How Does Jurisdictional Competition Affect Minimum Capital Requirements? A Comparative Analysis of the US, EU and Taiwan

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Abstract

By making comparison among cases from the Unites States ("US"), the European Union ("EU") and Taiwan, this paper looks into how jurisdictional competition contributed to the reduction or abolishment of minimum capital requirements. Examining the evolutionary processes of minimum capital requirements in American, European and Taiwanese company law provides us the opportunity to scrutinize the O'Hara-Ribstein law market theory in the international context and, more importantly, to have a general and fresh look at the interaction between jurisdictional competition and legal restrictions. Specifically, this paper analyzes how the ability to choose the jurisdiction of incorporation has posed a competitive threat to local legislators. This paper continues to explain how the following jurisdictional competition affected company law reforms, particularly the reduction or abolition of minimum capital requirements. This paper asserts that the pressure of jurisdictional competition drove the US, EU and Taiwan toward the liberalization of minimum capital requirements. Above all, the case of Taiwan demonstrates that such an international organization as the World Bank through annually publishing "Doing Business" surveys since 2003 have been promoting international jurisdictional competition. This jurisdictional competition arguably compelled Taiwan to abolish the statutory minimum capital in 2009. The findings in this paper have three significant implications. First, jurisdictional competition has long been at work both across states or nations and in different times. Second, by explicating how jurisdictional competition leads to the liberalization of minimum capital requirements, this paper demonstrates that while there are in appearance some differences, similar law market dynamics exists in the jurisdictional competition, no matter under federalism, such as the US or EU federal system, or in the international setting, such as Taiwan's case. Finally, by echoing the argument made by O'Hara and Ribstein that jurisdictional competition provides a significant check on governments, this paper argues that jurisdictional competition also acts as a restraint on the sort of jurisdiction that overlooks business demands for legal flexibility.

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I. Introduction

Governments' capacity for enforcing the laws and regulations they prefer may be constrained by international jurisdictional competition through the "law market." The law market is referred to as the competitive mechanism through which "governing laws can be chosen by people and firms rather than mandated by states. This choice is created by the mobility of at least some people, firms, and assets and the incentives of at least some states to compete for people, firms, and their assets by creating desired laws."[1] It follows that, as Professors Erin O'Hara and Larry Ribstein explain, jurisdictional competition through the market for law provides a significant check on governments.[2] Comparing company law reforms on statutory minimum capital among the United States ("US"), the European Union ("EU") and Taiwan in different times provides the opportunity not merely for testing the O'Hara-Ribstein law market theory in the international dimension, but also, more importantly, for a general and fresh look at the interaction of jurisdictional competition and legal restrictions. In other words, this paper studies how jurisdictional competition affected company law reforms, particularly the reduction or abolition of minimum capital requirements.

Specifically, under the respective circumstances in the US, European jurisdictions and Taiwan, firm mobility has been strengthened to such an extent that entrepreneurs have been more capable of choosing the jurisdiction of incorporation. As a result, this firm mobility enables firms to opt out of the company law of their home jurisdictions and instead to avail themselves of the company law of another jurisdiction. Thus, "[l]egal constrains on company formation have ceased to be binding insofar as other company laws offer less restrictive rules."[3] Put simply, mobility feeds business demands for legal flexibility. This demand side of the market for corporate law activates the foreign jurisdictions to provide the best possible legal product.[4] In other words, the corporate law type of forum-shopping induces foreign jurisdictions to offer the best form of business entity for a firm's particular needs. On the other hand, the foreign or international supply of law poses a competitive threat to domestic

[1] ERIN A. O'HARA & LARRY E. RIBSTEIN, THE LAW MARKET 65 (2009).
[2] *Id.* at 13-14.
[3] Reiner Braun et al., *Does Charter Competition Foster Entrepreneurship? A Difference-in-Difference Approach to European Company Law Reforms* 3 (May 1, 2011), *available at* http://ssrn.com/abstract=1827962.
[4] Scholars studying competitive or corporate federalism are used to comparing the law to the product a jurisdiction offers. *See, e.g.,* Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J. L. ECON. & ORG. 225 (1985).

legislators in the regulating jurisdictions. As a result of the demand and supply, the foreign or international supply side (i.e., the reforms adopted in foreign jurisdictions) then promotes the need for domestic legal reforms (i.e., the domestic supply of law) in these regulating jurisdictions.

Generally speaking, firm or capital mobility spurs jurisdictional competition by offering the more efficient legal product. Foreign jurisdictions may find it in their interest to market their company law to domestic firms in the regulating jurisdictions (the "offensive" regulatory competition); or, at the very least, the regulating jurisdictions may intend to avoid losing their own firms to foreign jurisdictions by supplying less restrictive rules to defend against the sale of foreign jurisdictions (the "defensive" regulatory competition). As a consequence, either type of regulatory competition may actively or passively compete for the company law which appears most attractive to entrepreneurs and firms. This paper compares the U.S., European and Taiwanese cases on the major underlying factors which contributed to the relaxation of minimum capital requirements. Both of the aforementioned regulatory competition pushes the evolution of company law reforms towards more legal flexibility, especially on the trend that minimum capital requirements were reduced or abolished.

This paper is organized as follows: Section II theoretically explains the operation of jurisdictional competition and extends the O'Hara-Ribstein law market framework to include international jurisdictional competition. Section III elaborates on why minimum capital requirements were initially imposed in history and then why justifications for these requirements have been gradually lost and fading away. Section IV, by comparing among cases of the US, the EU and Taiwan, illustrates that jurisdictional competition galvanizes the abolition or reduction of these requirements, which have been proved to be mostly outdated and inefficient. Section V concludes by further arguing that although this paper demonstrates the effect of jurisdictional competition on the tendency toward less restrictive rules in corporate law to facilitate incorporations, whether such company law reforms would in reality increase entrepreneurial activity in Taiwan remains to be further inquired.

II. The Operation of Jurisdictional Competition

This section discusses the underlying factors which spurred the law market in a global setting. The increase of international factor mobility caused by globalization lowers firms'

exit costs, which in turn intensifies the international jurisdictional competition for mobile resources. Out-flowing capital and emigrating labor compels regulatory jurisdictions to improve the quality of their regulations. In other words, the international movement of production factors, delivered through domestic interest groups to political policy makers within a regulating jurisdiction, could induce the liberalization of costly regulation.

A. Mobility and Jurisdictional Competition

The view of the law as a tradable good in a market comes from a broader theory originating in public economics with the publication of the Tiebout model in 1956, applicable to all public goods in general.[5] In brief, this theory suggests that different state governments compete with each other in the supply of public goods to consumers who on their side can choose between the public goods offered according to their preferences.[6] Under this view, this market approach will most efficiently allocate public goods between the consumers according to their preferences, on the following conditions: (1) "people and resources are mobile" between jurisdictions; (2) "the number of jurisdictions is large;" (3) "jurisdictions are free to select any set of laws they desire;" and (4) "there are no spillovers," positive or negative externalities, among jurisdictions.[7] Furthermore, John Coffee adds another condition: "individuals or firms make the choice among jurisdictions . . . based simply on which jurisdiction . . . offers the most efficient and least costly regulatory regime."[8] To sum up, the more fully these conditions are fulfilled, the more likely jurisdictional competition would be effective.[9]

More importantly, "while some view the normative aspect of [Tiebout's] model (i.e., jurisdictional competition is efficient) as controversial, few would contest its positive aspect (i.e., competitive incentives drive local policies)."[10] This paper mainly focuses on a positive account that jurisdictional competition brought about by firm mobility will provoke changes

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[5] H. Spencer Banzhaf & Randall P. Walsh, *Do People Vote with Their Feet? An Empirical Test of Environmental Gentrification* 1 (RFF Discussion Paper No. 06-10, 2006), *available at* http://ssrn.com/abstract=901657 ("Tiebout's (1956) suggestion that people 'vote with their feet' to find the community that provides their optimal bundle of taxes and public goods has played a central role in the theory of local public finance over the past 50 years"). The basic structure underlying the Tiebout model is that "households do appear to vote with their feet in response to changes in public goods." *Id* at 4.

[6] Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 424 (1956). The genesis of the jurisdictional competition theory can trace back to this article.

[7] Larry E. Ribstein & Bruce H. Kobayashi, *The Economics of Federalism* 3 (University of Illinois Law & Econ. Working Paper Series, Working Paper No. LE06-001, 2006), *available at* http://ssrn.com/abstract=875626.

[8] John C. Coffee, Jr., *Competition versus Consolidation: The Significance of Organizational Structure in Financial and Securities Regulation*, 50 BUS. LAW. 447, 453-54 (1995).

[9] For further discussion, *see* DENNIS C. MUELLER, PUBLIC CHOICE III 186-206 (2003).

[10] Doron Teichman, *The Market for Criminal Justice: Federalism, Crime Control, and Jurisdictional Competition*, 103 MICH. L. REV. 1831, 1837 (2005) (alteration in original).

in local company law (e.g. on minimum capital requirements) to attract incorporations of foreign firms (the offensive regulatory competition) or, at the very least, to prevent the departure of domestic firms for foreign jurisdictions (the defensive regulatory competition).

B. The Dynamics of International Jurisdictional Competition under Globalization

1. Globalization and Jurisdictional Competition

As we have known, "[t]he reduction in barriers to trade and the liberalization of financial markets, transportation and telecommunications have created the basis for the increase in flows of factors of production between jurisdictions."[11] This increase in mobility is also because of the drop in exit costs:

> Since the 1960s, the competition among distant locations and national jurisdictions for mobile production factors, such as capital, has greatly intensified. In part this is due to advances in technology. In the second half of the twentieth century, containerization, roll-on/roll-off ships, pipelines and jumbo jets have saved transport costs in innovative ways. But advances in transport technology pale in comparison to the revolutionary advances in communication ("the transportation of ideas"). The fax, satellite communication, fiber cables, computing and data compression, e-mail, microwave transmission and widely available portable video cameras have brought down the costs of long-distance communication by phenomenal margins. People are better informed about living and working conditions in distant places and civilizations.[12]

The above phenomenon is "globalization," which is essentially "the phenomenon of increased international factor mobility."[13] Kasper further argues that "government administration is a production factor, since good government is an ingredient in production,

[11] Damien Geradin & Joseph A. McCahery, *Regulatory Co-opetition: Transcending the Regulatory Competition Debate* 1 (Amsterdam Center for Law & Econ. Working Paper No. 2005-06, 2005), *available at* http://ssrn.com/abstract=821087.

[12] WOLFGANG KASPER & MANFRED E. STREIT, INSTITUTIONAL ECONOMICS: SOCIAL ORDER AND PUBLIC POLICY 344 (1998).

[13] WOLFGANG KASPER, GLOBAL COMPETITION, INSTITUTIONS, AND THE EAST-ASIAN ASCENDANCY 4 (1994).

raises the productivity of all the other production factors, and enhances a country's attractiveness to mobile production factors."[14] Furthermore, Geradin and McCahery also find:

> As countries move to a more liberalized domestic economy, questions of competition between jurisdictions abound. With the prospect of increased capital mobility, it is becoming conventional wisdom that national governments are forced to perform their economic policy functions more efficiently since governments that yield optimal levels of public goods may be more successful in the competition between jurisdictions for attracting mobile resources. The concern to attract mobile resources has shaped entire areas of governmental policy and plays a determinative role for firms locating new plants.[15]

Since national laws and institutions are an important type of government-provided goods, globalization has also galvanized international jurisdictional competition for mobile production factors by offering better laws and institutions.

