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DÉJÀ VU ALL OVER AGAIN? THE INTERNAL AFFAIRS RULE AND ENTITY LAW CONVERGENCE PATTERNS IN EUROPE AND THE UNITED STATES

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INTRODUCTION AND OVERVIEW

The internal affairs rule is probably the most well-established choice-of-law principle in American corporate law. This rule holds that the law governing a corporation's internal matters, like shareholder/management relations, is the law of the state/country where the corporation is organized.[1] As an example, a corporation may incorporate in Delaware, thereby adopting Delaware's corporate governance rules, and at the same time locate its company headquarters and conduct all business elsewhere. The internal affairs rule stands in marked contrast to the real seat choice-of-law doctrine that continental European countries have traditionally applied in the field of company (corporate) law. Under the latter approach, a business entity must organize itself under the company law of its "real seat" jurisdiction. The company's real seat is the state/country where the company's administrative headquarters—its nerve center—and presumably its center of interest is located.[2]

Because the internal affairs rule permits business managers to select the incorporating jurisdiction based on corporate governance considerations alone, it is generally agreed that the rule facilitates a market for corporate laws across the United States.[3] Scholars from a variety of perspectives have long argued that Delaware dominates this market, and that Delaware's dominance has in turn triggered a convergence of state corporate laws around permissive approaches to corporate governance that impose relatively few constraints on shareholders, managers, and other corporate

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1. *See generally* FRANKLIN A. GEVURTZ, CORPORATION LAW § 1.2 (2d ed. 2010) (explaining the internal affairs rule); *see also infra* notes 8–18 and accompanying text.

2. *See generally* Werner F. Ebke, *The "Real Seat" Doctrine in the Conflict of Corporate Laws*, 36 INT'L LAW. 1015 (2002) (explaining the real seat doctrine); *see also infra* notes 27–30 and accompanying text.

3. *See, e.g.*, Larry E. Ribstein & Erin Ann O'Hara, *Corporations and the Market for Law*, 2008 U. ILL. L. REV. 661, 662 ("Because of the [internal affairs doctrine], states can compete to supply corporate law separate from tax law, regulatory law, or other benefits. To obtain tax and other benefits in a particular state, a corporation might need to locate a plant or other assets in that particular state. By incorporating in a different state, the corporation can choose among the particular beneficial aspects of each state's laws. Without the [internal affairs doctrine], the corporation would be forced to choose a single state's bundle of laws, including corporate, tax, and regulatory law."); *see also infra* notes 4 and 21–25.

participants.[4] In contrast, because the real seat doctrine precludes a business from choosing a jurisdiction for its company law without also locating company headquarters there, European countries have historically been insulated from significant company law competition[5] and have imposed more mandates relating to corporate governance than their U.S. counterparts.[6] Contemporary developments in both Europe and the United States provide an interesting opportunity to consider, from a comparative perspective, whether these traditional patterns still hold. That is the purpose of this Article.

Part I describes recent changes in European Union (EU) case law that have effectively replaced continental Europe's real seat doctrine with the internal affairs rule. Part I also explains related EU legislative developments that make it easier for existing companies within the European Union to change their governing law. As Part II then shows, despite a number of predictions to the contrary, these EU changes have thus far failed to produce significant jurisdictional competition or convergence in the field of European company law, and no "Delaware of Europe" has emerged.

Part III of the Article contrasts the European developments with nearly contemporaneous changes made to U.S. business association laws. In a remarkably short period of time during the early 1990s, U.S. unincorporated business association laws changed and converged dramatically as all jurisdictions rapidly enacted new laws authorizing limited liability companies (LLCs) and limited liability partnerships (LLPs). These novel unincorporated entity laws emerged and converged around common denominators across the country *before* it became clear that the internal affairs rule applied to them.

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4. For example, nearly forty years ago, Professor William Cary and Judge Ralph Winter argued from opposing perspectives concerning the merits of Delaware law, yet both hypothesized that competitive pressures from Delaware had caused most states to adopt similar corporation codes. *See* William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 664–66 (1974) (describing the early history of New Jersey and Delaware's competition for corporate charters and Delaware's emergence as a leading source of American corporate law); Ralph K. Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251, 258 (1977) (arguing that investors favor Delaware because its corporate laws enhance shareholder value); *see also* William J. Carney, *The Political Economy of Competition for Corporate Charters*, 26 J. LEGAL STUD. 303, 303 (1997) (arguing that the "common market" in corporate laws that has long prevailed in the United States has produced corporate laws that provide relatively less regulation than their European counterparts).

5. *See, e.g.*, Hanne S. Birkmose, *A Market for Company Incorporations in the European Union—Is* Überseering *the Beginning of the End?*, 13 TUL. J. INT'L & COMP. L. 55, 56 (2005) (stating that under the real seat doctrine, jurisdictional competition in European business association laws has been "impossible and unwanted"); Jens C. Dammann, *Freedom of Choice in European Corporate Law*, 29 YALE J. INT'L L. 477, 479 (2004) ("[T]he ability of corporations to choose the applicable corporate law regime has long faced a formidable obstacle in the so-called real seat doctrine.").

6. *See* Carney, *supra* note 4.

If the internal affairs rule and jurisdictional competition are key drivers of change and convergence of business association laws, one would expect different results than those described above. With competitive forces unleashed by a new EU internal affairs rule, company laws across Europe should have changed and converged around permissive corporate governance models that are more efficient than traditional European approaches. In the United States, where it was unclear whether the internal affairs rule applied to LLCs and LLPs, and where there had previously been little or no jurisdictional competition in the unincorporated business association field, business owners and jurisdictions should have been slow to embrace the novel entities.

Part IV argues that the actual results support nuanced theories of jurisdictional competition and entity law convergence that have recently been advanced as alternatives to prevailing "market for corporate law" theories. These nuanced views recognize that convergence of business association laws (or not) is likely influenced by a variety of idiosyncratic factors, including forces that naturally resist efficiency-based convergence trends. At the same time, business association laws may converge for reasons other than economic efficiency. The failure of European company laws to converge despite new possibilities for jurisdictional competition within the European Union is an excellent example of the first phenomenon, while the rapid convergence of U.S. unincorporated business association laws illustrates the second. In sum, we should not be surprised that it has not been "déjà vu all over again"[7] as the internal affairs rule takes root in Europe and in new unincorporated business association settings in the United States. As explained in the Article's concluding section, we should instead use these disparate experiences as new opportunities to learn from comparative study in the business association law field.

I. THE U.S. INTERNAL AFFAIRS RULE, THE EUROPEAN REAL SEAT DOCTRINE, AND RECENT EU CHANGES

This Part of the Article briefly explains the internal affairs rule and the real seat doctrine, the competing choice-of-law approaches that have respectively governed American corporate law, and the company law of continental Europe since the mid-nineteenth century. This Part also explains how, over the past dozen years, European Court of Justice decisions construing the EU Treaty have dramatically limited EU Member States' ability to adhere to the real seat doctrine. These decisions, along with other legal developments in the European Union, now effectively require European countries to apply the internal affairs rule when resolving

7. YOGI BERRA, THE YOGI BOOK 30 (1998) (describing Mickey Mantle and Roger Maris repeatedly hitting back-to-back home runs in the early 1960s).

corporate choice-of-law questions, and thereby make competition and convergence in the field of European company law a real possibility.

A. THE INTERNAL AFFAIRS RULE

Like other legal persons in the United States, a corporation is subject to the laws of any state in which it conducts business. If the laws of more than one jurisdiction potentially apply to a dispute that involves the corporation, like a contract or tort lawsuit with multi-state dimensions, ordinary choice-of-law principles determine which law controls.[8] Since at least the 1860s, however, a unique choice-of-law rule has traditionally applied to corporate governance questions.[9] The "internal affairs" rule dictates that the law of the jurisdiction where the corporation is organized should control these legal issues.[10] For example, legal problems relating to a corporation's issuance of stock, rules governing shareholder voting, fiduciary duties of management, dissolution procedures, and the like are all resolved using the corporate law of the state of incorporation, even if another jurisdiction has a more significant relationship to the corporation or persons litigating the issues.[11]

When a U.S. corporation conducts business outside of its incorporation jurisdiction, the corporation must comply with "foreign corporation" registration requirements (a process sometimes called "qualifying to do business") in any state where the corporation establishes a sufficient jurisdictional presence.[12] But registration as a foreign corporation does *not* change the internal affairs rule. In the qualifying state, as elsewhere, the foreign corporation's internal governance matters are still controlled by the law of its state of incorporation.[13] In fact, a corporation may incorporate in one jurisdiction in order to take advantage of its corporate law but conduct most (or all) of the corporation's business elsewhere as a "pseudo-foreign"

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8. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 301 (1971) ("The rights and liabilities of a corporation with respect to a third person that arise from a corporate act of a sort that can likewise be done by an individual are determined by the same choice-of-law principles as are applicable to non-corporate parties."); *see also* WILLIAM M. RICHMAN & WILLIAM L. REYNOLDS, UNDERSTANDING CONFLICT OF LAWS § 91 (3d ed. 2002) ("[I]f the problem centers around corporate responsibility to others (a breach of contract claim, for example), then the normal or otherwise applicable choice-of-law rules govern.").

9. Frederick Tung, *Before Competition: Origins of the Internal Affairs Rule*, 32 J. CORP. L. 33, 44 (2006) (stating that "courts first began to articulate the doctrine in the 1860s").

10. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 302 (providing that, except in unusual cases, "the local law of the state of incorporation" determines "[i]ssues involving the rights and liabilities of a corporation, other than those dealt with in § 301").

11. *See id.* cmt. a. A few states decline to apply the internal affairs rule in certain cases. *See infra* note 14.

12. *See, e.g.*, MODEL BUS. CORP. ACT § 15.01 (1984) (requiring foreign corporations that "transact business" in the state to obtain a certificate of authority—a process often referred to as "qualifying to do business" in a state).

13. *Id.* § 15.05 ("This Act does not authorize this state to regulate the organization or internal affairs of a foreign corporation authorized to transact business in this state.").

corporation—a corporation that is foreign where its principal place of business is located, but only because the corporation happens to be incorporated under a different state's law.[14] Many corporations chartered in Delaware fit this description.

There are a number of justifications for the internal affairs rule, which now applies not only to corporations but also to other U.S. business associations that are formed under a particular state's laws.[15] The rule vindicates the choice-of-law preferences of those who organize the business and offers uniform legal treatment to its participants.[16] As the Supreme Court has observed, application of a single body of law to internal governance questions provides "certainty and predictability of result" and protects "the justified expectations of parties with interests in [the business organization]."[17] The internal affairs rule also reduces the possibility of inconsistent regulation of governance issues, and thus has constitutional dimensions.[18]

Although there is strong policy support for the internal affairs rule, there are competing views about its merits, as discussed in more detail in the concluding section of this Article.[19] There are also competing views about the "markets" for corporate law (to use law and economics terminology)[20] and the corporate law convergence patterns that the internal affairs rule apparently produces. For example, scholars agree that the rule permits corporate managers to shop across jurisdictions for favorable corporate law, but there is disagreement about the precise dynamics and character of the resulting law markets.[21] There is also debate about whether

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14. A few states (e.g., California) have enacted statutes that purport to regulate certain corporate governance issues for foreign corporations whose business and stockholders have strong connections to the state. *See, e.g.*, CAL. CORP. CODE § 2115 (West 2010) (providing that various parts of the California Corporations Code apply to a foreign corporation if more than fifty percent of its corporate income, property, and payroll factors are based in California and more than fifty percent of the corporation's voting stock is owned by Californians, with exceptions for public corporations). Conflict of law scholars have noted that "[s]uch regulation raises questions concerning constitutional limitations on choice of law." *See* RICHMAN & REYNOLDS, *supra* note 8, at 293 n.10.

15. *See, e.g.*, UNIF. LTD. P'SHIP ACT § 901 (2001), 6A U.L.A. 254 (2008) (stating that the law of the state where the limited partnership is organized governs the partnership's internal affairs).

16. *See* Tung, *supra* note 9, at 40 (stating that, for corporations, the internal affairs rule "vindicates corporate managers' and shareholders' choice of governing law" and "offers uniform treatment of all shareholders").

17. First Nat'l City Bank v. Banco Para el Comercio, 462 U.S. 611, 621 (1983).

18. *See generally* RICHMAN & REYNOLDS, *supra* note 8, §§ 97–99 (discussing various provisions in the Constitution that may limit the application of choice-of-law rules).

19. *See infra* notes 224–235 and accompanying text.

20. *See supra* note 3 (explaining the market for corporate law theory).

21. *See, e.g.*, Mark J. Roe, *Delaware and Washington as Corporate Lawmakers*, 34 DEL. J. CORP. L. 1 (2009) (arguing that jurisdictional competition in American corporate law should be characterized as a triangular contest running on two sides between Delaware and all other states, and on the third side between Delaware and the U.S. government, which makes corporate law for public companies through securities regulation).

the competition that occurs in such markets is beneficial. The most famous dispute, now forty years old, ran between the late Professor William Cary and Judge Ralph K. Winter, Jr. Cary contended that the internal affairs rule fuels a competitive *race to the bottom* that pressures states to forgo desirable corporate governance regulation, whereas Winter described a *race to the top* that forces states to enact corporate laws that maximize shareholder value.[22]

One thing is clear: the content of corporate laws *has* converged across the United States. Most states' corporation laws are now substantially similar in substance, if not style, to the Delaware General Corporation Law or the ABA's Model Business Corporation Act.[23] Law and economics scholars like Professor Roberta Romano contend that this corporate law convergence is a byproduct of the internal affairs rule and resulting state law competition, and that such competition produces the most efficient and desirable levels of corporate regulation.[24] Other scholars make similar claims about global corporate law convergence patterns. Professor Franklin Gevurtz has summarized these arguments as follows:

> Corporations are in constant competition with each other and, in a global economy, this means competition with corporations from other countries. Corporations operating with less efficient corporate laws and structures will be at a disadvantage in this competition.
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> . . . .
>
> [C]apital will gravitate toward companies organized under more efficient laws and institutions. This means that more new, or more vibrant and growing companies will be formed under efficient laws and institutions, gradually replacing or rendering less relevant the aging or smaller companies that were formed under less efficient laws and institutions. Also, the greater tax base provided by companies formed under more efficient laws and institutions will lead governments to change less

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22. *See* Cary, *supra* note 4; Winter, *supra* note 4; *see also* Curtis Alva, *Delaware and the Market for Corporate Charters*, 15 DEL. J. CORP. L. 885, 890–95 (1990) (describing the competing views of Professors William L. Cary, Roberta Romano, and Jonathan R. Macey and Geoffrey P. Miller).

23. As noted in the text, the Delaware General Corporation Law has long had a major influence on U.S. corporation law. The Model Business Corporation Act has also had a significant impact. *See* JAMES D. COX & THOMAS LEE HAZEN, LAW OF CORPORATIONS § 2:5 (3d ed. 2010) (noting that "the Model Act was intended not to become a uniform corporation law but rather to serve as a drafting guide for the states" and that "[e]ventually, the Model Act became the pattern for large parts of the corporation statutes in most states"). A recent article has used the phrase "constructive symbiosis" to describe the process of drafting and amending both the Model Business Corporation Act and the Delaware General Corporation Law over a period of many decades. *See* Jeffrey M. Gorris et al., *Delaware Corporate Law and the Model Business Corporation Act: A Study in Symbiosis*, 74 L. & CONTEMP. PROBS. 107, 107 (2011).

24. ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 147 (1993) ("The genius of American corporate law . . . is that the dynamics of state competition reduces the number of extraneous regulations that must be bypassed.").

> efficient laws and institutions. Along similar lines, the greater interests of those who profit more from corporations operating under efficient laws and institutions will eventually place more pressure on governments to adopt such laws and institutions than the pressure governments feel from those who profit, but less in the aggregate, from inefficient laws and institutions.[25]

Perhaps the strongest claim, made more than a decade ago by Professors Henry Hansmann and Reinier Kraakman, is that the "end of history" for corporate law will be marked by global convergence of corporate governance systems around a single, standard shareholder-centered model of the corporation that is more efficient and cost-effective than competing state- or stakeholder-oriented models of the corporation.[26]

B. THE REAL SEAT DOCTRINE

Starting in the mid-nineteenth century, several key jurisdictions in continental Europe departed from the "state of incorporation" theory, as the internal affairs rule is known there, and began to follow instead what is now called the "real seat" doctrine.[27] Under this choice-of-law rule, sometimes called *siege réel* or *siege social* in France or *sitztheorie* in Germany, a company must be organized under the laws of the country where its real seat—its administrative or management headquarters—is located.[28] As one writer explains,

> the main philosophy behind [the real seat doctrine] is that a company must be subject to the law of the state in which its corporate centre of gravity is located. This is because it is assumed that the majority of the corporate stakeholders will be located there. Such stakeholders include shareholders, creditors, employees, and suppliers. It is also assumed that societal interests are best served when a company is subject to the law of the state where its central administration is located.[29]

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25. Franklin A. Gevurtz, *The Globalization of Corporate Law: The End of History or a Never-Ending Story?*, 86 WASH. L. REV. 475, 494–95 & nn.109–15 (2011). As discussed below, (see text accompanying notes 185–188), Professor Gevurtz does not necessarily subscribe to the views of the scholars whose work he summarizes in the quoted textual material.

26. Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001). The authors cite the corporate laws of postwar France and Japan as examples of state-oriented corporate laws where the government "play[ed] a strong direct role in the affairs of large business firms." *Id.* at 446–47. They cite Germany's corporate laws, which provide for labor representation on the boards of some companies, as a variant of stakeholder-oriented corporate law. *Id.* at 445–46, 449.

27. *See generally* Elvin R. Latty, *Pseudo-Foreign Corporations*, 66 YALE L.J. 137, 166–70 (1955) (describing the real seat doctrine as a response by France and Belgium to the loss of chartering business to England, which functioned as the Delaware of Europe in the second half of the nineteenth century).

28. *See* Ebke, *supra* note 2, at 1015–17.

29. Birkmose, *supra* note 5, at 67–68.

The real seat doctrine is enforced in several ways. First, a company organized in a country other than that of its real seat is not recognized as a legal entity in the real seat jurisdiction. Non-recognition disables the company from using the courts of the real seat jurisdiction to assert or protect its legal rights; it also puts the company's owners at risk of personal liability there as de facto partners.[30] In addition, if a company is initially organized where its real seat is located but tries to relocate the company seat to another jurisdiction without also reincorporating there, the country in which the company was originally organized might treat the transfer of the real seat as an involuntary dissolution/liquidation of the company, triggering potentially adverse tax consequences.[31]

So long as the real seat doctrine prevailed in continental Europe,[32] there was little prospect for regulatory competition or convergence in the field of European company law.[33] This situation persisted even after the advent of the European Union and the promulgation of several company law "harmonization" directives that required Member States to conform portions of their company law to EU standards.[34] The directives did not

30. *See id.* at 69–71 (explaining the various consequences that could follow for a company that organizes and operates across borders without regard to the real seat doctrine).

31. *Id.* at 70; *see also* Benjamin Angelette, Note, *The Revolution That Never Came and the Revolution Coming—*De Lasteyrie Du Salliant*,* Marks & Spencer*,* Sevic Systems *and the Changing Corporate Laws in Europe*, 92 VA. L. REV. 1189, 1194 (2006).

32. *See* Dammann, *supra* note 5, at 479 n.9 (listing Austria, Belgium, France, Germany, Greece, Italy, Luxembourg, Portugal, and Spain as countries that apply some form of the real seat doctrine, and Denmark, Finland, Ireland, the Netherlands, Sweden, and the United Kingdom as countries following the incorporation theory); *see also* Ebke, *supra* note 2, at 1016 (stating that the real seat doctrine "is applied in one form or another by the majority of the Member States of the [European Union]"); Nicole Rothe, Comment, *Freedom of Establishment of Legal Persons Within the European Union: An Analysis of the European Court of Justice Decision in the* Überseering *Case*, 53 AM. U. L. REV. 1103, 1110 (2004) ("Germany, France, Italy, and Spain[] adhere to the real seat doctrine, while the Netherlands, Great Britain, Ireland, and Denmark follow the incorporation theory.").

33. *See supra* note 5; *see also* Carney, *supra* note 4, at 317–18 (describing European company law as follows: "The evidence . . . is consistent with the development of interest group bargains prior to the elimination of trade barriers . . . ."); Didier Martin & Forrest G. Alogna, *A European Delaware: The Nascent Regulatory Market in Europe*, REVUE TRIMESTRIELLE DE DROIT FINANCIER, Dec. 2007, at 4, 4–5 ("In continental Europe, the real seat . . . doctrine has historically been a strong barrier to a European market for corporate charters.").

34. EU lawmakers have attempted to harmonize key aspects of Member States' company law (and other laws of Member States) through mandatory EU directives that are to be implemented through national law reforms. *See* Louis F. Del Duca, *Teachings of the European Community Experience for Developing Regional Organizations*, 11 DICK. J. INT'L L. 485, 536–37 (1993) (explaining process of harmonization). But as one paper explains, in the field of company law the harmonization process has "reinforced the non-competition equilibrium among the [M]ember [S]tates." William W. Bratton et al., *How Does Corporate Mobility Affect Lawmaking: A Comparative Analysis*, 57 AM. J. COMP. L. 347, 353 (2009); *see also* Luca Enriques, *EC Company Law Directives and Regulations: How Trivial Are They?*, 27 U. PA. J. INT'L ECON. L. 1, 8 (2006) (arguing that the European Union's corporate law harmonization program has had little impact on core aspects of European corporations' governance and management).

preempt Member States' ability to regulate company board structure,[35] or to protect employee interests through company law co-determination requirements—a mandate that labor interests be represented in the management of large companies[36]—or to include gender equity standards in company law.[37] Nor did the directives prevent Member States from imposing minimum capital requirements that exceeded those provided in the directives[38] or their own "wrongful trading" liability standards on directors who failed to declare their company insolvent in a timely fashion.[39] Some EU Member States, notably the United Kingdom, had relatively relaxed standards on one or more of these issues or refused to impose such requirements on companies organized there.[40] However, the real seat doctrine prevented European businesses from taking advantage of more flexible foreign company laws and effectively insulated other EU Member States from competition in the field of company law, whether from the United Kingdom or elsewhere.[41]

C. ECJ Decisions Limiting the Real Seat Doctrine and EU Legal Developments Expanding Company Mobility

Starting in 1999, a series of European Court of Justice (ECJ) decisions began to curb application of the real seat doctrine pursuant to EU Treaty articles 43 and 48. These "freedom of establishment" provisions of the Treaty prohibit Member States from imposing "restrictions on the freedom of establishment of nationals of [other] Member State[s]" in their territory,

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35. Uwe Blaurock, *Steps Toward a Uniform Corporate Law in the European Union*, 31 CORNELL INT'L L.J. 377, 389 (1998) ("Within the European Union, there are various models for the administration of stock corporations.").

36. *See* Jens C. Dammann, *A New Approach to Corporate Choice of Law*, 38 VAND. J. TRANSNAT'L L. 51, 89 n.165 (2005) ("Several Member States, including Germany, the Netherlands, Denmark, Luxembourg, and Sweden, have adopted statutes that govern codetermination for employees on supervisory and management boards.").

37. *See* JUSTIN BORG-BARTHET, THE GOVERNING LAW OF COMPANIES IN EU LAW 69 (2011) (noting that "a number of European states have adopted laws to bring about equal representation of each gender in the boards of certain companies").

38. *See* Luca Enriques & Jonathan R. Macey, *Creditors Versus Capital Formation: The Case Against the European Legal Capital Rules*, 86 CORNELL L. REV. 1165, 1174 (2001) (noting that "many Member States go beyond the Second Directive's legal capital rules, providing for a stricter regime intended to better protect creditors").

39. *See* Gabriele Apfelbacher, *The German Corporate Governance Code,* PRACTISING LAW INSTITUTE SECOND ANNUAL INSTITUTE ON SECURITIES REGULATION IN EUROPE, at 591 (2002) (noting that "the details [of European wrongful trading laws] vary considerably").

40. *See* John Armour, *Who Should Make Corporate Law? EC Legislation Versus Regulatory Competition* 21 (Inst. for Law & Fin., Working Paper No. 41, 2005), *available at* http://www.ilf-frankfurt.de/uploads/media/ILF_WP_041.pdf ("[D]espite the early harmonisation efforts, many feel that the UK's company law still has a substantially more flexible character than the company laws of many other European jurisdictions.").

41. *See* Carney, *supra* note 4, at 318 (describing post-EU company law in Member States as characterized by "effective interest group resistance to competitive forces once a common market was created").

including "the setting-up of agencies, branches or subsidiaries."[42] The right of freedom of establishment extends not only to natural persons, but also to "[c]ompanies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the [European Union]."[43] Three ECJ cases applying these Treaty provisions in the field of company law are particularly noteworthy.

A 1999 decision, *Centros Ltd. v. Erhvervs-og Selskabsstyrelsen*,[44] was the opening salvo. The ECJ held that Danish citizens who organized a U.K. company for the sole purpose of doing all of its business in Denmark, and who chose the U.K. entity in order to evade Denmark's minimum capital requirements for domestic companies, were nonetheless entitled to register the U.K. company to do business in Denmark.[45] Denmark's refusal to register the company, the ECJ held, violated the company's right to freedom of establishment under the Treaty.[46] Denmark had defended its refusal on public interest grounds—protection of creditors—but the ECJ held that other means less burdensome to fundamental EU Treaty freedoms, like disclosure in Denmark of the company's status as a U.K. entity, were available for that purpose.[47]

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42. Consolidated Version of the Treaty Establishing the European Community, Dec. 24, 2002, O.J. (C 325) 33 (2002), ch. 2, art. 43. Article 43 EC provides:

> Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

Id.

43. Article 48 EC extends the freedom of establishment to business entities:

> Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.

Id. art. 48.

44. Case C-212/97, Centros Ltd. v. Erhvervs-og Selskabsstyrelsen, 1999 E.C.R. I-1459.

45. *Id.* para. 39.

46. *Id.* para. 30.

47. The court concluded that Denmark's refusal of company registration in order to protect its minimum capital standards did not satisfy the four conditions necessary for national measures that hinder the exercise of fundamental Treaty freedoms. As noted by the court, according to the standards laid down in its *Cassis de Dijon* decision, such measures "must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it." *Id.* para. 34.

The next landmark decision, *Überseering BV v. Nordic Construction Co. Baumanagement GmbH (NCC)*,[48] came in 2002. Überseering was a Dutch company that had been acquired by German nationals who moved its headquarters to Düsseldorf.[49] Thereafter, Überseering brought suit in Germany against Nordic, a German company, as a result of a construction dispute. The German court concluded that Überseering had no capacity to sue in Germany because the company's real seat had been transferred there when German nationals acquired ownership of its shares and relocated the company's central administration to Düsseldorf.[50] The real seat doctrine required reincorporation of Überseering in Germany at that point, but the company had not done so.[51] The ECJ disagreed, holding that the German court was wrong to refuse Überseering access to German courts because Treaty articles 43 and 48 required Germany to recognize both Überseering's legal capacity as a Dutch company (despite the relocation of the company's real seat to Germany) and the company's right to sue in Germany.[52]

The ECJ further enhanced EU companies' freedom of establishment rights in *Kamer Van Koophandel en Fabrieken Voor Amersterdam v. Inspire Art Ltd.*,[53] a 2003 case testing whether the Netherlands could impose special requirements on a U.K. company organized by Dutch nationals for the purpose of doing business in the Netherlands. Dutch corporate law recognized the right of such a pseudo-foreign company to conduct business there but conditioned that right on the company's compliance with certain requirements of Dutch company law (e.g., provisions regarding share capital) that were intended to protect creditors.[54] The ECJ held that the Netherlands could not so condition recognition of the foreign company without infringing the EU Treaty's freedom of establishment principles.[55]

Scholars now agree that the ECJ's expansive interpretation of business entities' rights to freedom of establishment under the EU Treaty in *Centros*, *Überseering*, and *Inspire Art* has considerably diminished the impact of the real seat doctrine in the European Union, especially for newly formed companies.[56] As one writer puts it, "The net effect [of the three decisions] is

48. Case C-208/00, Überseering BV v. Nordic Constr. Co. Baumanagement GmbH (NCC), 2002 E.C.R. I-9919.

49. *Id.* para. 7.

50. *Id.* paras. 9–10.

51. *Id.*

52. *Id.* para. 94.

53. Case C-167/01, Kamer van Koophandel en Fabrieken voor Amersterdam v. Inspire Art Ltd., 2003 E.C.R. I-10155.

54. *Id.* paras. 22–33.

55. *Id.* paras. 97–98, 101. As in both *Centros* and *Überseering*, the ECJ rejected arguments in *Inspire Art* that interference with freedom of establishment was justified to protect the public interest. *Id.*

56. *See, e.g.*, Bratton et al., *supra* note 34, at 374 ("The ECJ decisions in *Centros*, *Überseering* and *Inspire Art* make it possible for new [EU] firms to migrate to more favorable jurisdictions.");

the importation of the American internal affairs doctrine which requires that the only state which is entitled to regulate the organisation of companies is the state under whose laws the company is incorporated."[57]

Concurrently with these EU case law developments, changes in other EU laws created additional possibilities for existing companies to reorganize or move across Member State lines.[58] These new EU rules include a cross-border merger directive that forbids EU Member States from restricting merger transactions to domestic entities.[59] EU legislation also now authorizes creation of a "Societas Europea," a business entity that combines companies from two different Member States into a new company governed primarily by only one of those States' company laws.[60] In addition, the ECJ's 2012 *VALE* ruling[61] will facilitate company conversions from the governing law of one Member State to another.

