Corporate Mobility in the European Union – a Flash in the Pan?
An empirical study on the success of lawmaking and regulatory competition

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WOLF-GEORG RINGE*

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ABSTRACT

This paper discusses new data on regulatory competition in European company law and the impact of national law reforms, using the example of English company law forms being used by German start-ups. Since 1999, entrepreneurs in the EU have been allowed to select foreign legal forms to govern their affairs. The data show that English limited companies were very popular with German entrepreneurs in the first few years of the last decade but have experienced a sharp decline since early 2006. This decline casts doubt over the claim that the German company law reform from November 2008 ‘successfully fought off’ the use of foreign company forms. Moreover, by contrasting the German data with the corresponding developments in Austria, the paper further demonstrates that the latter jurisdiction is also seeing a similar decline, and without having reformed its company law. Instead of exclusively seeing law reform responsible for the declining number of foreign incorporations, this paper offers a number of alternative or complementary explanations for the striking developments. These findings are important for our understanding of (defensive) regulatory competition and successful lawmaking.

Keywords: regulatory competition, company law, Centros, minimum capital.

* Professor of International Commercial Law, Copenhagen Business School, and University of Oxford. I am grateful to John Armour, Sonja Bydlinski, Manfred Grünanger, Heribert Hirte, Peter Hubalek, Colin Mayer, Andrea Polo, Jonathan Rickford, Edmund Schuster, Beate Själfjell, Oren Sussman, Christoph Teichmann, Thomas Traar, as well as the participants at the Law & Finance Law Faculty seminar at the University of Oxford, a workshop at the Chamber of Commerce in Vienna, an empirical law studies workshop at the University of Oslo, and the 7th ECFR symposium in Luxembourg.
I. INTRODUCTION

Corporate mobility has reached a certain level of maturity in Europe. The EU legal framework is established and well understood, and it rests largely on case-law from the European Court of Justice. Beginning with the seminal *Centros* decision, the Court has effectively opened the borders between EU Member States little by little, and entrepreneurs now de facto have the right to select the foreign corporate law that governs the legal form of their company, at least at the company formation stage. Moreover, researchers have begun to empirically study how the case-law has impacted the market and how the market has reacted. While much effort has been spent evaluating the early market reactions, following the partial market opening made possible by *Centros*, relatively little attention has been devoted to subsequent developments. This is surprising because the various lawmakers’ responses to the wave of entrepreneurial migration offer a rare glimpse at the effects of regulatory competition and subsequent business’ reaction, as well as providing insights into the relevance and effects of lawmaking and regulatory responses to market pressure.

This paper explores the responses by European businesses to the (limited) occurrences of regulatory competition flowing out of *Centros* and subsequent case-law. It uses new empirical data on Germany, the most prominent example of a country that was under pressure from regulatory competition. The paper confirms earlier findings that entrepreneurs in continental Europe, at first, increasingly used English letterbox companies to govern their affairs, without doing any business in the UK. The present analysis goes further, however, and shows that incorporation numbers have dropped considerably since 2006, falling to remarkably low numbers today. I then go on to evaluate the role that regulatory reform may have played in this development. Many lawmakers in continental European jurisdictions claim ‘success’ in the sense that the legal reforms of domestic company laws have caused foreign (English) corporations to fall out of vogue with their respective entrepreneurs as these entrepreneurs have begun to increasingly use domestic company types. The data evaluated in this study seem to weaken this claim: first, I show that the number of foreign incorporations in Germany has dropped even before the law reform came into force. Secondly, I go on to compare the German data with the situation in Austria, a natural comparison to make as these two systems share many similarities – with the exception that Austria did not reform its legal system as a consequence of EU regulatory competition. Surprisingly, however, the drop in the number of foreign incorporations in Austria coincided with the development of the reform in Germany; in other words, the rate began to drop at about the same time as in Germany. This may lead to the conclusion that reasons other than legal reform must have played a role in shaping businesses’ preferences. This paper is the first part of a larger research
initiative to explore the merits of corporate mobility and regulatory competition in Europe.

The paper is organised as follows. Part II provides the legal and empirical background on developments that have led to the current (limited) scope of regulatory competition for incorporations within the EU. Part III evaluates these developments and offers an assessment of the academic work done so far. Parts IV and V introduce new empirical data for Germany and Austria, shedding light on the implications of the German 2008 law reform and questioning traditional assumptions of its effects on foreign incorporations. Part VI seeks to find explanations for the results and advances a number of possible conjectures. Part VII concludes.

II. LEGAL AND EMPirical BACKGROUND

Free mobility for companies across borders has been a long-standing dream for European businesses. One would imagine that the creation of the European Union – or its predecessors, the European Economic and the European Communities – with its concept of an ‘Internal Market’ and the instrument of ‘freedom of establishment’ for corporations would help this dream come true. Yet it took over forty years from the inception of the EEC for the European Court of Justice, in its famous Centros judgment, to allow for a certain – and limited – freedom in this field. The Centros saga has been discussed in sufficient detail elsewhere. In summary, Centros effectively allows for choice of incorporation: entrepreneurs are free to form a company registered in Member State A while doing business exclusively in Member State B (the latter usually being their entrepreneur’s home state). This means that for instance German entrepreneurs are no longer exclusively reliant on German company forms. They can form a company in any of the other EU (or EEA) Member States as a ‘letterbox’ company, which keeps nothing more than a registered office in that Member State, and does its business exclusively in Germany. To the extent that company laws diverge between Member States, there may accordingly be an incentive to choose any foreign company law for domestic purposes. The Centros case created a sudden awareness of the possibilities offered by the Internal Market, provoking a storm of academic literature and corresponding business behaviour that quickly adapted to the situation.

The concept first articulated in Centros was later expanded and clarified. Subsequent case-law – cases like Überseering (2002) and Inspire Art (2003) – supported and reinforced the liberal interpretation of the European treaty framework, whereas cases like Cadbury Schweppes (2006) and Cartesio (2008) limited the scope of the concept. Nevertheless, it is safe to say that by the end of 2003, when the judgment in Inspire Art was handed down, market participants had a clear framework of permissible cross-border mobility at hand.

1. Legal framework

We can summarise the legal situation as follows:

As described, entrepreneurs can form a company in a Member State of their choice (‘home Member State’) and subsequently carry out business with this company in another jurisdiction (‘host Member State’). The host Member State has to recognise the legal capacity and the legal characteristics of this company as such – this means that the rules of company law pertaining to internal organisation, legal status, liability of directors, etc, are all governed by the law of the home Member State. From a legal perspective, the company has to set up a branch in the host Member State, which has to be registered in the register of the host Member State in accordance with the rules laid down in the eleventh Company Law Directive. Although technically a branch, this may de facto be the ‘head office’ or even the sole place of operation for the entire company. In this case, the company keeps nothing more than a registered office in the home Member State (‘letterbox company’).


5 Case C-167/01 Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd [2003] ECR I-10155.
6 Case C-198/04 Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue [2006] ECR I-7995.
7 Case C-210/06 Cartesio Oktató és Szolgáltató bt [2008] ECR I-9614.
The case-law sets limits, however, for existing companies wishing to emigrate into another Member State.\textsuperscript{10} For this reason, cross-border mobility so far has been confined only to the stage of company \textit{formation}. There has not been any serious ‘midstream’ migration of existing companies. The possibility of a relocation of an existing business is still to some degree uncertain, due to lacunae in the Court’s case law.\textsuperscript{11} This aspect of mobility has, rather, been the realm of legislation. After the Commission officially dropped the plans for a proposed directive\textsuperscript{12}, the European Parliament has repeatedly tried to revive the project\textsuperscript{13}, and the Commission has now initiated a public consultation on the case for such a directive.\textsuperscript{14} However, within the existing body of law, the Cross-Border Mergers Directive\textsuperscript{15} and Article 8 of the European Company Statute (SE)\textsuperscript{16} currently provide for the only means of moving an existing business across the border without being dissolved or having to register as a new company. The recent \textit{Vale} case illustrates that the case-law developed by the ECJ may help in some situations.\textsuperscript{17}

Even at formation stage, where \textit{Centros} and other cases have facilitated foreign incorporations, things did not develop as smoothly in the beginning, as there was much legal uncertainty as to the exact borderlines between permissible and abusive behaviour. This was largely due to the question as to whether the so-called ‘real seat’ theory was in any way impinged upon by this judgment. The real seat theory is a conflict-of-laws rule, determining the law applicable to companies (the \textit{lex

\textsuperscript{10} ‘Migration’ can take two forms: companies may wish to move either their registered office or their head office (‘real seat’) across the border. Both ways have recently become easier, due to fresh case-law from Luxembourg (\textit{Cartesio} [n 7] and case C-378/10 Vale Építési kft not yet reported). Comment on the recent case-law includes C Gerner-Buerle and M Schillig ‘The Mysteries of Right of Establishment after Cartesio’ (2010) 59 International & Comparative Law Quarterly 303; D Szabó and K Engsig Sørensen, ‘Cross-Border Conversion of Companies in the EU: The Impact of the VALE Judgement’ Nordic & European Company Law Working Paper No. 10-33.