2. The Mechanism of the Market for Law Underlying International Jurisdictional Competition

Law market forces operate actively in international jurisdictional competition. As globalization lowers exit costs across borders and enhances firm and capital mobility, it increases international jurisdictional competition for worldwide mobile factors of production as different jurisdictions offer laws and institutions which provide benefits that are worth the additional expense. We in turn look into the interaction between the economic process in the international environment and the political process within a jurisdiction when it engages in

[14] *Id.* at 11. In the second half of the 20th century, "[i]ncreasingly, local and national institutions are becoming a key cost factor that determines what is produced where—not surprisingly, because coordination costs account often for half of all costs and because these are greatly influenced by prevailing institutions." KASPER & STREIT, *supra* note 12, at 345. Moreover, the surveys of national competitiveness issued by International Institute for Management Development, a.k.a. "IMD", and World Economic Forum, a.k.a. "WEF", frequently report the high ranking of Hong Kong and Singapore. This fact suggests that the government administration in these two jurisdictions performs pretty well. Their business-friendly environments as well as laws and institutions give them advantages to become regional operations centers and global legal centers. *See* Ying-Yi Tu, *Cong Xin Jia Po Yu Xiang Gang Kan Tai Wan Ru He Gai Shan Jing Zheng Li* [*How Taiwan Can Improve Its Competitiveness: Lessons from Singapore and Hong Kong*], 156 QUAN QIU TAI SHANG E JIAO DIAN [THE E-FOCUS OF GLOBAL TAIWANESE FIRMS] (2010), http://twbusiness.nat.gov.tw/.

[15] Geradin & McCahery, *supra* note 11, at 1.

competition through changes in laws and institutions. Suppose that the jurisdiction proposes a law favored by pro-regulatory interest groups, which is costly for firms and meanwhile creates a demand for legal flexibility and also an incentive for firms to leave. In the international economy, firms as "economic agents" have a degree of jurisdictional choice. This mobility feeds the demand side of the law market which firms' exit rights underlie, and sparks competition for the supply of law by other jurisdictions. Exit and entry by firms seeking to avoid regulation creates costs and benefits for other interest groups in the jurisdiction. For example, corporate lawyers and accountants benefit when firms stay and suffer when firms exit. This mobility can thus activate domestic interest group competition on the supply side. In particular, mobility may provide "an indirect voice to outsiders and a stronger voice to insiders who will be burdened by [the] proposed law."[16]

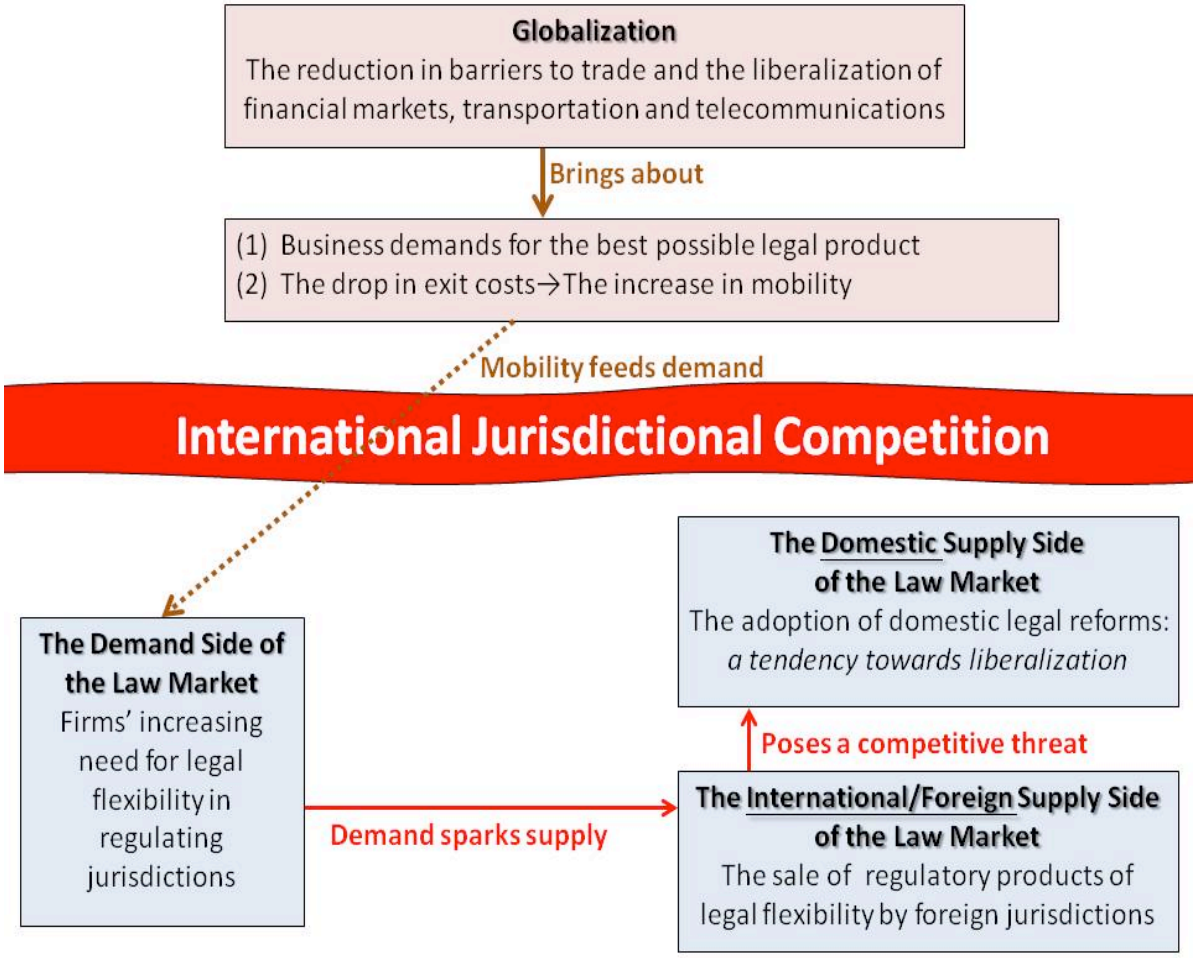
In the domestic political process, these "exit-affected" interest groups join with the groups that are directly burdened by the regulation to promote legal changes even if the directly affected groups could not defeat the regulation proposed by the pro-regulatory interest groups alone. This in turn pressures politicians and lawmakers within the regulating jurisdiction, as "political agents," to appreciate the significance of the economic exit signals, to discover that they need to supply laws and institutions which constitute "an attractive locational factor,"[17] and to enable the relaxation of the costly law. Hence, where a regulation might be costly, the jurisdictional competition could push the regulating jurisdiction to improve the substantive content of local laws.[18] What's more, "[l]egal changes would be provoked by firms' increasing need for legal flexibility."[19] In other words, as Professor Ribstein argues, "the mobility of firms, people and money across borders, transmitted through interest groups to political decision-makers, can produce long-run legal changes."[20] That is, the feedback mechanisms, options of exit (choice of location) and voice (political action), can be translated into the regulatory evolution, or the liberalization of costly regulation.

Let us return to the dynamics of international jurisdictional competition under globalization. Globalization promotes mobility of capital, talent, and firms, and reduces their costs of exit from a country. This in turn helps materialize the rise of international jurisdictional competition, or international law market. In the long run, even for large countries with local captive markets, these jurisdictions are also affected by the law market

[16] O'HARA & RIBSTEIN, *supra* note 1, at 29 (alteration in original).
[17] KASPER & STREIT, *supra* note 12, at 403.
[18] *See* O'HARA & RIBSTEIN, *supra* note 1, at 191, 199.
[19] *Id.* at 110.
[20] Larry E. Ribstein, *Cross-Listing and Regulatory Competition*, REV. L. & ECON. Vol. 1, Issue 1, Art. 7, 97, 99 (2005), *available at* http://www.bepress.com/rle/vol1/iss1/art7.

forces underlying international jurisdictional competition.[21] Accordingly, we understand that if a country's regulation on firms is over-burdensome, it would be disciplined by the international law market and thus inevitably pressured to moderate the regulation to some degree. Exactly as Professors Butler and Ribstein emphasized in their analysis of the impact of the US "Sarbanes-Oxley" regulations (the "SOX"), this understanding "would involve regulators appreciating the significant limitations on government's ability . . . to anticipate the full consequences of regulation."[22] The dynamics of international jurisdictional competition under globalization can be summarized in Figure 1.

Figure 1 **The Dynamics of International Jurisdictional Competition under Globalization**



[21] *See* Mihir A. Desai, *The Decentering of the Global Firm*, 32 WORLD ECON. 1271, 1282 (2009) (arguing that the US limits on firms' ability to change their legal domicile "will surely fail in the long run as the global market for corporate control can circumvent local efforts to retain ownership").

[22] HENRY N. BUTLER & LARRY E. RIBSTEIN, THE SARBANES-OXLEY DEBACLE: WHAT WE'VE LEARNED; HOW TO FIX IT 96 (2006).

III. The Rise and Fall of Minimum Capital Requirements

Prior to dwelling on that jurisdictional competition caused the imposition of such outmoded regulations as statutory minimum capital to make little sense, this section sheds light on why minimum capital requirements were historically and theoretically laid down. Subsequent to explaining the reasons why these requirements appeared less and less justified and even deemed inefficient, this section further introduces the current trend that these requirements seemed in reality to be on the decline internationally. This discussion lays the foundation for later explicating the factors of jurisdictional competition which led to the relaxation of these requirements in Section IV.

A. Reasons Minimum Capital Requirements Were Initially Imposed

Before dissecting costs and benefits of a minimum capital requirement, we need to trace back to the broader concept of legal capital of which a minimum capital requirement constitutes one of the subsidiary elements. This concept was initially intended to point to "the amount of money and other assets contributed to the corporation by its shareholders and committed to use in the corporation's business for the indefinitely long term – that is, the shareholders' 'permanent investment'" as well as to "the absolute minimum amount that shareholders were pledged not to withdraw from the company while any of its debts were unpaid."[23] Also, Legal capital signified "the quid pro quo for granting limited liability to shareholders."[24] Therefore, the amount of legal capital connotes "a kind of 'minimum collateral' requirement to help protect creditors against excessively large uncompensated

[23] ROBERT C. CLARK, CORPORATE LAW 611 (1986).

[24] *Id.* at 611. This justification also applies to minimum capital requirements. *See* Richard A. Booth, *Capital Requirements in United States Corporation Law*, *in* LEGAL CAPITAL IN EUROPE 620, 623 (Marcus Lutter ed., 2006) (arguing that minimum capital requirements "were likely seen as the *quid pro quo* for limited liability."); Horst Eidenmüller, Barbara Grunewald & Ulrich Noack, *Minimum Capital in the System of Legal Capital*, *in* LEGAL CAPITAL IN EUROPE 19 (Marcus Lutter ed., 2006) (describing that "minimum capital can be characterized as the 'price' for obtaining limited liability...."). From an economic perspective, minimum capital reuqirements stand for "legal responses to the externality problem posed by limited liability," and "purportedly oppose externalization of costs to creditors." WOUTER H.F.M. CORTENRAAD, THE CORPORATE PARADOX: ECONOMIC REALITIES OF THE CORPORATE FORM OF ORGANIZATION 335 (2000). *See also* EASTERBROOK, FRANK H. & FISCHEL, DANIEL R., THE ECONOMIC STRUCTURE OF CORPORATE LAW 60 (1991) ("The lower a firm's capitalization, the higher the probability that it will engage in excessively risky activities. Legislative imposed minimum-capitalization requirements are one method of internalizing the costs of risk taking.").

transfers of property by their corporate debtor."[25] In other words, "legal capital compels shareholders to assume some of the risk associated with the corporate venture. This, in turn, should improve the average credit quality of corporations because it prevents some bad business projects that shareholders only pursue if they can pass most of the risk to creditors."[26]

To ensure the system of legal capital, historically, a minimum capital requirement, one of the subsidiary elements of this minimum protection that all the creditor are entitled to assume will be there, was produced.[27] This requirement is one of the ways "in which legal capital ensures at least some amount of risk bearing on the part of shareholders."[28] A minimum capital requirement indicates "an amount of equity funding that owners must pay or promise to pay when they establish the firm."[29] In other words, this concept requires that an "amount of assets must be paid in to an enterprise by its shareholders before it will be permitted to enter the market place."[30] Minimum capital requirements demanded that an entrepreneur seeking to set up a corporation in order to do business, who was normally called a *promoter* in the older cases, "specify in advance the number of shares to be sold and the price at which thoses shares would be sold. Practically speaking, investors would not likely invest unless they knew these facts."[31] The requirements were "probably viewed as a way to protect creditors who could not pursue their claims against the assets of individual stockholders if a business failed as they would be able to do against partners in an ordinary partnership."[32]

Summarizing some justification for minimum capital requirements, Braun and others expressed:

> [O]n a more optimistic account regulatory costs may be justified by countervailing benefits. The registration process can serve as a screening process for start-up firms to ensure minimum standards of quality, including integrity and financial soundness. Restricting start-up activity can protect uninformed creditors and reduce information asymmetries.