A few important limitations on freedom of establishment still linger. For example, EU regulatory changes designed to establish a supranational EU incorporation option for small firms—the European Private Company—have not yet borne fruit.[62] In addition, the ECJ's ruling in *Cartesio Oktato es Szolgaltato bt*[63] suggests that barriers may remain for existing companies that want to relocate to a new EU jurisdiction. *Cartesio* permits an EU Member State to condition the continued existence of a company formed under its laws on the company's maintenance of a real seat in the jurisdiction.[64] Because a company must legally exist in order to invoke its

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Angelette, *supra* note 31, at 1221 ("The Court's interpretation of Articles 43 and 48 of the EC Treaty threatens to make the place of central administration wholly irrelevant for corporate law purposes."); Armour, *supra* note 40, at 13 ("Essentially, the Court ruled that as a matter of EC law, a company, once validly formed under the laws of *any* Member State, becomes a 'person' and is consequently entitled to exercise the Treaty Freedoms."); Birkmose, *supra* note 5, at 106 ("There is no doubt that the ECJ has radically changed the corporate landscape in the last five years."); *see also* Christoph Allmendinger, *Company Law in the European Union and the United States: A Comparative Analysis of the Impact of the EU Freedoms of Establishment and Capital and the U.S. Interstate Commerce Clause*, 4 WM. & MARY BUS. L. REV. 67, 103 (2013) (stating that "it has to be concluded that the ECJ's interpretation of the Freedoms of Establishment and Capital limits the powers to regulate company law at the state level more severely than does the Supreme Court's interpretation of the dormant Interstate Commerce Clause").

57. BORG-BARTHET, *supra* note 37, at 122.

58. *See* Bratton et al., *supra* note 34, at 358–66 (discussing both the EU's Cross-Border Merger Directive and the SE Regulation).

59. Council Directive 2005/56/EC, 2005 O.J. (L 310) 1.

60. Commission Regulation 2157/201, para. 7, 2001 O.J. (L 294) 1 (EC).

61. Case C-378/10, VALE Epitesi kft, 2012 E.C.R. I-0000 (holding that there is an impermissible restriction on freedom of establishment under EC Treaty Articles 49 and 54 when national legislation of a Member State allows a domestic company to convert into another domestic business entity but does not allow a company organized under another Member State's law to so convert); *see also* Justin Borg-Barthet, *Free at Last? Choice of Corporate Law in the EU Following the Judgment in* VALE, 62 INT'L & COMP. L.Q. 503 (2013).

62. *See* Jaap Barneveld, *Will the European Private Company See Daylight After All?*, Post No. 40, DEFINING TENSION (May 30, 2011) (on file with author).

63. Case C-210/06, Cartesio Oktató és Szolgáltató bt, 2008 E.C.R. I-09641.

64. *Id.* para. 124.

rights to free establishment under the EU Treaty, this qualification on *exit* rights may limit some existing companies' ability to relocate unless they reorganize as a new company in the destination Member State.[65] Finally, whether or not obstacles to relocation exist under *Cartesio*, tax laws may yet impede cross-border relocations in the European Union.[66]

II. COMPETING PREDICTIONS AND EVIDENCE CONCERNING THE EFFECT OF THE DEMISE OF THE REAL SEAT DOCTRINE AND RELATED EU DEVELOPMENTS

This Part of the Article describes the predictions of commentators about whether the ECJ decisions and other EU changes described in Part I would prompt Member States to compete in the field of company law. This Part also describes the latest evidence on jurisdictional competition. The evidence shows that, to date, there has been scant competition and only limited change and convergence in European company law. In short, there is no apparent Delaware effect in Europe.[67]

A. COMPETING PREDICTIONS

The ECJ decisions and other EU changes described in Part I naturally prompted predictions that Member States would or should modify their company laws to compete with other jurisdictions for company formations.[68] For example, Professor (then-graduate student) Jens Damman posited that to the extent the European Union embraced a free choice model for incorporations, companies would likely migrate towards those states that offer the "most efficient corporate law" (i.e., more permissive or lax regulatory schemes) and that "Member States—under pressure from local attorneys not to remain passive in the charter market—will probably engage in a race for quality, competing with each other more vigorously than their

65. According to one recent analysis, the impact of *Cartesio* on exit rights depends on whether or not the company is exiting from or migrating to a real seat state, or from or to an incorporation theory state. *See* Carsten Gerner-Beuerle & Michael Schillig, *The Mysteries of Freedom of Establishment After* Cartesio, 59 INT'L & COMP. L.Q. 303 (2010).

66. *See, e.g.*, Armour, *supra* note 40, at 381 (noting that many EU member states impose "exit taxes on companies which seek to relocate"); Bratton et al., *supra* note 34, at 371 ("Reorganizing under a foreign corporate law statute often triggers taxes . . . .").

67. For one discussion of the "Delaware effect," see Joseph A. McCahery & Erik P. M. Vermeulen, *Does the European Company Law Prevent the 'Delaware Effect'?*, 11 EUR. L.J. 785, 789–91 (2005).

68. *See, e.g.*, Birkmose, *supra* note 5, at 108 ("[T]here is no doubt that the ECJ has started a process that might eventually lead to the creation of a market for company incorporations."); Carsten Frost, *Transfer of Company's Seat—An Unfolding Story in Europe*, 36 VICT. U. WELLINGTON L. REV. 359, 387 (2005) ("As a result of the ECJ decisions, the pressure on national legislators in the EU Member States has increased to make their corporate laws more attractive to investors."); Martin & Alogna, *supra* note 33 (arguing that France should enact corporate law reforms to attract EU businesses).

U.S. counterparts."[69] Many believed that the resulting competition would trigger company law convergence across the European Union and, perhaps, the emergence of a Delaware of Europe.[70]

Some commentators disagreed that an American-style race to the bottom (or to the top, depending on one's perspective) would occur in Europe.[71] Those in the latter group identified a number of disincentives, summarized below, that might impede jurisdictional competition for company formations within the European Union and/or convergence of European company law.

1. Disincentives for Member State Company Law Competition

Several commentators cited Member State financial considerations as a factor that might limit competition. For example, because EU law prevents a Member State from collecting franchise taxes from a company whose only connection to the Member State is that it was organized there, many argued that chartering fees and taxes would not be a great incentive for European jurisdictions to compete for company formations.[72] Others pointed out that if an EU Member State wanted to compete effectively in the field of company law, the jurisdiction would have to develop not only superior substantive company law, but also a corresponding system of judicial expertise in the field—a difficult and expensive proposition.[73]

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69. Dammann, *supra* note 5, at 543.

70. *See, e.g.*, Angelette, *supra* note 31, at 1223 (noting, among other possible scenarios, that inter-jurisdictional competition for incorporations might result in a race of laxity in EU corporate law); Dammann, *supra* note 5 at 530 ("European corporations faced with the prospect of free choice are likely to reincorporate in one or a few Member States, and it is highly probable that one or more of the smaller Member States will emerge as the leading jurisdiction(s)."); Laura Jankolovits, Note, *No Borders. No Boundaries. No Limits: An Analysis of Corporate Law in the European Union after the* Centros *Decision*, 11 CARDOZO J. INT'L & COMP. L. 973, 1004 (2004) ("[T]he holding in *Centros* may create a race for the bottom in Europe.").

71. *See, e.g.*, Luca Enriques & Matteo Gatti, *The Uneasy Case for Top-Down Corporate Law Harmonization in the European Union*, 27 U. PA. J. INT'L ECON. L. 939, 947 & nn.25–27 (2006) (arguing that "no Member State is likely to enter the market for incorporations" and listing other authorities who concurred). As indicated in the text parenthetical, scholars disagree whether jurisdictional competition in the field of American corporate law is beneficial. *Compare* Lucian Arye Bebchuk & Allen Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, 99 COLUM. L. REV. 1168 (1999) (arguing that state competition likely does not maximize shareholder wealth), *with* ROMANO, *supra* note 24, at 14–24 (arguing that state competition benefits shareholders). *See also* Dammann, *supra* note 36, at 53 & nn.4–5 (collecting authorities on both sides).

72. *See, e.g.*, Birkmose, *supra* note 5, at 107 (stating under EU rules, "taxation seems unlikely to be an incentive to compete for company incorporations"); Frost, *supra* note 68, at 379–80 (stating that "Member States do not earn significant amounts of money from incorporating businesses"); *but see* Dammann, *supra* note 5, at 525 (offering reasons that "the European market for corporate charters [might] not be substantially less lucrative than the U.S. market").

73. *See* Dammann, *supra* note 5, at 532 ("Any state—large or small—interested in establishing itself as an attractive destination for firms looking to reincorporate must make a substantial investment in its legal and judicial services.").

2. Disincentives for EU Businesses to Use Foreign Company Laws

There were also disincentives for European businesses that might want to use another Member State's company law. One disincentive was uncertainty about the very existence and scope of the new EU internal affairs rule. While there is now general agreement that the EU Treaty requires Member States to apply the internal affairs rule to companies organized in other European countries, when *Centros* and its progeny first emerged, legal scholars did not agree on the extent to which those decisions, and the EU Treaty freedom of establishment provisions on which they were based, required Member States to abandon the real seat doctrine.[74]

Another disincentive for using foreign company laws was uncertainty about their content and the mechanics of corporate mobility for existing firms, especially during the period before the European Union's cross-border merger directive was finalized in 2005,[75] but thereafter as well.[76] For example, if an existing, large European company wants to reorganize as a public limited liability company regulated under EU law (Societas Europaea or SE) and change its governing national company law in the process, as Allianz did in 2006,[77] many procedural obstacles exist.[78]

Commentators also questioned whether the content of harmonized European company law was sufficiently different across jurisdictions to create incentives for forum shopping by new or existing business entities.[79] And, assuming an EU Member State's company law was especially attractive to businesses from other countries, it was unclear whether those

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74. *See, e.g.*, Werner F. Ebke, Centros*—Some Realities and Some Mysteries*, 48 AM. J. COMP. L. 623, 624 (2000) ("Throughout the European Union, legal scholars and practitioners . . . are trying to comprehend and explain the Court's holdings in the *Centros* case."). Even today, uncertainty lingers across the European Union about the content of corporate choice-of-law rules, since neither *Centros* nor its progeny expressly dealt with conflicts of law rules as such. *See* Frost, *supra* note 68, at 369 (noting that "[t]he cases fail to deal expressly either with conflict of law rules, or with company law").

75. Before this directive, discussed *supra* at notes 58–59 and accompanying text, took effect, the laws of some Member States authorized mergers only for domestic companies, thus precluding a cross-border merger—traditionally the easiest method for an existing company to seamlessly reincorporate under the company law of another jurisdiction.

76. *See, e.g.*, Bratton et al., *supra* note 34, at 350 (stating that after the cross-border merger directive took effect, "[t]he door to [corporate] mobility ha[d] opened only in theory").

77. *Allianz SE - Societas Europaea*, ALLIANZ, https://www.allianz.com/en/about_us/management/corporate_governance/legal-form.html (last visited Apr. 11, 2014).

78. *See* Martin & Alogna, *supra* note 33, at 7–8 (describing various approval requirements that a firm organized as a French Societe Anonime (S.A.) must satisfy to become an SE).

79. *See, e.g.*, Luca Enriques, *EC Company Law and the Fears of a European Delaware*, 15 EUR. BUS. L. REV. 1259, 1269 (2004) ("Compared with the corporate law environment in the US when chartermongering began, not only are European company laws much more flexible than those of most US states back then, but also some of their inflexible features . . . cannot be done away with by Member States, because they are imposed by EC law.").

businesses would (or should) be concerned that ongoing compliance obligations in the formation jurisdiction might prove unduly burdensome in the long run.[80]

Commentators also pointed to litigation obstacles that might be associated with corporate migration within Europe. For example, it was argued that the act of forming a company in one Member State and maintaining the company's real seat in another might create a sufficient connection to the first jurisdiction so that the company could be compelled to litigate external affairs as well as internal affairs there—a potentially costly and inconvenient result for a company situated elsewhere.[81] Such a company might also encounter difficulty if its internal affairs matters were litigated in its real seat Member State, where courts might be unfamiliar with the language or company law of the organizing jurisdiction.[82]

3. Cultural and Political Disincentives

Other commentators noted that cultural and political factors would make corporate migrations "less frictionless" in Europe than in the United States, and thus reduce the level of competition and convergence in the field of European company law. As summarized by one writer, "[l]anguage is the most obvious cultural factor, alongside more specific business culture matters. Firms are in fact embedded in their nation's social context, which company law rules reflect. Given the EU's lesser cultural uniformity, heterogeneous preferences may make alternative company law regimes unattractive."[83] Another similarly argued that, "[d]espite increasing economic ties, the Member States have maintained their individuality and nationalism" and that such nationalism might "keep businesses, especially private or smaller business, within the founding citizens' personal jurisdiction."[84] Other commentators concurred in these assessments, noting that for smaller firms, "the vast majority of [which] . . . are still formed under local corporate law rules," there was "inertia in terms of barriers of language, a lack of information regarding other systems and ignorance

80. *See, e.g.*, Bratton et al., *supra* note 34, at 376–77 (describing ongoing compliance obligations for companies organized as a U.K. Limited Company).

81. *See* Dammann, *supra* note 5, at 492–97. In contrast, while a U.S. corporation is subject to general personal jurisdiction in its state of incorporation, defending litigation in a "foreign" state presents no serious concerns given that state legal systems, language, and culture are similar across the United States.

82. *See* Dammann, *supra* note 5, at 498.

83. Enriques, *supra* note 79, at 1265; *accord* Dammann, *supra* note 5, at 502 (stating that "language barriers may be of considerable importance to small firms who do business mostly in their real seat state," but also acknowledging that this problem is unlikely to "deter larger corporations who do business in multiple Member States").

84. Jankolovits, *supra* note 70, at 1004.

regarding alternatives, and the competitive advantages in some industries based on being incorporated locally."[85]

Finally, it was suggested that members of the legal profession in the various Member States would resist company law competition. Because local lawyers would lose business if entity clients organized or reorganized elsewhere, commentators argued, lawyers would be unlikely to recommend that their clients use other Member States' company laws.[86]

B. THE EMPIRICAL EVIDENCE TO DATE

As described below, the evidence to date largely bears out predictions that there would not be dramatic competition and convergence in the field of European company law.

1. Entity Choice Patterns

Empirical scholarship shows that large firms in the European Union are not engaging in forum shopping, despite new possibilities for cross-border reincorporation of such businesses through mergers or the SE statute.[87] A recent study by Professors Marco Becht, Colin Mayer, and Hannes Wagner found that no EU Member State incorporated "significant numbers" of public companies in the United Kingdom—a logical jurisdiction of choice because of its permissive company law.[88] With respect to SEs, which are generally large firms, a study by Professors William Bratton, Joe McCahery, and Erik Vermeulen similarly concluded, "Corporate law forum shopping ha[d] not been a salient motivation for the 310 SEs" that had been formed as of 2009.[89]

Both these groups of scholars, as well as others, have identified a *slight* trend over the past decade that favors the U.K. private company limited by shares (the U.K. Limited), at least for small, start-up firms, many of which are formed for businesses based in Germany or the Netherlands.[90] It is assumed that these new firms have been attracted to the U.K. Limited's lower start-up costs (low initial capital requirements) and the relatively

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85. Martin & Alogna, *supra* note 33, at 9.

86. *See, e.g.*, Enriques, *supra* note 79, at 1264 (arguing that home state counsel would be likely to oppose decisions by company law clients to organize or reorganize elsewhere).

87. *See supra* notes 58–60 and accompanying text (describing these new options).

88. Marco Becht et al., *Where Do Firms Incorporate? Deregulation and the Cost of Entry*, 14 J. CORP. FIN. 241, 247 (2008).