\textsuperscript{11} Critically on this WG Ringe, ‘No Freedom of Emigration for Companies?’ (2005) 16 European Business Law Review 621.


\textsuperscript{14} Consultation on the cross-border transfers of registered offices of companies (January-April 2013), see http://ec.europa.eu/internal_market/consultations/2013/seat-transfer/index_en.htm. Cf Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions – Action Plan: European company law and corporate governance – a modern legal framework for more engaged shareholders and sustainable companies (December 2012), at 4.1.


\textsuperscript{17} Case C-378/10 Vale Építési kft not yet reported.
societatis) according to the company’s head office or ‘real seat’, which was subscribed to by a number of EU Member States. Without going into the detail here, this theory was applied in a way detrimental to corporate mobility which made it de facto impossible for foreign companies to register in a Member State, but do business exclusively in another Member State which followed the real seat theory.

The Centros case law has had a significant impact on company activity in Europe. With every free movement judgment handed down from Luxembourg, enterprises became increasingly assured that the freedom of establishment indeed allowed them to register in Member State A, while conducting their business exclusively in Member State B. In this manner, the Court of Justice has created a market for corporate forms within the European Union, granting entrepreneurs de facto a choice between the legal forms of Member States.

2. Empirical evaluations

It is generally accepted that in this battle, English company law has proved to be the most competitive company law jurisdiction in the EU. The English private company limited by shares can be set up in a comparatively fast and easy way and does not require any minimum capital or the involvement of a public notary. Because of these advantages, many companies have been set up in the years following Centros, Überseering and Inspire Art by entrepreneurs from outside the UK who conduct business exclusively in their home Member States. Special agencies sprang up like mushrooms in continental Europe, helping entrepreneurs to set up an English company seeking to further promote this legal form and to profit from its popularity. These marketing agencies hailed the advantages of English company law and convinced inexperienced businessmen on the continent of the degree of ease with which an English company can be established. One of these agencies claimed to have set up over 40,000 English companies alone in Germany. Against the total number of about 1 million private companies registered in Germany, this seems like a sizable number.

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This estimate may well be tainted by a certain degree of self-interest. However, academics and government officials have worked based on empirical data, providing a more accurate approximation of the number of these ‘foreign’ limited companies. A more detailed survey was compiled by several German academics whose estimates, however, diverged significantly. One short study calculated by way of extrapolation that the total number of English limited companies in Germany amounted to 30,300 in December 2005 and to 46,000 in November 2006. Another—more detailed—study by Wilhelm Niemeier offers various calculation methods and suggests a number of between 7,100 and 7,600 at the end of 2005, based on data collected from German registration sources. However, Niemeier points out that, presumably, the real number is significantly higher, since not all foreign companies in Germany fulfill their duties to register a branch in Germany and to apply for a trade concession. Furthermore, he stresses the fact that those studies analysing data from the Companies House (the British company register) come to a different outcome. A similar approach is put forward in a study by Horst Eidenmüller.

Not only the German, but also the English-speaking academic literature has tried to quantify this German interest in a foreign legal form. In a first, impressionistic overview, John Armour arrived at a figure of over 500 ‘German’ English companies at the end of 2004. One of the major studies that followed the methodology of collecting data from the English Companies House and then filtering out those companies apparently conducting business exclusively in other countries is the study conducted by Becht, Mayer and Wagner, which had been discussed as a working paper since 2006 and was published in 2008. This detailed study counts a total of 41,499 ‘German’ English companies set up between 1997 and 2006. Of course, the

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25 Reply by the Federal Government to the question by the deputies Otto Fricke, Dr Max Stadler, Jens Ackermann, further deputies and the FDP parliamentary party (Drucksache 16/134) of 16 December 2005, Bundetags-Drucksache 16/283.
28 Niemeier (n 27 above) 2242.
30 Armour (n 3 above) 386. This data was identified by searching Companies House for companies with largely German-language names, but ending with the word ‘Limited’.
32 Becht et al (n 31 above) 248, table 3, panel B.
study does not take into account the number of firms that were wound up during the same period. Arguably, this number is relatively high, since ‘foreign’ English companies suffer from an increased risk of being shut down during the period of their early existence.

Graph 1. Newly Set Up English Private Limited Companies Doing Business Exclusively in Germany

[insert graph 1 here]

Source: adapted from Becht et al (n 31 above).

The study by Becht et al goes beyond merely calculating the number of ‘foreign companies’ incorporating in England. It also analyses the reasons for the high number of these foreign companies. The study shows that amongst the main reasons are the substantial differences regarding minimum capital requirements, set-up costs and set-up speed. Facilitated by the famous Doing Business reports from the World Bank, the differences between countries have become comparable and transparent. Other aspects might include the rules of company organisation, including the co-determination rights of employees. A partly different author team complemented this perspective by studying the costs of branching in the respective destination country: that is, the factual and administrative costs of setting up a branch of the English company in the various destination jurisdictions.

3. National lawmakers’ responses

The national lawmakers responded to the challenge posed by English company law that was triggered by the Centros / Inspire Art case law.

In France and Spain, new, deregulated forms of limited liability companies were introduced soon after Inspire Art. Since 2003, it has been possible in France to found the Société à Responsabilité Limitée (SARL) within twenty-four hours and with a nominal minimum capital of EUR 1 (previously, the minimum capital for the SARL had been EUR 7,500). The formalities of incorporation were reduced to a
minimum—even applications for registration via the internet became possible. Founders can also seek the assistance of a Centre de Formalités des Entreprises. The French reform legislation included further facilitative measures in other areas: the newly-founded companies enjoy certain tax and social contribution reductions within the first years of their existence and may use the private address of the founder as the corporate seat even where this would otherwise be contrary to rental contracts or general city planning legislation. In sum, the main purpose of this new legislation is to encourage small start-up enterprises that have their real seat and their main field of activity in France, to choose the French legal form.\textsuperscript{41} Largely similar legislation has existed in Spain since April 2003\textsuperscript{42} with the adoption of the Sociedad Limitada Nueva Empresa (SLNE) as a special form of the traditional Sociedad de Responsabilidad Limitada (SL or SRL).\textsuperscript{43} In contrast to French law, the SLNE must have a minimum nominal capital of EUR 3,012.\textsuperscript{44} Like the new French SARL, the nueva empresa is designed to encourage and support small and medium sized start-up enterprises located in Spain.\textsuperscript{45} One special feature is a quick set-up procedure: according to Article 134 of the amended version of the Ley de Sociedades de Responsabilidad Limitada, the SLNE can be founded within forty-eight hours.\textsuperscript{46} Arguably, these two ‘early’ reforms have already significantly reduced the business exits in these two countries, as compared to other EU countries.\textsuperscript{47} In the meantime, France has already adopted a second reform. After the 2003 reform concerning the SARL, the Société par Actions Simplifiée (SAS) was reformed in 2008.\textsuperscript{48} The SAS is a legal form between the SARL and the Société Anonyme (SA), the latter being the French public limited company. Amongst the various amendments to the SAS, the most remarkable element of the reform was without doubt the waiving of the previous minimum capital requirement of EUR 37,000.\textsuperscript{49} One of the explicit goals was again the desire to make the French company legal form more attractive and competitive.\textsuperscript{50}

Other countries have followed suit. In the Netherlands, a fundamental review of the private limited (BV) law has been conducted over the last years. The legislation

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\textsuperscript{41} The new form of SARL has not been introduced with a view to attract incorporations from abroad.

\textsuperscript{42} Ley 7/2003 of 1 April 2003, de la Sociedad Limitada Nueva Empresa por la que se modifica la Ley 2/1995, de 23 de marzo, de Sociedades de Responsabilidad Limitada, BOE núm 79, de 2 de abril, Sec 1, 12679.


\textsuperscript{44} The new legislation also fixes a maximum nominal capital of EUR 120,200.

\textsuperscript{45} Embid Irujo (n 43 above) 761.

\textsuperscript{46} Embid Irujo (n 43 above) 763.

\textsuperscript{47} Becht et al (n 31 above) 252.


