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Silence Is Golden: The European Company Statute As a Catalyst for Company Law Arbitrage

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Abstract

Following the skimming process that led to its final approval in October 2001, the European Company Statute provides only a patchy set of uniform rules applying to the new legal form, the Societas Europaea or SE. The Statute covers a limited range of issues, most of them only partially and often leaving options open to Member States or to companies themselves. Matters not covered by the Statute are governed by the law on public limited-liability companies of the Member State in which the SE has its registered office and central administration. The purpose of this paper is to show that the very lack of a uniform regime on issues affecting a company's position (as prey or predator) in the market for corporate control may prove to be a key factor for the success of this new legal form. First, it is highlighted how the European Company may turn out to be an attractive vehicle for company-law shopping within the EU. Then, it is showed that the absence of rules on shares, and to a lesser degree on legal capital and financing enhances the appeal of the European Company Statute as a vehicle for company law shopping. Finally, the picture is broadened to discuss the very desirability of regulatory arbitrage (and competition) with specific regard to rules concerning deviations from the one-share-one-vote principle.

Keywords: European Company, Societas Europaea, Regulatory Arbitrage, EC Company Law, Dual Class Shares

JEL Classifications: G32, G34, G38, K22

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I. Introduction

Following the skimming process that led to its final approval in October 2001, the European Company Statute[1] provides only a patchy set of uniform rules applying to the new legal form, the *Societas Europaea* or SE. The Statute covers a limited range of issues, most of them only partially and often leaving options open to Member States or to companies themselves. In short, the SE Statute deals with the formation of an SE, its seat, its governance structure (two-tier or one-tier) and the involvement of employees in its management.[2] Other company law matters, as well as those covered by the Statute insofar as this does not provide complete rules, are governed by the law on public limited-liability companies of the Member State in which the SE has its registered office and head office (or better, as versions in other languages of the Statute suggest, its central administration).[3]

This legislative outcome can be viewed as either bad or good, depending on the function one attaches to the European Company. If one still thinks that the European Company should be, as was originally intended, a new, exclusively (or at least mainly) European legal form for multinational businesses,[4] then the lack of uniform rules is a major shortcoming of the European Company Statute

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[1] This heading captures Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European Company (SE) (O.J. L 294, 10/11/2001, 1), which is supplemented by Council Directive 2001/86/EC of 8 October 2001 (O.J. L 294, 10/11/2001, 22), on the involvement of employees.

[2] For an overview of the European Company Statute see, *e.g.*, M. Menjucq, *La société européenne*, in Revue des sociétés, 2002, 225.

[3] In Article 7 of the SE Statute expressions equivalent to "central administration" are used in most languages (*e.g.*, "Hauptverwaltung," "administration centrale," "administración central," "amministrazione centrale," "administração central"). "Central administration" was also used in the 1991 draft Regulation (Article 5(1)). This expression, which is more familiar to EC law than "head office" (see Article 48, EC Treaty), will be used in the following.

[4] See P. Sanders, *Vers une société anonime européenne?*, in Riv. soc., 1959, 1163, especially at 1166.

and, no matter what its preamble states,[5] the SE Statute has failed to deliver.[6] However, a different assessment is justified if one contents oneself with the idea that the European Company is "a mere instrument,"[7] perhaps cumbersome, for facilitating cross-border mergers[8] and, even more importantly, reincorporations, thus facilitating regulatory arbitrage[9] in the company law area within the EU.[10]

The purpose of this paper is to show that the very lack of a uniform regime on issues affecting a company's position (as prey or predator) in the market for corporate control may prove to be a key factor for the success of this new legal form. Part II thus highlights how the European Company may turn out to be an attractive vehicle for company-law shopping within the EU. Part III shows that the absence of rules on shares, and to a lesser degree on legal capital and financing enhances the appeal of the European Company Statute as a vehicle for company law shopping. Part IV broadens the picture to discuss the very desirability of regulatory arbitrage (and competition) with specific regard to rules concerning deviations from the one-share-one-vote principle.

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[5] Recital (7) is unquestionably misleading in its promise that "[t]he provisions of such a Regulation will permit the creation and management of companies with a European dimension, free from obstacles arising from the disparity and the limited territorial application of national company law."

[6] See, *e.g.*, T. Raiser, *Die Europäische Aktiengesellschaft und die nationalen Aktiengesetze*, in M. Bierich, P. Hommelhoff and B. Kropff (eds.), *Festschrift für Johannes Semler zum 70. Geburtstag am 28. April 1993*, Berlin-New York, 1993, 277, 278-79.

[7] I borrow Professor Viandier's words: see A. Viandier, *Free Movement and Mobility of Companies*, in 9 Eur. Bus. L. Rev. (1998), 301, 303 (reporting the view of some respondents to a survey on issues related to freedom of movement of companies within the EU).

[8] See J. Epstein and G. Le Breton, *Sociétés transfrontalières et sociétés de droit européen*, in Revue du Marché commun (1996), 228, 234.

[9] Reference is made here to regulatory arbitrage as a concept distinct from regulatory (jurisdictional) competition. The former "is the action taken by market operators in selecting the best location for investment or economic activity depending on the local regulatory environment" (*i.e.*, in our context, in selecting the most advantageous company law) (S. Woolcock, *Competition among rules in the single European market*, in W. Bratton et al., *International Regulatory Competition and Coordination*, Oxford, 1996, 289, 298). The latter refers to "competition between regulators to attract investment or business activity or to promote the competitiveness of indigenous industries by providing a more favourable regulatory environment" (*i.e.*, a more favourable company law) (*ibid.*, 297-98). While one cannot have regulatory competition without regulatory arbitrage, one can have regulatory arbitrage without regulatory competition, as is the case when strong national or local preferences, interest groups (or the lack of strong interest groups favouring a competitive legal environment), or path dependence prevent States from competing (compare Id., *op. cit.*, 292; K. Heine and Wolfgang Kerber, *European Corporate Laws, Regulatory Competition and Path Dependence*, in 13 Eur. J. L. and Econ. (2002), 47, 64).

[10] See A. Wehlau, *The Societas Europea: A Critique of the Commission's 1991 Amended Proposal*, in 29 CML Rev. (1992), 473, 502, and, critically, C.D. Stith, *Federalism and Company Law: A "Race to the Bottom" in the European Community*, in 79 Georgetown L.J. 1549, 1606 and 1611. See also J. Wouters, *European Company Law:* Quo Vadis*?*, in 37 CML Rev. (2000) 257, 287.

II. The SE As a Vehicle for Company Law Arbitrage

There are three possible reasons why European businesses might want to opt for the SE legal form. The official ones, so to speak, are, first, that this new legal form allows multinational firms to save on transaction costs for the formation and maintenance of subsidiaries in each Member State[11] and, second, that it facilitates cross-border joint ventures and mergers.[12]

Yet another, perhaps even stronger, reason for choosing the SE legal form could well be that it makes it easier to shop around for a friendlier company law.[13] This opportunity may also be interesting for businesses, even *Mittelstand* ones,[14] with no significant cross-border ramification. As a matter of fact, for an SE to be formed by merger, the Statute requires only that at least two of the companies involved be "governed by the law of different Member States," without requiring that each carry on an active business.[15] Hence, for instance, the formation by merger of an SE of the Irish type between an "active" Portuguese company and a newly formed Irish shell company totally owned by the former would be legal. This, incidentally, is the typical procedure that US companies use to reincorporate in Delaware.[16]

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[11] See M. Menjucq, *Droit international et européen des sociétés*, Paris, 2001, 119-20; F. Blanquet, *Das Statut der Europäischen Aktiengesellschaft (Societas Europaea "SE")*, in ZGR 2002, 20, 34-35.