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[25] CLARK, *supra* note 23, at 708.
[26] Andreas Engert, *Life Without Legal Capital: Lessons from American Law*, *in* LEGAL CAPITAL IN EUROPE 646, 649-50 (Marcus Lutter ed., 2006).
[27] *See also* Eva Micheler, *England* [Part 2 Single Country Reports], *in* LEGAL CAPITAL IN EUROPE 413, 414 (Marcus Lutter ed., 2006) (In British law, "[t]he requirement for a minimum capital has been implemented to protect creditors. Whether or not a company has to have a minimum capital is irrelevant to shareholders or minorities. Shareholder and minority interests are not effected. The proposed abolition of minimum capital will therefore not prejudice shareholder or minority rights.").
[28] Engert, *supra* note 26, at 650.
[29] Braun et al., *supra* note 3, at 6.
[30] BAYLESS MANNING & JAMES J. HANKS, JR., LEGAL CAPITAL 21 (3rd. 1990).
[31] Booth, *supra* note 24, at 623.
[32] *Id.*

> More specifically, minimum capital requirements may sort out "necessity nascent entrepreneurs" who start a business only to escape unemployment. Such entrepreneurs are less wealthy and therefore more strongly affected by registration costs. At the same time, they have been shown to have no beneficial effect on technological development. Stricter requirements can thus serve to prevent market failures and lead to socially superior outcomes, as the 'public interest theory of regulation' contends.[33]

B. Weakened Justification for Minimum Capital Requirements

As far as the administration costs of a minimum capital requirement which is also part of entry regulation are concerned, "entry regulation serves mainly competitors and bureaucrats to extract rents . . . . Accordingly, its effect is to stifle entrepreneurial activity without an offsetting gain."[34] In concrete terms, a seminal article published in 2002 by Djankov and others used to foster this viewpoint by presenting data on the number of procedures, official time, and official cost, which are necessary for starting a business in 85 countries. They found that heavier regulation of entry generally has something to do with higher corruption and larger unofficial economies; in addition, countries whose governments are more democratic and limited lay down lighter entry regulation, and this regulation seems to be beneficial to politicians and bureaucrats but yield few socially superior outcomes.[35] As Djankov further argues,

> [a]n effective reform of business entry is to cut the capital requirement. Some countries justify the capital requirement as protecting creditors, as protecting the company against insolvency, and as protecting consumers against bad products. But this makes little sense. Lenders base their decisions on commercial risk, not whether a business meets a

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[33] Braun et al. *supra* note 3, at 7 (citation omitted).
[34] *Id* (citation omitted).
[35] *See generally* Simeon Djankov et al., *The Regulation of Entry*, 117 Q.J. Econ. 1 (2002). Also, according to a Nigerian example provided in *the Economist*,

> Mr Oyekunle [(the owner of a property consultancy in Lagos, Nigeria's business capital)] says he has no problem in principle with having to register his companies, apply for permits and so on. It is just that the rules are executed painfully slowly. Everyone knows that having "an ally in the ministry" can speed things along, he says; it may be that the fees he pays to lawyers to push through his paperwork include backhanders to such "allies"—though he doesn't ask. This is a common phenomenon in business-unfriendly countries.

Business and Bureaucracy: Snipping off the Shackles, THE ECONOMIST, Nov. 6, 2010, at 71-72 (hereinafter *Bureaucracy*) (alteration in original).

> government-imposed capital requirement. And in many countries, for example in Bulgaria, minimum capital can be paid with in-kind contributions or withdrawn immediately after registration—hardly of value in insolvency. Recovery rates in bankruptcy are no higher in countries with capital requirements than in those without.[36]

In other words, it did not seem that the amounts of statutory minimum capital would give a lot of protection to creditors. Undoubtedly whether a sophisticated lender would be willing to grant a loan to a corporation did not depend on the payment-in of the minimum capital before commencing business. A minimum capital requirement might work to an extent in the jurisdictions applying the requirement equally to all companies; nevertheless, the theory would have little validity "when applied to statutes which allow corporations to minimize the requirement by the use of a certain type of stock."[37] Moreover, Allen and others also argue:

> Even in jurisdictions where minimum capital requirements continue to exist, they are fixed at levels that seem to provide a form of de minimis screening rather than a substantial form of creditor protection. One reason that minimum capital requirements cannot be an effective creditor protection is that this check, where it exists, is fixed at the date of organization of the corporation. But, even if companies cannot dip into minimum capital to pay shareholders, normal business activity can easily dissipate a company' capital, leaving nothing on the books or in the kitty for its creditors.[38]

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[36] Simeon Djankov, *The Regulation of Entry: A Survey*, 24 The WORLD BANK RES. OBSERVER (NO. 2) 183, 188 (2009). Paul Davies also argues:

> [M]inimum capital requirements operate, by definition, when the company begins trading. The creditors need their protection, however, when the company becomes insolvent. A minimum capital requirement at the time the company commences trading does not guarantee any particular level of assets being available for the creditors at this later date, since, as we have seen, no legal rule can protect a company against unsuccessful trading.

PAUL L. DAVIES, GOWER AND DAVIES' PRINCIPLES OF MODERN COMPANY LAW 229-30 (7th ed. 2003). *See also* REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 131 (2nd ed. 2009) ("It seems unlikely that minimum capital requirements provide any real protection to creditors, as a firm's initial capital is likely to be long gone if it files for bankruptcy."). Besides, how do the World Bank's "Doing Business" projects push through the liberalization of the entry regulation? According to *The Economist*,

> [w]herever the red tape is thickest, the result is widespread informality. Many small firms operate under the radar of officialdom, dodging taxes and ignoring rules to survive. But they have to stay small, and thus contribute much less than they might otherwise do to a country's prosperity. The [World Bank] believes that by making politicians concerned about improving their country's position in the league, it is slowly helping to make it possible for informal businesses to get legit, thereby giving governments more scope to raise revenues.

Bureaucracy, *supra* note 35, at 72-73 (alteration in original).

[37] *Statutory Minimum Capitalization Requirements*, 5 WILLIAMETTE L.J. 331, 343 (1969).

[38] WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE

In addition, critics of legal capital often argue that minimum capital requirements are inefficient. On the one hand, "[t]he minimum capital provisions have been very easy prey for the critics of legal capital because a one-fits-all approach can hardly be efficient for every single corporation."[39] For example in the US, many state corporate act used to require that the minimum capital be paid in prior to commencing business. The amounts of the statutory minimum capital have mostly disappeared. Presumably the disappearance might be due to "the recognition that it is impossible to specify one minimum level of capital which will not be unnecessarily large for corporations conducting very small operations, but not ridiculously small for corporations conducting more substantial ventures."[40] On the other hand, some commentator argues that "minimum capital requirements are not the best means to meet its declared goals"[41], and that "[t]he strongest arguments why minimum capital requirements are

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LAW OF BUSINESS ORGANIZATION 140 (3rd ed. 2009).

[39] Engert, *supra* note 26, at 650. As Paul Davies similarly maintains,

> company laws normally set only one or a small number of minimum capital rules (for example, one for private and another for public companies), but in fact, to be effective, the minimum capital requirement ought to be related to the riskiness of the business which the company undertakes. General minimum capital requirements tend either to be too low effectively to protect creditors (as in the case of the current British requirement) or too high, in which case they simply reduce competition (by discouraging new entrants into the field) whilst over-protecting creditors.

DAVIES, *supra* note 36, at 229. Likewise, from an economic perspective, Easterbrook and Fischel reason:

> [Minimum capital requirements] have problems of their own. One is the obvious administrative cost associated with determining what amount of capital firms should raise. Another is the cost of error. If capital requirements are set too high, this will impede new entry and permit the existing firms to charge monopoly prices. Still another is the question of how firms must satisfy their capitalization requirements. For such requirements to be effective, the corporation must post a bond equal to its highest expected liability or hold sufficient funds in the corporate treasury and invest them in risk-free assets. The total held in this way will far exceed the expected risk created by firms as a group (because not all firms go bankrupt or incur the maximum possible loss). Under either alternative, the rate of return on equity investments will decrease. Thus at the margin people will shift capital away from equity investment in risky industries. This too represents a social cost.

EASTERBROOK & FISCHEL, *supra* note 24, at 60 (alteration in original).

[40] FRANKLIN A. GEVURTZ, CORPORATION LAW 129 (2nd ed. 2010). This problem has long been highlighted by Manning and Hanks before:

> The question of what amount of assets must be paid in to an enterprise by its shareholders before it will be permitted to enter the market place has never been candidly addressed in American corporate law. For a governmental agency to prescribe minimum capital standards for particular enterprises or economic sectors has been considered wholly impractical as well as antithetical to the way in which we go about our economic process. There are exceptions to this statement, and they are significant ones; banks, insurance companies, and corporate trustees offer instances of enterprises where, as we have learned painfully, undercapitalization can be a public menace and in those instances a combination of statutes and regulations compels a minimum pay-in of equity assets. But the only fields of endeavor in which our law seriously undertakes to set minimum standards of capitalization are those we view as industries affected with a special public interest, and which we regulate in a number of other ways as well.

MANNING & HANKS, *supra* note 30, at 21.

[41] BERNHARD UMFAHRER, THE REFORM OF EUROPEAN LEGAL CAPITAL RULES—ITS IMPACT ON UK AND

simply not necessary are . . . that personal sanctions on the controllers of companies are far more efficient."[42] This is because, in the English system for example, "the important cases for ex post remedies . . . [demonstrate that] the courts' decisions [are] thus quite predictable and so offers overall a well balanced system that is at least more efficient to serve the encouragement of new businesses and creditor protection at the same time than compulsory minimum capital requirements."[43] Andreas Pentz and others second this view by asserting that "[w]aiving the requirement of minimum capital as the necessary (minimum) provision of assets for commercial activities could be substituted by the personal liability of the shareholders or members of the management board."[44]

In conclusion, from a perspective of cost-benefit analysis, a commentator reasons:

> The benefits of a minimum capital requirement would not necessarily be a steady pool of assets available to satisfy creditors' claims, but rather a "threshold of seriousness" only preventing the most unsuitable of incorporating a company by encouraging them to take some advice beforehand which they otherwise would not. As this benefit is relatively small, it has to be considered if it really justifies the administration costs of a minimum capital requirement.[45]

Put simply, the costs may not be justified.[46] Therefore, the abolition of minimum capital requirements might be taken into consideration. To date, more and more jurisdictions adopted this deregulatory approach to corporate finance. For instance, in the past, "EU firms that [adopted] the open corporate form must have initial legal capital of at least Euro 25,000, although Member States [might] set higher thresholds if they [wished]. Similarly, Japanese minimum capital requirements [ranged] from roughly US $30,000 to US $100,000, depending on the type of corporate form."[47] Nonetheless, there has been a tendency towards liberalizing the statutory minimum capital:

> Internationally, minimum capital requirements have historically been significant but seem to be on the decline. Japan used to impose relatively high capital requirements on

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AUSTRIAN COMPANY LAW 85 (2009).