89. Bratton et al., *supra* note 34, at 361. The number of new SEs continues to grow across the European Union. One recent data compilation reports the SE total as 2052, many of which are organized under the laws of Germany or the Czech Republic. *See* Anders Carlson et al., *Overview of Current State of SE Founding in Europe*, WORKER PARTICIPATION, 3 (Jan. 1, 2014), http://www.worker-participation.eu/content/download/5793/96801/file/SE-Facts&Figures-01-01-2014.pdf.

90. *See* Armour, *supra* note 40, at 387 (reporting growing trend of German firms incorporating in the United Kingdom); Bratton et al., *supra* note 34, at 374–80; *see generally* Becht et al., *supra* note 88.

short time frame (days rather than weeks) in which a U.K. Limited can be established.[91]

The trend favoring the U.K. Limited appears to have slowed in recent years, however, as start-up firms fail or encounter difficulties with ongoing U.K. reporting requirements.[92] Moreover, the volume of firms taking advantage of the U.K. Limited option has been characterized as "rather trivial . . . , both as an economic proposition and as a lawmaking motivation."[93] In short, after considering the results of a prior study, as well as their own research into EU entity choice patterns, Bratton and his co-authors conclude: "Mobility is still largely constrained by member state regulation."[94]

2. Convergence

Scholars have found some evidence that EU Member States with restrictive corporate laws are responding to competitive pressures in the post-*Centros* era, particularly as regards costs of formation.[95] Examples include recent company law changes in France reducing the capital required to form a limited liability company—known there as a *société par actions simplifiée* (SAS)—to one Euro.[96] Germany has also enacted company law reforms, known by the acronym MoMiG, in response to what one commentator calls "The 'Invasion' of the British Ltd."[97] These changes relax the requirements of Germany's limited liability company law—the law applicable to a *Gesellschaft mit beschrankter Haftung* (GmbH)—to, among other things, reduce minimum capital requirements and speed up registration processes.[98] The Netherlands has also enacted reforms that

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91. Becht et al., *supra* note 88, at 250 ("[The data show that] what *does* matter for corporate mobility are the large differences regarding minimum capital requirements and setup costs."); Bratton et al., *supra* note 34, at 376 ("European firms incorporating in the United Kingdom are mostly 'round-trippers' looking for rock bottom cost and speed."). Web ads like those on the U.K. Companies House website show how simple the process is. *Web Incorporation Service*, COMPANIES HOUSE, https://ewf.companieshouse.gov.uk//runpage?page=welcome (last visited Apr. 11, 2014).

92. Bratton et al., *supra* note 34, at 376 (characterizing the survival rate of foreign private limited companies as "extraordinarily low").

93. *Id.* at 352.

94. *Id.* at 385.

95. *See, e.g.*, Becht et al., *supra* note 88, § 4.4; Bratton et al., *supra* note 34, at 380–84.

96. This development is reported by Bratton et al., *supra* note 34, at 379. For a more detailed summary of recent changes to French company law, see Martin & Alogna, *supra* note 33, at 16 nn.123–24.

97. Gregor Bachmann, *Introductory Editorial: Renovating the German Private Limited Company—Special Issue on the Reform of the GmbH*, 9 GER. L.J. 1063, 1066 (2008).

98. *See* Michael Beurskens & Ulrich Noack, *The Reform of German Private Limited Company: Is the GmbH Ready for the 21st Century?*, 9 GER. L.J. 1069, 1071 (2008).

reduce initial capital requirements for small businesses and permit shareholders to contract for special corporate governance rules.[99]

These changes do not reflect a dramatic level of corporate law convergence across the European Union. One set of scholars recently concluded: "The scope of [recent corporate law] reforms [in the European Union] remains narrow because the competitive pressure is largely limited to economically-negligible small entrepreneurs, who mostly aim to minimize the out of pocket costs of incorporation."[100] Other scholars have assessed the EU environment as having the *potential* for competition and convergence in the field of company law, a state of affairs that does not yet fully exist.[101]

C. Anecdotal Evidence from EU Business Lawyers and Experts

During the summer of 2009, the author discussed these EU developments with attorneys and legal scholars from France, Germany, the Netherlands, and the United Kingdom in series of in-person interviews.[102] The goal of meeting with these various experts, all active in the field of European business association law, was to gauge their attitudes and understanding about the use of foreign business entity forms in the European Union. The author wanted to ascertain, among other things, whether those operating at ground level perceived that recent EU developments had changed the business entity landscape for lawyers and clients in day-to-day practice. In short, had the new EU internal affairs rule taken root with company law practitioners in Europe? The author's most important findings are summarized below.

1. Use of Foreign Business Entities: Reputational Concerns

All of the lawyers the author interviewed outside the United Kingdom—French, German, and Dutch—were familiar with the U.K. Limited entity option. Yet none of the interviewees had used that form to

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99. *See* Tom van Duuren et al., *Reform Private Company Law (Flex BV) Effective from 1 October 2012*, CLIFFORD CHANCE (July 10, 2012), http://www.cliffordchance.com/publicationviews/publications/2012/06/reform_private_companylawflexbveffectiv.html.

100. Bratton et al., *supra* note 34, at 385.

101. *See generally* Karolina Carlsson, A Possible European Delaware—Can the European Private Company Prevent It? (2006) (unpublished Master's thesis, Jönköping University), *available at* http://hj.diva-portal.org/smash/get/diva2:4090/FULLTEXT01.pdf.

102. Interviewees included attorneys at a law firm in Paris who specialized in transactional law, as well as French legal academics. The author also interviewed transactional lawyers from a large, multinational law firm in Frankfurt, as well as German corporate law scholars. In the Netherlands, the author again interviewed transactional lawyers from a large, multinational law firm, as well as a Dutch law professor who was also an active corporate practitioner. In the United Kingdom, the author spoke with the Dean of the Oxford University Business School.

organize a client's domestic business. The reasons varied, but one theme that emerged was that of reputation.

For example, lawyers from a large multinational law firm in Frankfurt reported having read legal publications that reported trends favoring use of U.K. Limiteds.[103] One of these attorneys was familiar with what he called a "how-to/cookbook" publication on the formation of a U.K. Limited.[104] But these same lawyers did *not* use the U.K. Limited form for their clients and stated confidently that sophisticated, wealthy clients in Germany "would not use" that option.[105] Indeed, these lawyers expressed the opinion that German lenders would "require" use of a GmbH rather than deal with a foreign entity, in part because of familiarity with creditor rights associated with the GmbH form.[106]

Similarly, the French lawyers who were interviewed—specialists in transactional law—reported that they did not form foreign entities for their clients who conducted domestic businesses, and preferred instead to use the French SAS or SARL.[107] Like the German lawyers, the French lawyers were also concerned about reputation. The lawyers noted, as an example, that one of their clients (one not initially organized by them) *was* a U.K. Limited that conducted business as a pseudo-foreign entity in France. They reported that this company encountered operational difficulties within France. For instance, the company's landlord was "leery" of extending credit to it and required additional guarantees as a condition of doing business.[108]

Business lawyers in the Netherlands also agreed that *Centros* and its progeny had not produced much movement of corporations within the European Union generally or within the Netherlands in particular, save possibly for some small firms.[109] In the view of the lawyers interviewed at the Amsterdam offices of a multinational law firm, which included a notary who specialized in corporate law, it would be "odd" for a Dutch business to organize as a U.K. Limited, and such a move might "signal a problem" to

103. Interview with Attorneys, Freshfields Bruckhaus Deringer LLP, in Frankfurt, Ger. (June 30, 2009) [hereinafter Freshfields Interview].

104. *Id.*

105. *Id.*

106. *Id.*

107. Interview with Lawyers, Didier & Lévy, in Paris, Fr. (July 10, 2009) [hereinafter Didier Interview]. The lawyers did acknowledge that in certain circumstances, tax law considerations might dictate a foreign incorporation, giving as an example a French investment company organized in Luxembourg. The acronym "SARL" used in the text stands for *Société Anonyme a Responsabilité Limitée*, a form of limited liability company.

108. *Id.*

109. Interview with Lawyers, Norton Rose Fulbright LLP, in Amsterdam, Neth. (July 6, 2009) [hereinafter Norton Interview]. The author also conducted an extensive interview with Erik Vermeulen, a Professor of Law at Tilburg University who serves as Vice President of Philips International B.V. (Corporate and Financial Law) and has written about choice of law in the European Union in the wake of *Centros*. *See supra* notes 34 and 67.

outsiders, or at least be perceived to do so unless tax reasons justified a different jurisdictional choice.[110] In fact, these lawyers reported seeing examples where lenders used covenants in loan documents to guard against any change of jurisdiction by the borrower.[111]

The Dutch lawyers' concerns about the reputation of U.K. Limiteds may be justified, at least based on recent press reports that post-date the interviews. As summarized in a recent post on *The Defining Tension*, dated May 30, 2011, "the [U.K. Limited] has got a bad reputation over the last years among bankruptcy trustees. [A leading Dutch financial] newspaper researched the files of 123 [U.K. Limiteds] that went bankrupt in the Netherlands. In 79 [of these companies], the bankruptcy trustees reported mismanagement; in 23 cases, fraud was reported."[112] The poster concludes: "The [U.K. Limited] seems to attract entrepreneurs who have gone bankrupt before."[113]

2. Use of Foreign Business Entities: Concerns About Compliance Obligations

As some commentators had surmised,[114] interviewees expressed concerns about reporting requirements that a foreign entity like the U.K. Limited might entail. For example, German lawyers cited ongoing annual filing obligations associated with the U.K. Limited as a potential obstacle to use of that entity in Germany. The lawyers were concerned not only about the work that such filings would entail for their clients, but also about additional expenses from service companies that might be enlisted to assist with completion and filing.[115] These concerns may also be well-founded; recent press reports suggest that large numbers of German firms that have used the U.K. Limited form are, in fact, failing to comply with U.K. reporting requirements.[116]

The French lawyers were similarly concerned about ongoing filing requirements for U.K. Limited doing business in France. They noted that in addition to complying with the U.K. rules, such a firm would also have to

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110. Norton Interview, *supra* note 109.

111. *Id.*

112. *See* Matthijs J. de Jongh, *Abuse of British Ltd's in the Netherlands*, Post No. 28, DEFINING TENSION (Feb. 27, 2011) (on file with author).

113. *Id.*

114. *See supra* note 80 and accompanying text.

115. Freshfields Interview, *supra* note 103. The German lawyers also expressed concerns that if a U.K. Limited did not properly file the necessary U.K. reports—a task that might be difficult for German owners—veil-piercing theories might put the company's owners at risk. *Id.*

116. Hugh Williamson, *Germans Break UK Limited Company Rules*, FIN. TIMES (Oct. 4, 2006), http://www.ft.com/cms/s/0/00877330-5345-11db-99c5-0000779e2340.html#axzz2VvL8E4QU ("Between 30 per cent and 50 per cent of the estimated 30,000 limited companies in Germany are failing to file financial results and other data to Britain's Department of Trade and Industry, according to industry insiders and a recent survey.").

satisfy special requirements of French law relating to reporting of financial statements.[117]

3. Changes in Domestic Company Law

Despite predictions by some scholars that the United Kingdom was likely to emerge as a company law jurisdiction of choice,[118] none of the lawyers or other experts the author interviewed believed that a Delaware of Europe had emerged or was likely to do so in the near future. Among the reasons cited by interviewees were recent reforms of domestic company laws that add flexibility to entity formation processes. Indeed, interviewees in France, Germany, and the Netherlands were all quite eager to discuss recent or proposed changes to their respective countries' company laws. As explained below, the prevailing perception was that these changes were responsive to *Centros* and related EU developments that made it possible for domestic businesses to organize in other EU countries. However, interviewees did not perceive that any one Member State had emerged as a model or was making a concerted attempt to attract foreign incorporations. Instead, they characterized ongoing company law reforms as designed to keep domestic companies chartered at home.

For example, the French lawyers extolled the virtues of the French SAS as a flexible business entity form with no minimum capital requirements.[119] They credited the efforts of France's Senator Phillipe Marini, as well as a company law organization known as ANSA, as catalysts for French company law reforms.[120] Although not directly related to company law, the French lawyers also called attention to France's new "Auto-Entrepreneur" law as an example of changes in France designed to make it easier for small businesses and individual entrepreneurs to conduct business there.[121]

As is explained in more detail in other sources, Germany's "MoMiG" reforms, passed in 2008, relax various requirements associated with use of the GmbH, including minimum capital requirements.[122] Interviewees stated that these changes were designed to encourage German businesses to organize under German law rather than to attract foreign investors to the

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117. Didier Interview, *supra* note 107.

118. *See* Armour, *supra* note 40, at 393–95 (arguing that the United Kingdom has incentives to compete in the field of company law).

119. Didier Interview, *supra* note 107.

120. "ANSA" stands for Association Nationale des Sociétés par Actions (National Association of Stock Companies).

121. *See generally* Nadine Levratto & Evelyne Serverin, *Become Independent! The Paradoxical Constraints of France's "Auto-Entrepreneur" Regime*, 52 J. SMALL BUS. MGMT. (forthcoming 2014), *available at* http://ssrn.com/abstract=1780485.

122. *See supra* notes 97–98 and accompanying text. The German stock company law has been reformed as well. *See generally* Jessica Schmidt, *Reforms in German Stock Corporation Law*, 9 EUR. BUS. ORG. L. REV. 637 (2009).

GmbH form.[123] Interviewees also identified several other subsidiary motives for the changes. For example, one lawyer suggested that Germany passed MoMiG partly out of a sense of "national pride"—a desire that the GmbH not be perceived as inferior to the U.K. Limited. He also pointed out that so long as a German company organized as a GmbH rather than as a U.K. Limited, German creditors would be better protected. Using a GmbH instead of a U.K. Limited would also be helpful to management and shareholders, he argued, because German courts would be familiar with GmbH law if a dispute were to arise.[124]

4. Forum Shopping in Special Purpose Situations

Several interviewees acknowledged that some forum shopping for entity law *did* occur in the European Union, but mainly in response to special situations. The French lawyers, for example, pointed out that Luxembourg offers a variety of attractive vehicles for investment funds.[125] The German lawyers cited strategic use of the SE to accomplish corporate restructuring, as in the case of Allianz, which has been much reported in the press.[126] The German lawyers also agreed with scholarly assessments that the SE might enable a German S.A. to obtain a single-tier board and/or to renegotiate co-determination requirements with employees.[127] The Dutch lawyers noted that they had seen examples of leveraged buyout (LBO) transactions where the participants selected an incorporation jurisdiction in the European Union that would facilitate necessary legal opinions to "wash clean" the LBO.[128] But none of these narrow situations reflects a general trend to embrace a single new EU entity or company law jurisdiction.