[12] But see J. Freedman, *European company statute proposal*, in Law Society's Gazette, No. 22, 13 June 1990, 36 (noting that "[m]ethods of dealing with many of the technical inhibitions to cross-border mergers have […] been found"). See also G. Morse (principal ed.), *Palmer's Company Law*, London, para. 16.428; H. Rasner, *Die Europäische Aktiengesellschaft (SE) – ist sie wünschenswert?*, in ZGR 1992, 314, 316; M. Menjucq, *La mobilité des sociétés dans l'espace européen*, Paris, 1997, 188-89; E. Wymeersch, *Some Aspects of Cross-Border Co-operation Between Business Enterprises*, in N. Horn (ed.), *Cross-Border Mergers and Acquisitions and the Law*, The Hague-London-New York, 2001, 63, 64-74.

[13] Compare S. Israel, *The European Company Statute - "SE,"* in E. Wymeersch (ed.), *Further Perspectives in Financial Integration in Europe*, Berlin-New York, 1994, 219, 225. See also H. Merkt, *Europäische Aktiengesellschaft: Gesetzgebung als Selbstzweck?*, in Betriebs-Berater 1992, 652, 660.

[14] But see P. Hommelhoff, *Einige Bemrkungen zur Organisationsverfassung der Europäischen Aktiengesellschaft*, AG 2001, 279, 286-87 (arguing that the European Company statute does not leave enough scope for contractual freedom, for it to appeal to medium and small size businesses); H. Merkt, *op. cit.*, *supra* note 13, 655 (same). Compare also A. Wehlau, *Die Europäische Aktiengesellschaft – eine Option für die GmbH?*, in GmbH Rundschau 1992, 640, 642-43.

[15] See U. Morera and A. Nuzzo, *Lo statuto di "Società Europea": un modello uniforme per le imprese internazionali*, in AA.VV., *L'integrazione fra imprese nell'attività internazionale*, Torino, 1995, 11, 19. Compare also P. Woodland, *La Société Européenne (SE): la dernière ligne droite?*, in Revue du Marché commun (1991), 808, 814-15.

[16] See, *e.g.*, R.J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 Am. J. Comp. L. (2001), 329, 355.

A. The real seat rule is not a serious obstacle. The provision requiring the SE's registered office to be located in the same Member State as its central administration[17] should be no serious obstacle to using the SE as a vehicle for company law shopping.[18] If "central administration," as in Article 48 EC Treaty, stands for "centre de décision, là où siègent les organes de la société et où s'établit la politique général de l'entreprise,"[19] then a multinational firm will have no difficulty in establishing its central administration wherever it likes,[20] especially if the firm results from a cross-border merger.[21] Not to mention that information and communication technology may now render the very concept of "central administration" meaningless.[22] Further, even accepting that the real seat rule has some practical significance, the risk of enforcement is remote, since Article 64 grants the host Member State the authority to verify that no violation of the rule has taken place: presumably, that State will have little incentive to enforce the rule effectively.

This is not to say that the real seat rule will not discourage the use of the SE as a migration tool: the fact that in order to obtain a friendlier legal system the central administration has to be transferred to the new host State, although not necessarily costly, may have symbolic value.

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[17] Article 7. See *supra* note 3.

[18] *Contra*, *Palmer's Company Law*, *supra* note 12, para.16.420. It is true that for companies already located in countries that impose no limitation on a company's choice of head office location (like the U.K.) a rule like this makes the SE less attractive, in that it significantly restricts freedom and flexibility. See J. Gray, *Law Society Company Law Committee Responds to DTI Consultation Paper on the European Company Statute*, in Comp. Law. 1997, 18(10), 331, 332 (reporting the Law Society Company Law Committee's view).

[19] J.M. Bischoff, *Article 58*, in V. Constantinesco, J.-P. Jacqué, R. Kovar and D. Simon (eds.), *Traité instituant la CEE. Commentaire article par article*, Paris, 1992, 303, 306; see also W. Müller-Huschke, *Artikel 48*, in J. Schwarze (ed.), *EU-Kommentar*, Baden-Baden, 2000, 738, 741 ("der Ort […], an dem die unternehmerischen Entscheidungen durch das Leitungsorgan, d.h. die Geschäftsführung oder den Vorstand, getroffen werden"), and P. Troberg, *Artikel 58*, in Hans von der Groeben, J. Thiesing and C.-D. Ehlermann (eds.), *Kommentar zum EWG-Vertrag*, 4. Auflage, Baden-Baden, 1991, Band 1, 1024, 1027 ("der Ort, an dem Willensbildung und die eigentliche unternehmische Leitung der Gesellschaft erfolgt, also meist der Sitz der Organe"). With specific regard to the SE Statute, see J.-L. Colombani and M. Favero, *Societas Europaea. La société Européenne*, Paris, 2002, 65, according to whom the "administration centrale" is a "terme des plus imprécis qui semble vouloir indiquer l'endroit où sont prises les décisions."

[20] C.D. Stith, *op. cit.*, *supra* note 10, 1605-06.

[21] J.-L. Colombani and M. Favero, *op. cit.*, *supra* note 19, 65-66.

[22] See U. Noack, *Moderne Kommunikationsformen von den Toren des Unternehmensrechts*, in ZGR 1998, 592, 615-16; D. Zimmer, *Von Debraco bis DaimlerChrysler: Alte und neue Schwirigkeiten bei der internationalgesellschaftsrechtlichen Sitzbestimmung*, in T. Baums, K.J. Hopt and N. Horn (eds.), *Corporations, Capital Markets and Business in the Law. Liber Amicorum Richard M. Buxbaum*, London-The Hague-Boston, 2000, 655, 665-667; G.B. Portale and U. Tombari, *Opa transnazionale e decentramento delle strutture di governance*, in Banca, borsa e titoli di credito, 2002, I, 295, 309; M. Neville, N. Winther-Sørensen and K.E. Sørensen, *Free Movement of Companies under Company Law, Tax Law and EU Law*, in M. Neville and K.E. Sørensen (eds.), *The Internationalisation of Companies and Company Laws*, Copenhagen, 2001, 181, 185-88.

Political pressure against such a move is accordingly likely.[23] Hence, the prospective SE will have to weigh the risk that the competent authority use its power to oppose the formation of an SE by merger "on grounds of public interest," as Article 19 of the Statute allows.[24]

B. The SE as a way to overcome national legal obstacles to company migration. The fact that adopting the SE legal form makes it possible to shift to another jurisdiction simply by transferring the central administration there is certainly advantageous to companies in those countries that treat reincorporation in a foreign jurisdiction as entailing compulsory dissolution,[25] if only for tax purposes.[26]

Furthermore, the SE Statute will make it possible to reincorporate in the U.K., an option which British conflict-of-law rules have so far precluded.[27] This is an important development because undoubtedly the U.K. has one of the most flexible, albeit complex, company laws in Europe,[28] which should become even more flexible and attractive to European businesses once the ongoing reform process, designed for simplification, is completed.[29]

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[23] Compare C.D. Stith, *op. cit.*, *supra* note 10, 1611.