\textsuperscript{50} Mortier (n 49 above) 2233.
was debated for several years and came into force on 1 October 2012. The reform provided for more freedom for entrepreneurs in that businesses will have more options in their articles of association to depart from the default provisions of law on matters such as voting rights, board member appointment and shareholder resolutions. Most importantly, in most cases the earlier minimum capital of EUR 18,000 for BVs is no longer required. Furthermore, the set-up speed for businesses, which was in urgent need of reform, as this was an important ground for Dutch entrepreneurs to seek incorporation abroad, is set to be improved.

Similarly, Germany has adopted a major company law reform. At first, it was uncertain whether the country would take the Spanish route of adopting a new legal form alongside the existing ones, or rather follow the French/Dutch example of reforming the existing legal forms. Finally, a compromise was found: the existing Gesellschaft mit beschränkter Haftung (GmbH, private limited liability company) was reformed and at the same time, a variant of the GmbH was introduced. Whereas the existing GmbH still requires the minimum capital of EUR 25,000, the new younger brother of the GmbH, the Unternehmergesellschaft (‘UG’—start-up company), is integrated into the existing GmbH statute and can be set up without minimum capital. However, the new code imposes some restrictions: the UG is not allowed to fully distribute its profits until its level of capital has reached the threshold of the regular GmbH (EUR 25,000).

One principal concern of the German reform is to facilitate and accelerate the establishment of a business. Thus, for instance, model articles of association are made available for standard set-ups, without having to

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51 Wet vereenvoudiging en flexibilisering Nederlands bv-recht (‘Wet Flex BV’).
54 Various suggestions were made to this end: the Bavarian idea of a Kaufmann (single trader) with limited liability (www.justiz.bayern.de/imperia/md/content/stmj_internet/minsterium/ministerium/gesetzgebung/gesetzentwurf_kaufmann_mbh_16_05_2007.pdf) or the North Rhine-Westphalian suggestion of a ‘Basis-GmbH’ (www.justiz.nrw.de/JM/justizpolitik/gesetzgebung/gesetzgebungsvorhaben/gmbh_recht/inhalt_gesetzentwurf/gesetzentwurf.pdf). The Green Party developed the concept of a ‘Personengesellschaft mit beschränkter Haftung (PmbH)’ (partnership with limited liability), see M Berninger and H Schnittker, Eckpunktepapier zur Schaffung der Gesellschaftsform einer Personengesellschaft mit beschränkter Haftung (June 2006). Finally, an academic came up with the ‘Leipzig draft’ of a Kommanditgesellschaft with limited liability (KmbH), see T Drygala, ‘Für eine alternative Rechtsform neben einer reformierten GmbH—Leipziger Entwurf einer Kommanditgesellschaft mit beschränkter Haftung (KmbH)’ [2006] Zeitschrift für Wirtschaftsrecht (ZIP) 1797.
55 The full name of the legal form is ‘Unternehmergesellschaft (haftungsbeschränkt)’.
56 Section 5(1) of the new GmbH-Gesetz (GmbHG, act on the private limited liability company).
57 Section 5a of the new GmbH-Gesetz.
consult a public notary. Furthermore, the set-up process is accelerated. Table 2 shows the timeline of developments for the German reform; this specific information will be of importance at a later stage.

**Table 2. Steps of the German MoMiG law reform**

<table>
<thead>
<tr>
<th>Step</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>First rumours about reform activity by German government</td>
<td>31 August 2004</td>
</tr>
<tr>
<td>First (unpublished) government draft, proposing to abolish minimum capital for private limited liability companies</td>
<td>30 November 2004</td>
</tr>
<tr>
<td>Rumour that government could increase rather than reduce minimum capital</td>
<td>March 2005</td>
</tr>
<tr>
<td>First government drafts, proposing to reduce minimum capital to EUR 10,000</td>
<td>April-June 2005</td>
</tr>
<tr>
<td>Drafts were not adopted – early General Election changes government</td>
<td>18 September 2005</td>
</tr>
<tr>
<td>First new proposal to reform the GmbH, proposing a minimum capital of EUR 10,000</td>
<td>29 May 2006</td>
</tr>
<tr>
<td>Amended government proposal, introducing the Unternehmergesellschaft, a GmbH variant without minimum capital</td>
<td>25 July 2007</td>
</tr>
<tr>
<td>MoMiG law adopted and in force</td>
<td>23 October and 1 November 2008</td>
</tr>
</tbody>
</table>

But it is not only continental Europe that is responding to international developments, as the UK itself also attempts to further modernise its company law.

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58 See on this also H Fleischer, ‘Einleitung’ in H Fleischer and W Goette (eds), *Münchener Kommentar zum GmbHG* (Munich 2010), paras 116-117.  
59 There had been prior discussions to reform abusive practices, but they did not intend to reform minimum capital requirements. See H Hirt, ‘Die organisierte "Bestattung" von Kapitalgesellschaften: Gesetzgeberischer Handlungsbedarf im Gesellschafts- und Insolvenzrecht’ [2003] Zeitschrift für das gesamte Insolvenzrecht (ZInsO) 833-844.  
64 Referentenentwurf eines Gesetzes zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen (MoMiG) of 29 May 2006.  
65 Gesetzentwurf der Bundesregierung Entwurf eines Gesetzes zur Modernisierung des GmbH-Rechts und zur Bekämpfung von Missbräuchen (MoMiG) of 25 July 2007, Bundestags-Drucksache 16/6140.
One of the explicit ambitions of the new Companies Act 2006 was to make the UK even more competitive in an ever more globalised and interlinked environment. To be sure, it has not been the objective of the UK lawmakers to actively ‘export’ their company law to the rest of Europe. Rather, the goal of the 2006 reform was to ‘maintains the UK’s position as one of the most attractive places in the world to set up and run a business’ and ‘to promote growth, competitiveness and jobs’. Moreover, the company law reform in the UK started well before the ECJ handed down its judgment in Centros. Nevertheless, the UK seems eager to take up the global challenge and to safeguard its leading position in Europe.

Not all countries have embraced this general tendency, however. One of the counter-examples is Austria, where no comparable reform has been implemented and the minimum capital requirement remains unchanged at EUR 35,000. There were discussions over the past years to follow the general trend, but no reform step has yet been taken. One of the main reasons for the government’s reluctance in recent years seems to have been the potential loss of tax revenue, since the minimum corporation tax depends on the company’s share capital. More recently, the government has reinvigorated its attempts to reform Austrian company law, with a plan to reduce minimum capital to EUR 10,000.

4. Responsive lawmaking and defensive competition

In sum, the Court’s case law has created a level playing field for entrepreneurs in the European corporate market. The ECJ case-law has facilitated the usage of foreign legal forms. EU Member States are responding to the success of UK company law by so-called ‘responsive lawmaking’. Now that EU Member States have to recognise each other’s companies, some Member States are enacting corporate law preferred by their shareholders (especially entrepreneurs), managers or both, and are thus luring companies away from other Member States which have a less attractive company law system. Nevertheless, it is unclear to what extent Member States have incentives to

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68 White Paper (n 66) 9.
69 This, too, can be a form of (defensive) regulatory competition. The White Paper (n 66) notes that ‘Increasingly, businesses can make choices as to where to incorporate, and recent legal judgments are tending to make such cross-border incorporations easier.’ See also already Company Law Review Steering Group, Modern Company Law for a Competitive Economy – The Strategic Framework (1999) 5.6.12.
70 On the reform discussion, see T Bachner (ed), GmbH-Reform – Erleichterte Gründung, Gläubigerschutz, Insolvenzprophylaxe (Vienna, 2008); Dommes and others (n 94);
engage in regulatory competition. Some authors suggest that the European development after Centros and Inspire Art may in some ways resemble the US developments in connection with the ‘Delaware effect’ in corporate law in the nineteenth century. Others stress the difference between the EU and the US situations. In contrast to the US, Member States in the EU cannot raise franchise taxes from in-state incorporations. Hence, any incentives they might have will be of a more indirect nature – such as benefits for domestic legal services industries. The reform attempts described above are indications that Member States try to prevent a loss in market share for their domestic legal products, i.e. they do engage in ‘defensive regulatory competition’. But it is questionable whether Member States also have incentives to offensively reform and market their own legal products, i.e. engage in ‘offensive regulatory competition’.