[42] *Id.* at 69.

[43] *Id.* at 66.

[44] Andreas Pentz, Hans-Joachim Priester & André Schwanna, *Rasing Cash and Contributions in Kind when Forming a Company and for Capital Increases*, *in* LEGAL CAPITAL IN EUROPE 42, 56 (Marcus Lutter ed., 2006).

[45] UMFAHRER, *supra* note 41, at 41. *See also* KRAAKMAN ET AL., *supra* note 36, at 131 ("Most entrepreneurs appear to invest some capital in newly formed firms, even in the absence of minimum capital rules. This may indicate that the presence of capital is a rough-and-ready proxy for the 'seriousness' of entrepreneurs, by showing that they commit a non-trivial amount of money to their project.").

[46] *See* UMFAHRER, *supra* note 41, at 41.

[47] REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 84 (2004).

corporations but abolished these requirements as of May 2006, though a Japanese corporation must now have 3 million yen in assets (~ $30,000) before it can distribute profits. The European Union imposes a minimum capital requirement of approximately [Euro 25,000] for "open" corporations, but the European Commission is currently considering relaxing this requirement.[48]

IV. Effects of Jurisdictional Competition on Minimum Capital Requirements

As argued below, besides concerns for efficient effects of minimum capital requirements, there appears to be other motivating forces to turn the tide running in the direction of liberalization of minimum capital requirements, i.e. law market forces underlying jurisdictional competition. Specifically, the corporate law market is simply a part of the broader market for law.[49] Generally speaking, a market for corporate law is based on parties' contracting for or choosing, through incorporation, the law of a specific state or nation. This market, as a self-ordering phenomenon, could impose discipline on lawmaking by forcing states or nations to compete with one another. Additionally, respecting contractual choice-of-law, or recognizing the incorporation of a locally-based foreign corporation, would encourage legal improvements to evolve more rapidly and efficaciously. With firms' ability to move among states or nations, the market for corporate law arises not only in both the US and European federal systems[50] but also in the international context[51] (as shown in the case of Taiwan), despite local officials' efforts to protect their lawmaking authority.[52]

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[48] ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 38, at 139-40 (alteration in original).

[49] Larry E. Ribstein & Erin Ann O'Hara, *Corporations and the Market for Law*, 2008 U. ILL. L. REV. 661, 665 (2008).

[50] This paper's classifying EU as a federal system is based on the argument made by O'Hara and Ribstein: "The U.S. federal system enables competition across the states for the provision of state law. Other countries are bound into various kinds of federations that facilitate comparable markets. Most important, the European Union has been moving toward a legal system that has some elements of US federalism." O'HARA & RIBSTEIN, *supra* note 1, at 12.

[51] Arguing that law market forces function ubiquitously, Ribstein and O'Hara make a similar comparison between law market forces operating within federal systems and those in the international setting: "International securities regulation … operates on the national level rather than within a federal system like the United States or Europe. However, recent developments in international securities regulation show that forces similar to those operating on corporate law within federal systems are also operating on international securities laws." *Id.* at 710.

[52] *See* O'HARA & RIBSTEIN, *supra* note 1, at 217. O'Hara and Ribstein further argue:

> Governments cannot control everyone everywhere. Physical mobility allows a person or firm to choose a single state whose law would apply to all her or its activities. States compete for mobile parties and their assets by attempting to provide the laws that they want. . . . [P]arties' fundamental ability to choose among these bundles generates a willingness on the part of states to enforce choice-of-law clauses, which in turn

A. Jurisdictional Competition in the US and EU Federal Systems

1. The United States

Minimum capital requirements in state statutes used to be quite common in the middle of the second half of the twentieth century. The most popular minimum amount of capital specified in these statutes was $1,000; some statutes, however, required $500 or some other amount.[53] Nowadays most of the states have abolished such requirements in the sense that "any minimum amount of capitalization is arbitrary and does not provide meaningful protection to creditors. The major problem with these minimum capital provisions was that they took no account of the specific capital needs of the particular business."[54] In addition, "the requirement of $1,000, while perhaps meaningful in the 1950's or 1960's, had become the victim of inflation and was much less significant by the 1990's."[55] As Robert Hamilton adds,

> [t]he old Model Business Corporation Act eliminated its minimum capitalization requirement in 1969, and the trend is definitely in the direction of eliminating all such requirements. Thus, in most states today it is theoretically possible (as it is under the MBCA (1984)) to form a corporation with a capitalization of one cent.[56]

> facilitates an even more valuable market in laws governing particular relationships and disputes.

Id. at 66.

[53] ROBERT W. HAMILTON, THE LAW OF CORPORATIONS IN A NUTSHELL 88 (5th ed. 2000).

[54] *Id.* at 88.

[55] *Id.* at 89.

[56] *Id. See also* ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 38, at 139-40 ("[W]ithin the United States, statutory minimum capital requirements are either truly minimal ($1,000) or entirely nonexistent. (Neither the DGCL nor the RMBCA requires a minimum capital amount as a condition of incorporation.)"); CHARLES R.T. O'KELLEY & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS: CASES AND MATERIALS 568-70 (1999) ("[F]or much of [the twentieth] century, a number of state corporation codes specified a minimum total amount of capital that each corporation must possess before starting business. However, the required minimum capital was invariably insignificant (typically between $500 and $1,000), and such rules have been abandoned in almost every state.") (alteration in original); Booth, *supra* note 24, at 622-23 (describing that after states gradually started to permit free incorporation in the late nineteenth century, the provisions included in states statutes or constitutions usually prohibited the corporation from commencing business unless it had received a specified minimum amount of capital). Manning and Hanks similarly reason:

> Until very recently state corporation acts genuflected to the desirability of requiring a minimum amount of assets to be paid in to a new enterprise as a prerequisite to achieving corporate status, or at least before commencing business. But these provisions were always *pro forma* only, typically requiring a de minimis

State competition in company law ("charter competition") has been around in the US for more than a century. In spite of the different opinions among scholars (charter competition may have been a race to the top or to the bottom), "the debates share a basic assumption that competition for charters was the fundamental engine that produced today's corporation law."[57] Harwell Wells argues that "[w]hile inter-state competition for corporate charters is an important element in the story, this account reveals that competition was not the only driver of legal change."[58] He adds that drafters for state corporate laws designed the new laws, "not merely to attract corporations, but to protect shareholders," that "they aimed less to attract out-of-state incorporators than to retain incorporations of corporations already located there", and that "[i]nterest groups were certainly involved in drafting and adoption - the laws gained great support from state bar associations - but alongside these local interest groups worked legal reformers."[59] Put simply, state competition for corporation charters was identified as "the engine of change in corporation law". States either changed their corporation law to "compete for incorporations on a national stage" (i.e. the offensive regulatory competition), or "aimed merely to produce laws that were sufficiently attractive that they would dissuade local corporations from reincorporating elswhere."[60] The latter type is the aformentioned defensive regulatory competition, which will also be discussed in the EU case below.

From a contemporary perspective, the corporate law market, or the jurisdictional competition for corporate charters fuelled by firm mobility, did drive moderation of strict legal restrictions on corporations which encompass such legal capital rules as minimum capital requirements.[61] The history of the changes made by New York, Michigan, Massachusetts and other leading industrial states is illustrative. The removal by these states of

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> pay-in on the order of $1,000 or less, and with no provision precluding an immediate return of this amount to the shareholders. In the last few years, however, most state statutes have eliminated even these *pro forma* requirements for initial pay-in by shareholders. In general, therefore, the creditor has received little or no direct protection through legislative or regulatory prescription requiring an incorporated enterprise to have a minimum amount of assets at its inception.

MANNING & HANKS, *supra* note 30, at 21 (footnote ommited).

[57] Harwell Wells, *The Modernization of Corporation Law, 1920-1940*, 11 U. PA. J. BUS. L. 573, 575 (2009).

[58] *Id.*

[59] *Id.*

[60] *Id.* at 627.

[61] *See* William J. Carney, *The Political Economy of Competition for Corporate Charters*, 26 J. LEGAL STUD. 303, 321 (1997) (arguing that "[m]ost…older requirements concerning legal capital that are gradually being abandoned, as well as that as of 1997 only 6 states required "minimum capital to be paid in at the time of incorporation or the beginning of business" and 5 states set "a statutory minimum for subscribed capital before beginning business"). He adds that the statutory minimum capital is merely "an anachronism still present in a few U.S. state laws". *Id.* at 324.

the limitations upon the size and powers of business corporations appears to have been due to the conviction that it was useless to maintain them in the sense that local restrictions would be evaded by firms incorporating in, say, New Jersey.[62] Indeed, as Yablon discusses,

> the basic contours of the law that emerged in New Jersey in the 1890s is [sic] essentially the same as the Delaware law that governs most publicly traded corporations today. Many of the changes that New Jersey instituted at that time—such as the abolition of limitations on the size, duration, and power of corporations to hold and sell stock in other corporations, limitations on potential shareholder liability to creditors for issuing undervalued shares, and development of enabling statutes giving incorporators greater freedom to create and structure corporate powers—were criticized at that time as removing important protections for the public. Most corporate law theorists today, however, would view them as reasonable, efficiency-promoting rules.[63]

In other words, charter competition may result in the liberalization of legal capital rules which could be proved to be inefficient.[64]

Hence, from the viewpoint of the law market, at the turn of twentieth century,

> legal changes were provoked by firms' increasing need for legal flexibility. For example, state rules requiring shares to be priced at their initial sale price, or "par," even as the

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[62] Louis K. Liggett Co. v. Lee, 288 U.S. 517, 560-64 (1933) (Brandeis, J., dissenting).

[63] Charles M. Yablon, *The Historical Race Competition for Corporate Charters and the Rise and Decline of New Jersey: 1880-1910,* 32 J. CORP. L. 323, 328 (2007) (footnote omitted).

[64] As Booth details,

> [i]t is widely believed that the various states compete with each other to attract corporations . . . . [M]any observers have suggested that the dilution of substantive rules such as those relating to legal capital may be attributable to destructive competition and the so-called race to the bottom in corporation law as each state competes to attract corporations by eliminating restrictions on their activities. Nevertheless, it is important not to jump to conclusions about the temptation of states to compete with each other. Indeed, several studies indicate that stock price tends to be higher for Delaware corporations than for corporations of other states, which suggests that stockholders may view the supposedly lax Delaware rules as better than those of other states. There is no reason to think that the states would not compete with each to offer the best possible legal product. Thus. Although it may be tempting to assume that the demise of the legal capital rules is an example of increasing laxity in corporation law, it may also be the case that such rules proved to be inefficient and that other more efficient rules have evolved.

Booth, *supra* note 24, at 622 (citation omitted).

> market price rose or fell, significantly constrained corporate finance in modern capital markets. Firms could and probably did lobby their home states to ease these restrictions, but clearly found it easier to choose another states' law without having to physically move there.[65]

In terms of states' abolition or reduction of minimum capital requirements, which together with par value rules constitute the statutory structure of legal capital, we can reasonably presume: If a state from which firms exit is unwilling to moderate the regulation on minimum capital to contain the outflow of firms and capital, or to engage in defensive regulatory competition, just as the general law market forces "can pressure states to enforce contractual choice of law in order to encourage firms to maintain and enhance connections with their states,"[66] the same underlying supply and demand forces in the market for law contribute to deregulation in non-competing states which at least aim to keep local corporations from incorporating elsewhere. For instance, if firms avoid states with stringent minimum capital requirements, such exit-affected interest groups as lawyers may lose potential clients and litigation business. Therefore, ignoring business demands for legal flexibility (that is, abolition or reduction of minimum capital requirements as applied to local firms) could deter firms from making significant local investments, "which might trigger a local political backlash against the regulation."[67] In short, the output of these market interactions in the jurisdictional competition for corporate charters demonstrates that the US corporate law market operates to satisfy business demands for legal flexibility.