III. "UNCORPORATION" BUSINESS DEVELOPMENTS IN U.S. JURISDICTIONS

The relative stasis in substantive EU company law over the past dozen years or so contrasts sharply with the dramatic transformations that occurred in the field of U.S. unincorporated business association law a decade earlier. As this Part of the Article shows, limited liability companies (LLCs) and new limited liability forms of partnership—limited liability partnerships (LLPs) and limited liability limited partnerships (LLLPs)—emerged and surged in popularity through much of the 1990s as all U.S. jurisdictions passed laws authorizing the creation of the new entities. These

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123. Freshfields Interview, *supra* note 103.
124. *Id.*
125. Didier Interview, *supra* note 107.
126. *See, e.g.*, *SE change: Allianz Becomes the First Truly European Company*, INSTITUTIONAL INVESTOR (Oct. 11, 2005), http://www.institutionalinvestor.com/Article/1025923/Asian-Markets-Archive/SE-change-Allianz-becomes-the-first-truly-European-company.html.
127. Freshfields Interview, *supra* note 103.
128. Norton Interview, *supra* note 109.

remarkable developments entailed significant innovation in and convergence of U.S. unincorporated business association laws around new models. Indeed, an entirely new lexicon developed to accommodate a novel business association environment that the late Professor Larry Ribstein described as "uncorporation."[129] What is particularly noteworthy for purposes of the EU comparison is that all of these developments occurred in the face of considerable uncertainty about whether and how the internal affairs rule applied to the new business forms.

A. THE RISE OF THE LLC

The limited liability company, or "LLC" as it has come to be known, is an unincorporated business association comprised of members who enjoy considerable flexibility in structuring company management and operations through an internal operating agreement.[130] Although an LLC is primarily a creature of contract (the voluntary association of its members as expressed through the terms of an operating agreement),[131] the LLC is a legal entity that must be organized pursuant to prescribed state procedures that include a public filing.[132] The LLC has both partnership and corporate characteristics; it is ordinarily taxed as a partnership, i.e., with no entity level tax,[133] and combines that feature and flexible management rules with a corporate attribute considered equally desirable for a business entity: limited liability for owners and managers.[134]

The origins of the LLC in the United States can be traced to a 1977 Wyoming enactment and similar Latin American business entity laws that pre-date it.[135] As Professor Susan Pace Hamill and others have described,

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129. LARRY E. RIBSTEIN, RISE OF THE UNCORPORATION (2010).

130. *See generally* CARTER G. BISHOP & DANIEL S. KLEINBERGER, LIMITED LIABILITY COMPANIES: TAX AND BUSINESS LAW (2008). The operational "flexibility" noted in the text refers to the fact that company members may participate directly in LLC management as partners do in a partnership, or they may opt for centralized management of the company by one or more managers, similar to management by general partners in a limited partnership or by directors in a corporation. *See, e.g.*, UNIF. LTD. LIAB. CO. ACT § 407 (2006) (internal quotation marks omitted) (providing as a default rule that management of an LLC shall be "vested in [its] managers").

131. *See, e.g.*, Daniel S. Kleinberger, *The Closely Held Business Through the Entity Aggregate Prism*, 40 WAKE FOREST L. REV. 827, 842 (2005) (collecting authorities and asserting that "the LLC is as much a creature of a contract among its members as it is an entity created pursuant to statute").

132. This state formation filing is typically called "articles of organization" or a "certificate of organization." *See* UNIF. LTD. LIAB. CO. ACT § 202 (1996), 6B U.L.A. 574 (2008) (articles of organization); REV. UNIF. LTD. LIAB. CO. ACT § 201 (2006), 6B U.L.A. 456 (2008) (certificate of organization).

133. *See* Treas. Reg. § 301.7701 (1997).

134. *See generally* Matthew G. Doré, *What, Me Worry? Tort Liability Risks for Participants in LLCs*, 11 U.C. DAVIS BUS. L.J. 267, 269 (2011) (discussing the LLC's limited liability shield and exceptions to it).

135. William J. Carney, *Limited Liability Companies: Origins and Antecedents*, 66 U. COLO. L. REV. 855, 857–63 (1995) (describing the original Wyoming legislation and its roots in the Latin American *limitada*).

the LLC did not receive widespread attention in the United States until 1988, when the Internal Revenue Service first confirmed in Revenue Ruling 88-76 that an LLC could be taxed as a partnership, i.e., on a pass-through basis with no entity-level tax.[136] At that time Wyoming and Florida were the only states authorizing formation of LLCs, and both used LLC acts that were primitive, cut-and-paste jobs combining various features of partnership, limited partnership, and corporation law.[137] After 1988, when the LLC was finally recognized as a vehicle that provided the long-sought combination of owner limited liability and partnership taxation in one entity, other jurisdictions quickly added LLC acts to their business association laws and considerably refined LLC law in the process.[138]

Professor Hamill has tallied the legislative count: two states enacted LLC laws in 1990, and four more states followed suit in 1991.[139] At that point, as she tells it, the floodgates were wide open:

> From 1992 through 1996, LLC legislation swept across the country. In 1992 ten additional states, including Delaware, passed legislation recognizing LLCs, bringing the total to eighteen. In 1993, the year showing the greatest number of state enactments, eighteen additional states passed LLC legislation, bringing the total to thirty-six. By the end of 1994, twelve additional states, including New York and California, authorized the formation of LLCs under their laws. Only three remaining states were without LLC legislation, and by the close of 1996, they had passed statutes establishing the LLC in all U.S. jurisdictions.[140]

These new LLC laws were not simply added to the statute books for show; lawyers and clients were also quick to embrace them. As Professor Hamill reports in another article, "[b]etween September 2, 1988, the eve of the IRS's release of Revenue Ruling 88-76 (when the U.S. had less than 100 LLC filings) and December 31, 1995, over 210,000 business ventures filed to become LLCs."[141] Although corporate and partnership formations outpaced new LLCs during this period on a national basis,[142] the LLC continued to increase in popularity across the country each subsequent year, and by the mid-2000s, the formation data showed clearly that the LLC was

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136. Carney, *supra* note 135, at 858 (stating that the 1988 revenue ruling "opened the floodgates" of LLC legislation); Susan Pace Hamill, *The Origins Behind the Limited Liability Company*, 59 OHIO ST. L.J. 1459, 1460 (1998) ("After the Internal Revenue Service . . . formally recognized the LLC's ability to be taxed as a partnership in 1988, interest in LLCs grew exponentially.").

137. *See, e.g.*, Carney, *supra* note 135, at 858 (describing Wyoming's first LLC law).

138. Carol R. Goforth, *The Rise of the Limited Liability Company: Evidence of a Race, But Heading Where?*, 45 SYR. L. REV. 1193, 1220–62 (1995) (describing the sequence of state adoptions and influences on the process).

139. Hamill, *supra* note 136, at 1470–74.

140. *Id.* at 1475–77.

141. Susan Pace Hamill, *The Limited Liability Company: A Catalyst Exposing the Corporate Integration Question*, 95 MICH. L. REV. 393, 404 (1996).

142. *Id.* at 405.

on top.[143] By 2011 it was fair to say that the "LLC ha[d] emerged as the leading entity choice for new [U.S.] businesses, surpassing even the corporation in popularity."[144]

Among the most remarkable features of the rise of the LLC in the United States was the "meteoric pace"[145] of events. As described above, between 1988 and 1996 every American state and the District of Columbia followed Wyoming's and Florida's lead in passing LLC laws.[146] Professor William Carney observes that "[t]he speed with which this change occurred is nearly unprecedented in the history of American business association law."[147] Professor Hamill agrees: "In an incredible stampede that took less than twenty years, most of it occurring from 1990 through 1996, LLCs traveled from an obscure unknown business form in 1977 to a well-recognized alternative for doing business."[148] While the resulting LLC laws are not strictly uniform,[149] the various state enactments share common characteristics on most key issues. As I have written, "most states drafted

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143. *See, e.g.*, Rodney D. Crisman, *LLCs Are the New King of the Hill: An Empirical Study of the Number of New LLCs, Corporations, and LPs Formed in the United States Between 2004–2007 and How LLCs Were Taxed for Tax Years 2002–2006*, 15 FORDHAM J.L. & FIN. 459–60, 473–75 (2010) (reporting the following 2007 numbers for LLCs, corporations, and limited partnerships, respectively: 1,375,148 (63.58%); 747,533 (34.56%); 40,229 (1.86%)). Professor Larry Ribstein, reporting in May 2006 on filing data from thirty-five jurisdictions, found that "LLCs [were] up in 2005 from the prior year in almost every state, while they [were] down for corporations in most states." *See* Doré, *supra* note 134, at 270 n.6.

144. Doré, *supra* note 134, at 269 (collecting entity formation statistics).

145. Hamill, *supra* note 136, at 1477 (noting that the explosive growth in LLC formations "mirrored the meteoric pace of [enactment of state LLC] statutes"); *see also* Hamill, *supra* note 141, at 404 (referring to the "meteoric pace" of state enactments).

146. *See supra* note 140 and accompanying text.

147. Carney, *supra* note 135, at 859.

148. Hamill, *supra* note 136, at 1478.

149. Drafters began work on a uniform LLC act in the early 1990s, but the final version was not completed until 1996, by which time nearly every jurisdiction had already adopted an LLC law. Larry E. Ribstein & Bruce H. Kobayashi, *Uniform Laws, Model Laws and Limited Liability Companies*, 66 U. COLO. L. REV. 947 (1995) (describing state adoption processes and the relatively modest influence of NCCUSL's Uniform Limited Liability Company Act (1995) and the ABA's Prototype Limited Liability Company Act (1992)). As Professor Carney and others have described, rather than waiting for a uniform law option, state bar associations took the lead in drafting new LLC acts in an attempt to keep their respective states' business association offerings competitive with those already available in other parts of the country:

> I attribute the reasons for [the unusually rapid enactment of LLC laws] to a highly competitive legal market, in which lawyers seek to offer clients attractive new products at competitive prices. I have little doubt that local bar associations are largely responsible for this change . . . . Behind these bar associations are energetic lawyers constantly seeking new ways to better satisfy clients' needs. I recall the conversations within the committee in Georgia: that some south Georgia businesses were turning to Florida LLCs, and that it was time for Georgia to catch up with our Florida competition. I suspect that similar conversations took place across the country. The rapid adoption of similar statutes by Colorado and neighboring states may have been influenced by the presence of the Wyoming Act.

See Carney, *supra* note 135, at 859.

LLC laws by building on earlier states' efforts much like a cook might tinker with a newly-received recipe."[150]

B. THE LIMITED LIABILITY PARTNERSHIP REVOLUTION

The registered limited liability partnership, or "LLP" as it came to be known, is another new limited liability entity choice that has recently become available across all U.S. jurisdictions. Like the LLC, the LLP was spawned by developments in the late 1980s. The key event for the LLP was the savings and loan debacle, which sent thousands of financial institutions into receivership in the late 1980s and early 1990s.[151] Federal regulators, seeking to hold responsible parties accountable for the crisis, turned their sights not only on the officers and directors of failed financial institutions, but also on the law firms and accounting firms who had advised them.[152] These claims highlighted for lawyers and accountants the potential benefits associated with practicing their profession through a limited liability entity. Neither limited partnerships nor professional corporations provided a sound alternative to the general partnership business form that most professional firms then used, and LLCs were not then widely available.[153]

The registered LLP offered a solution. Texas enacted legislation in 1991 that provided a partner in a general partnership with a significant

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150. Doré, supra note 134, at 284; *see also* Tara J. Wortman, Note, *Unlocking Lock-In: Limited Liability Companies and the Key to Underutilization of Close Corporation Statutes*, 70 N.Y.U. L. REV. 1362, 1405 (1995) (observing that "LLC laws have developed rather uniformly").

151. *See* Matthew G. Doré, *Statutes of Limitation and Corporate Fiduciary Claims: A Search for Middle Ground on the Rules/Standards Continuum*, 63 BROOK. L. REV. 695, 706 (1997) ("In the 1980s and early 1990s, banks and savings and loans failed at an unprecedented rate. The Federal Deposit Insurance Corporation, and its now extinct colleagues, the Federal Savings and Loan Insurance Corporation and the Resolution Trust Corporation . . . , typically acted as receivers or successors of these institutions.").

152. For a description of the professional liability crisis that erupted in the wake of the savings and loan debacle, see Matthew G. Doré, *Presumed Innocent? Financial Institutions, Professional Malpractice Claims, and Defenses Based on Management Misconduct*, 1995 COLUM. BUS. L. REV. 127, 132–33; *see also* John S. Dzienkowski, *Legal Malpractice and the Multistate Law Firm*, 36 S. TEX. L. REV. 967, 981–82 (1995) (describing the "significant threat of vicarious liability for law partners" posed by banking regulators' negligence claims and noting that "[m]any of the settlements [of these claims] came very close to [malpractice] policy limits"); Robert W. Hamilton, *Registered Limited Liability Partnerships: Present at the Birth (Nearly)*, 66 U. COLO. L. REV. 1065, 1071 (1995) (describing regulatory malpractice suits against law firms in the late 1980s that "caught the attention of the hundreds of law firms that had represented banks or thrifts").

153. Limited partnerships were not a viable option because, under traditional limited partnership principles, limited partners could not actively manage a partnership and at the same time preserve their limited liability shield. *See* UNIF. P'SHIP ACT § 303 (amended 1985). Conversion to a professional corporation presented tax and organizational difficulties for many professional firms, and the soundness of the resulting corporate liability shield was unclear. *See, e.g.*, Charles W. Wolfram, *Inherent Powers in the Crucible of Lawyer Self-Protection: Reflections on the LLP Campaign*, 39 S. TEX. L. REV. 359, 377–81 (1998) (stating that "at the time of enactment of the recent wave of LLP legislation, there was significant authority refusing to permit limited liability" for lawyers).

measure of limited liability protection if the partnership registered as an LLP.[154] The LLP partner was personally liable for his own actions, and for contractual obligations of the partnership, but not for the "errors, omissions, negligence, incompetence or malfeasance" of co-partners, or of partnership employees.[155] Thus, with a simple filing and payment of nominal filing fees, an existing general partnership could convert to a partial-shield, limited liability entity.[156] In all other respects, the normal "partnership" rules of the Uniform Partnership Act continued to apply to general partnerships that registered as LLPs.[157]

Although the LLP marked a dramatic transformation in traditional partnership law, the LLC had already paved the way for that result, combining pass-through taxation and limited liability in a non-corporate structure. Nor was it surprising that the LLP form proved enormously attractive to professional partnerships or that other states soon emulated the Texas statute. According to Professor Ribstein, "[LLP legislation] was adopted in Louisiana in 1992, in three more jurisdictions in 1993 and in thirteen additional jurisdictions in 1994."[158] By 1995, half of U.S. jurisdictions had LLP legislation,[159] and by 1998 nearly all the remaining states enacted such laws.[160]

As was the case with LLCs, slight LLP law variations emerged over the course of multiple state enactments.[161] The most important change was that,

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154. Registration entailed an annual partnership filing with the Texas Secretary of State, maintenance of a designated amount of malpractice insurance, payment of an annual fee, and use of the designation "LLP" or "registered limited liability partnership" in the firm name. TEX. REV. CIV. STAT. ANN. art. 6132b, §§ 45-A–45-C (West 1993) (repealed 2003); *see also* Steven A. Waters & Matthew D. Goetz, *Partnerships*, 45 SW. L.J. 2011, 2022 (1992). For current LLP registration requirements in Texas, see TEX. BUS. ORG. CODE § 152.802 (West 2012).

155. CIV. art. 6132b, § 15 (repealed 2003). Two conditions were attached: First, the liability must have resulted from acts with which the partner was not involved, either directly or in a supervisory capacity (i.e., vicarious tort liability was the apparent target). Second, at the time of the acts giving rise to the liability claim, the partnership must have been properly registered with the state as an LLP. Provisions governing the liability of LLP partners have since been revised and recodified at BUS. ORG. § 152.801.