Table 3. Company Law Reforms in Several EU Countries 2003–2008

<table>
<thead>
<tr>
<th>Feature/Country</th>
<th>Legal Form</th>
<th>Pre-reform</th>
<th>Post-reform</th>
<th>Alteration in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Denmark</td>
<td>Anpartelskab (ApS)</td>
<td>16,800</td>
<td>16,800</td>
<td>0</td>
</tr>
<tr>
<td>France</td>
<td>Société à Responsabilité Limitée (SARL)</td>
<td>7,500</td>
<td>1</td>
<td>- 99</td>
</tr>
<tr>
<td>Germany</td>
<td>Gesellschaft mit beschränkter Haftung (GmbH)</td>
<td>25,000</td>
<td>25,000</td>
<td>0</td>
</tr>
<tr>
<td>Netherlands</td>
<td>Besloten Vennootschap (BV)</td>
<td>18,000</td>
<td>1</td>
<td>- 99</td>
</tr>
<tr>
<td>Spain</td>
<td>Sociedad de Responsabilidad Limitada (SRL)</td>
<td>3,010</td>
<td>3,012</td>
<td>+ 0.07</td>
</tr>
</tbody>
</table>

73 At the end of the nineteenth century, the states of New Jersey and Delaware, concerned about entrepreneurs’ decisions as to the place of their companies’ incorporation, adopted modernised statutes on incorporation. Eventually, Delaware’s statute made it the leading state for incorporations in the United States from the 1920s onwards, presently serving as the state of incorporation for nearly half of the corporations listed on the New York Stock Exchange and as the major destination for reincorporations. See R Romano, The Genius of American Corporate Law (Washington, AEI Press 1993) 6.


77 L. Klöhn, ‘Supranational Legal Entities and Vertical Regulatory Competition in European Corporate Law: The Case for Market-Mimicking EU Corporate Forms’ (2012) 76 RabelsZ 276. However, there is one element in the German law reform, which could be categorised as ‘offensive regulatory competition’, namely the change in the law that now allows the German GmbH to have its head office abroad. See new § 4a GmbHG which gave up the requirement to have the head office or a place of business in Germany.
### Set-up Costs (in EUR)

<table>
<thead>
<tr>
<th>Country</th>
<th>Incorporation Type</th>
<th>Cost (EUR)</th>
<th>Set-up Speed (in Days)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Denmark</td>
<td>ApS</td>
<td>6,715</td>
<td>0 - 100</td>
</tr>
<tr>
<td>France</td>
<td>SARL</td>
<td>450</td>
<td>310 - 13</td>
</tr>
<tr>
<td>Germany</td>
<td>GmbH</td>
<td>1,500</td>
<td>n.a.</td>
</tr>
<tr>
<td>Netherlands</td>
<td>BV</td>
<td>1,750</td>
<td>n.a.</td>
</tr>
<tr>
<td>Spain</td>
<td>SRL</td>
<td>600</td>
<td>450 - 25</td>
</tr>
</tbody>
</table>

Source: adapted from Bratton et al (n 75 above); Becht et al (n 31 above); www.doingbusiness.org; [www.gruenderstadt.de/Infopark/spanische_sln.html](http://www.gruenderstadt.de/Infopark/spanische_sln.html)

### Set-up speed (in days)

<table>
<thead>
<tr>
<th>Country</th>
<th>Incorporation Type</th>
<th>Cost (EUR)</th>
<th>Set-up Speed (in Days)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Denmark</td>
<td>ApS</td>
<td>23</td>
<td>6 - 74</td>
</tr>
<tr>
<td>France</td>
<td>SARL</td>
<td>10</td>
<td>7 - 30</td>
</tr>
<tr>
<td>Germany</td>
<td>GmbH</td>
<td>16-18</td>
<td>n.a.</td>
</tr>
<tr>
<td>Netherlands</td>
<td>BV</td>
<td>10</td>
<td>n.a.</td>
</tr>
<tr>
<td>Spain</td>
<td>SRL</td>
<td>47</td>
<td>2 - 96</td>
</tr>
</tbody>
</table>

III. Assessment

Thus far this paper has revealed that there is ample evidence that: (i) liberal ECJ case-law has granted companies the opportunity to register in a Member State of their choice while conducting their entire business in another; and (ii) EU Member States are indeed responding to this phenomenon by amending their corporate laws to remain attractive in the face of competition from other jurisdictions.

In considering the merits of these two developments, there are a number of questions. What is the impact of the various law reforms on the continent? Has this legislation been successful in convincing entrepreneurs to choose domestic rather than English law? Scholars have begun to explore the merits of law reform for entrepreneurship generally, but the present study is more interested in the particular effect of the German law reform: we study a new sample of incorporations motivated by the Centros case-law. We can thereby test the claim that law reform as part of defensive regulatory competition is ‘successful’ in reducing arbitrage. If, as Becht et al. have shown, corporate mobility is driven by costs of regulation and companies have moved to the UK because of a more attractive legal environment, we would expect this effect to be reduced if not eliminated by ensuing law reform on the continent. And as some commentators indeed claim, the German law reform has been ‘successful’ in fending off the invasion of foreign company law forms.79

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To test this claim, we study a sample of companies formed between 2004-11 in a ‘Centros style’ structure between the UK and Germany. That is, these companies are set up in the UK by German entrepreneurs, but operate in Germany. If the hypothesis is right, the entering into force of the German law reform in November 2008 should reduce the number of incorporations in the UK.

In a second step, we test the claim further by comparing the results to another jurisdiction, Austria. The reason is straightforward: since there has been no comparable law reform in Austria, but instead minimum capital has remained unchanged at EUR 35,000, we would expect foreign companies in Austria unchanged.

We advance the following hypotheses: (1) The de facto abolition of minimum capital in Germany following the entering into force of the MoMiG reform law in November 2008 should lead to a significant reduction in the formation numbers of English limited companies in Germany; (2) as no comparable reform has been done in Austria, we hypothesise that no comparable reduction takes place there.

IV. GERMAN DATA AND RESULTS

In order to test these hypotheses, we extract data from the English Companies House via the commercial FAME Database. This database contains data on all UK incorporated companies. We limit the time period to the years 2004-2011. This is for the following reason: the Centros trilogy of cases was completed by the end of 2003. As explained above, European businesses and entrepreneurs have a reliable legal framework for incorporation a Centros-type company only from this moment on. Since we are not interested in the early years, where the arbitrage opportunities first arose, we concentrate on the years following 2004 where the impact of the case-law has been most strongly felt. Moreover, the extension of the dataset through to 2011 gives us the opportunity to study the effects of the law reform in Germany, which entered into force in November 2008. In extending the period of study through to 2011, we also have a much broader view than most other studies carried out before, which end earlier.

The crucial question in all previous studies has been how to filter out those companies that fulfil the ‘Centros criteria’, i.e. are set up in the United Kingdom but have their head office in Germany. No official register or search criterion exists to identify this specific target group. Studies in the past years have all chosen different strategies and proxies to reach their desired outcome. We apply the following filters to the database: (1) the company is incorporated in the United Kingdom; (2) at least one director is German; and (3) the company shares its registered office with at least 100 other companies. While criteria (1) and (2) may seem self-explanatory, criterion (3)

80 The Inspire Art decision was handed down on 30 September 2003.
81 For example, the Becht et al study covers the period from 1997 to 2006 only.
needs further elaboration. As emphasised above, it is well-known that most the ‘foreign incorporations’ that are of interest here are facilitated and managed by so-called incorporation agencies. These agencies help entrepreneurs by offering them the complete package of administering the incorporation process for a flat fee. This service is in high demand as (usually legal illiterate) entrepreneurs do not just face problems with the legal framework of their home country, but that of another country as well. Incorporation agencies help by setting up the company and registering it, and some even stay on board by accompanying it over the years with respect to filing returns, taking care of accounting and other administrative work. These agencies follow one pattern: they usually register all companies at the same address – with the effect that all companies which have been set up by them have an identical registered office, although their operations are located at entirely different places. We use this piece of information as a proxy to filter out those companies that are set up by foreign entrepreneurs. Admittedly, this proxy is not perfect – but no other filter criterion seems to produce better results.

All of these steps applied, we receive a sample of 48,103 ‘German’ incorporations between 2004 and 2011 in the UK. Tables 4a and 4b list some summary statistics. In short, virtually all of these companies were private companies limited by shares (99.83%). Another interesting finding is that by February 2012, roughly 72% of these companies were dissolved or in default, and only 18% of them were active and running, suggesting a high rate of entrepreneurs who later discontinued their business activity – be it because of business failure, or simply because the company was struck off the register but the business continued elsewhere.

