efforts of Regulatory Competition*, 3 EUR. BUS. ORG. L. REV. 179, 187 (2004); even before the *Centros* line of cases, *see* Alfred F. Conard, *The European Alternative to Uniformity in Corporation Laws*, 89 MICH. L. REV. 2150, 2194 (1991).

[199] *See* Kamar, *supra* note 134, at 1752 (noting that, even after *Centros* Luxembourg "has done nothing to signal an intention to compete for incorporations.").

[200] *Id.* (pointing to the alleged bad quality of Luxemburg's corporate law, the unfamiliarity of lawyers outside the country with its corporate statutes and deterring language barriers).

[201] The bond turnover observed in 2006 at the Luxembourg Exchange was Euro 1,291.7 million compared to Euro 187.3 million in equity. Significantly, trading in UCIs largely takes place outside Luxembourg's exchange. Luxembourg's UCIs in 2006 held net-assets of Euro 1,844.9 billion but total UCI-turnover on Luxembourg's exchange amounted to Euro 21.3 million only. Source: Bourse de Luxembourg Factbook 2006, Statistics, pp. 64-65; 73-74 *available at* http://www.bourse.lu/application;JSESSIONID_BDL=HghJwCmKTJv83hkBtTm2DSrn10LGQpR54

legislative directives considered in this paper.[202] As to the latter, if the post-FSAP regulatory framework substantially raised the cost of listing debt on the Luxembourg exchange for EU issuers, they might simply incorporate a Luxembourg shell company, let it issue the debt securities, act as guarantor and use the proceeds via an intra-group loan: they would not need to reincorporate the parent company itself in Luxembourg.

C. Bundling Securities Law Aspects of Takeovers with Listing

Finally, an interesting exception to the registered seat criterion can be found in the Takeover Bids Directive: the Directive makes an offeror subject to the disclosure, procedural and price-related rules of the target company's home Member State if the shares are listed in a home market, while, in case shares are not listed on a home market, to the rules of the host Member State where the shares were first admitted to trading; in case the dual listing occurred simultaneously, companies may elect the competent authority and therefore the applicable law.[203] In the last case, the securities law aspects of takeover law are bundled only with the few host state rules applying to an EU issuer from another State, *i.e.* with the Market Abuse Directive's requirements.[204] In other words, it basically allows for the cherry picking of one country's securities law for takeovers.[205]

Suppose that a given jurisdiction ("A") decided to enact a very friendly regulation on on-going disclosure, mainly deferring to other Member States' laws when an issuer is also listed elsewhere, in terms of compliance procedures and so on. The

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[202] Prospectus Directive, art. 1(2)(a); Takeover Bids Directive, art 1(2); Transparency Directive, art. 1(2) all define UCIs as falling outside the scope of their regulations.

[203] *Cf.* Takeover Bids Directive, art 4(2) and *supra* III.C.2.

[204] *Supra* III.E.2.

[205] *See* Mathias M. Siems, *The Rules on Conflict of Laws in the European Takeover Directive*, 1 EUR. CO. & FIN. L. REV. 458, (2004).

costs of Market Abuse Directive compliance in A would hence be low. Suppose also that A chose to impose highly demanding securities law rules for takeovers. An EU company wishing to go public and particularly averse to the risk of a hostile takeover might decide simultaneously to list in A and in Luxembourg and choose A's anti-bidder regime for hostile bids. To be sure, if it comes to hostile takeovers the more daunting shark repellents will be those involving board activity, the latitude for the latter being invariably tied to the law of the registered office.[206] Yet, given the proclivity of managers' to insulate firm's with dispersed ownership structures from takeover-threats as effectively as possible,[207] it is conceivable that some issuers will fetch any opportunity to impede takeovers, particularly if the chance to do so is cheap.

Conversely, another jurisdiction ("B") may supply a regime that does not adequately protect minority shareholders in the event of a friendly sale of control potentially triggering the Directive's mandatory bid requirement. For instance, B may allow for a *de facto* unequal treatment of shareholders,[208] a low level of bidder disclosure, discounts on the mandatory bid price etc., catering to those companies that anticipate a friendly deal on control later on (typically companies controlled by a dominant shareholder that does not anticipate dilution of her control stake).

As an outcome, already today, no matter how difficult regulatory arbitrage is, issuer choice is available with respect to important takeover law issues. Even here, provided that countries are sufficiently differentiated in their treatment of such aspects, separating equilibria are likely, with some companies choosing very bad juris-

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[206] Takeover Bids Directive, art. 4(2)(e); *see supra* III.B.2

[207] *Cf. supra* note 168.

[208] Takeover Bids Directive, art. 3(1)(a) stipulates shareholder equality in control transactions as the overarching principle for Member States' implementing measures. Yet, by leaving acquirers greater latitude in determining the price of a mandatory bid, shaping disclosure requirements less ambitiously etc. a great deal of subsurface inequality can persist.

diction in terms of minority shareholder protection, and others choosing the ones that make life the hardest for hostile bidders.

V. CONCLUSION

We explored the prospects of legal arbitrage in European securities regulation following the implementation of post-FSAP EU securities law measures. Although European lawmakers have made considerable efforts to harmonize capital market regulation, we identified significant latitude for Member States to retain national idiosyncrasies in securities laws. Legal arbitrage considerations are still of considerable relevance with regard to the regime of private liability for false statements in disclosure documents, the public administration and enforcement of securities laws in general, and less densely harmonized takeover law.

Furthermore, we showed that the conflict of laws rules contained in the FSAP-implementing directives with regard to initial and continuous disclosure obligations as well as takeover defenses bundle the choice of applicable securities laws with the issuer's registered office. On the other hand, disclosure duties and traffic rules accompanying public tender offers as well as *ad hoc* disclosure obligations are governed by the law of the market where the issuer's securities are admitted to trading.

We deemed it too early for a conclusive assessment whether corporate migration will be a realistic scenario for existing companies in Europe and hence scrutinized the prospects of issuer choice in two scenarios.

While the home state rule generally serves to disentangle choice of law considerations from non-legal determinants such as market development, depth, and liquidity, it also creates so far unknown multi-jurisdiction problems where issuers face considerable barriers to a transfer of their registered office. Moreover, where corporate law arbitrage is unavailable, the home state rule strips issuers of the opportunity

to signal their high quality by opting into a better securities law regime and exempts national regulators from competitive pressure working to improve their practice.

If future developments should render the transfer of an existing company's seat a viable option thereby facilitating issuer choice, we predict that Europe will not see a race to the bottom. The EU will rather end up with a separating equilibrium offering socially beneficial choice of law opportunities for different types of issuers. Concerns that the quality of securities regulation in the EU would inevitably fall because issuer choice would thwart credible long-term commitments to high standard regulation are unwarranted because legal and non-legal institutions sufficiently prevent midstream opportunism.

Bundling corporate and securities laws potentially stimulates defensive regulatory competition in corporate law because jurisdictions that lose incorporations at early stages are confronted with path dependence if they attempt to recoup them later down the road. Yet, as any path dependence favors the status quo, it also threatens the dynamics of the market for corporate charter. Hence, at the margin the home state rule reinforces the U.K.'s dominant position in the market for newly founded businesses. This is all the more true as we do not expect any other jurisdiction actively to compete with the U.K.

With regard to the aspects of takeover law that are governed by the affected market rule, we show that already today issuer choice offers a broad variety of options. Once again, we expect a separating equilibrium to be the outcome.

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