156. The term "partial" shield refers to the fact that, as the LLP was originally conceived, partners remained jointly liable for obligations of the partnership that were not based in tort. *See supra* note 153 and accompanying text.

157. This practice has been carried over to the Revised Uniform Partnership Act, which includes only a few provisions that distinguish LLPs from other partnerships organized thereunder. *See* UNIF. P'SHIP ACT §§ 303, 1101–05 (amended 1985).

158. Larry E. Ribstein, *Choice of Form and Network Externalities*, 43 WM. & MARY L. REV. 79, 86–87 (2001).

159. Hamilton, *supra* note 152, at 1095 ("As of the beginning of 1995, legislation recognizing LLPs has been enacted in twenty-four states . . . .").

160. Ribstein, *supra* note 158, at 87 ("Virtually all states had adopted LLC statutes by early 1998 . . . .").

161. For example, most states dropped the requirement that LLPs carry minimum liability insurance. *See* J. WILLIAM CALLISON & MAUREEN A. SULLIVAN, PARTNERSHIP LAW AND PRACTICE § 32:2 (2011) ("Several of the early LLP statutes . . . mandate that an LLP have

by the mid-1990s, states began to provide "full-shield" liability protection to LLP partners, affording them liability protection identical to that of a corporate shareholder or LLC member.[162] In 1997 this change was incorporated as part of the Revised Uniform Partnership Act, which has now replaced its 1914 predecessor in most jurisdictions.[163] The final LLP innovation, which followed close on the heels of original LLP legislation in most states, was the extension of full-shield limited liability protection to both general and limited partners in limited partnerships, creating the "limited liability limited partnership," or LLLP.[164]

C. THE UNCERTAIN ROLE OF THE INTERNAL AFFAIRS RULE IN LLC AND LLP LEGISLATION

Current state LLC and LLP acts include provisions that expressly adopt the internal affairs rule. For example, both the latest Uniform LLC Act and its predecessor provide that the law of the jurisdiction under which a foreign LLC is organized governs the company's internal affairs, as well as the liability of company managers, members, and their transferees.[165] The Uniform Partnership Act's LLP provisions similarly provide that the law under which a foreign LLP is formed governs "relations among the partners

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insurance or an escrow account to cover liabilities . . . . More recent statutes typically do not mandate insurance . . . .").

162. *See, e.g.*, MINN. STAT. § 323.14(2) (1995) (repealed 1997). For a complete comparative breakdown of the LLP liability shields in the late 1990s, see Darryl Van Duch, *Some Firms Hesitate to Adopt L.L.P.,* NAT'L L.J., May 5, 1997, at A1, A20.

163. UNIF. P'SHIP ACT § 306(c) (1997), 6 U.L.A. 117 (2001). The most recent count by the Uniform Law Commission lists thirty-nine jurisdictions as having adopted the Uniform Partnership Act. *See Legislative Fact Sheet—Partnership Act*, UNIFORM L. COMM'N, http://uniformlaws.org/LegislativeFactSheet.aspx?title=Partnership Act (last visited Apr. 11, 2014).

164. *See* Carter S. Bishop, *Unincorporated Limited Liability Business Organizations: Limited Liability Companies and Partnerships*, 29 SUFFOLK U. L. REV. 985, 1003–04 (1995). The pattern of LLLP laws is more varied than laws governing LLCs and LLPs. A few jurisdictions expressly prohibit LLLPs; other jurisdictions expressly authorize them through provisions in general or limited partnership statutes; the remaining jurisdictions authorize LLLPs inferentially through general partnership LLP provisions. *See* Daniel S. Kleinberger, *A User's Guide to the New Uniform Limited Partnership Act*, 37 SUFFOLK U. L. REV. 583, 619 n.170 (2004). As Professor Kleinberger's article explains, the most recent version of the Uniform Limited Partnership Act expressly includes LLLP provisions. As of fall 2012, nineteen jurisdictions had adopted that statute. *See Legislative Fact Sheet—Partnership Act*, UNIFORM L. COMM'N, http://uniformlaws.org/LegislativeFactSheet.aspx?title=Limited Partnership Act (last visited Feb 9, 2014).

165. *See* UNIF. LTD. LIAB. CO. ACT § 801(a) (2006), 6B U.L.A. 515 (2008) ("The law of the . . . jurisdiction under which a foreign limited liability company is formed governs: (1) the internal affairs of the company; and (2) the liability of a member as member and a manager as manager [for company obligations]."); *id.* § 1001(a), at 640 ("The laws of the . . . jurisdiction under which a foreign limited liability company is organized govern its organization and internal affairs and the liability of its managers, members, and their transferees."); *see also The Revised Prototype Limited Liability Company Act*, 67 BUS. LAW. 117, 186 (2011) (noting, in comment to section 801, that "[LLC] acts around the country . . . [provide] that the organization and internal affairs of a foreign limited liability company are governed by the laws of its jurisdiction of formation").

and between the partners and the partnership and the liability of partners for obligations of the partnership."[166] States that have adopted non-uniform versions of these laws do the same.[167]

In contrast to the clarity of current law on these points, during the period when LLCs and LLPs first emerged and when states were rushing to craft legislation authorizing them, it was far from clear whether and how the internal affairs rule applied to the new entities and whether their limited liability shields would be respected outside the jurisdictions in which the entities were organized.[168] As Professor Carney describes it, "LLCs remained surrounded with uncertainties" at this time, including "uncertainties about the extent of limited liability for members where LLCs did business outside their home jurisdiction in a foreign state lacking authorizing legislation for LLCs."[169] A similar uneasiness applied with respect to LLPs operating outside their formation state.[170]

The primary concern was that if litigation were commenced against an LLC or LLP doing business in a jurisdiction that had not yet adopted a similar law, or at least a law providing for the qualification of foreign LLCs or LLPs, courts in the forum state might decide that recognizing the foreign

166. UNIF. P'SHIP ACT § 1101(a) (1997), 6 U.L.A. 255 (2001).

167. *See, e.g.*, DEL. CODE ANN. tit. 6, § 18-901(a)(1) (2013) ("The laws of the . . . jurisdiction . . . under which a foreign limited liability company is organized govern its . . . internal affairs and the liability of its members and managers . . . ."). It may seem odd that these statutory choice-of-law rules encompass not only internal affairs but also limited liability rules that affect third parties, which are clearly external affairs. Nonetheless, accepted corporate conflict of law principles normally defer to the organizing jurisdiction on similar limited liability issues. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 307 (1971) (providing that "the local law of the state of incorporation will be applied to determine the existence and extent of a shareholder's liability to the corporation for assessments or contributions and to its creditors for corporate debts").

168. *See, e.g.*, Robert R. Keatinge et al., *The Limited Liability Company: A Study of the Emerging Entity*, 47 BUS. LAW. 375, 448–56 (1992) (arguing that U.S. jurisdictions should treat a foreign LLC like a foreign corporation and thereby respect both the company and its limited liability shield); Joseph A. Rodriguez, Comment, *Wyoming Limited Liability Companies: Limited Liability and Taxation Concerns in Other Jurisdictions*, 27 LAND & WATER L. REV. 539, 539 (1992) (examining "the potential problems that a Wyoming LLC may face if it extends its operations into foreign jurisdictions").

169. Carney, *supra* note 135, at 859; *accord* Thomas E. Rutledge, *To Boldly Go Where You Have Not Been Told You May Go: LLCs, LLPs, and LLLPs in Interstate Transactions*, 58 BAYLOR L. REV. 205, 206 (2006) ("When . . . LLCs . . . were available in relatively few states, there existed a continuing uneasiness with the use of these novel structures in interstate commerce because of uncertainty regarding whether limited liability would be retained for the members (and managers) doing business in those jurisdictions that had not yet adopted LLC acts.").

170. *See* Martin I. Lubaroff, *Registered Limited Liability Partnerships: The Next Wave*, FORMING AND USING LIMITED LIABILITY COMPANIES AND LIMITED LIABILITY PARTNERSHIPS, at 503, 539 (PLI Corp. Law & Practice, Course Handbook Ser. No. 836, 1994) ("[If] a partnership operates solely in a state that recognizes an LLP and is formed under the laws of that state, there should not be any question concerning recognition . . . . Apart from [that] example, under a more traditional choice-of-law analysis, consideration must be given to the extent of the relationship of a partnership with the state of formation and to the conflict of law approach under the law of the jurisdiction in which litigation arises . . . .").

entity and its liability shield would be contrary to the forum state's own policy interests. Those policy interests might include the fact that the forum state had not yet authorized such novel entities and that the foreign entity's limited liability shield could limit recovery by claimants from the forum state.[171]

Some scholars reasoned that states without LLC or LLP laws might nonetheless respect and apply such laws as enacted by other states. The basis for recognition might be principles of comity[172] or requirements under the Full Faith and Credit or Interstate Commerce clauses of the U.S. Constitution.[173] But it was difficult to be confident on either score because the extension of limited liability principles made by LLC and LLP laws could easily raise policy concerns on the part of states that had not yet enacted them.

As more and more states adopted LLC and LLP laws through the 1990s, and certainly as more and more LLC and LLP statutes expressly embraced the internal affairs rule through foreign qualification provisions, concerns ultimately subsided about application of the internal affairs rule to foreign LLCs and LLPs, and about respect for their liability shields across state lines.[174] The point, for present purposes, is that given the *initial* uncertainty surrounding the internal affairs rule as applied in the new LLC and LLP settings, one can hardly credit application of the internal affairs rule, and the jurisdictional competition it facilitates, as the sole reason why U.S. jurisdictions so readily embraced LLC and LLP laws.

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171. *See, e.g.*, Keatinge, *supra* note 168, at 452 ("If an LLC member is analogized to a limited partner or general partner . . . , the Restatement does not provide a dispositive rule as to whether the forum state would adopt the limited liability provisions of the LLC's state of organization. Instead, section 295 of the Restatement indicates that the local law of the state selected by applying the rules under section 6(2) of the Restatement would govern. Section 6(2) gives the forum court wide latitude in examining the critical 'relevant policies of the forum' factor.").

172. Comity is the conflict of laws principle that a state will recognize and effectuate the laws of another state so long as the foreign state's law does not conflict with local law or raise other policy concerns. As one source recently expressed it, in the United States, "comity has served as a principle of deference to foreign law and foreign courts . . . ." Joel R. Paul, *The Transformation of International Comity*, 71 L. & CONTEMP. PROBS. 19, 20 (2008). For an argument that states without LLC laws might recognize foreign LLCs based on principles of comity, see Keatinge, *supra* note 168, at 453–54. For a similar argument concerning LLPs, see Lubaroff, *supra* note 170, at 536.

173. *See* Keatinge, *supra* note 168, at 454–56 (making Full Faith and Credit and Interstate Commerce Clause arguments for recognition of foreign LLCs); Lubaroff, *supra* note 170, at 536 (making Full Faith and Credit Clause argument for recognition of LLPs).

174. For an analysis of a few lingering concerns about the scope of liability protection for participants in LLCs, LLPs, and LLLPs that do business across state lines, see Rutledge, *supra* note 169.

IV. COMPARING THE RECENT EUROPEAN AND U.S. EXPERIENCES

If the new EU internal affairs rule and the EU legal changes described in Part I permit jurisdictional competition in the field of European company law, why have Europe's company laws not changed and converged in content as their U.S. corporate counterparts have? And if the internal affairs rule is a key driver of jurisdictional competition and convergence, why did U.S. unincorporated business association laws change and converge dramatically to embrace LLCs and LLPs, even before it became clear that the internal affairs rule applied to the new entities? This Part argues that the answer lies in nuanced views of jurisdictional competition and corporate law convergence patterns that several scholars have recently advanced. These views not only provide alternative perspectives on these issues, but also serve as a helpful reminder that focusing on jurisdictional competition and convergence patterns can obscure a key purpose of comparative corporate governance study—to learn from other legal systems.

A. CHALLENGES TO MARKET COMPETITION THEORIES OF CORPORATE LAW CONVERGENCE

As explained in the Introduction, commentators have long contended that corporate laws are shaped by market forces and jurisdictional competition that the internal affairs rule makes possible.[175] Part I.A further described how law and economics scholars have built on this assumption and made stronger claims: that the internal affairs rule, together with market forces, promote adoption of more efficient corporate laws that eliminate unnecessary regulation.[176] Recall as well the prediction that the "end of history" for corporate law would be marked by global convergence on a shareholder-centered model of the corporation.[177]

But there are competing views. For example, Professor Mark Roe has explained that the development and survival of corporate laws and institutions are influenced not only by efficiency considerations, but also by "initial, often accidental conditions (chaos theory), [by] the history of problems that had to be solved in the past but that may be irrelevant today (path dependence), and [by] evolutionary accidents—what might do best today could have been selected out for extinction in the past."[178] Although Roe agrees that the laws and institutions that survive "cannot be too inefficient," he contends that an "evolution-toward-efficiency" theory "constrains but does not fully determine" the current condition of business

175. *See supra* notes 3–4 and accompanying text.
176. *See supra* notes 25–26 and accompanying text.
177. *See supra* note 26 and accompanying text.
178. Mark J. Roe, *Chaos and Evolution in Law and Economics*, 109 HARV. L. REV. 641, 641 (1996).

association laws.[179] To take one example, Roe's seminal work *Strong Managers, Weak Owners* illustrates the phenomenon of "path dependency," explaining how populist politics operating in a federal system limited the role of financial institutions in U.S. corporate governance, and thus put state corporate laws on a different "path" than those adopted in other countries.[180] Among other important lessons, Roe's work demonstrates that efficiency considerations are not the only forces that determine the content of business association law; historical accidents, political vectors, and resulting path dependencies are also important determinants that shape its contours.

Building on Roe's work, Professor Ronald Gilson has argued that corporate institutions respond to competitive pressures in a variety of ways. These include adoption of what Gilson calls "functional convergence" measures, where the formal legal environment remains static, but corporate actors utilize available flexibility within the existing legal system to find new solutions "within their path dependent limits."[181] In Gilson's words, "institutions are shaped by a form of corporate governance plate tectonics, in which the demands of current circumstances grind against the influence of initial conditions."[182]

More recently, Professor Donald Clarke has argued that comparative corporate governance scholarship places undue emphasis on convergence as a function of competitive economic pressures.[183] "Since corporations have not as an empirical matter all migrated out of all countries except one (the one that has the best rules)," he points out, "it must not be true that selection pressures work the way the [law and economics] story says they do."[184]

Professor Franklin Gevurtz also disputes that corporate law convergence is the inevitable result of competitive pressures for ever more efficient laws.[185] Gevurtz agrees with Roe and Gilson that path dependencies and other forces may preserve divergent corporate laws despite the laws' relative merits on an efficiency scale, and he argues further that corporate law convergence can occur as a result of "fads and fashions," promoting new norms that lack any particular efficiency

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179. *Id.*

180. *See, e.g.*, MARK J. ROE, STRONG MANAGERS, WEAK OWNERS (1994); *see also* Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127 (1999) (describing two sources of path dependence: initial ownership structures and initial corporate law rules).

181. Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329, 338 (2001).