Table 4a. UK incorporations operating exclusively in Germany 2004-11 by company type

<table>
<thead>
<tr>
<th>#</th>
<th>Total</th>
<th>Ltd</th>
<th>Plc</th>
<th>Company ltd by guarantee</th>
<th>Unlimited</th>
<th>LLP</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>48,103</td>
<td>48,022</td>
<td>18</td>
<td>12</td>
<td>1</td>
<td>4</td>
<td>44</td>
<td></td>
</tr>
</tbody>
</table>

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82 See above text to notes 21-22.
83 In many instances, the incorporation agencies even formally act as the company’s ‘secretary’ under English law.
84 See above text to notes 21-22.
85 In fact, other studies run the risk of being over-inclusive. Our approach certainly might be under-inclusive, see on this below text on n 88.
86 See on this below section VI.3.
Further, we sort the sample according to date of incorporation and develop a graph. Analysis of the dates of incorporation reveals an important finding: the data confirm that the first years post *Centros / Inspire Art* saw a strong increase in incorporations, and that this trend has been reversed since 2006, the peak being in March 2006. Since then, numbers have been falling continuously – in March 2006, we count 1322 incorporations, and they have fallen to just 49 incorporations in December 2011. Graph 5 illustrates the trend by splitting up the number of incorporations over time to monthly rates.\(^{87}\) As long as the two studies overlap, we compare our figures to the data from the Becht et al study. As one might expect, the present figures are lower, but similar; further, the ratio between the two studies remains almost stable – which increases the confidence in our results.\(^{88}\)

[insert graph 5 about here]

In the next step, we aim to exclude other potentially relevant factors. This relates in particular to the general economic downturn which, as generally acknowledged, started in 2007 and eventually led to a recession all across Europe. In order to exclude a potential bias of the data because of the general economic situation, we compare our figures in relation to all company formations in the United Kingdom over the same period. The purpose is to find out how large the share of ‘German-based’ UK incorporations in relation to the overall rate of company formation was over the time period studied. The result confirms our earlier finding: seen as a sub-category of the overall incorporation activity in the UK, ‘German’ company

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87 This confirms the recent findings by W Niemeier, ‘What Kinds of Companies will a “One-Euro-EPC” generate? Market data and observations from the German “laboratory”’ in H Hirte and C Teichmann (eds), *The European Private Company – Societas Privata Europaea (SPE)* (de Gruyter, Berlin/Boston 2013) 293, 307.

88 For the years 2004, 2005 and 2006, Becht et al find (in their second dataset) 9,038 / 12,777 / 15,633 companies, respectively. The ratio to the number of incorporations presented here fluctuates between 1.14 and 1.21 (7,900 / 10,958 / 12,940).
formations climb at first and then steadily fall. They start with 2.19% in January 2004 and climb up to a maximum value of 4.11% in December 2005, from where they fall steadily to a value of 0.13% in December 2011. Graph 6 thus shows a similar tendency as graph 5 by depicting the sample in relation to all UK incorporations between 2004-2011.

Finally, the same calculation is carried out with regard to all German incorporations over the same period of time. After all, the entrepreneurs are active in the German market and have to choose between the German GmbH and the English private limited company. This additional step will also exclude any bias due to the idiosyncrasies of the English market. The German data comes from a comparable database to the one used above: Orbis provides comprehensive firm-level data for companies worldwide. Unfortunately, the database does not allow for a monthly breakdown so that we can only extract yearly incorporation data. Using private company formations for Germany (GmbH), we aim at confirming the above findings in relations to the overall rate private company formation in Germany. The result confirms both findings made above: seen as a sub-category of the overall incorporation activity in Germany, figures for German entrepreneurs choosing an English limited company are increasing in the first years of the time period studied. English limited companies accounted for 15.23% of the formation numbers of private companies in Germany in 2004. This figure climbed up to a maximum value of 21.46% in 2006, whereby the value for 2006 was only slightly higher than the value for 2005 (20.30%). The figures show a stark decline over the following years until they end at 1.13% in 2011. Graph 7 thus confirms both previous illustrations, albeit in a more coarse calibration, due to the lack of monthly data.

What does this mean for our hypothesis? The important finding is that the numbers seem to fall way before the German law reform took effect. Without claiming any causality or statistical significance, the finding is nevertheless intuitively clear: a peak in Centros-type incorporations in early 2006 at least questions the claim that the German law reform from November 2008 was causal for the decline of English limited companies in Germany. In fact, the change in the law itself seems to have had little effect at all: by November 2008, the incorporation rate had already reached the figure of only 300 per month (down from a peak value of 1322 in March 2006) and the rate of decline has even further slowed down since then.89

One possible counter-argument will immediately come to mind: anticipation of law reform. Arguably, entrepreneurs knew that law reform would be coming and would have an incentive to wait until the German reform law takes effect. However, 89

The average monthly growth/decline rate was +0.38% in 2006, -4.99% in 2007, -5.16% in 2008, -3.00% in 2009, -1.94% in 2010 and +1.03% in 2011.
this argument is to be dismissed, and this for two reasons. Firstly, we describe above the various and complicated steps of the German law reform process.\textsuperscript{90} Looking at the timeline, it becomes clear that in March 2006, entrepreneurs will most certainly have been aware of the impending law reform. However, at the time, the state of the discussion was to lower minimum capital requirements to EUR 10,000 only – the complete abolition of minimum capital requirements being proposed much later, in July 2007.\textsuperscript{91} Whereas the proposed move from EUR 25,000 to EUR 10,000 is certainly substantial, it will probably not induce entrepreneurs to wait with starting their business idea for months of uncertainty. Secondly, consider the early years of rising incorporation numbers. We noted above that first rumours about a law reform emerged already in the second half of 2004.\textsuperscript{92} If an anticipation effect existed, we would expect the growth in incorporations to slow down already at this point in time and accordingly much earlier than what the figures tell us. It is inconsistent with the anticipation effect that foreign incorporations continued to rise for 18 months after the government discussed legislative action, including a draft from November 2004 which proposed to abolish minimum capital requirements altogether.\textsuperscript{93} Graph 8 illustrates this line of thought by mapping the legislative process on the real data.

In conclusion, the data presented here suggest that the German law reform which came into effect was not, at least not only, the relevant reason for the decline in English private limited companies set up by German entrepreneurs to operate in Germany, nor was there any significant anticipation effect of the law reform. We can thereby make a first cautious statement to question the claim of a ‘successful’ German law reform in a sense that it claims to have reduced the number of foreign incorporations in Germany.

V. AUSTRIAN DATA AND RESULTS

In order to test the reliability of these findings, the second part of this study evaluates a second sample of foreign incorporations, this time for Austria. The contrast between Germany and Austria is extremely striking and revealing for the current study, since both countries have had an experience with English-incorporated companies.\textsuperscript{94} It is even more useful as a comparative measure to test the validity of our initial thinking above, and this is for the two following reasons.

\textsuperscript{90} See above, Table 2.
\textsuperscript{91} See above, Table 2.
\textsuperscript{92} See above, Table 2.
\textsuperscript{93} See above, Table 2.
First, Austrian company law bears a remarkable similarity to its German counterpart. It is not only that both countries share a common history, culture and language, but specifically the law on business organisation has common roots.\textsuperscript{95} Accordingly, not only legal concepts in Germany and Austria are very similar, but corporate forms have a very similar twin across the border, with even the same technical names: for example, the German Gesellschaft mit beschränkter Haftung (GmbH) corresponds to the Austrian Gesellschaft mit beschränkter Haftung (GesmbH).\textsuperscript{96}

Secondly, and importantly for the question under consideration here, in contrast to the German MoMiG law reform enacted in 2008, the Austrian private company has not been reformed in the wake of the Centros case law. So different from most other continental legal systems described above, Austria has not seen a reaction prompted by the invasion of English private limited companies, at least not yet.\textsuperscript{97} To be sure, there has been ample discussion regarding such a reform, yet no legal action has been taken.\textsuperscript{98} The lack of any reform legislation over the sample period makes Austria a phenomenally interesting case to study: in Austria, the minimum capital for private companies amounts to EUR 35,000 (which is even higher than the German pre-reform amount of EUR 25,000).\textsuperscript{99} This amount has not been changed in Austria over the past years. If the hypothesis described above is correct, we would expect to see no decline in English companies in Austria – since the market need for a cheap-cost alternative is as big as it was just after Centros.\textsuperscript{100} We would therefore expect the developments in both Germany and Austria to diverge: the German law reform, allegedly having fought back the invasion of English companies, would have led to a decline in foreign companies, whereas Austria did not react and should, accordingly, not see a comparable decline.

Consequently, in the same methodology as described above for Germany, we go on to collect data for Austria. Accordingly, we extract data via FAME for the same


\textsuperscript{96} Both company forms were adopted around the turn of the 20\textsuperscript{th} century: the German GmbH originates in 1892, the Austrian counterpart is from 1906.