[24] Interestingly, this provision applies only to formation by merger.

[25] This appears to be the case, for example, in the U.K. and in Germany (see R.R. Drury, *Migrating Companies*, in 24 Eur. L. Rev. (1999), 354, 358; M. Neville, N. Winther-Sørensen and K.E. Sørensen, *op. cit.*, *supra* note 22, 188-89).

[26] This appears to be the case in all Member States: see H. Merkt, *Das Europäische Gesellschaftsrecht und die Idee des "Wettbewerbs der Gesetzgeber,"* 59 RabelsZ (1995), 545, 561-62.

[27] See P.St.J. Smart, *Corporate Domicile and Multiple Incorporation in English Private International Law*, in J. Bus. L. (1990), 126, 133. The significance of this feature of British conflict of laws rules for competition among European jurisdictions in the company law area has been highlighted by B.R. Cheffins, *Company Law. Theory, Structure and Operation*, Oxford, 1997, 427-28. See also P. Behrens, Centros *and the Proper Law of Companies*, in G. Ferrarini, K.J. Hopt and E. Wymeersch (eds.), *Capital Markets in the Age of the Euro. Cross-Border Transactions, Listed Companies and Regulation*, The Hague-London-New York, 2002, 503, 520. To be sure, there are ways around these obstacles (see, *e.g.*, F. Munari and P. Terrile, *The* Centros *Case and the Rise of an EC Market for Corporate Law*, *Ibid*., 529, 557); however, these ways "may come at higher transaction costs, and a higher level of costs may constitute an impediment to changes of the law governing corporate affairs" (*Id*., at 558).

[28] B.R. Cheffins, *op. cit.*, *supra* note 27, at 441 ("by European standards, British company law still offers managers a permissive regime within which to operate"); S. Deakin, *Regulatory Competition versus Harmonization in European Company Law*, in D.C. Esty and D. Geradin (eds.), *Regulatory Competition and Economic Integration*, Oxford, 2001, 190, 205-06 (same); J.A. McCahery and E.P.M. Vermeulen, *High-tech Start-ups in Europe: The Effect of Regulatory Competition on the Emergence of New Business Forms*, in 7 Eur. L.J. (2001), 459, 463 (same). Compare also M. Andenas, *European Law Reform and the United Kingdom*, Comp. Law. 2000, 21(2), 36, 37. On the complexity of today's U.K. company law see, however, A. Tunc, *Le droit anglais des sociétés anonimes*, 4th ed., Paris, 1997, 19-21.

[29] See The Company Law Review Steering Group, *Modern Company Law For a Compatitive Economy. Final Report*, 2 Vol., June 2001, especially Vol. 1, 3-21; *Modernising Company Law, White Paper*, 2 Vol., July 2002,

C. Regulatory arbitrage: the supply side. Despite the EC harmonisation effort, uniformity even of public limited-liability company laws within the EU is far from sufficient[30] to make company-law shopping useless. As we have said, British company law differs enough from the others in flexibility to make migration to the U.K. an interesting option for continental European companies. This may well not be enough for jurisdictional competition in the company law area to emerge within the EU; but it is sufficient to allow for regulatory arbitrage.[31] And, in any case, there is evidence that States compete to attract incorporations within the EU,[32] especially in the area of newly formed closely-held companies, for which the obstacles to regulatory arbitrage are much weaker. Thus, the idea that the SE may be used for migration purposes cannot be dismissed by arguing that there simply are not relatively more attractive company laws within the EU.

D. Regulatory arbitrage: the demand side. In short, the SE legal form may serve as a suitable vehicle for European businesses that want to shop around for a better company law. However, one may well question whether European businesses actually have an incentive to do so. In fact, Europe lacks the one feature of the American corporate law landscape that is supposed to

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especially Vol. 1, 17-53 (interestingly, the White Paper states that the British Government does not intend to modify its conflicts-of-law rules to make jurisdictional migrations easier: *ibid*., 54-55).

[30] B.R. Cheffins, *op. cit.*, *supra* note 27, 434; H.S. Birkmose, *The Fear of the Delaware-effect – The American Demon*, in M. Neville and K.E. Sørensen (eds.), *op. cit.*, *supra* note 22, 243, 264; S. Deakin, *op. cit.*, *supra* note 28, 190; A. Paciello, *La società europea*, in Rivista di diritto dell'impresa, 2001, 317, 319; Stith, *op. cit.*, *supra* note 10, at 1593; with specific regard to the Second Directive, see M. Lutter, *Genügen die vorgeschlagenen Regelungen für eine "Europäische Aktiengesellschaft"?*, in AG 1990, 413, 416-18; H. Halbhuber, *National Doctrinal Structures and European Company Law*, in 38 CML Rev. (2001), 1385, 1406-07. Harmonisation of company laws may have made them more uniform in one dimension, though: it has required Member States to enact provisions that allow specific interest groups, such as accountants and public notaries, to extract rents from European businesses: see especially the Eighth and the First Company Law Directives. See also L. Enriques and J.R. Macey, *Creditors Versus Capital Formation: The Case Against the European Legal Capital Rules*, in 86 Cornell L. Rev. (2001), 1165, 1202-03 (providing an interest-group explanation of the Second Directive and identifying accountants as one of the interest groups extracting rents thanks to its provisions); compare J.A. McCahery and E.P.M. Vermeulen, *op. cit.*, *supra* note 28, 475-76 (identifying public notaries in continental Europe as an influential interest group in the company law area). Much of the harmonisation process can in fact be viewed as a way to protect the rents extracted by such interest groups in individual Member States against the risk of reincorporation aimed precisely at avoiding them (see W.J. Carney, *The Political Economy of Competition for Corporate Charters*, in 26 J. Legal Studies (1997), 303, especially at 317). Hence, there is no much room for corporate migrations with such motivation.

[31] See *supra* note 9 for the distinction between regulatory arbitrage and regulatory competition. According to a recent account, even in the US there is no real competition among States in corporate law, since Delaware is the only State engaged in significant efforts to attract incorporations: see M. Kahan and E. Kamar, *The Myth of State Competition in Corporate Law*, forthcoming in 55 Stan. L. Rev. (2002), available at Social Sciences Research Network Library (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=334120; search of 16 October 2002).

motivate reincorporations in Delaware: namely, the threat of litigation against mergers, IPOs, and antitakeover tactics.[33] Litigation by minority shareholders is still fairly rare in Europe. Consequently, company law is much less of a concern for controlling shareholders and managers of companies planning such transactions in Europe than in the US. More generally, the low risk of litigation makes differences among Member States in the law on directors' and controlling shareholders' duties (and more generally in the law governing the relation between management and minority shareholders) much less relevant.[34]

There is, however, one alternative reading of the dynamics of company law jurisdictional competition within the US that is worth recalling. In this view, such competition can be called a "race to protect managers from takeovers."[35] The key factor driving reincorporations in Delaware, and making Delaware law attractive to corporate managers (and controlling shareholders) is their desire for a shield against hostile takeovers.[36] Without inquiring into the relative merits of this theory, it is safe enough to state that corporate control issues are central to regulatory arbitrage in the US. Generalising, one could further state that in the absence of relevant obstacles what really drives regulatory arbitrage is company law features that significantly affect a company's position, either as prey or as predator, in the market for corporate control. This appears to be true within the

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[32] See J. Wouters, *op. cit.*, *supra* note 10, 286, who makes reference to the introduction of the *société par actions simplifiée* in France as "partly a reaction to the success of the Netherlands 'B.V.'"