182. Ronald J. Gilson, *Corporate Governance and Economic Efficiency: When Do Institutions Matter?*, 74 WASH. U. L.Q. 327, 332 (1996).

183. Donald C. Clarke, *'Nothing but Wind'? The Past and Future of Comparative Corporate Governance*, 59 AM. J. COMP. L. 75 (2011).

184. *Id.* at 100.

185. Gevurtz, *supra* note 25.

advantage.[186] Most importantly, Gevurtz reminds us that the critical tensions that corporate and other business association laws must address—tensions between owners and managers, owners and creditors, majority owners and minority owners, etc.—have never been capable of easy resolution.[187] As a result, he contends, global convergence around any one solution or set of solutions that purports to resolve those issues is unlikely, if not impossible.[188]

B. THE EU EXPERIENCE AND FORCES OF DIVERGENCE

Considered from the perspective of these more nuanced scholarly views about competition and corporate law convergence, it is not entirely surprising that European jurisdictions have not yet competed vigorously in the field of company law despite the freedom to do so and that European company laws do not yet all conform to the most efficient alternatives. Recall the various forces of divergence described in Part II.A: franchise tax obstacles that may diminish incentives for EU Member States to compete for new company formations; the importance of judicial expertise in creating an attractive company law for foreign users; uncertainty about the scope of the new EU internal affairs rule and the mechanics of corporate mobility; ongoing compliance difficulties and possible litigation obstacles that pseudo-foreign companies may face within the European Union; as well as cultural and political disincentives that might discourage use of foreign company laws.[189] Whether best understood as vestiges of path dependence or as idiosyncratic counterweights that naturally resist efficiency-based forces, these vectors, individually or collectively, may well be sufficiently powerful to overcome natural competitive pressures that favor more permissive company laws.

Alternatively, and taking a leaf from Professor Gilson's convergence analysis, EU countries directly threatened by outside competition, such as France, Germany, and the Netherlands have faced from the United Kingdom, may have already accomplished *functional* convergence with the United Kingdom with reforms that favorably affect cost and speed of company formation.[190] These modest legal adjustments may alleviate the need for more extensive, conforming changes to French, German, and Dutch company laws. When the U.S. experience with uncorporation is added to the discussion, there is some evidence of a related trend on the

186. *Id.* at 496–500.
187. *Id.* at 511–20.
188. *Id.* at 520.
189. *See supra* notes 72–86 and accompanying text.
190. As described in Part II.A, two potentially important advantages that a European company law *could* offer over its competitors in other Member States—low filing fees and rapid processing of entity formation paperwork—appear to have prompted some movement within the European Union towards the U.K. Limited and modest conforming changes in at least three Member States' business entity laws. *See supra* notes 95–98 and accompanying text.

importance of costs. At least one study has found that the *use* of new LLC laws over corporation laws across the United States is best predicted not by the content of such laws, but rather by start-up costs—specifically, whether the LLC enjoys a formation fee advantage over a corporation.[191]

C. THE U.S. UNCORPORATION EXPERIENCE AND INEFFICIENT FORCES OF CONVERGENCE

The convergence of U.S. unincorporated business association laws around new LLC and LLP entity options is a useful counterexample to the European experience and may illustrate the impact of what Professors Roe or Gevurtz might characterize as "inefficient" convergence forces. These novel laws developed and converged across the United States at a time when it was not yet clear that the internal affairs rule applied to the new entities, thus making jurisdictional competition for new entity formations at best a weak force promoting change and convergence.[192] Even today, when statutory law makes clear that the internal affairs rule applies to LLCs and LLPs, there is little evidence of inter-jurisdictional competition for "uncorporation" formations.[193] If not competition for entity formations under the internal affairs rule and pressures to enact ever more efficient business association laws, what forces prompted convergence of state laws around new LLC and LLP options?

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191. *See* Daniel M. Hausermann, *For a Few Dollars Less: Explaining State to State Variation in Limited Liability Company Popularity*, 20 U. MIAMI BUS. L. REV. 1, 3 (2011) (finding that formation fee differentials explain more of the variation of LLC popularity across jurisdictions than any other factor).

192. *See supra* Part III.C.

193. Three separate empirical studies have found little evidence that U.S. jurisdictions currently compete for LLC formations, or that such competition (as it exists) favors Delaware more than at the margins. *See* Jens Dammann & Matthias Schündeln, *Where Are Limited Liability Companies Formed? An Empirical Analysis*, 55 J. L. & ECON. 741 (2012) (finding that for LLCs with more than twenty members, companies are more likely to be formed outside the state of their primary place of business if the primary place of business does not allow members to trigger the dissolution on oppression grounds, or if it does not shield from veil piercing for the mere failure to observe formalities); Franklin A. Gevurtz, *Why Delaware LLCs?*, 91 OR. L. REV. 57, 57–58 (2012) (reporting results of an attorney survey showing that attorneys forming LLCs evidenced a modest preference for Delaware when forming LLCs outside their home state); Bruce H. Kobayashi & Larry E. Ribstein, *Delaware for Small Fry: Jurisdictional Competition for Limited Liability Companies*, 2011 U. ILL. L. REV. 91, 94 (summarizing findings of "little evidence that [LLCs] choose to form outside their home state in order to take advantage of variations in [LLC] statutory provisions" and some evidence that large LLCs are more likely to organize outside their home state, with Delaware as the "dominant" destination jurisdiction). Indeed, one scholar has recently argued that "the high level of contractability and the resulting reduction in legal indeterminacy available under LLC law" reduces Delaware's traditional competitive advantages in the LLC field when compared to those that Delaware enjoys in corporate law. Mohsen Manesh, *Delaware and the Market for LLC Law: A Theory of Contractability and Legal Indeterminacy*, 52 B.C. L. REV. 189, 189 (2011).

1. A "Better Law" Movement, Path Dependent Development, or "Fad and Fashion"?

Of course, competition for entity formations under the internal affairs rule is only one chapter in the law market story. In the view of some scholars, "the United States has fostered an active law market, not because of the choice-of-law rules themselves, but because of the dynamism inherent in the institutional features of the American federal system."[194] Even if states have not competed to attract new LLCs and LLPs, the uncorporation revolution might be characterized as a movement by states towards substantively better or more efficient laws within a broader market for business association laws across the United States. Thus, one might argue, the primary reason new uncorporation laws spread rapidly across jurisdictions was because states recognized that these new entities offered sound solutions for vexing tax, liability, and organizational problems confronting closely held businesses.

As described in Part III, LLC and LLP laws accomplish a striking achievement—combining limited liability, pass-through taxation, and organizational flexibility in one unincorporated business entity.[195] Because these new entities are primarily creatures of contract (an LLC operating agreement or an LLP partnership agreement), they are also products of private ordering processes that should foster efficient outcomes, and many law and economics scholars support the expansion of limited liability on efficiency grounds.[196] Without question, the lawyers who drafted LLC and LLP laws and who pressed for their passage in the various states—typically through state bar association committees—had no doubt about the benefits the new entities offered for their business clients.[197] Why should we be surprised that states rushed to authorize LLCs and LLPs?

But there were countervailing considerations. To state the obvious, expanding the reach of pass-through taxation, and thus eliminating one

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194. Larry E. Ribstein & Erin Ann O'Hara, *Rules and Institutions in Developing a Law Market: Views from the United States and Europe*, 82 TULANE L. REV. 2147, 2162 (2008).

195. *See notes* 135–138, 152–156 and accompanying text; *see also* Larry E. Ribstein, *The Emergence of the Limited Liability Company*, 51 BUS. LAW. 1, 1 (1995); *see generally* Hamill, *supra* note 141, at 395.

196. *See* Jonathan R. Macey, *The Limited Liability Company: Lessons for Corporate Law*, 73 WASH. U. L.Q. 433, 450–51 (1995) (arguing that the economic justifications for limited liability are valid in closely held LLCs); Larry E. Ribstein, *Limited Liability and Theories of the Corporation*, 50 MD. L. REV. 80, 101–06 (1991) (arguing that limited liability is efficient even in closely held firms).

197. Professor Ribstein and other law and economics scholars have characterized these new laws as examples of legal innovations that were largely byproducts of practicing business lawyers who drafted laws and lobbied for their enactment on behalf of clients. Bruce H. Kobayashi & Larry E. Ribstein, *Law as a Byproduct: Theories of Private Law Production* 19–20 (Ill. Law, Behavior & Soc. Sci. Research Paper Series, Paper No. LBSS11-27, 2011), *available at* http://www.law.yale.edu/documents/pdf/cbl/SSRN-id1884985_(1).pdf; *see also supra* note 149 (exploring Professor William Carney's similar assessment of LLC laws).

level of tax, may have diminished state revenues.[198] And extending the corporate limited liability shield to non-corporate entities shifted tort liability risks to accident victims who would rarely, if ever, be able to protect themselves in advance by contract.[199]

Yet, whether or not new LLC and LLP laws offered economic efficiency or other advantages that outweighed these concerns was *not* debated or even discussed as the laws were passed in state legislatures. As several commentators have shown, LLC and LLP laws were enacted by legislators who assumed without question that the new entity options would be "good for business," and without any serious debate about the merits of the new business formats.[200] Dean Allan Vestal and unincorporated business law expert Thomas Rutledge conclude after a "close review of the legislative record" that "in state after state the serious policy and fiscal implications of [LLCs] were not even addressed, much less seriously discussed."[201]

Commentator Bill Callison concurs with the Vestal/Rutledge analysis and analogizes the rapid movement by states to extend limited liability through LLC and LLP laws to the cattle herd that stampedes when the coyote howls.[202] Callison disputes the economic efficiency justifications that have been advanced for the new entities[203] and instead makes the case that the LLC/LLP movement illustrates Roe's path dependence model:

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198. Allan W. Vestal & Thomas E. Rutledge, *Disappointing Diogenes: The LLC Debate That Never Was*, 51 ST. LOUIS U. L.J. 53, 80–90 (2006) (examining revenue implications of expanded pass-through entity taxation in Kentucky).

199. *Id.* at 72–73; *see also* Doré, *supra* note 134, at 270–71.

200. *See generally* Vestal & Rutledge, *supra* note 198; *accord* Robert W. Hillman, *New Forms and New Balances: Organizing the External Relations of the Unincorporated Firm*, 54 WASH. & LEE L. REV. 613, 613 (1997) ("Like Diogenes wandering the streets of Athens, lantern in hand, searching for the honest man, anyone seeking evidence of a debate among lawmakers over the wisdom of limited liability or the cost-shifting consequences of LLCs and LLPs is destined for disappointment."); Robert W. Hillman, *Limited Liability in Historical Perspective*, 54 WASH. & LEE L. REV. 615, 627 (1997) (noting that legislatures in earlier times (e.g., the nineteenth century) displayed "a level of inquiry, a quality of debate, and an awareness of history that is largely absent from contemporary discussions of limited liability"); *see also* Allan W. Vestal, *"Real Partnerships" and Real Problems, Conforming Business Entity Law to Fiscal Realities and Popular Conceptions*, 28 DEL. J. CORP. L. 877, 880 (2003) (arguing that "[t]he policy implications of extending limited liability to the members of [general partnerships through the LLP] were never seriously discussed"); Robert W. Hamilton & Larry E. Ribstein, *Limited Liability and the Real World*, 54 WASH. & LEE L. REV. 687, 691 (1997) ("[S]tates that have broadened the LLP concept have in effect reversed the default rule without in any way considering or justifying that action."); *but see* Ribstein & Kobayashi, *supra* note 149, 951–52 ("[T]he collective wisdom over time of fifty-one legislatures and bar drafting committees must be far greater than that of one uniform or model law drafting organization.").

201. Vestal & Rutledge, *supra* note 198, at 55.

202. J. William Callison, *Federalism, Regulatory Competition, and the Limited Liability Movement: The Coyote Howled and the Herd Stampeded*, 26 J. CORP. L. 951, 961 (2001) ("[L]egislators failed to consider the public policy aspects of expansive limited liability protection before they acted . . . .").

203. *Id.* at 964–71.

"[T]he IRS's regulatory response to Wyoming LLCs," he argues, "introduced dynamic forces into business organization law, and the law responded by referring back to, and evolving from, existing structures and rules."[204] Whether or not Callison's path dependence analysis is accurate, his herd analogy is illuminating. Given the lack of policy debate in state legislatures concerning LLC and LLP laws that Vestal, Rutledge, and others have demonstrated, one is strongly tempted to conclude that the passage of these entity laws illustrates what Professor Gevurtz calls "fads and fashions" in business association law—where laws of multiple jurisdictions converge in a popular trend without regard for legal efficiency or other considerations.[205]

2. Rule-Driven Path Dependence (Foreignness Matters)

Theories of path-dependent evolution of business association laws also encompass "rule-driven path dependence": the idea that existing structures and institutions influence choices about what rules should be adopted or maintained in the future.[206] One way this might occur is that the "foreignness" (or not) of a new business association law—a factor unrelated to the competitive merits of any particular law—might influence change and convergence patterns across jurisdictions. The stasis in European company law, when compared to the U.S. uncorporation revolution, could well be an example of this phenomenon.

Remember that although corporate laws across different national jurisdictions share many common functional characteristics,[207] formal rules of corporate regulation differ significantly across nations, including across EU Member States with harmonized company law.[208] Of those commentators who correctly predicted that the EU legal developments described in Part I.B would not produce dramatic change and convergence in the field of European company law, several based their forecast on a variety of obstacles that these formal legal differences might create, along with related cultural and political hurdles.[209]

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204. *Id.* at 962.

205. Gevurtz, *supra* note 25, at 496–97.

206. *See* Bebchuk & Roe, *supra* note 180, at 154 ("Corporate rules, we argue, are themselves path dependent. The rules that an economy has at any given point in time depend on, and reflect, the ownership and governance structures that the economy had initially . . . . The initial structures affect future corporate rules which in turn affect future decisions on corporate structures.").

207. *See generally* REINER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH (2004) (using a functional approach to show how countries with very different legal rules have developed similar solutions to common corporate law problems).

208. For example, of the five different corporate law jurisdictions selected for comparative analysis in *The Anatomy of Corporate Law*, three (the United Kingdom, France, and Germany) are EU Member States. *See id.*

209. *See supra* notes 81–86 and accompanying text. Consistent with these predictions, the EU legal experts the author interviewed all expressed concerns that a European business would face

The recent U.S. uncorporation experience bolsters those predictions, albeit as a counter-example. One reason that it was easy for U.S. jurisdictions to rapidly embrace LLCs and LLPs was that the novel entities were not particularly "foreign" to new users. LLC and LLP laws, though new, were adapted from familiar common sources—general partnership, limited partnership, and corporate law—that were shared by all states.[210] In addition, U.S. business association laws, including new LLC and LLP laws, are more limited in scope than their European counterparts, which often include not only creditors' rights, but also employment law provisions as well.[211] The narrower reach of U.S. business association laws reduces the potential scope of any legal conflicts that might otherwise impede the adoption of such laws across jurisdictions.[212] Finally, while the new EU internal affairs rule has had a mixed reception across Europe,[213] lawyers

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reputational obstacles and uncertain compliance burdens if it organized under another Member State's law and operated domestically as a pseudo-foreign company. *See supra* notes 101–111 and accompanying text.