\textsuperscript{97} Very recently, the government has proposed to finally reform its company law, with a plan to reduce minimum capital to EUR 10,000. See Begutachtungsentwurf eines Gesellschaftsrechts-Änderungsgesetzes 2013 (GesRÄG 2013), available at <http://justiz.gv.at/internet/html/default/2e9484853d643b33013d8d8493ae52be.de.html>. The Austrian notaries support the proposal but want to add the German approach of requiring companies to save additional capital until they have reached the traditional minimum capital level. See Österreichische Notariatskammer (Austrian Notary Chamber), ‘Österreichs Notare unterstützen raschere und kostengünstigere Unternehmensgründungen’, press release of 22 March 2013, available at <http://www.ots.at/presseaussendung/OTS_20130322_OTSO139>.

\textsuperscript{98} On the reform discussion, see T Bachner (ed), GmbH-Reform – Erleichterte Gründung, Gläubigerschutz, Insolvenzprophylaxe (Vienna, 2008); Dommes and others (n 94).

\textsuperscript{99} See Austrian GmbH law, § 6(1).

\textsuperscript{100} See above end of Part III.
timeframe, 2004-2011. Corresponding filtering criteria are applied in the same way to limit them to Centros-style companies operating in Austria.\textsuperscript{101}

The results are depicted in Graph 9. In summary, we count a total of 3,585 ‘Austrian’ incorporations over the years 2004-11. Strikingly, the development is very similar to the German story: the formations continue to grow until spring 2006, and from then seem to steadily fall. The peak value in April 2006 is 148 incorporations per month, although this value appears to be an outlier, compared with 98 incorporations for March 2006 and 60 incorporations for May 2006. The lowest value in December 2011 amounts to a mere 13 incorporations.

[insert graph 9 here]

One major finding from this is that the German and Austrian developments seem to have been quite similar: both increase substantially over the first years and begin to fall in spring 2006. This finding appears to be in a somewhat uneasy tension with our hypothesis. If English incorporations operating in Austria declined in the same way as in Austria, the logical consequence is that the German law reform has certainly not caused (at least not exclusively) the German development.

As a caveat, there is a possibility that Austrians, too, may have been using the (reformed) German UG since it came into force. For an Austrian entrepreneur, a low-cost legal form similar to the one he is familiar with must seem attractive and maybe even preferable over the English legal form. The Austrian entrepreneur could easily register such a German UG without any language difficulties and, particularly if he lives in the border region, in geographical proximity. As explained above, the German GmbH (and UG) does not any more require a head office or even place of business in Germany.\textsuperscript{102} So we might expect Austrian entrepreneurs wishing to escape from domestic minimum capital requirements to opt for the German UG rather than the British Limited. This would mean that the German law reform could have similar effects on the Austrian market as it would in Germany. Our current data do not allow us to verify this hypothesis. Even if this assumption were correct, however, we would expect to see an effect on the Austrian incorporation activity much later than the observed peak and downward trend in early 2006. Due to initial legal uncertainty, such a spill-over effect would probably even come with a greater time delay.

As with Germany, we subsequently test our findings within the general market environment of both the UK and Austria, excluding a general downward trend in the market; and as with Germany, relative rather than absolute figures show the same effect (see graphs 10 and 11).

\textsuperscript{101} One adjustment is made, however: since the size of the Austrian economy in relation to the German economy is roughly 1:10, we apply this factor to our filter criterion. Consequently, we are looking for firms where the registered office corresponds to that of at least 10 (and not 100) others.

\textsuperscript{102} New § 4a GmbHG. See above n 77.
VI. Analysis

After studying and discussing the data for both Germany and Austria, this section attempts to synthesize the findings and provide a number of explanations for the results.

First, the empirical data analysed here have revealed the following: (1) foreign English incorporations in Germany show a strong increase between 2004 and early 2006, and an equally strong decrease between early 2006 and 2011. (2) The data for Austria show a similar picture, although the Austrian slope appears not as steep as the one for Germany.

This double finding is dramatic in its combination: it brings us to the conclusion that the German law reform from November 2008 was not ‘effective’ as is claimed. This conclusion rests on two pillars: first, the German figures were declining well ahead of the German law reform taking effect and, secondly, the counter-example of Austria shows that British incorporations are disappearing even in a similar jurisdiction where minimum capital has not been reformed. Far from establishing empirical proof in the mathematical sense, the more modest approach undertaken here is limited to a more intuitive understanding of the figures. To a lawyer’s mind, the data produced here put at least a question mark behind the claim of a ‘successful law reform’.

What, then, might be possible explanations for the striking development in Germany? I limit myself to five conjectures, all of which have probably contributed in some form or another to the development.

1. Restrictive attitude in lawmaking and case-law

The first observation is that German lawmakers, courts, and public authorities have become increasingly restrictive over the years in their attitude towards foreign-incorporated companies. Under the banner of combating abusive practices, this has led to a number of attractive features of foreign incorporations disappearing.

Consider the developments in German case-law. Initially, German courts were surprisingly open and friendly towards English companies. Naturally, the European Court of Justice in Überseering directly overruled German case-law, but Centros and Inspire Art, for example, did not directly concern problems of German law. In any case, the highest German civil court, the Bundesgerichtshof (BGH), in 2003 already confirmed that it would no longer apply the infamous real seat theory to EU-based companies, thus accepting foreign incorporations by unreservedly applying the law of
the registered office.\textsuperscript{103} This was extended in 2005 to a second seminal BGH judgment, confirming that liability questions of both shareholders and of directors would not be considered according to German, but rather according to English law; in other words, the choice of foreign law was uncompromisingly accepted.\textsuperscript{104} These (and other\textsuperscript{105}) cases paved the way for a high increase in English incorporations operating in Germany.

This liberal attitude shifted to a more restrictive trend from early 2006 onwards, in particular in order to prevent abusive practices and to close loopholes. Several aspects deserve to be mentioned.

First, the courts clarified that the strict insolvency filing obligation principles under German law and the corresponding liability provisions would apply to foreign-incorporated companies operating in Germany. The \textit{Landgericht Kiel} handed down its seminal judgment on this question in April 2006, which has remained the standard authority on this issue for the coming years.\textsuperscript{106} It was eventually confirmed by other courts\textsuperscript{107} and by the legislature in the 2008 MoMiG law reform.\textsuperscript{108} Following this line, setting up a foreign company would not help firms to escape from German insolvency law and in particular the strict filing obligations under German law.

The next instance was the extension of the German prohibition system for disqualified directors to directors of foreign companies. This had presented a loophole in the early years of the \textit{Centros} era: German businessmen who had been disqualified in Germany (i.e. were banned from exercising the position of a director) simply set up an English company in order to circumvent this provision – the German disqualification system only prevented them from becoming a director of a \textit{German} company.\textsuperscript{109} It was the \textit{Oberlandesgericht (OLG) Jena} in March 2006, which was the first German court to apply this system by analogy to directorships in foreign companies, such as the English limited company.\textsuperscript{110} This decision was subsequently confirmed by the BGH\textsuperscript{111} and eventually codified in the MoMiG reform.\textsuperscript{112}

\begin{footnotes}
\item[103] BGH, judgment of 13 March 2003 (VII ZR 370/98), BGHZ 154, 185; BGH, judgment of 2 June 2003 (II ZR 134/02), NJW 2003, 2609.
\item[104] BGH, judgment of 14 March 2005 (II ZR 5/03), ZIP 2005, 806.
\item[105] Lower instance case-law includes BayObLG (Bavarian Supreme Court), judgment of 19 December 2002, 2 Z BR 7/02, BayObLGZ 2002, 413; OLG Frankfurt (Court of Appeal, Frankfurt), judgment of 23 May 2003 (23 U 35/02), OLGR Frankfurt 2003, 447; LG (Regional Court) Hannover, judgment of 2 July 2003 (20 T 39/03), ZIP 2003, 1458; Kammgericht (Court of Appeal, Berlin), judgment of 18 November 2003 (1 W 444/02), NJW-RR 2004, 331. Even the fiscal judiciary concurred, see Bundesfinanzhof (Federal Finance Court), judgment of 29 January 2003 (I R 6/99), BFHE 201, 463.
\item[106] LG Kiel, judgment of 20 April 2006 (10 S 44/05), EuZW 2006, 478. The court found that \textit{Centros}-type companies had their Centre of main interests (COMI) in Germany and thus applied the German filing obligation via Art 4 of the European Insolvency Regulation 1346/2000.
\item[107] Kammgericht, judgment of 24 September 2009 (8 U 250/08), ZIP 2009, 2156.
\item[108] MoMiG (n 53), Article 1 no 43 and Article 9 no 3 (introducing new § 15a InsO).
\item[109] See GmbHG § 6(2) in the version prior to November 2008.
\item[110] OLG Jena, decision of 9 March 2006 (6 W 693/05), ZIP 2006, 708. Technically, this concerned the registration of the English company’s branch in Germany.
\item[111] BGH, decision of 7 May 2007 (II ZB 7/06), BGHZ 172, 200.
\item[112] MoMiG (n 53), Article 1 no 7 and Article 3 no 5.
\end{footnotes}
this shift in attitude made English incorporations less attractive to German businessmen, since one of the interesting loopholes had now been closed.