To summarize, how jurisdictonal competition for corporate charters changed minimum capital requirements in state statutes can go roughly like this: "corporate federalism created the possibility of competition for charters; states began to compete for charters, producing laws to attract incorporators; once competition began, states were compelled to continually update the laws simply to stay competitive."[68] Then the resulting competitive dynamic drove states to offer the more efficient legal product, that is, the abolition or reduction of minimum capital requirements.

2. The European Union

Not long ago, European countries had applied the so-called "real-seat" (siège réel, siège

[65] O'HARA & RIBSTEIN, *supra* note 1, at 110. *See also* Carney, *supra* note 61, at 324 ("Par value appears to be taken as seriously in Europe as it was in the United States in the late nineteenth and early twentieth centuries, although American lawyers have come to believe such protections are largely illusory.") (footnote omitted).
[66] O'HARA & RIBSTEIN, *supra* note 1, at 113.
[67] *Id*.
[68] Wells, *supra* note 57, at 628.

social) choice-of-law rule, under which the law of a "company's real or effective seat," its "central administration," or its "brain or nerve center" where the main operational decisions are made, rather than that of statutory domicile (registered office), was followed by European nations except for the United Kingdom and the Netherlands.[69] Nevertheless, as in the US, increased firm mobility provoked by liberal trade rules within the EU put pressure on the choice of law rule. The revolution took place in 1999 with the *Centros* case, which were followed by two others—the *Überseering* and *Inspire Art* cases. Overall, theses cases clarified that the EU law fundamentally protects full-fledged Delaware-type corporate charter competition for "tramp" or, in European parlance "brass plate," corporations.[70]

What should be emphasized first here is the seminal *Centros* case.[71] On March 9, 1999, the ECJ held that Centros Ltd., incorporated in the UK, could not be denied registration in the Danish Business Register even though the company operated entirely within Denmark and was incorporated in the UK merely in order to avoid more stringent Danish incorporation requirements on minimum capital.[72] In other words, the founders of a pseudo-foreign corporation[73] publicly acknowledged that they intended to circumvent the Danish minimum capital rules, and the ECJ disallowed the Danish regulators from interfering.[74] This case suggested that even though a company, as a pseudo-foreign corporation, simply wanted the more favorable and flexible law of the incorporation jurisdiction, the ECJ would also enforce the Incorporation Theory or the Internal Affairs Doctrine (the "IAD")[75], because the real seat doctrine violated the "freedom of establishment" given by Article 43(1) of the Treaty Establishing the European Community (the "EC Treaty").[76] As Enriques and Gelter note, "[c]orrespondingly, the ruling prevented Member States from imposing their own corporate law on such businesses, other than under very limited conditions. In the past few years, newly incorporated businesses have started to take advantage of this new development, choosing

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[69] *See* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW 132 (1993). *See also* ERIC STEIN, HARMONIZATION OF EUROPEAN COMPANY LAWS, NATIONAL REFORM AND TRANSNATIONAL COORDINATION 29-31 (1971); Braun et al., *supra* note 3, at 11 ("[T]he real seat theory is designed to prevent incorporators from choosing a company law of their liking. It protects national company laws against 'legal arbitrage' and competitive pressure from other states.").

[70] Ribstein & O'Hara, *supra* note 49, at 707.

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

[72] Marco Becht, Colin Mayer & Hannes F. Wagner, *Where Do Firms Incorporate? Deregulation and the Cost of Entry*, 14 J. CORP. FIN. 241, 246 (2008).

[73] Pseudo-foreign corporations are "corporations essentially local in character but incorporated in a foreign state." Elvin R. Latty, *Pseudo-Foreign Corporations*, 65 YALE L. J. 137, 137 (1955). *See also id.* at 161-62. In another word, this corporation "is incorporated in another jurisdiction but has no significant contacts with that other jurisdiction." Christian Kersting, *Corporate Choice of Law — A Comparison of the United States and European Systems and A Proposal for A European Directive* 28 BROOK. J. INT'L L. 1, 1 (2002).

[74] *Id.* at 74.

[75] This rule holds "that the law of the state of incorporation governs the relationship between the managers, the shareholders and the corporation. Corporations can choose their place of incorporation without having any other connection with the state of incorporation." Ribstein & O'Hara, *supra* note 49, at 662 (footnote omitted).

[76] *See* Jens C. Dammann, Note, *The Future of Codetermination after Centros: Will German Corporate Law Move Closer to the U.S. Model?*, 8 FORDHAM J. CORP. & FIN. L. 607, 614-18 (2003).

English law in relatively high numbers."[77]

In addition, the *Inspire Art* case[78] should be stressed as well. On September 30, 2003, the ECJ further confirmed the decision taken by Inspire Art Ltd.—a private company incorporated in Folkestone, England—to incorporate there; meanwhile it had its main business extensively within the Netherlands. The Dutch government maintained that while the company were able to legally operate in the Netherlands, it was necessary for it to abide by existing laws provided for real foreign corporations, which *inter alia* requires "that directors are personally liable if the firm has minimum capital below the minimum capital requirement for Dutch firms."[79] The ECJ held that Inspire Art Ltd.'s tactic was "permissible even if the only reason for incorporating in the UK was to circumvent Dutch minimum capital requirements."[80] That is to say, the ECJ ruled that the Netherlands must not impose local regulations on a locally-based company that had incorporated elsewhere solely in order to circumvent these regulations.

The above cases determined a European version of the IAD or the Incorporation Theory, "by which firms that incorporate in one Member State of the E.U. are free to do business in any other Member State," and stressed "that freedom of incorporation also holds for 'round-trip' incorporations, when residents of country A incorporate in country B with the sole purpose of doing business in country A."[81] Evidently, *Centros* and its progeny have galvanized not only certain European competition in the form of "tramp" UK incorporations by firms based somewhere else in Europe, but also regulatory responses by other European countries to slash the minimum capital for limited liability companies ("LLC") and cutting down costs of incorporations.[82] In other words, "the proliferation of the UK private company limited by shares has posed a competitive threat to many European legislators."[83] Since ECJ exposed European jurisdictions to competitive pressure from the main contender, the UK private LLCs, various European jurisdictions were driven to engage in jurisdictional competition through company law reforms, particularly the reduction or abolition of minimum capital requirements.[84]

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[77] 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, 580 (2007) (footnote omitted).
[78] Case C-167/01, Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd., [2003] E.C.R. I-10155.
[79] Becht et al., *supra* note 72, at 246.
[80] *Id.* at 243.
[81] *Id.*
[82] Ribstein & O'Hara, *supra* note 49, at 707.
[83] Braun et al., *supra* note 3, at 1.
[84] *See* Braun et al., *supra* note 3, at 3-4 ("After the ECJ unleashed charter competition . . . [four European jurisdictions] decreased or abolished the statutory minimum capital . . . . The reforms seem to respond to the new competitive pressure exercised by less restrictive company law jurisdictions, notably the UK."). *See also id.* at 11-12 ("[A] couple of EU member states have reformed incorporation procedures and requirements after 1999.

To be concrete, as Enriques & Gelter have discussed in 2007, the EU Second Directive

> requires public corporations to have a legal capital of at least €25,000, which need not be entirely covered by assets at the time of incorporation. With the Second Directive not applying to private limited companies (Ltds), Member States have been able to choose freely the amount for this set of corporations. This resulted in a broad variety of regulations, ranging from no such requirement in the [UK], Ireland, and Cyprus to a requirement of €35,000 in Austria. *Centros* has already induced France, effectively to abolish minimum capital for private corporations, and even the German Ministry of Justice proposed a reduction from €25,000 to €10,000. [85]

Hence, since the adjudication of *Centros*, some regulatory arbitrage at the incorporation country in order to escape rules on minimum capital for private corporations have already led to defensive regulatory competition, which have already led a few Member States such as France and Germany to relax these requirements "that were apparently the outcome of isolation from competition."[86] To put it another way, the regulatory arbitrage "can, at least partly, be credited for a trend toward the abolition of minimum capital requirements in some countries."[87] Also, since these avoided minimum capital requirements are outdated as well as unhelpful to creditors and thus rational creditors should not be concerned about them, "then the changes in the law induced by corporate law arbitrage so far are not really an issue of creditor protection, but rather a removal of administrative slack affecting only the interests of the founders of new companies."[88] More importantly, European countries are responding to

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For some of them, the emerging market for company law has been a driver of change . . . . Reforms in EU member states thus not only respond to charter competition but also reflect a general trend towards deregulation . . . . ") (alteration in original) (citation omitted).

[85] Enriques & Gelter, *supra* note 77, at 600-01 (alteration in original) (footnote omitted). *See also* Federico M. Mucciarelli, *Freedom of Reincorporation and the Scope of Corporate Law in the U.S. and the E.U.* 46 (NYU Law and Economics Research Paper No. 11-07, 2011), *available at* http://ssrn.com/abstract=1783607 (reporting that France, Italy and Germany amended the related legal rules). In fact, in the case of the German UG GmbH, "the minimum capital requirement has been abolished." Braun et al., *supra* note 3, at 20. In addition, Hungary and Poland lowered minimum capital requirements not just for the private LLC but at the same time for the public LLC. *Id.* at 16.

[86] Enriques & Gelter, *supra* note 77, at 600. *See also* Mucciarelli, *supra* note 85, at 46 (numerous EU member states, "in recent years, perhaps as a form of defensive regulatory competition, have relaxed the mechanism for creditors' protection of 'private' limited liability corporations"). As mentioned above, defensive regulatory competition here denotes: Jurisdictions that do not aggressively engage in charter competition at least try to avoid losing their own firms to foreign jurisdictions or keep domestic firms from using foreign law; therefore this competitive pressure also compels them to offer less restrictive rules in company laws or facilitate incorporations, particularly by cutting the statutory minimum capital.

[87] Enriques & Gelter, *supra* note 77, at 613.

[88] *Id*. The administration costs of a minimum capital requirement exhibits, as the opposing view on minimum capital requirements argues, "that entry regulation serves mainly competitors and bureaucrats to extract rents . . . . Accordingly, its effect is to stifle entrepreneurial activity without an offsetting gain." Braun et al., *supra* note 3, at 7 (citation omitted).

the inflow of new incorporations to the UK by decreasing or abolishing the statutory minimum capital and costs of incorporation more generally. Further, "[t]his race to match [UK] standards shares characteristics with the regulatory competition emphasized by the U.S. corporate mobility,"[89] even though the phenomenon in the EU is in appearance different from that within the US.

In addition, before the corporate charter competition in Europe was initiated, the legal system creating the US common market where there is no tariffs made it possible for US firms to exit from costly legal regimes from state to state, which explains the competitive difference between Europe and the US. Exactly as Carney argues, "[t]hese different competitive settings explain substantive differences in corporate laws."[90] In the US, since there are state regulators competing with each other for corporate charters, "mandatory provisions that are not cost-justified will tend not to survive over time because firms will exit [from] the regime with the undesirable mandates, migrating to regimes in which they are absent."[91] As discussed above, the "real-seat" rule might have obstructed jurisdictional competition in the EU. Studying the difference between US state corporation laws and those of EU Member States, William Carney found that there are a large percentage of the mandates in the EU company law directives; most of them don't exist in any US state laws. In effect, these mandates which used to be in US state codes have been abolished for several decades since they are not favorable for contemporary business practices.[92] This evidence might support the proposition that the ongoing jurisdictional competition for corporate charters in Europe is, after *Centros*, nudging European corporate law, at least for private LLCs, in the direction of legal flexibility.[93] This propensity for fewer costly mandates in the corporate law, or rather the trend toward the reduction or abolition of minimum capital requirements, can also be explained by applying the same general supply and demand law market forces as in the US to European firms' business demands for legal flexibility.[94] Furthermore, subsequent to *Centros*, all Member States in the EU are required essentially to adhere to business demands for regulatory products of legal flexibility, which are driving the European corporate law market.