[33] See R. Romano, *The Genius of American Corporate Law*, Washington D.C., 1993, 32-33.

[34] See R. Romano, *Explaining American Exceptionalism in Corporate Law*, in W. Bratton et al. (eds.), *International Regulatory Competition and Coordination. Perspectives on Economic Regulation in Europe and the United States*, Oxford, 1996, 127, 142-143.

[35] See L.A. Bebchuk and A. Farrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, in 99 Colum. L. Rev. 1168 (1999), *passim*.

[36] For empirical evidence supporting this theory see L. Bebchuk and A. Cohen, *Firms' Decisions Where to Incorporate*, ECGI Finance Working Paper No. 3/2002, in Social Sciences Research Network Library (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=304386; search of 3 January 2003); G. Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching*, in 150 U. Pa. L. Rev. (2002), 1795.

EU as well, in the light among other things of the high value of corporate control, especially in some countries.[37]

III. Silence Is Golden: Why the Renvoi Technique Makes the SE Statute More Attractive

This part shows how the very *absence* of a relevant set of uniform rules makes the SE a more attractive legal form for European businesses. First, it highlights the advantages of the renvoi technique in general. Then, it shows how the renvoi to national law on shares, financing and legal capital in particular, *i.e.* on the issues most relevant to a company's strength within the market for corporate control, makes the SE legal form attractive.

A. General advantages of the renvoi technique. To begin with, once it was decided not to regulate the SE totally under EC law, the wider use of the renvoi technique reduces the relevance of two potential obstacles to the adoption of the SE legal form by European businesses.[38]

First, due to the lack of a body of case law on SEs and the paucity of scholarly work addressing the SE statute, transaction costs will be higher than those normally encountered by businesses choosing well established national legal forms. Until a sufficient number of SEs are constituted, the choice of this legal form implies a reduction in the benefits stemming from the

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[37] See, *e.g.*, T. Nenova, *The Value of Corporate Votes and Control Benefits: A Cross-country Analysis*, 2000, Social Sciences Research Network Library (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=237809; search of 6 August 2002) (finding a high voting premium – a proxy of the value of control – in France and in Italy).

[38] It is assumed here that the transaction costs of the mandatory bargaining procedure imposed by Section II of Directive 2001/86/EC and, after that, the costs of the agreement with employees representatives or with the participation rules of the Annex to the Directive will not seriously discourage adoption of the SE legal form. This seems reasonable, since workers' participation will not be a relevant issue for companies established in EU countries which already have some kind of rule on employee participation, nor, of course, for companies to which Directive 94/45/EC on European Work Councils applies (see Article 13, Directive 2001/86/EC). Employee participation in the supervisory organ is mandated (with qualifications) in Austria, Denmark, Germany, Luxembourg, the Netherlands, and Sweden (see Weil, Gotshal & Manges LLP, *Comparative Study Of Corporate Governance Codes Relevant to the European Union And Its Member States*, Final Report & Annexes I-III, 2002, p. 44). Other Member States mandate forms of employee participation other than co-determination. See K.J. Hopt, *Labor Representation on Corporate Boards: Impacts and Problems for Corporate Governance and Economic Integration in Europe*, in R.M. Buxbaum et al. (eds.), *European Economic and Business Law. Legal and Economic Analyses on Integration and Harmonization*, Berlin-New York, 1996, 261, 275 (citing the different models of employee participation in France, Italy, and the U.K.). It is also assumed that there are no relevant tax obstacles to the creation of SEs.

positive network externalities one can derive from choosing an established legal form.[39] Accordingly, the regular use of the renvoi technique implies a smaller reduction in such benefits, since positive network externalities will stem from the application of the many national rules applicable to SEs.[40]

Additional transaction costs will stem from the difficulty of determining the "borders" between EC and national rules. These will ultimately have to be traced by the Court of Justice,[41] and preliminary reference procedures will slow down company dispute resolution.[42] Moreover, co-ordination of the Statute with national rules, when the former governs only partly, will be far from easy.[43] Apparently, this kind of problem is also mitigated by the higher frequency of "complete" renvois to national laws by the final Statute as opposed to the frequent "partial" renvois in the previous drafts.[44]

B. The lack of rules on capital, shares and financing as a key factor for the success of the SE legal form. The Statute's lack of rules on shares and, to a lesser extent, on financing and legal capital,[45] coupled with the divergences in Member States' company law in the regulation of such matters, is a significant factor in making the option of reincorporation through an SE (and hence the formation of an SE) attractive to European companies currently regulated by less flexible company laws.

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[39] See, *e.g.*, M. Klausner, *Corporations, Corporate Law, and Networks of Contract*, in 81 Va. L. Rev. (1993), 757, *passim*; K. Heiner and W. Kerber, *op. cit.*, *supra* note 9, at 62.

[40] Compare U. Trojan-Limmer, *Die Geänderten Vorschläge für ein Statut der Europäischen Aktiengesellschaft (SE)*, in 37 RIW (1991), 1010, 1012.

[41] See E. Werlauff, *EC Company Law*, Copenhagen, 1993, 75.

[42] See K.J. Hopt, *The European Company (SE) Under the Nice Compromise: Major Breakthrough or Small Coin for Europe?*, in Euredia, 2000, 465, 470.

[43] See U. Trojan-Limmer, *op. cit.*, *supra* note 40, 1012-13. For a specific illustration relating to the 1991 draft's provisions on pre-emption rights see M. Lutter, *op. cit.*, *supra* note 30, 419.

[44] See M. Menjucq, *La société européenne*, in *Revue des sociétés*, 2002, 225, 233

[45] Article 5 of the SE Statute provides that "[s]ubject to Article 4(1) and (2), the capital of an SE, its maintenance and changes thereto, together with its shares, bonds and other similar securities shall be governed by the provisions which would apply to a public limited-liability company with a registered office in the Member State in which the SE is registered." Article 4, in turn, provides that the SE's capital must be expressed in euro and that the subscribed capital shall not be less than 120.000 euro. For a more detailed analysis on the rules on capital, shares and financing applying to SEs see L. Enriques, *Capital, actions et financements de la Société Européenne : lorsque moins est mieux*, forthcoming in K.J. Hopt, M. Menjucq, and E. Wymeersch (eds.), *La Société Européenne. Organisation juridique et fiscale, intérêts, perspectives*.