The German courts went on to clarify more open questions in a way that was increasingly restrictive towards foreign-incorporated companies. In a seminal decision from February 2007, the BGH clarified that German principles of estoppel liability (Rechtsscheinhaftung) would apply to Centros-type foreign companies.\(^{113}\) Similarly, a 2010 decision confirmed that German criminal law, in particular the rules on embezzlement, would apply to such a company.\(^{114}\) And finally, German courts took the view that jurisdiction for intra-company disputes according to Article 22(2) of the Brussels I Regulation was not in Germany, but rather in the UK.\(^{115}\) The effect of the latter judgment was that shareholders and directors of a UK-incorporated but Germany-based company can bring intra-company litigation only in the UK, which makes it excessively more costly for entrepreneurs domiciled in Germany.

Interestingly, not only in Germany, but also the UK itself contributed to this trend. The reform of English company law with the Companies Act 2006 led to two important aspects that fit into the line of arguments presented here. First, the Act extended the reach of the English system of directors’ disqualification to cover directors disqualified abroad. This move is an almost mirror image of the German initiative described above: each of the two systems had somehow been limited to their own domestic firms and directors.\(^{116}\) In the 2006 reform, the UK expanded the scope of the English directors’ disqualification system to cover potential directors who had been disqualified abroad.\(^{117}\) This would neatly complement the German trend and catch all those who are disqualified in Germany and choose a British company as a second attempt. Secondly, the CA 2006 introduced a ban on sole ‘corporate directors’ under English law. Whereas previously, the directors of a company could be any other (including legal) person, the new law stipulates that at least one of the directors has to be an individual.\(^{118}\) The old system had been prone to abuse: in particular, control structures are difficult to trace in companies which exclusively have corporate directors. Those intending to commit fraud may use a company with corporate directors to help obscure the identities of the persons involved. As the discussions around the introduction of the CA 2006 pointed out, this ‘can be a particular problem with the corporate directors of companies established in overseas jurisdictions with

\(^{113}\) BGH, judgment of 5 February 2007 (II ZR 84/05), NJW 2007, 1529.
\(^{114}\) BGH, judgment of 13 April 2010 (5 StR 428/09), ZIP 2010, 1233.
\(^{115}\) OLG Frankfurt, judgment of 3 February 2010 (21 U 54/09), ZIP 2010, 800; confirmed by BGH, judgment of 12 July 2011 (II ZR 28/10), BGHZ 190, 242.
\(^{117}\) See CA 2006, section 1184. No secondary legislation has been made to date.
\(^{118}\) CA 2006, section 155(1). The provision came into effect on 1 October 2008, but did not apply to existing companies until 2010.
poor records of transparency and corporate law enforcement. English company law thereby explicitly refers to the usage of English legal forms through foreign businesspersons and intentionally eliminates another loophole potentially subject to abuse.

In sum, we see on both sides of the Channel activities by lawmakers, courts, and authorities to address lacunae that were felt to be unacceptable, thereby making the use of foreign companies to run a business at home less attractive.

2. Acceptance and reputation problems

The second aspect that may help us understand the decline of English companies in Germany relates to psychological acceptance problems in the market. It is well-known that the English company form, when used by domestic entrepreneurs, went through a series of reputational problems, which further increased over time. The ‘Limited’, as it was called in the German public discourse, was characterised as a cheap and dishonest vehicle, used by businesses with apparently dubious objectives.

The core of truth in this is that, as we have seen above, the rate of Centros-type companies in Germany ceasing to operate has been very high. This has sometimes been misinterpreted as a high insolvency rate. Another emotional side of the debate relates to the fact that minimum capital is still seen as a legitimate and useful element of corporate law by many in continental Europe. Although it has increasingly been acknowledged that minimum capital is largely unsuitable as a creditor protection tool, many see it at least as a ‘threshold of seriousness’. If in such an environment suddenly the opportunity arises to ‘circumvent’ rules which are generally seen as useful, those who make use of it will automatically be regarded as dishonest.

It is worth noting that this negative public perception has been further fuelled by interest groups who campaigned against foreign company forms for thoroughly rational motives. For example, this is true for public notaries, whose duties include an advisory role for and certification of the incorporation of a domestic GmbH; accordingly, they stand to lose income if start-ups switch to foreign company

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119 Hansard, HC Standing Committee D, 2nd Sitting, col.494 (6 July 2006).
120 See above Table 4b.
121 As explained above, the high rates of companies that are ‘dissolved’ does not necessarily mean insolvency, it can be interpreted as companies that are struck off the register but may continue their business elsewhere.
122 See i.a. the volume by M Lutter (ed), Legal Capital in Europe (de Gruyter, Berlin 2006).
124 H Eidenmüller, B Grunewald and U Noack, ‘Minimum Capital in the System of Legal Capital’ in Lutter (n 122) 17, 30; A Pentz, HJ Priester and A Schwanna, ‘Raising Cash and Contributions in Kind when forming a Company and for Capital Increases’ in Lutter (n 122) 42, 46, 72; M Miola, ‘Legal Capital Rules in Italian Company Law and the EU Perspective’ in Lutter (n 122) 515, 517 f, 551.
forms. Lawyers who have been working all their life on German company law suddenly face the problem of being confronted with a new legal system which they do not understand; the logical reaction of many is to speak against it. Similar motives hold true for registration authorities and judges. It has even been suggested that German lawyers ought to be liable if they choose an English company form instead of a German one.

3. Underestimation of costs

Reportedly, many entrepreneurs underestimated the costs that would be involved in running a foreign company. This behavioural misconception may help explain the initial popularity of the British legal form in Germany and its subsequent decline.

At first glance, the formation of a Centros-type English company with operations in Germany was promulgated since it would allegedly be cheaper than its German counterpart. This may have appeared thus at first glance – when comparing minimum capital figures as well as set up speed and costs. These, however, have to be contrasted with additional costs of running a foreign company – language, certification and translation costs, information costs for legal advice, double accounting obligations (for main company and branch), to name just a few.

Moreover, the true hidden costs for running an English company are that English law is substantially more demanding than German law when it comes to continuous disclosure obligations and filing obligations of documents. This applies in particular to the filing of annual accounts, which have to be submitted to the Companies House in English, thus usually producing translation costs for continental businesses. Non-compliance may trigger serious consequences in the form of civil penalties on the company and criminal liabilities on the directors. The registrar of companies operates a very tough enforcement system indeed, using computer-generated default notices proceedings with cumulative daily default fines and strike-

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125 See the account at Becht, Enrique and Korom (n 39) 186 f.
127 See, for example, the article by registration judge Peter Ries, ‘„Rule Britannia“: Betrachtungen zur SPE aus der Sicht eines deutschen Registerrichters’ [2009] NZG 1052.
129 See above Table 3 (pre-reform figures).
130 For example, English company documents frequently have to be translated and certified for the registration authority supervising the German branch of the company.
132 See Davies and Worthington (n 116) 21-35.
off notices (producing over 95% compliance rates on first due date). Many foreign entrepreneurs concerned will have been very surprised to experience the vigour of enforcement of these reporting obligations, which is much stricter than in most other jurisdictions. If the Registrar has reason to believe that a company is not carrying on business or is not in operation, he may initiate a procedure with a view of striking the company’s name off the register, an inexpensive way of dissolving inactive companies without any substantial assets. Striking-off may also be used where liquidation cannot be carried out due to a lack of resources for the liquidation procedure.

It is plausible to partly explain the decline of foreign incorporations over 2006-08 in both Germany and Austria by this strict disclosure regime and its enforcement. Some of the foreign entrepreneurs may have realised the high costs of disclosure and translation for the first time after their first year of operation and, subsequent hereto, did not think the continuance of their business worthwhile. In the case of non-compliance, they may have been either deterred from continuing by the high penalties imposed on them or they will have been deleted from the register (by ‘striking-off’) for not complying with the disclosure obligations.

Looking at the time scale, the filing of accounts must be carried out within ten (now nine) months after the end of the company’s financial year. Taking into account the company’s first business year and the subsequent ten-month window means that the annual accounts have to be filed for the first time at the latest 22 months after the company was incorporated. Add another six months for the striking-off procedure, and we can expect many companies being struck off the register after 28 months. These dramatic consequences will then slowly become known to the German market. The big wave of companies that were incorporated in the early years 2003-2005 inevitably arrived at this moment sometime between 2005 and 2008 and may account for a drop in interest in the English legal form.