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[89] Becht et al., *supra* note 72, at 252 (alteration in original).
[90] Carney, *supra* note 61, at 303.
[91] Roberta Romano, *Is Regulatory Competition a Problem or Irrelevant for Corporate Governance?*, 21 OXFORD REV. ECON. POL'Y 212, 217 (2005) (alteration in original).
[92] Carney, *supra* note 61, at 319-24. He adds that "[m]uch of the regulation provided by the [EU] directives involves creditor protection" and that "[s]ome of these rules might be viewed as substitutes for the disclosure required by securities laws in the United States and Canada, but they include substantive regulation that goes beyond the role of securities laws in most jurisdictions." *Id.* at 324.
[93] Braun et al., *supra* note 3, at 12 (EU jurisdictions' legislative changes "also tend to reduce or abolish minimum capital requirements. Reforms in EU member states thus not only respond to charter competition but also reflect a general trend towards deregulation . . . .").
[94] *See* O'HARA & RIBSTEIN, *supra* note 1, at 117.

To put it in more detail, even though Europe and the US have distinct competitive environments,[95] the same essential forces of the law market reign in both situations.[96] Legislators in both federal systems seek to regulate corporate governance under the support of local pro-regulatory interest groups just as they deal with other types of contracts. However, the ECJ rulings led by *Centros* have created an active incorporation market in the European Union.[97] As Becht and others note, "[i]n some countries in particular, entrepreneurs are increasingly aware that they can freely choose among all the limited liability vehicles in the EU to run a business in their home state."[98] Small firms' mobility, first enhanced by *Centros* and other following cases, feeds the demand side of the law market which their exit rights underlie, and then sparks competition for the supply of law by foreign jurisdictions. Those firms thus attempt regulatory arbitrage in other EU Member States to satisfy their demands for legal flexibility. For example, "[b]etween 2003 and 2006 more than 40,000 residents of Germany incorporated a UK Limited."[99] Apparently, on the international supply side, the UK has catered to this market, at least to the extent of lowering incorporation costs for small firms.[100] Moreover, small firms' exit strengthens their voice on the domestic supply side to petition for less costly regulation of incorporation. We can find evidence that the governments of European jurisdictions such as France, Germany, Poland, Hungary and the Netherlands carried through reforms with a view either to facilitating establishment of small firms and entrepreneurship in their own countries or to preventing their losing jurisdictional control of considerable portions of their economies.[101] Specifically, Becht and

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[95] As Mucciarelli argues in terms of the distinct background where charter competition emerged,

> [i]n the European Union, "federal" E.U. law is the driver of the evolution of member states' laws towards a more liberal approach on corporate mobility. This is a significant difference with the U.S., where states voluntarily adopt the internal affairs doctrine and allow outbound reincorporations. Without the action of the European Union bodies, member states would still be defending own domestic choice-of-law criteria and own national privileges. Case law of the European Court of justice of the last decades has banned unreasonable barriers to inbound transfers of the headquarter of foreign corporations and to cross-border mergers.

Mucciarelli, *supra* note 85, at 62.

[96] Ribstein & O'Hara, *supra* note 49, at 709.

[97] Braun and others elaborates:

> The ECJ thus removed the main legal barrier against company law choice within the EU. . . . [A] substantial number of firms from Germany and other continental European jurisdictions did use the new opportunities and opted to incorporate in the UK after the ECJ's judgments. . . . As the cost burden on legal arbitrage diminishes over time, the competitive pressure on national company laws is likely to increase.

Braun et al., *supra* note 3, at 11 (citation omitted).

[98] Marco Becht, Luca Enriques & Veronika Korom, *Centros and the Cost of Branching*, 9 J. CORP. L. STUD. 171, 172 (2009).

[99] *Id.*

[100] Braun et al., *supra* note 3, at 4 ("[O]ne important reason for the UK's leading position is the absence of a minimum capital requirement for private LLCs.") (citation omitted).

[101] Becht et al., *supra* note 72, at 252 ("Domestic incorporation is *per se* perceived to be important even if it

others note that "there is a political cost of loss of control in the case of entrepreneurs choosing to incorporate abroad. If corporate law is a means of implementing a political agenda then politicians have an incentive to keep entrepreneurs from incorporating their companies abroad."[102] Put differently, the demand side of the market for law, or the economic exit in the international environment signaled by small firms, bolsters their voice rights in the political process in the domestic context, and this domestic supply side then pressures politicians or lawmakers within respective Member States to enable the relaxation of outdated minimum capital requirements. In brief, spurred by the ECJ rulings, law market forces underlying jurisdictional competition among Member States are leading local governments to provide less costly corporate law, or rather the trend towards the alleviation of rules on minimum capital at least for private LLCs.

3. Summary

What drove the corporate charter competition in the nineteenth century in the US and in contemporary Europe? Why do they end up with a trend towards legal flexibility, or liberalization of costly regulation (minimum capital requirements, for instance)? To start with the implication from the US story, for New Jersey to succeed, other states had to apply New Jersey law to New Jersey corporations. Why did they cooperate? The explanation ultimately rests at least partly on demand-side factors. Without broader recognition of New Jersey law, corporations might have decided to sell their stock and locate their factories and other corporate assets only in states that applied the IAD. To be sure, these moves could impose significant costs on firms, particularly if firms had to forgo conducting business with customers, suppliers or shareholders in non-cooperating states. But at the same time corporations benefited significantly from the flexible rules New Jersey offered. And they also had strong reasons to want a single corporate law to apply to their internal affairs.[103] As Ribstein and O'Hara argue,

> the corporate law market is simply a part of the broader market for law. . . . [T]he law market exists because parties to most contractual relationships have a strong incentive to contract for the law applicable to those relationships. States enforce these contracts despite the fact that they have the effect of eroding connected states' regulatory power. States cede this regulatory authority in order to attract, or at least to avoid repelling, mobile firms. In short, the IAD did not spring only from forces unique to corporations, but also from these general law market forces.[104]

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does not bear directly on government revenues or the location of production or control").

[102] *Id.* at 243.

[103] Ribstein & O'Hara, *supra* note 49, at 677-78.

[104] O'HARA & RIBSTEIN, *supra* note 1, at 109.

Once more, the usual supply and demand forces of the law market are functioning in the European jurisdictional competition for corporate charters, even if "this time under different legal and cultural conditions from those in the United States."[105]

It emerges that the jurisdictional competition in the EU occurred later than that of the US, following the rash of American business mergers beginning in the 1880s by nearly a century. Even though there are different competitive conditions between Europe and the US, "[a]ny differences between the United States and the EU will not be because different forces are at work, but because the specific environment affects the strength of each of these forces—the demand for regulation . . . the supply of regulation . . . and the resistance of local pro-regulatory interest groups . . . ."[106] To put it somewhat differently, even if the breeding grounds of these two phenomena seem in appearance to be disparate, the underlying competitive dynamics may, to an extent, be the same, in the sense that, responding to similar law market supply and demand forces, jurisdictional competition in both federal systems spurred by business demands for legal flexibility drove the provision of increasingly cost-effective corporate law. That is not merely because jurisdictional competition "provides regulators with incentives and the necessary information to be accountable and responsive to the demands of the regulated," but also "because there is a feedback mechanism in a competitive system that indicates to decisionmakers when a regime need to be adapted and penalizes them when they fail to respond: the flows of firms out of regimes that are antiquated and into regimes that are not."[107] To sum up, as Romano argues, "[t]his is an important regulatory characteristic in the corporate context, because firms operate in a changing business environment, and their regulatory needs concomitantly change over time."[108] All in all, jurisdictional competition in the US and EU federal systems galvanized a tendency of company law reforms towards legal flexibility, particularly the reduction or abolition of minimum capital requirements.

B. International Jurisdictional Competition: The Case of Taiwan

[105] *Id.* at 123.
[106] Ribstein & O'Hara, *supra* note 49, at 710.
[107] Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L. J. 1521, 1598 (2005).
[108] *Id.* at 1598-99.

1. Globalization and A Quest for National Competitiveness

Concerning the issues peculiar to international trade and the movement of capital, know-how and firms across national borders, Kasper and Streit asserted:

> [O]penness gives the subjects of national jurisdictions the exit option. This weakens the power of governments. It is sometimes perceived as an affront to the rulers. Powerful national interest groups who clamour for protection from international competitors often induce governments to interfere with international trade, capital flows, migration and technological exchanges. This reduces competition, diminishes the institutional underpinnings of a non-discriminatory order based on private property and abridges the property rights of foreigners and nationals. It is also a source of international conflict. It is therefore useful to constrain the scope for opportunistic national interventions in international exchanges. This is done, for example, under the World Trade Organization (WTO) and OECD codes on foreign investment.[109]

As Kasper and Streit added, globalization, by strengthening the influence of openness, promoted jurisdictional competition.[110] Put it differently, globalization has generated "institutional (or systems) competition"[111], or jurisdictional competition through offering the best possible legal product. Obviously, laws and regulations affect cost levels so that they serve as crucial factors in international competition to the private sector.[112] As a result, local governments in different jurisdictions compete more or less directly with each other by providing for better and cost-effective laws and regulations.[113]

Furthermore, "as globalization made issues of *national competitiiveness* increasingly salient," corporate governance regimes in different jurisdictions seem to compete in a very similar way where products do.[114] Local governments would try to bring in corporate

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[109] *See* KASPER & STREIT, *supra* note 12, at 342.
[110] *See id.* at 381 ("[I]n the late twentieth century, the impact of openness has been advanced greatly by what has become known as globalisation, intensifying international trade and worldwide factor mobility. National cultures and external institutions are now exposed to competition with other cultures and institutional systems.").
[111] *Id.* at 403.
[112] *Id.* at 381 ("Rule systems form important competitive assets in the competition between producers, traders and investors in different jurisdictions; but they can also constitute severe competitive liabilities.").
[113] *See id.* at 345, 399,.
[114] Donald C. Clarke, *"Nothing But Wind"? The Past and Future of Comparative Corporate Governance*, 59 AM. J. COMP. L. 75, 83 (2011) (emphasis added).

governance regimes "that possess relative competitive advantage".[115] The adopted better and cost-effective laws and regulations would thus exert a positive influence on entrepreneurial activity and then national competitiveness. The World Bank's "Doing Business" reports are the exact example which directed the attention of governments across jurisdictions to fostering national competitiveness by stifling unnecessary regulatory barriers to new firm creation. As for the theoretical basis on which the World Bank promoted this competitive adaptation, Braun and others indicate:

> Entrepreneurial activity is a key driver of economic growth and development. Workable policies to encourage business ventures are, therefore, in strong demand. In this regard, the entrepreneurship literature has recently taken a vivid interest in regulation as a potential constraint on start-up activity. The new line of inquiry originates from the more general research on the impact of law and regulation on economic development. [La Porta and others'] law and finance literature holds that "law matters" for the financing of economic activities and hence for the comparative success of economies. To make their case, law and finance scholars try to identify a link between legal rules and institutions in the various jurisdictions and economic performance.[116]

Although law and finance scholars studied distinct types of laws and regulations, one of their focus has been on the "regulation of entry"; this major strand could be represented by Djankov and others' (2002) work.[117] Following this line, the World Bank has played a leading role in formulating a strategy of regulatory reform to boost economic development. "Since 2002, it has been monitoring the legal and regulatory conditions for 'doing business' in various economies. The general claim of this research is that stricter regulation tends to stifle start-up activity."[118] More importantly, the World Bank's "Doing Business" project "has succeeded in

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[115] *Id.* at 84.