1. Rules on legal capital. Legal capital rules are mostly "unimportant," to use Professor Black's term,[46] especially for well-established businesses. In general it is not plausible that differences among national company laws in this area may prompt regulatory arbitrage through reincorporation as SEs. There is, however, one exception. In some countries, public limited-liability companies cannot delegate the issue of new shares to directors while denying shareholders pre-emption rights (as is the case in Italy)[47] or may do so only under specific circumstances and/or subject to limits (in Germany and in France).[48] Such restrictions are not imposed by the Second Directive[49] and are absent in the U.K.[50] Their effect is to make new share issues by listed companies more costly. They require calling a shareholder meeting for each issue. This obviously has administrative costs and, more importantly, entails the risk that market conditions will change in the interval between the management's decision and its execution (after approval by the shareholder meeting). Alternatively, before selling the new shares on the market, directors must wait until pre-emption rights expire.[51] This lag again entails the risk that the price set prior to offer to shareholders will not correspond to the market price at the end of the period. Thus, underwriting these issues is riskier and investment banks will charge a higher fee.[52] Furthermore, it will be harder to use the new issue as consideration for acquisitions.

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[46] B.S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, in 84 Nw. U. L. Rev. 542, 560 (1990).

[47] Under the prevailing construction of Article 2441 Civil Code: see P. Marchetti, *Commento* sub *art. 23*, in Id. (ed.), *Commentario del d.p.r. 10 febbraio 1986, n. 30*, in Nuove leggi civili commentate 1988, 1, 199, at 201. The Company Law Reform Act of January 2003, coming into force on January 1, 2004, replaces this rule with a regime similar to that of France.

[48] See, *e.g.*, H. Halbhuber, *op. cit.*, *supra* note 30, 1406-07; M. Germain, *Traité de droit commercial G. Ripert/R. Roblot*, Tome 1, Vol. 2, 18th ed., Paris, 2002, 624.

[49] See Article 29(5), Second Directive. For the more general observation that "in implementing the rules contained in the Second Directive on the right of pre-emption of existing shareholders when new shares are issued […], a number of Member States have been very restrictive, and have ignored various possibilities and exceptions which were allowed for in the Directive," see J. Wouters, *op. cit.*, *supra* note 10, 267.

[50] See, *e.g.*, I. MacNeil, *Shareholders' Pre-emptive Rights*, in J. Bus. L. 2002, 78, 86-87.

[51] Such period can be no shorter than fourteen days from publication of the offer of subscription on a pre-emptive basis: Article 29, para. 3, Second Directive.

[52] See L. Enriques, *Nuova disciplina delle società quotate e attivismo degli investitori istituzionali: fatti e prospettive alla luce dell'esperienza anglosassone*, in Giurisprudenza commerciale 1998, I, 680, 698.

In short, for companies that repeatedly raise new equity and those that pursue growth through acquisitions, migration (via an SE) from a jurisdiction that restricts such transactions to one that does not might well be an interesting prospect.[53]

2. Financing. The absence of rules on financing in the European Company Statute may also make the SE attractive for company-law shopping, because here too some legal systems are stricter than others.

For instance, in Spain rules on bonds and other debt securities are fairly restrictive. The issue of bonds must be authorised by the general meeting with a qualified majority[54] and the face value of outstanding bonds and other debt securities may not be greater than equity.[55] Hence, a Spanish company interested in access to public debt markets, possibly with a view to financing acquisitions, may find the SE option interesting.

3. Shares. The issue of dual class shares is the most straightforward way to raise equity capital without weakening dominant shareholders' control.[56] In fact, the practice is quite common in continental Europe.[57]

Deviations from one-share-one-vote also turn out to be useful in gaining control of other companies. For instance, the issue of tracking stock, *i.e.* shares that mirror the economic performance of a corporate division,[58] deviates from one-share-one-vote. The voting rights attached to tracking stock are inferior to those attached to common stock, often varying in time according to their relative market value.[59] The lesser voting power of tracking stock reflects the fact that their

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[53] Compare T. Raiser, *op. cit.*, *supra* note 6, 288.

[54] Article 103, Ley de sociedades anonimas (Real Decreto Legislativo 1564/1989, de 22 de diciembre).

[55] Article 282, Ley de sociedades anonimas.

[56] See *infra*, Part IV.

[57] See M. Faccio e L.H.P. Lang, *The Ultimate Ownership of Western European Corporations*, in 65 *Journal of Financial Economics* (2002), 365, 386-87.

[58] See, *e.g.*, T. Baums, *Spartenorganisation, "Tracking Stock" und deutsches Aktienrecht*, in C.T. Ebenroth, D. Hesselberger and M.E. Rinne (eds.), *Veranwortung und Gestaltung. Festschrift für Karlheinz Boujong zum 65. Geburtstag*, München, 1996, 19, 19-21 (outlining the functions of tracking stock).

[59] See, *e.g.*, I. Natusch, *Neue Wege der Beteiligungsfinanzierung deutscher Unternehmen durch die Ausgabe von "Tracking Stocks"?*, in 50 Der Betrieb 1997, 1141, 1147.

holders have less incentive to monitor the issuing company's managers, the value of their shares being tied to one division only.[60]

Tracking stocks are a useful tool for acquisitions. They may be more attractive than the common stock of the acquiring company to the shareholders of the target company, allowing them to retain securities whose performance is linked to the prior business as opposed to the whole business of the acquiring conglomerate; they could also be useful in retaining and motivating the acquired company's management.[61]

Finally, deviations from one-share-one-vote may also prove useful in closely held companies in order to preserve the joint control of individuals or groups of shareholders. For instance, in the U.K. the so called *Bushell v Faith* clause is used for the entrenchment of shareholders' original bargain:[62] this clause "is triggered by a proposal to remove a shareholder from the office of director and […] provides that, in that event, the votes attaching to the shares held by that shareholder will be multiplied to an extent that it is sufficient to defeat the motion."[63]

By eliminating previous draft Statutes' restrictions on dual or multiple classes of shares,[64] not only has the final Statute eliminated a significant competitive disadvantage vis-à-vis most national company laws;[65] it has also made the SE more attractive as a vehicle for company-law

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[60] See D.R. Fischel, *Organized Exchanges and the Regulation of Dual Class Common Stock*, in 54 Univ. Chicago L. Rev. (1987), 119, 140.

[61] See, *e.g.*, Y. Schnorbus, *Tracking Stock in Germany: Is German Corporate Law Flexible Enough to Adopt American Financial Innovations?*, in 22 U. Pa. J. Int'l Econ. L. (2001) 541, 556-58.

[62] E. Ferran, *Company Law and Corporate Finance*, Oxford, 1999, 49.

[63] *Ibid*.

[64] See Article 52 of Amended proposal for a Council Regulation (EEC) on the Statute for a European Company, COM(91) 174 final, 16 May 1991, O.J. C176, 1: this draft provision, while allowing for the issue of different classes of shares, would have significantly constrained contractual freedom: it would have fixed a cap on the issue of non-voting and limited-voting shares at half the subscribed capital and forbidden multiple voting shares; it would also have banned all other limitations or extensions of voting rights, *i.e.*, "digressive voting scales and/or actual vote ceiling" (E. Werlauff, *op. cit.*, *supra* note 41, 82).