210. Consider the state of U.S. business association law in the late 1980s and early 1990s, the time period when LLC and LLP laws first emerged. Then, as now, the corporate law of nearly all states was derived from one of only two primary sources—the ABA's Model Business Corporation Act or the Delaware General Corporation Law. *See* COX & HAZEN, *supra* note 23, § 2:5 (noting that "[e]ventually, the Model Act became the pattern for large parts of the corporation statutes in most states"); *see also* Gorris et al., *supra* note 23. State general and limited partnership laws were even more uniform at that time than they are today, with nearly all state laws for general partnerships based on the Uniform Partnership Act, and in the case of limited partnerships, either the original or revised Uniform Limited Partnership Act. Thus, when a lawyer or her business client encountered a "foreign" corporation or partnership—one organized in another U.S. jurisdiction—that entity was not very foreign at all and would not have raised reputational concerns for the lawyer or client. At that time it was fair to say that in the United States, a general partnership was the same legal entity, regardless of the state law under which it was organized. The same was largely true for limited partnerships and corporations.

211. Not only do European company laws often include important creditors' rights provisions, bankruptcy laws also vary across the European Union. *See* Luca Enriques & Martin Gelter, *How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law*, 81 TUL. L. REV. 577, 581, 622–23 (2007); *see also* Federico M. Mucciarelli, *The Function of Corporate Law and the Effects of Reincorporations in the U.S. and the EU*, 20 TUL. J. INT'L & COMP. L., 421 (2012) (noting the connections between creditor protections in European company laws and rates of reincorporation). For a discussion of European company law provisions protecting employees, see *supra* note 36 and accompanying text.

212. U.S. business association laws leave most creditor protection issues to other law, important parts of which are either uniform (e.g., the Uniform Fraudulent Transfer Act) or federal, in the case of bankruptcy. Moreover, all U.S. jurisdictions address employment law matters separately from business association law and much of that law is federalized and thus effectively uniform across the states.

213. As described in Part I.B., the various EU Member States did not adopt a new European internal affairs rule because of a shared belief in the rule's merits—what one might call a "bottom-up" approach to choice of law. Rather, the ECJ imposed the internal affairs rule on the Member States from the top down, through novel case law interpretations of the EU Treaty. As described in Part II, this state of affairs produced uncertainty not only about the scope and applicability of the new internal affairs rule, but also about attendant procedures necessary for businesses to effectively utilize the rule, like foreign qualification processes and foreign jurisdiction litigation risks. *See supra* notes 74–78 and 81–82 and accompanying text.

across U.S. jurisdictions have confidence in the internal affairs rule and the foreign qualification processes that have developed along with it. After an initial period of uncertainty, these familiar processes were later easily adapted to the new unincorporated entity options, thus reducing the risks associated with foreign operations under the new laws.[214]

In short, one might fairly describe new LLC and LLP laws as old wine in new bottles for the most part. Whatever the analogy, when one compares the U.S. uncorporation revolution to company law stasis in Europe, it is tempting to conclude that the foreignness (or not) of business association laws across jurisdictions—a factor largely unrelated to competitiveness and efficiency merits of any particular new law—influences the rate of change and convergence of competing business association laws.

CONCLUDING REMARKS: THE IMPORTANCE OF LEARNING FROM COMPARISONS

The persistent stasis in European company law following new possibilities for jurisdictional competition for company formations within the European Union, and the unexpected convergence of U.S. jurisdictions on novel unincorporated business forms before the internal affairs rule clearly applied to them, both call into question the traditional view that jurisdictional competition under the internal affairs rule, and related market pressures that favor the adoption of ever more "efficient" business association laws, are the principal drivers of corporate and business association law convergence. Indeed, it may be the case that no single theory will likely predict successfully how state and national business association laws will change and evolve. But to concede that fact does not diminish the importance of comparative law scholarship in the business association law field.

Both Professors Clarke and Gevurtz have recently reminded us that if comparative corporate governance study focuses solely on competition and convergence of business association laws, we will likely miss opportunities to learn from the approaches taken by other legal systems. As Professor Clarke puts it, "[t]here is value in determining which features of which system do what well and do what badly. If policy advocacy has any real-

214. As explained in Part III.C, while there was some early uncertainty in the United States about whether the internal affairs rule applied to novel entities like LLCs and LLPs, the rule stands on much firmer footing here than it does in the European Union. In the early years of LLC and LLP laws, uncertainty concerning the internal affairs rule stemmed only from the fact that all jurisdictions had not yet adopted such laws. As states enacted LLC and LLP acts, none deviated from the internal affairs choice-of-law approach. Thus, jurisdictions embraced the rule in bottom-up fashion, reflecting the business law community's confidence in and comfort with the correctness of that choice-of-law approach for the new entities. In addition, limited partnership and corporate laws provided a familiar and simple template for the new entity laws' foreign qualification processes, thus eliminating concerns about compliance for any LLCs or LLPs that might do business across state lines.

world effect, then one should advocate what seems to work well, regardless of what direction the rest of the world is going in."[215]

In the words of Professor Gevurtz:

> [To dispute efficiency theories of corporate law convergence] is not to say that observing other nations' corporate laws is useless or unwise. If nothing else, we will learn that there are alternate approaches which may be as effective as our own. We may also learn, however, that when it comes to the really tough issues, no nation has a good solution—which is why these are the really tough issues in corporate law.[216]

And, in fact, there are many good reasons to compare U.S. corporate and unincorporated business association law experience with company law developments in Europe now that it is apparent that European company law schemes will continue to depart in important ways from traditional U.S. models. Areas for productive inquiry could include the following:

U.S. Benefit Corporations and European Company Law Stakeholder Models. A number of U.S. jurisdictions have recently authorized new corporate forms, called "benefit" or "B-" corporations, which are permitted to advance non-shareholder interests alongside a traditional, for-profit agenda.[217] As this movement occurs, important questions are resurfacing about which corporate stakeholders are worthy of special protection and the most effective corporate governance mechanisms to accomplish that goal. One hot topic, for example, is whether a corporation must have special obligations to protect the environment in order to qualify as a benefit corporation. A number of states have enacted the "B-Lab" organization's model benefit corporation legislation, which requires that a benefit corporation's charter must have as an objective "to provide a material positive impact on society and the environment, taken as a whole, as assessed against a third-party standard."[218] A few states, like California, have enacted a "flexible public purpose" corporation law alongside the B-Lab's model benefit corporation law, with the former defining "public benefit" in broader terms.[219] Looking to past and present European company law experience with stakeholder protection may help shed light on these and other issues that will undoubtedly emerge as benefit corporation

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215. Clarke, *supra* note 183, at 103.

216. Gevurtz, *supra* note 25, at 520–21.

217. So far, eighteen states have enacted benefit corporation laws based on Model Benefit Corporation Legislation promulgated by the B-Lab group. *See Legislation*, B LAB, http://www.bcorporation.net/what-are-b-corps/legislation (last visited Apr. 11, 2014); *see also* Michael R. Deskins, *Benefit Corporation Legislation, Version 1.0—A Breakthrough in Stakeholder Rights?*, 15 LEWIS & CLARK L. REV. 1047 (2011).

218. *See* MODEL BENEFIT CORP. LEGISLATION § 102 (B Lab 2013), *available at* http://benefitcorp.net/storage/documents/Model_Benefit_Corporation_Legislation.pdf (Definitions).

219. *See* Arthur Rieman et al., *California's New Hybrid Corporation Statute*, L.A. LAW., Sept. 2012, at 19.

legislation takes root. Fortunately, comparative corporate governance scholarship is now emerging on these topics.[220]

Fiduciary Duties in the Zone of Insolvency and Wrongful Trading Liability Standards. Much ink has been spilled over the vexing problem of whether or when managers of U.S. corporations and other business associations owe duties to creditors, and the topic of fiduciary duties of managers of businesses operating in the "zone of insolvency" has attracted renewed attention following the recent recession.[221] Perhaps an examination of European wrongful trading liability standards, which penalize directors who take no action to protect creditors' interests during their company's slide into insolvency, will yield fresh insights.[222] Comparative corporate governance scholarship is beginning to emerge on this topic as well.[223]

Regulation of Pseudo-Foreign Entities in the United States and Europe. Application of the internal affairs rule to pseudo-foreign entities—firms not organized under the law of their real seat jurisdiction and whose only connection to the organizing jurisdiction is the company's charter—raises special concerns. The United States might usefully learn from European experience in this area as well.

The legal developments in the European Union described in Part I.B have not met with unqualified acceptance. Justin Borg-Barthet, a scholar who has extensively studied the new EU internal affairs rule, makes a persuasive case that Europe should enact legislation that scales back application of the internal affairs rule for pseudo-foreign companies.[224] He proposes choice-of-law reforms for the European Union that would permit a real seat Member State to require pseudo-foreign companies to comply with critical components of the Member State's company law.[225] As students of American corporate law will recognize, these arguments echo both

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220. *See, e.g.*, Katharine V. Jackson, *Towards a Stakeholder-Shareholder Theory of Corporate Governance: A Comparative Analysis*, 7 HASTINGS BUS. L.J. 309 (2011); Alissa Mickels, Note, *Beyond Corporate Social Responsibility: Reconciling the Ideals of a For-Benefit Corporation with Director Duties in the U.S. and Europe*, 32 HASTINGS INT'L & COMP. L. REV. 271 (2009).

221. *See, e.g.*, John A. Pearce & Ilya A. Lipin, *The Duties of Directors and Officers Within the Fuzzy Zone of Insolvency*, 19 AM. BANKR. INST. L. REV. 361 (2011); Neil Ruben, Note, *Duty to Creditors in Insolvency and the Zone of Insolvency: Delaware and the Alternatives*, 7 N.Y.U. J.L. & BUS. 333 (2010).

222. For a discussion of wrongful trading standards see Andrew Keay, *Wrongful Trading and the Liability of Company Directors: A Theoretical Perspective*, 25 J. LEGAL STUD. 431 (2006).

223. *See, e.g.*, Oscar Couwenberg & Stephen J. Lubben, *Solving Creditor Problems in the Twilight Zone: Superfluous Law and Inadequate Private Solutions*, 34 INT'L REV. L. & ECON. 61 (2012).

224. BORG-BARTHET, *supra* note 37, at 142–70. Borg-Barthet points out that corporate choice-of-law principles are derived theories of party autonomy that also influence contractual choice-of-law principles. *Id.* at 21. Although the latter often command application of the law chosen by contracting parties, he notes, choice-of-law theory recognizes that public policy considerations sometimes justify a jurisdiction's decision to override that choice. *Id.* at 19–29. Borg-Barthet contends that the same must therefore be true for the internal affairs rule.

225. *Id.* at 149–70.

continuing criticisms of the internal affairs rule as applied in corporate law[226] and the modified version of the internal affairs rules that California and New York apply to pseudo-foreign corporations with strong ties to those states.[227]

While there are potential Commerce Clause objections to internal affairs rules exceptions,[228] the issue certainly merits current consideration in the field of LLC law. The use of LLCs as asset protection devices has raised concerns, for example, about whether the internal affairs rule should apply when creditors of LLC members obtain charging orders.[229] Moreover, while state LLC acts are broadly similar across the country, many diverge considerably on at least one critical issue: the extent to which participants in an LLC may waive fundamental fiduciary duties when adopting or amending the company's operating agreement.[230] Delaware, unlike most states, permits participants in LLCs to eliminate all fiduciary duty protections.[231] For a U.S. jurisdiction that values fiduciary standards, a modified internal affairs rule for pseudo-foreign LLCs—perhaps one patterned on California's or New York's corporate choice-of-law rules, or on the new internal affairs rule models that Borg-Barthet proposes for the European Union—could protect the state's LLC law on fiduciary duties against incursions from Delaware or other jurisdictions with more lax requirements.

226. *See, e.g.*, Kent Greenfield, *Democracy and the Dominance of Delaware in Corporate Law*, 67 L. & CONTEMP. PROBS. 135 (2004).

227. *See* CAL. CORP. CODE § 2115 (West 2010) (establishing a multi-part test to determine whether a corporation's dominant relationship is with California and providing that specific provisions of the California Corporations Code will apply to such corporations); N.Y. BUS. CORP. LAW §§ 1319–20 (McKinney 2012) (providing that certain New York rules on shareholder rights and mergers are applicable to non-public corporations that conduct more than one-half of their business income activities in New York).

228. Allmendinger, *supra* note 56, at 83 (noting that "the issue of whether the laws on pseudo-foreign companies are constitutional under the Commerce Clause is . . . unresolved in legal debate" and citing authorities).

229. *See* Jay D. Adkisson et al., *Recent Developments in Charging Orders*, BUS. L. TODAY, Feb. 2013, at 1, 3 (stating that "[T]he courts are just beginning to scratch the conflicts-of-law issues").

230. DEL. CODE ANN. tit. 6, § 18-1101(c) (2013) ("to the extent that, at law or in equity, a . . . manager . . . has duties (including fiduciary duties) to [the LLC] or [any] member . . . , [the] manager's . . . duties may be expanded or restricted or eliminated by provisions in the [LLC operating] agreement; provided, that the [LLC operating] agreement may not eliminate the implied contractual covenant of good faith and fair dealing.").

231. *See, e.g.*, Sandra K. Miller, *What Fiduciary Duties Should Apply to the LLC Manager After More Than a Decade of Experimentation?*, 32 J. CORP. L. 565, 568 (2007) ("Some states contain mandatory statutory standards, while others defer to the contractual provisions adopted by the LLC members. The state of Delaware—long considered the most important jurisdiction in developing business entity laws in the United States—has taken the lead in permitting not merely the modification of default fiduciary duties, but their elimination by contract.").

Dean Vestal made a similar proposal in the field of partnership law almost two decades ago.[232] Vestal's analysis of the constitutional dimensions of the internal affairs rule as applied to partnerships are likely applicable to LLCs as well,[233] but we could also learn from Europe. The *Inspire Art* case[234] may not have resolved all questions about the application of real seat jurisdiction company laws to pseudo-foreign firms under the EU treaty. And to the extent that EU charter provisions permit some regulation of pseudo-foreign companies, an EU-U.S. comparison could be instructive. Christoph Allmendinger, a legal expert from Germany, has recently undertaken the task. He compares the extent to which U.S. and European jurisdictions may regulate pseudo-foreign corporations under the Commerce Clause and EU treaty, respectively, and concludes that as compared to the EU charter, the U.S. constitutional framework may afford states broader discretion to regulate such companies.[235]

There are doubtless other examples where comparative study of European and U.S. business association laws will be productive. If scholars and other students of comparative company law are to embark on such inquiries, they would be well-advised to first relax the traditional scholarly focus on competition and convergence of business association laws as the inevitable byproduct of jurisdictional competition under the internal affairs rule. May this Article mark a small first step in that direction.

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232. Allan W. Vestal, *Choice of Law and the Fiduciary Duties of Partners Under the Revised Uniform Partnership Act*, 79 IOWA L. REV. 219 (1994).

233. *Id.* at 252–56 (describing potential constitutional objections to application of the internal affairs rule to partnerships); *id.* at 261–64 (noting potential constitutional dimensions of the internal affairs rule).

234. *See supra* notes 53–55 and accompanying text.

235. Allmendinger, *supra* note 56, at 67.