[116] Braun et al., *supra* note 3, at 2 (alteration in original) (citation omitted). La Porta and others' law and finance literature mainly refer to the following articles: Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997); Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998).

[117] Djankov, *supra* note 35. Djankov elaborated on how this research field arose:

> Business entry reforms have been the prevalent legal and administrative reform around the world in the past decade. This reform enthusiasm was partly triggered by de Soto's (1989) work, but mostly by the collapse of central planning in Eastern Europe. The publication of Djankov and [others'] (2002) [work] also contributed to the popularity of business entry reforms. . . . In terms of research, the 1990s work on institutions and their importance to growth by Mancur Olson, Douglass North, Robert Hall and Charles Jones led to a cohort of researchers interested in the mechanisms by which specific institutions affect business decision. The work on legal origin by Andrei Shleifer and co-authors further opened the field of comparative economics by encouraging cross-country comparisons in various areas of law. Djankov and [others'] (2002) [work followed] these contributions.

Djankov, *supra* note 36, at 199-200 (alteration in original).

[118] Braun et al., *supra* note 3, at 2 (citation omitted). Regarding the origin and after effects of the World Bank's

putting the issue of business red tape on the international political agenda", which can be illustrated as follows:

> A recent summit of Asia-Pacific countries, which have become the most enthusiastic reformers, agreed on five priority areas, from simplifying business start-up procedures to better enforcement of contracts. Passing such reforms often means overcoming resistance, especially from bureaucrats. But in an era of tight budgets and high unemployment, they make even more sense as a way to create jobs and boost growth while costing governments little or nothing.[119]

When it comes to how international organizations interplay with international jurisdictional competition in weakening the intensity of regulation on entry, first of all, Andrew Morriss argues: "The General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO) are examples of measures designed, albeit imperfectly, to reduce the opportinities available to domestic politicians to insulate areas of their economies from competition."[120] More importantly, he adds:

> Regulatory competition can similarly limit such rent-seeking because it facilitates exit by those harmed by the rent-seeking. To the extent that it reduces the ability of domestic interest groups to rent-seek by making it more difficult to insulate areas of the economy from competition, interenational regulatory competition serves a valuable role in reducing deadweight losses due to rent-seeking.[121]

Accordingly, this paper argues that international organizations such as the World Bank or WEF encourage international jurisdictional competition for offering the best possible legal product.[122] This in turn reduces the opportinities available to domestic politicians to insulate

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"Doing Business" reports, Djankov discussed:

> Djankov and [others'] (2002) [work] resulted in the World Bank's Doing Business project. Published annually, Doing Business tracks regulatory reforms in 181 economies and documents the fastest reformers. . . . In turn, the new data collection work in the World Bank's Doing Business project, which follows the methodology of Djankov and [others'] (2002) [work], can lead to a further development: a better understanding of the characteristics of governments who reform.

Djankov, *supra* note 36, at 200 (alteration in original) (footnote omitted). *See also Bureaucracy*, *supra* note 35, at 73 ("So far this research has found that making it easier and cheaper to start businesses does indeed reduce the informal sector, create jobs, improve productivity and reduce corruption.").

[119] *Id.*

[120] Andrew P. Morriss, *The Role of Offshore Financial Centers in Regulatory Competition*, *in* OFFSHORE FINANCIAL CENTERS AND REGULATORY COMPETITION 102, 117 (Andrew P. Morriss ed., 2010).

[121] *Id.* at 117-18 (footnote omitted).

[122] *See* Djankov, *supra* note 36, at 184 ("The entry regulation indicators created in Djankov and [others'] (2002) [work] are also used in The Heritage Foundation's *Index of Economic Freedom*, the World Economic Forum's *Global Competitiveness Report*, and the Fraser Institute's *Economic Freedom of the World ranking*. These in

areas of their economies from competition. For instance, the World Bank regularly publishes "Doing Business" surveys, a sort of national competitiveness ranking report.[123] In addition, "[s]ince the World Bank's studies began, businesspeople globally have experienced a slight loosening of the red tape",[124] such as Taiwan's abolition of minimum capital requirements as discussed below. The World Bank notes that "the most dynamic and fastest growing countries continually improve and update their regulatory systems," whereas "the poorest ones plod along under business rules dating from the late 19th century."[125] This phenomenon appears to demonstrate that this sort of ranking reports published by such an international organization as the World Bank drove a variety of jurisdictions to engage in jurisdictional competition for the improvement of national competitiveness, which may be helpful for attracting internationally mobile factors of production. This international jurisdictional competition by improving and updating their regulatory systems may thus spur the relaxation of one of the red tape, minimum capital requirements. In other words, the World Bank's "Doing Business" project has led governments to keep an eye on their national competitiveness in order to boost economic development, which brought about jurisdictional competition through the supply of the less costly regulation on entry, including minimum capital requirements.

To summarize how international jurisdictional competition built up by the World Bank pushed the statutory minimum capital to be relaxed, La Porta and others likewise argue:

> Globalization leads to a much faster exchange of ideas, including ideas about laws and regulations, and therefore encourages the transfer of legal knowledge. Globalization also encourages competition among countries for foreign direct investment, for capital, and for business in general, which must as well put some pressure toward the adoption of good legal rules and regulations . . . . In one area where heavy regulation appears patently absurd—the entry of new firms—countries are rapidly tearing down the barriers.[126]

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turn motivate governments to reform.") (alteration in original). *See also* Clarke, *supra* note 114, at 97 ("An interesting development in recent years has been the explicit promotion of a corporate governance agenda by international financial institutions such as the World Bank, the International Monetary Fund, and the Asian Development Bank.").

[123] *Bureaucracy*, *supra* note 35, at 71 ("What ['Doing Business' reports] measure are the petty bureaucracy and onerous rules that can make life a nightmare for firms. But the findings correlate well with those of wider studies of *national competitiveness*, such as those by the OECD and the World Economic Forum.") (alteration in original) (emphasis added).

[124] *Id.*

[125] *Id.*

[126] Rafael La Porta, Florencio Lopez de Silanes & Andrei Shleifer, *The Economic Consequences of Legal Origins*, 46 J.ECON. LITERATURE 285, 327 (2008). In the context of comparative corporate governance, Donald Clarke might deem this kind of explanation as the theory of economic Darwinian selection:

> This view sees corporate governance as an organizational technology, and firms must adopt the best

Apparently, "Doing Business" reports may play a pivotal role in the worldwide reform of facilitaing incorporations and contribute to the liberalization of minimum capital requirements internationally.[127] Specifically, these reports are also the deregulation measures designed to limit domestic rent-seeking, which in the beginning activates international jurisdictional competition for the capital, know-how and firms. Various jurisdictions' incentives motivated by these reports to compete by supplying cost-effective laws may then lead to a quest for more legal flexibility, or bring about a trend toward the abolition or reduction of minimum capital requirements like domino effects globally. This paper takes advantage of Taiwan's experience below to test how international jurisdictional competition under globalization can produce company law reforms, especially in terms of the abolition of the statutory minimum capital.

2. Taiwan's Abolition of the Statutory Minimum Capital

Taiwan's Company Law follows the legal capital system and civil law approach of requiring a minimum paid-in capital not only for a company limited by shares (an equivalent to an EU public LLC) but also for a limited company (an equivalent to an EU private LLC). Since 1966 the competent authority, Ministry of Economic Affairs ("MOEA"), through the enactment of Paragraph 3 under Article 156 of the Company Law, has generally required a company limited by shares to have a minimum paid-in capital, i.e. NT$ 1 million (about US$

> available technology to survive. With the increased flow of information, lack of knowledge about this technology is no longer an obstacle to its diffusion. Countries that fail to adopt efficient rules will suffer: their corporations will be worth less, and will have a harder time raising capital. Business will suffer, or will move elsewhere.

Clarke, *supra* note 114, at 96-97 (footnote omitted). Therefore, "investors might plausibly threaten to leave (or not to come) if there is not reform." *Id.* at 97.

[127] As Djankov reports,

> [i]n a number of economies the [minimum] capital requirement is still a major obstacle to starting a business: Guinea-Bissau, Ethiopia, Niger, Timor Leste, Togo, Oman, the Central African Republic, Djibouti, Mauritania, Eritrea, Guinea, Mali, Chad, Benin, and the United Arab Emirates. In these countries, an entrepreneur needs to put up at least three times the average annual income to register—and often much more. Aside from Timor Leste, all are in Africa and the Middle East. Until 2007, Yemen came next, requiring 20 times the average annual income. However, in May 2008 the Yemeni government issued a law that reduces the requirement to a nominal value. Jordan did the same. This is one area of reform where the majority of countries that imposed a significant burden have removed it in the past decade. It is often argued that the inclusion of the Djankov and [others'] (2002) analysis in the World Bank's Doing Business project is the primary reason behind this trend . . . .).

Djankov, *supra* note 36, at 188-89 (alteration in original).

34,734 at present). In 1980, Taiwan's government aimed to prevent businessmen from taking the regulatory arbitrage to do business in the form of a limited company. Specifically, they turned into a limited company to avoid the minimum capital requirement for a company limited by shares. Hence, Paragraph 2 under Article 100 of the Company Law was also enacted to impose a minimum capital requirement on a limited company. Likewise MOEA, under the authorization of this provision, generally required a minimum capital, i.e. NT$ 500,000 (about US$ 17,367 at present).[128] Nonetheless, these requirements have not been effectively implemented in Taiwan. This is because these minimum thresholds of NT$ 1 million and 500,000 have not been adjusted for decades. Consequently, "effective thresholds for starting non-financial business actually have been reduced over time."[129]

Perhaps having felt the pressure for an inevitable reform, MOEA in 2008 lowered the statutory minimum capital both for a limited company and for a company limited by shares. In concrete terms, as to the former, the minimum capital for business start-up changed from NT$ 1 million to NT$ 500,000 (about US$ 17,367 at present); as for the latter, from NT$ 500,000 to NT$ 250,000 (about US$ 8684 at present).[130] Nonetheless, in April 2009 these minimum capital rules in Taiwan's Company Law were altogether repealed.[131] As a commentator argued, "[t]he repeal was made to 'enhance Taiwan's competitiveness', because these minimum capital rules put Taiwan's ranking for this topic in the World Bank's 'Doing Business' survey in an extremely unfavorable position."[132] In other words, it was the World Bank's "Doing Business" 2009 survey published in September 2008 that pushed Taiwan's executive and legislative branches to collaborate to swiftly abolish the minimum capital requirements. This abolition, however, would put Taiwan as co-ranking No. 1 in the category of "Paid-in Minimum Capital (% of income per capita)", along with 69 other countries in the world.[133] As the Official Comment to the proposal of abolition notes, minimum capital rules

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[128] Kuo-Chuan Lin, *Er Ling Ling Jiu Nian Shang Ban Nian Gong Si Fa San Ci Xiu Zheng Ping Xi* [*A Comment on Three Amendments to Taiwan's Company Act in the First Half of 2009*], 137 TAIWAN Fa Xue Za Zhi [Taiwan L. J.] 1, 11 (2009) (Taiwan).

[129] Lawrence S. Liu, *Global Markets and Local Institutions: Corporate Law System and Financial Reform Debates in Taiwan* 14 (October 8, 2001), *available at* http://ssrn.com/abstract=293082. *See also id.* ("[T]he minimum paid-up capital requirement has become a deeply embedded part of the regulatory culture in Taiwan. So much so that primary regulators often use this test as an entry barrier to the financial, telecommunications, transportation and other regulated industries.").

[130] Order of Ministry of Economic Affairs, Executive Yuan, Jing-Shang-Zi No. 09702407950 (passed Apr. 24, 2008).