[65] For instance, under French company law double voting shares are permitted (see, *e.g.*, M. Germain, *op. cit.*, *supra* note 48, 348), while in Italy, France and Spain voting caps are allowed (see, *e.g.*, L. Stanghellini, *I limiti statutari alla circolazione delle azioni*, Milano, 1997, 51-64 and 396; M. Germain, *op. cit.*, 348; R. Crespí-Cladera and M.A. García-Cestona, *Ownership and Control of Spanish Listed Firms*, in F. Barca and M. Becht (eds.), *The Control of Corporate Europe*, Oxford, 2001, 207, 213). In the U.K. there is no cap on the ratio of non-voting or limited-voting to full-voting shares, and multiple-voting shares are also permitted (see, *e.g.*, E. Ferran, *op. cit.*, *supra* note 62, 49 and 246). In Denmark and Sweden the minimum vote ratio is 1:10, while in Finland it is 1:20 (M. Neville, *Active Ownership and the Competition for International Capital – Recent Trends and Some Implications for Company Law*, in

shopping for businesses established in the jurisdictions that are restrictive on contractual freedom in this area. The relevance of this issue for controlling shareholders and managers (the people who, after all, will decide whether to opt into the SE legal regime) goes without saying.[66]

Furthermore, as the example of tracking stock illustrates, rules restricting deviations from one-share-one-vote might have unduly limited SEs' freedom to shape new financial instruments, thus increasing their cost of capital. More, such rules would also have weakened SEs' position in the mergers and acquisitions arena, depriving them of a useful acquisition tool. Companies incorporated in jurisdictions that are not flexible enough to allow tracking stock and other innovative financial instruments may thus take advantage of the SE legal form to migrate to more accommodating jurisdictions.[67]

IV. A Broader Picture: Is the Lack of Rules on Dual Class Shares Desirable?

We saw in Part III that the very lack of uniform rules, specifically but not exclusively on capital, on financing and most importantly on shares may make the SE an attractive vehicle for European businesses that want to shop around for a company law regulating companies in a laxer way. In the legal context of European countries, where shareholder litigation is a secondary concern for managers and controlling shareholders, the opportunity to reincorporate under company law that facilitates capital increases, debt financing and deviations from one-share-one-vote might well be a major consideration in deciding to form an SE.

Yet, no matter how important the lack of relevant rules on capital, financing and shares may be for the success of the SE, from a broader perspective one cannot but question whether it is really desirable to facilitate such "shopping." This applies especially to rules on dual class shares, because making regulatory arbitrage easier may trigger a race to laxity among Member States fearing

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3 European Organization Law Review (2002), 439, 469). There is no ratio of this kind in Austria or Ireland (M. Faccio and L.H.P. Lang, *op. cit.*, *supra* note 57, 386-87).

[66] See *infra* the discussion in Part IV.

corporate flight. In other words, one wonders whether it was wise to delete the constraints on deviations from one-share-one-vote, in that, if the SE becomes a tool for regulatory arbitrage, Member States may engage in a race to protect dominant shareholders from takeovers and repeal all or most of the national rules limiting such deviations.

Interestingly, the U.K. has one of the most liberal regimes in this regard, but dual class shares are rare among British listed companies, thanks to institutional shareholders' successful opposition.[68] A continental European company could exploit this by forming an SE of the British type: if this company does not list in the U.K., it will avoid the discipline of U.K. stock markets and thus be able to resort freely to dual class shares.

This Part discusses the desirability of the SE Statute's deregulatory solution as regards dual class shares in the light of its scope for regulatory arbitrage. Let us clarify that the point at issue here is not the desirability of harmonisation in this area.[69] As a matter of fact, one may well favour a common set of rules for SEs (in order to prevent regulatory arbitrage) while preferring that Member

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[67] As noted by S. Thiel, *Spartenaktien für deutsche Aktiengesellschaften*, Köln-Berlin-Bonn-München, 2001, 134, in the silence of the European Company Statute, SEs may issue tracking stock depending on whether this kind of stock is permissible under the relevant national law.

[68] See, *e.g.*, P.L. Davies, *Institutional Investors in the United Kingdom*, in D.D. Prentice e P.R. Holland (eds.), *Contemporary Issues in Corporate Governance*, Oxford, 1993, 70, 85-87.

[69] Some of the proposals by the High Level Group of Company Law Experts appointed by the European Commission may be viewed as an attempt to harmonise company law preventing *de facto* dual class shares and some other deviations from one-share-one-vote: these proposals would in fact deprive these practices of their essential function of protecting controlling shareholders from takeovers, thus making them unattractive. See *Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids*, Brussels, 10 January 2002, especially 20-22 (proposing that defensive measures be approved by a majority of shareholders, according to a proportionality rule that would grant one vote to each share, no matter whether voting, multiple voting or non-voting according to the company's statute) and 29 (proposing that a successful bidder, *i.e.* a bidder acquiring more 75 per cent of the share capital, no matter whether represented by voting or non-voting shares, in a general bid for all the shares of the company, should be able "to break-through any mechanisms which frustrate the exercise of proportionate control"). For critiques of these proposals see L. Enriques, *Euro-Opa, c'è il rischio di piramidi più forti*, in Il Sole-24 Ore, 2 February 2002, 28; Id., *In tema di difesa contro le opa ostili: verso assetti proprietari più contendibili o più piramidali?*, in Giurisprudenza commerciale 2002, I, 108; J. Palmer, *Comment: Why EU takeover plans would freeze Europe,s markets*, in Int'l Fin. L. Rev., May 2002, 13, 14-15; E. Berglöf and M. Burkart, *"Break-Through" in European Takeover Regulation?*, SITE Staff Papers 02/03, 2002, *passim*; L. Bebchuk and O. Hart, *A threat to dual-class shares*, in *Financial Times*, 31 May 2002, 18. For a defence of the proposals by one of the components of the High Level Group, see J. Garrido García, *Comment: Freeing Europe's corporates from minority control*, in Int'l Fin. L. Rev., June 2002, 12. The European Commission has partly followed the High Level Group's suggestions in its new Proposal for a Directive on takeover bids (see Articles 10 and 11 of the Proposal).

States remain free to regulate their domestic companies' capital structures as they wish.[70] Of course, the two issues are closely linked;[71] incidentally, the case for harmonisation of Member States' laws on dual class shares is strengthened by the European Company Statute, if this is viewed as a catalyst for regulatory (company law) arbitrage. In fact, in the absence of regulatory arbitrage (and competition), the idea that Member States should not be free to regulate their own (captive) companies as they wish with regard to dual class shares is much less convincing.

Why do companies deviate from one-share-one-vote? Primarily, the reason is that as long as corporate control confers substantial private benefits on dominant shareholders they cannot be expected to leave control "up for grabs,"[72] any time an injection of equity capital is needed. In the presence of large private benefits of control,[73] it is perfectly natural to deviate from one-share-one-vote in order to expand the company's business.[74] If dominant shareholders are not allowed to raise equity via non-voting or limited-voting stock (or if there are caps), they might simply opt against growth and condemn their companies to smaller size.[75] A simple numerical illustration is illuminating.[76]

Assume there are two Member States. State A has a strict one-share-one-vote rule, while State B leaves companies completely free to alter or limit voting rights. In this situation, companies

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[70] Much in the same way, one may favour worker participation rules in the SE Statute and oppose efforts to impose co-determination by way of company law harmonisation.

[71] All the more so if one considers that a company may reincorporate as an SE in a country that sets no limitations on dual class shares and then, after just two years, or after the first two annual accounts have been approved, convert into a national public limited-liability company (see Article 66(1), SE Statute).