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135 CA 2006, ss 1000-1011. The most common starting point for initiating such a procedure is indeed non-compliance with the duty to file annual accounts or annual returns, see PL Davies and S Worthington, *Gower and Davies’ Principles of Modern Company Law* (9th edn, London 2012) para 33-56.
136 CA 2006, s 1001.
137 Companies Act 1985, section 244; now Companies Act 2006, section 442.
In short, running a business with a foreign legal form creates additional costs which many entrepreneurs will not have been aware of or will have underestimated. Many will have found out about this over time, which explains the initial soaring of company formations and the subsequent decline.

4. Diffusion theory

In an attempt to present the previous points in a more formal context, the pattern that we observe in the present study can be understood as an account of ‘diffusion theory’. This theory, borrowed from organisational management science and from sociology, is a research discipline that seeks to explain how, why and at what rate new ideas, innovations and organisational concepts spread through companies. The theoretical literature essentially advances two sets of explanations regarding the process leading to the adoption of new practices. The first has its origins in traditional rational choice economics and stresses the importance of cost effectiveness and the likelihood of diffusion amongst peers, and focusses on the growing level of general information about the value of a diffusing innovation. By contrast, more sociology-based accounts tend to emphasize growing levels of social pressure towards conformity: in particular, they assume that organisations frequently imitate other organisations in order to appear legitimate and that with increasing institutionalisation the adoption of practices is therefore frequently driven by a desire to appear in conformance with social norms. More recently, this literature has been extended to analyse the processes of change and its sophistication within a diffusion process and the implications of contestation in diffusion processes. Specifically, scholars show that social consensus of contestation and negative press reporting about a specific organisational practice (here: golden parachutes in executive compensation) can have a negative impact on its adoption and ultimately lead to its decline.

These elements of organisational theory can help explain both the rise and the decline in English company forms on the continent. In the early years post Centros, the English limited company enjoyed a positive image, suggesting an innovative and cheap innovation of business organisation. Both rational choice considerations and

144 Fiss, Kennedy and Davis (n 143).
social advantages supported its popularity: entrepreneurs would imitate each other, presumably due to both social norms and expected lower costs. This changed with increasingly negative reporting about the foreign legal forms, prompted by unknown disadvantages, high compliance and enforcement costs and to reputational problems due the fact that many dubious entrepreneurs made use of the unconventional legal form. In particular, increasingly negative publicity in the German media and practitioner-oriented legal journals about the pitfalls of using English company forms may have contributed to a shifting social consensus on the integrity of using foreign legal forms.

5. Law reform

It is not the claim of this paper that law reform has not contributed to the decline of the English company form in continental Europe. Rather, this may well have been the case, but to a significantly lesser extent than previously accepted.

Law reforms (and their anticipation) certainly play a role. This is surely the case in Germany, where the reform of the GmbH has led to a dramatic increase in popularity for the new GmbH variant, the Unternehmergesellschaft (haftungsbeschränkt) (UG). First studies show that the UG has been well accepted by market participants: they report roughly 70,000 formations between November 2008 and February 2012. It is undeniably the case that those entrepreneurs seeking to incorporate their business without minimum capital will find the UG easier and more accessible to them. The other interesting question is whether Austrian entrepreneurs might make use of the German UG to any meaningful extent in the same way as they did with English companies – the UG, being based on German law, might be a more attractive and accessible company form also to them. This is, however, a subject matter beyond the scope of the present study.

Austria did not reform its own company law, as discussed above. There is one other interesting piece of law reform that deserves attention, however. Austria

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145 See on this above VI.2. and VI.3.
146 Compare, for example, the extremely positive 2003/04 press articles by M Behm, ‘Lieber ‘limited’ als beschränkt’ Financial Times Deutschland (Hamburg, 30 September 2003) 14 (suggesting that the German GmbH could soon be a phase-out model) and ‘Gründer bevorzugen Ltd. statt GmbH’ Süddeutsche Zeitung (Munich, 8 September 2004) 18 (suggesting that already every fourth German company formation uses an English legal form) with the 2007 article K Schulz-Trieglaff, ‘Ltd. schützt nicht vor Verbot’ Frankfurter Allgemeine Zeitung (Frankfurt, 30 October 2007) 31 (describing that the English limited company bears high hidden costs).
148 The Website <http://www.ugstattltd.at/> offers German UGs to Austrian entrepreneurs.
149 See above section V.
reformed its taxation law in early 2006 in order to charge a minimum corporation tax on British limited companies that would be equal to that of an Austrian GesmbH. This is due to the peculiarities of the Austrian corporate taxation system: the payable corporation tax depends on the amount of the legal capital of the respective company.\textsuperscript{150} The problem was that most Centros-type companies simply had no subscribed share capital of meaningful value (i.e. only £1 or £100 instead of EUR 35,000 and thus – absent profits – did not have to pay an equivalent corporation tax. A reform coming into effect in February 2006 closed this perceived ‘discrimination’ of the domestic company by treating foreign companies as if they had a minimum capital equalling that of the domestic GesmbH.\textsuperscript{151} This move may well have contributed to the loss in attractiveness of English companies in Austria as described above.\textsuperscript{152} To be sure, this reform is very different in character to the one described above: the Austrian law reform simply removed a tax incentive to run a business from the UK that solely existed due to the structure of its own taxation laws. As such, it is not a response to a more competitive foreign law.

\section*{VII. Conclusion}

In conclusion, this paper offers insights into the effects of lawmaking within a setting of regulatory competition. It questions the traditional assumption that the German 2008 law reform, abolishing minimum capital for closed corporations, caused a reduction in the number of foreign firms set up by German entrepreneurs. Rather, as we have seen, a number of other reasons may be responsible for the decline: in particular, the closing down of loopholes that had made the English limited company so attractive to some German entrepreneurs. Further, German start-ups underestimated the costs involved with running a foreign company and complying with disclosure obligations that are strictly enforced. They also encountered high acceptance and reputation costs at home. All of these problems in their combination can be framed in terms of diffusion theory, highlighting the sociological aspects of subscribing to innovations or new organisational concepts.

What are the implications? It would certainly be too much to conclude that the German law reform was superfluous, wrong or without effect. As emphasised earlier, the new UG legal form has certainly had its share in making the English limited company less attractive. But the paper at least cautions against overemphasising the importance of the MoMiG reform. The implications developed here may however well be of interest to lawmakers in general, and to the Austrian government in particular. As mentioned above, Austria is currently still debating whether to reform

\textsuperscript{150} Körperschaftsteuergesetz 1988, § 24(4).
\textsuperscript{152} See above Part V.
its company law. The data shown in this paper may well put the importance of this project into perspective.

Overall, I firmly believe that the effects of the defensive regulatory competition observed thus far have been positive. Lowering minimum capital requirements, reducing administrative burdens, and speeding up the incorporation process are positive elements of an ‘entrepreneurship culture’. Where EU Member States adopt reform statutes reducing start-up burdens, this gives businesses and investors the necessary legal framework for swift and uncomplicated practical implementation of entrepreneurial ideas and is thus beneficial for all.

Looking further ahead, an increasingly burgeoning amount of tools for cross-border movement has become available, and even the plans for the adoption of the Fourteenth Company Law Directive on the cross-border transfer of the registered office of limited companies are currently being revived. If cross-border mobility were to eventually become reality for existing companies (as opposed to start-ups), the entire debate around free movement of companies and regulatory competition would enter into an entirely new dimension.

On start-up competition, the final point is that there is still a solid number of German entrepreneurs who prefer an English company over the (reformed) German equivalent. It is submitted that the great wave of amateurs is over and that this is now the hour of the experts – sophisticated entrepreneurs, who make a rational comparison between the two regimes, taking into account the true costs of running a foreign business, and who resist any emotional or social pressure to the contrary.

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153 Especially the (Tenth) Cross-Border Merger Directive and the European Company Statute (see n 15 and n 16 above).
155 The last months of my sample show formation numbers of between 50 and 80 per month.
Graph 5

Germany-operating English companies 2004-2011

Incorporations
Graph 6

Germany-operating English companies as % of total UK companies
Graph 8

Germany-operating English companies 2004-2011

- Reform Rumours
- First draft 29/5/2006 (€ 10,000)
- Gvt draft 23/5/2007 (€ 10,000)
- MoMiG 23/10/2008
Austria-operating English companies 2004-2011

Incorporations
Austria-operating English companies as % of total UK companies
Graph 11

Austria-operating English company formations as % of total Austrian private company formations