[72] I borrow Professor Bebchuk's expression. See L.A. BEBCHUK, *A Rent-Protection Theory of Corporate Ownership and Control*, N.B.E.R. Working Paper n. 7203, 1999, 5-14.

[73] For a recent survey of the literature linking dual class share structures with private benefits of control, empirical evidence on the link and a useful taxonomy of private benefits of control, see O. Ehrhardt and E. Nowak, *Private Benefits and Minority Shareholder Expropriation – Empirical Evidence from IPOs of German Family-Owned Firms*, mimeo, 2002, Social Sciences Research Network Library (http://papers.ssrn.com/sol3/delivery.cfm/SSRN_ID302919_code020322530.pdf?abstractid=302919; search of 6 August 2002), 12-13.

[74] Compare G. Ferrarini, *Share Ownership, Takeover Law and the Contestability of Corporate Control*, Ce.Di.F. Working Paper N. 1, 2001, 13 (available at www.cedif.org; search of 12 August 2002).

[75] See K. Rydkvist, *Dual-class Shares: A Review*, 8 Oxford Rev. of Econ. Policy (1992), No. 3, 45, 51. M. Neville, *op. cit.*, *supra* note 65, 471.

[76] The example draws on those offered by Professors Bebchuk and Roe to illustrate that ownership structures may not evolve from concentrated to dispersed, even when it would be efficient, because controlling shareholders would lose part of their rents. See L.A. Bebchuk and M.J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, in 52 Stan. L. Rev. (1999), 127, 143-45.

in State A may consider forming an SE of State B type, in order to raise new capital by issuing non-voting shares.

This may be the case of Company Z, controlled by a dominant shareholder (DS) with 50 percent of the shares (granting private benefits worth 30) and having a market capitalisation of 100. This company has to decide whether to undertake an investment project to be financed by new equity worth another 100. Supposing that the new shares are issued at the current market price, after the capital increase DS would have only a 25 percent stake and the value of private benefits would drop to, say, 15, reflecting the probability of a successful hostile takeover.[77] Supposing further an expected return rate of 20 percent for the investment project, the market value of Company Z would grow to 220 once the investment project becomes public knowledge. In the end, the value of DS's controlling block falls from 80 (100/2 + 30) to 70 (220/4 + 15).[78] Hence, while outside shareholders and society in general would be better off if the investment project were pursued, the majority shareholder will veto it unless uncontestable control of the firm is retained, as the issue of non-voting shares would allow. If Company Z is incorporated in State A, then, reincorporating as a State B European Company could be a viable option.[79]

It is worth noting that if State A had a rule forbidding partial bids this would not change matters greatly for the dominant shareholder. In fact, the mandatory bid rule would reduce the probability of hostile takeovers by raiders interested in extracting larger private benefits to the detriment of outside shareholders,[80] but it would not protect the incumbents against value-increasing hostile takeovers, which would still leave them uncompensated for the loss of private

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[77] For the sake of simplicity, no account is taken here of the fact that such a toehold would still make takeovers unlikely. See, *e.g.*, J. Bulow, M. Huang e P. Klemperer, *Toeholds and Takeovers*, in 107 Journal of Political Economy (1999), 427, *passim*.

[78] Note that the example would hold even if the new shares were issued at a price incorporating the expected returns from the investment project (*i.e.*, after full disclosure about it). In fact, supposing that prior to the new issue, there were 100 shares outstanding, new shares would be sold at a maximum price of 1.2 (reflecting the expected return on capital of 20 percent). The dilution of DS's holding would be lower (in fact, in order to raise 100 it would be enough to issue 83.3 shares, so that DS would end up with a 27.3 percent stake), but still the control block would be worth less than before (27.3 percent of 220 + 15 = 60.06 + 15 = 75.06).

[79] As explained *infra*, text accompanying note 92, it would not be the only way to undertake the project.

benefits of control. Hence, with a mandatory bid rule the risk for DS of losing control would be lower, but still more than zero.

Unfortunately, value-decreasing reincorporations from State A to State B by forming an SE may also take place. For instance, a company might raise new capital by issuing non-voting shares in order to take control of a respected newspaper: this acquisition would make the dominant shareholder better off (granting him or her greater prestige and political power) and be accomplished even if the acquiring company were unable to manage the newspaper business as well as the previous management team.

Advocates of free competition for corporate charters in the US generally argue that market discipline prevents value-decreasing reincorporations.[81] However, it is highly doubtful that market discipline could be effective against reincorporations of the kind exemplified above. In fact, dual class share structures protect dominant shareholders from the disciplining effect of the market for corporate control and the effectiveness of other markets (such as the product market, the market for additional capital and the market for managerial services) in preventing opportunistic reincorporations is questionable, both in general and in the presence of a dominant shareholder, especially when reincorporations aim at exploiting friendlier regimes in terms of protection from takeovers.[82] The fact is that the dominant shareholder bears only part of the cost of such transactions, in terms of diluted cash flow rights: in part, minority shareholders bear the cost, unless they discounted the probability of an opportunistic reincorporation when they acquired their shares;

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[80] See, *e.g.*, L.A. Bebchuk, *Efficient and Inefficient Sales of Control*, in 109 Quart. J. Econ. (1994), 957, 961-63.

[81] See, *e.g.*, R.K. Winter Jr., *State Law, Shareholder Protection, and the Theory of the Corporation*, in 6 *Journal of Legal Studies* (1977), 251, *passim*.

[82] See L.A. Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, in 105 Harv. L. Rev. (1992), 1435, 1467-70 and 1476-78; L.A. Bebchuk and A. Farrell, *op. cit.*, *supra* note 35, *passim*. See also H.S. Birkmose, *op. cit.*, *supra* note 30, 243, 262-63.

this will obviously not be the case for those holding shares at the time the SE legal form becomes available.[83]

Leaving aside the contingent investment opportunity that might prompt a dominant shareholder to reincorporate in a laxer jurisdiction, it is far from clear that dual class structures have a negative impact on shareholder welfare. It is often claimed that they reduce outside investors' welfare by shielding companies and their incumbents against takeovers, which are said to be the most effective device for monitoring managers. But the market for corporate control, important though it is, is but one of a number of monitoring devices.[84] No less than other monitoring devices, takeovers have costs as well as benefits, which can vary significantly from industry to industry and from firm to firm.[85] Moreover, there can be substantial benefits to the protection of managers (and controlling shareholders) against takeovers, again varying from firm to firm. As Professor Rydkvist put it,

> "First, effective takeover defence stops uninformed outsiders from interfering with the operations of the firm. This reduces the risk for mistakes and unnecessary effort for explaining decisions or engaging in takeover battles. […] Second, without [protection from takevoers], the manager may be less enthusiastic about his work and underinvest in firm-specific human capital […]. Third, takeover defence reduces the risk for myopic behavior."[86]

Further, the very presence of a dominant shareholder may be beneficial, because he or she may monitor management.[87] Whether these benefits are enough, in the aggregate, to more than offset the costs of deviations from one-share-one-vote (in particular the higher agency costs)[88] is

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[83] For empirical evidence showing that in Germany investors were unable to discount opportunism by controlling shareholders of companies with dual class shares see O. Ehrhardt and E. Nowak, *op. cit.*, *supra* note 73, 37-39.

[84] See D.R. Fischel, *op. cit.*, *supra* note 60, 134.

[85] Id., at 135.

[86] K. Rydkvist, *op. cit.*, *supra* note 75, 51.

[87] See, *e.g.*, E. Berglöf and M. Burkart, *op. cit.*, *supra* note 69, 25.

[88] See especially L. Bebchuk, R. Kraakman e G. Triantis, *Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash Flow Rights*, in R.K. Morck (ed.), *Concentrated Corporate Ownership*, Chicago-London, 2000, 295, 301-06, for a theoretical illustration.

still open to debate.[89] The balance, we have hinted, presumably varies from firm to firm[90] and also from jurisdiction to jurisdiction: the outcome will in fact depend also on the legal bars to self-serving behaviour by controlling shareholders in the reincorporation State and on the social constraints on such behaviour in the Member State where the corporation mainly raises its capital or in which it has its central place of business.[91]

To evaluate the case for limiting deviations from one-share-one-vote in the SE Statute, one must also consider that dual class shares and the like are not the only tools for separating ownership from control without leaving the latter up for grabs. In fact, this can also be achieved by pyramids and cross-holdings, albeit in a more opaque and more costly way.[92] Pyramidal groups[93] entail the apparent administrative costs of maintaining one (usually listed) company for each layer of the structure and increase opportunities for intra-group self-dealing by dominant shareholders. Webs of cross shareholdings[94] may involve higher agency costs due to the voting power various blockholders have in each other's companies;[95] more, they may hinder the functioning of the market for corporate control even more seriously than dual class shares,[96] prove difficult and expensive to

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[89] E. Berglöf and M. Burkart, *op. cit.*, *supra* note 69, 25.

[90] See C.G. Holderness, *A Survey of Blockholders and Corporate Control*, in 2002 Econ. Policy Rev., 1, 5-6.

[91] See generally L. Bebchuk, R. Kraakman e G. Triantis, *op. cit.*, *supra* note 88, 311. For an analysis showing that private benefits of control vary greatly from country to country, even within the EU, see T. Nenova, *op. cit.*, *supra* note 37.

[92] See E. Berglöf and M. Burkart, *op. cit.*, *supra* note 69, 25.

[93] In its report on *A Modern Regulatory Framework for Company Law in Europe* (Brussels, 4 November 2002), the High Level Group of Company Law Experts suggests that the EU should ban stock pyramids, by forbidding admission to trading of shares issued by holding companies "whose sole or main assets are their shareholding in another listed company" and consider "a requirement […] for their delisting" (p. 99). For a critique of this proposal see L. Enriques and E. Spaventa, *Troppe ombre sulla nuova Opa europea*, in Il Sole-24 Ore, 8 December 2002, 23.

[94] No proposal to limit the use of cross-holdings can be found in the High Level Group of Company Law Experts' report on *A Modern Regulatory Framework for Company Law in Europe*, *supra* note 93.

[95] Suppose that a car company has blockholdings in a bank and an insurance company which in turn have blockholdings in the car company in order to reinforce the founding family's control. The bank and the insurance company may use their influence to sell their services to the car company at an augmented price.

[96] This may be so because, as is often the case, webs of cross-shareholdings involve many of the largest listed companies within an economy (see, *e.g.*, E. Wenger and C. Kaserer, *German Banks and Corporate Governance: A Critical View*, in K.J. Hopt et al., *Comparative Corporate Governance. The State of the Art and Emerging Research*, Oxford, 1998, 499, 503-511, for a picture of the pervasiveness of cross-holdings in corporate Germany; on the persistence of cross holdings in Germany see D. Wójcik, *Change in the German Model of Corporate Governance: Evidence From Blockholdings, 1997-2001*, mimeo, 2001, 17-19, Social Sciences Research Network Library, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=294459, search of 7 August 2002). Relations among these companies will hence be cosy and the probability of one attempting a hostile takeover of another, low.

disentangle, increase systemic risk in the capital market,[97] and make inefficient bailouts of insolvent companies more probable.[98]

It is hard to understand why the SE statute should limit the least costly form of deviation from one-share-one-vote (dual class shares and other restrictions or extensions of voting rights), while allowing others. Of course, it is much easier to ban dual class shares than to prohibit pyramids and cross-holdings: it would be difficult to draft prohibitions of this kind that would not, at the same time, prevent firms from adopting efficient forms of organisation or co-operation.[99] This explains why many Member States have adopted the "easier" rules on dual class shares, while leaving companies free to resort to other forms of separation between ownership and control, which are in fact extremely common in continental Europe.[100]

In this light, the absence of rules preventing or limiting deviations from one-share-one-vote cannot make things worse than they are. Actually, it could even improve matters, because it will allow companies wishing to deviate from one-share-one-vote to do so at lower cost (*i.e.*, without building pyramids or webs of cross-holdings), by forming an SE incorporated in a more flexible jurisdiction.[101]

Finally, limited-voting shares are not necessarily designed to protect dominant shareholders. As we saw in Part III, tracking stock often carries inferior voting rights. Rules restricting deviations from one-share-one-vote might have prevented companies incorporated in jurisdictions that impede

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[97] One may wonder what consequences for share prices, apart from investors' loss of confidence in managerial integrity, the recent major bankruptcies in the US would have had in European equity markets, in which financial institutions and manufacturing businesses are so often inter-connected through cross-holdings.

[98] This was often the case in corporate Europe until recently. See *The Big Crackdown*, Bus. Week (European Edition), 22 July 2002, 52, 52.

[99] Compare G. Ferrarini, *op. cit.*, *supra* note 74, 12-13.

[100] See, *e.g.*, M. Faccio and L.H.P. Lang, *op. cit.*, *supra* note 57, 389.

[101] All the arguments used so far in order to justify the claim that limits on deviations from one-share-one-vote by SEs are unjustified can also be used against a possible objection that society as a whole would be better off if all forms of separation between ownership and control which allow incumbents to be protected from hostile takeovers were prohibited (dual class shares etc., pyramidal groups, cross-holdings). Leaving aside their silence on cross-holdings, this is mostly the proposal arising from the two reports by the High Level Group of Company Law Experts (see *supra* notes 69 and 93). In a word, such a proposal, which, in any case, would be much harder to put into practice than it may seem at first sight, would only condemn European firms to smaller size, so long as corporate control has significant value for dominant shareholders.

tracking stock from migrating, via the SE, to more flexible jurisdictions in order to finance acquisitions, to reward and motivate managers of distinct divisions within a conglomerate and, in a word, to lower their cost of capital.

V. Conclusion

The legal regime of the SE can be found in the European Company Statute only in small part. On most issues, especially those that bear most powerfully on a company's position, as a prey or as a predator, in the market for corporate control, the company law of the State where the SE has its registered office directly applies. This legislative outcome makes the SE more attractive to European businesses, as a vehicle for reincorporating in jurisdictions with less restrictive rules on these matters.

From a broader perspective, it is difficult to say whether allowing companies to move from jurisdictions that impede deviations from one-share-one-vote to less restrictive jurisdictions is justified by considerations of efficiency. Since all Member States already allow for deviations from one-share-one-vote via costlier devices such as pyramids and cross-holdings, however, the absence of rules on shares that restrict contractual freedom in this regard can do little harm, and possibly some good.

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