[131] After these dramatic amendments by Taiwan's government, the World Bank's website has noted this reform: "DB2010: Starting a Business: Business start-up by reducing minimum paid-in capital from TWD 1 million to 500,000 in 2008 and abolishing it altogether in April 2009 . . . ." *See* World Bank, http://www.doingbusiness.org/reforms/overview/economy/taiwan,-china (last visited Dec. 20, 2010).

[132] Lawrence S. Liu, Executive Vice President, China Development Financial Holdings, Taipei, Taiwan, Legal Rules for Financial Conglomerates: Taiwanese Perspectives on Post-Crisis Financial Regulation, Address at International Conference on Financial Law Reform, NTU College of Law 7 (June 4, 2010) (transcript available in the Center for Corporate and Financial Law, NTU College of Law).

[133] Officials of MOEA expressed that Taiwan's minimum capital requirements put Taiwan's ranking for this

in Taiwan's Company Law require a minimum capital for a business start-up before incorporation; but what amount of assets must be paid in to an enterprise by its shareholders to meet start-up costs should be decided by respective enterprises. It is not appropriate for the central competent authority (i.e. MOEA) to prescribe one-size-fits-all minimum capital standards.[134] As the Official Comment to the amendment to Company Law § 100 (2) and § 156 (3) adds, the World Bank's "Doing Business" (2009) survey published in September 2008 indicates that Taiwan's paid-in minimum capital is more than 100% of income per capita. This figure puts Taiwan ranked as No. 157 globally for this category. Since a prerequisite to achieving corporate status in terms of the amount of equity capital of a company would be that this amount has been audited and certified by a certified public accountant as sufficient to meet start-up costs, the statutory minimum capital should be repealed in order to improve Taiwan's "doing business" environment and encourage business start-up.

3. Summary

Hence, this paper argues that the competitive pressure of international jurisdictional competition under globalization on Taiwan's government is reflected on the Official Comment to the proposal of abolition of minimum capital requirement that the amendment is aimed to advance Taiwan's ranking in Doing Business surveys published by such an international organization as the World Bank. This case study reveals that the World Bank directed global attention to attracting FDI and other mobile production factors by improving legal infrastructure so as to strengthen national competiveness. The publication of Doing Business surveys was thus intended to compel various countries to engage in international jurisdictional competition by offering the best possible legal product, such as the abolition of

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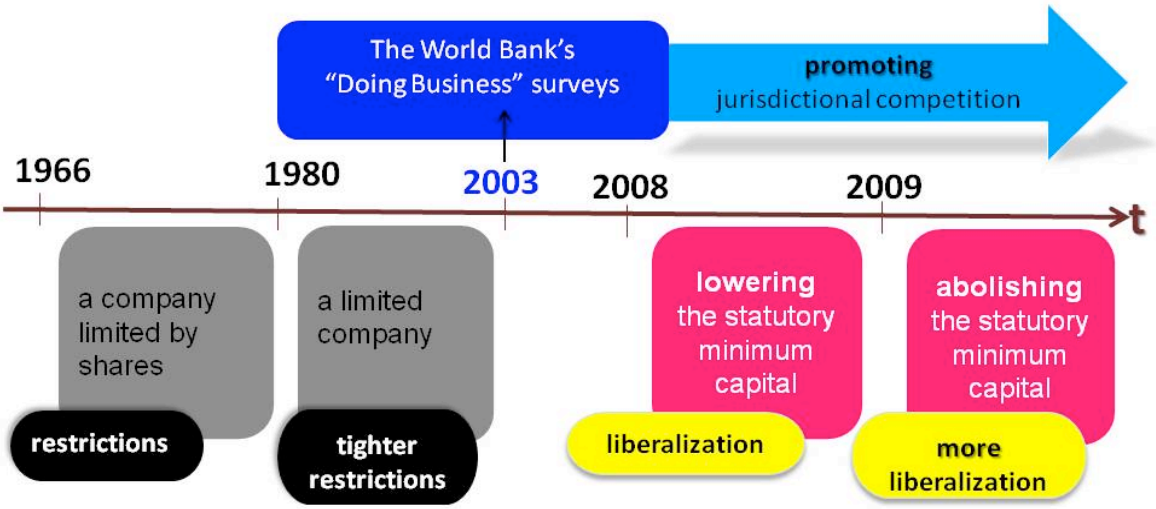
category as No. 157 and its overall ranking as No. 61. Given this embarrassing ranking, MOEA proposed abolishing two provisions in the Company Law regarding the statutory minimum capital. This abolition can advance the ease of starting up a business without the concerns for minimum capital. *Gong Si Zui Di Zi Ben E Xian Zhi Qu Xiao Xing Zheng Yuan Tong Guo Cao An* [*Taiwan's Cabinet Passed a Draft Amendment to Abolish the Minimum Capital Requirements*], FA YUAN FA LÜ XIN WEN [LAWBANK'S L. NEWS] (Taiwan), Jan. 23, 2009, http://www.lawbank.com.tw/news/NewsContent.aspx?AID=6&NID=66945.00&kw=%e5%85%ac%e5%8f%b8%e6%9c%80%e4%bd%8e%e8%b3%87%e6%9c%ac%e9%a1%8d%e9%99%90%e5%88%b6%e5%8f%96%e6%b6%88%7c%e8%a1%8c%e6%94%bf%e9%99%a2%e9%80%9a%e9%81%8e%e8%8d%89%e6%a1%88&TY=1,19,20,21,22&sd=2008-12-11&ed=2010-12-25&total=7 (last visited Dec. 17, 2010).

[134] According to the WEF's Global Competitiveness Report and the World Bank's Doing Business survey, Taiwan's ranking of national competitiveness and the environment to do business finally bounced back in 2009, thanks to its legislature's abolishing minimum capital requirements in April 2009. *See* Shang Zuo Lin, *Zhi Die Fan Tan Quan Qiu Jing Zheng Li Taiwan Pai Ming Di Shi Er* [*Taiwan's Global Competitiveness Ranking Stops Falling and Bounces Back to No. 12*], ZHONG GUO SHI BAO [CHINA TIMES] (Taiwan), Sep. 9, 2009, *available at* http://news.chinatimes.com/2007Cti/2007Cti-Rtn/2007Cti-Rtn-Content/0,4526,110101+112009041400626,00.html.

minimum capital requirements in Taiwan's case.[135] This characteristic is familiar in the European case that ECJ's rulings drove EU member states to engage in jurisdictional competition by facilitating incorporations, the liberalization of the statutory minimum capital in particular. In other words, Taiwan's case of the repeal of the statutory minimum capital shares characteristics with the jurisdictional competitions emphasized in the US and EU federal systems, even though Taiwan's background seems formally different from the phenomena in the West. To be concrete, international jurisdictional competition in Taiwan's case occurred on the national level in the strict sense rather than within federal systems as in the United States or Europe; Taiwan's story, however, implies that law market forces similar to those working as to charter competition within federal systems also function in the international context. Figure 2 outlines how international jurisdictional competition boosted by the World Bank's Doing Business surveys producd Taiwan's abolition of the statutory minimum capital.

Figure 2 **The Evolutionary Process of Taiwan's Minimum Capital Requirements**

[135] Chung-ying Hu, Council for Economic Planning and Development Vice Chairman, noted that the abolition of minimum capital requirements through the amendment to Taiwan's Company Law would help Taiwan attract FDI. *See* Shang Zuo Lin, *Jiang Di Wai Shang She Gong Si Men Kan Ni Xiu Fa* [*Taiwan Plans to Amend Its Company Law to Lower Thresholds of New Firm Creation for Foreign Businesses*], ZHONG GUO SHI BAO [CHINA TIMES] (Taiwan), Nov. 29, 2008, *available at* http://news.chinatimes.com/CMoney/News/News-Print/0,4733,contentx112008112900327,00.html. Thus, Taiwan can be said to engage in the offensive regulatory competition where it may find it in its interest to market their company law to not only domestic but also foreign firms.



V. Concluding Remarks

This paper explains that the pressure of jurisdictional competition drove the US, EU and Taiwan toward the liberalization of minimum capital requirements. Above all, the case of Taiwan demonstrates that such an international organization as the World Bank through annually publishing "Doing Business" surveys since 2003 have been promoting international jurisdictional competition. This jurisdictional competition arguably compelled Taiwan to abolish the statutory minimum capital in 2009. To summarize, Taiwan's case can go roughly like this: jurisdictional competition drove the abolishment of minimum capital requirements where the mobility of capital and firms enhanced by globalization acted as fuel to ignite and maintain the operation of international jurisdictional competition, which eventually led to such a local legal change in Taiwan. Just as Charles Tiebout's (1956) seminal article concerning jurisdictional competition suggests that competitive incentives drive local policies, all these three phenomena regarding the liberalization of minimum capital requirements tell with one accord that jurisdictional competition can drive a change in parochial legal restrictions to a more flexible regime.

The findings in this paper have three important implications. First, by illustrating the impact of jurisdictional competition on minimum capital requirements, this paper shows that jurisdictional competition has long been at work not only across states or nations, but also in different times. Second, this author used to publish a paper which highlighted a lesson learned from the SOX case, where the SOX drove away foreign issuers and then their physical exit provoked a change in the US regulation of non-US issuers. That paper compared the SOX case with another case study, in which Taiwanese firms listed shares overseas to avoid Taiwan's restrictions on outward investment in Mainland China. This comparison aimed to test how law market demand and supply forces (or underlying exit and voice rights) interplayed under international jurisdictional competition. In brief, both of the SOX and Taiwanese cases in terms of international listing markets implied that with somewhat disparate difference from the corporate law market under federalism in the US, there were a general law market forces at work internationally.[136] As discussed above, by describing how jurisdictional competition leads to the liberalization of minimum capital requirements, this paper again demonstrates that while there are some differences among them, the similar law market dynamics underlying jurisdictional competition operates, no matter under federalism, such as the US or EU federal system, or in the international setting, such as Taiwan's case. Third, by echoing the argument made by O'Hara and Ribstein that jurisdictional competition provides a significant check on governments, this paper argues that jurisdictional competition also serves as a restraint on the sort of jurisdiction that overlooks business demands for legal flexibility. Specifically, imposing outdated regulation such as statutory minimum capital would not necessarily work because of jurisdictional competition– there are many other places the would-be regulated firms can go. And the unwanted, unreasonable or unsuitable regulatory propensity will drive out the most mobile residents and investors. In addition, potential exit of firms (threats of exit) can be a powerful way to discipline a jurisdiction where political discipline is profoundly weak. So the less mobile businesses and individuals end up paying the costs in the short run. It's too late for these firms, but a lesson not lost on other firms thinking about moving to or expanding in the regulating jurisdiction. So in the long run the regulating jurisdiction loses. In short, this paper exhibits that the demand force of regulated firms seeking less strict rules, through mobility and exit, finally gets the regulating jurisdiction into the jurisdictional competition by supplying less strict legal restrictions, or rather the liberalization of minimum capital requirements in the US, EU and Taiwan.

Finally, would such company law reforms discussed above in practice encourage

[136] *See generally* Chang-hsien Tsai, *International Jurisdictional Competition under Globalization: From the U.S. Regulation of Foreign Private Issuers to Taiwan's Restrictions on Outward Investment in Mainland China*, ASIAN J. L. & ECON. Vol. 2, Iss. 1, Art. 5 (2011), *available at* http://www.bepress.com/ajle/vol2/iss1/5.

entrepreneurship more generally? As illustrated by Braun and others' (2011) study in the EU case,

> the surge in incorporations is greatest in France, Germany and Poland where the statutory minimum capital requirement was lowered or abolished. As to the effect on entrepreneurial activity more generally, we find that the legal changes not only boosted incorporations of private LLCs but also raised the total number of new firms. This result holds even if one takes possible substitution effects with UK private LLCs, partnerships and (in the case of Germany) "registered merchants" into account. These empirical results strongly support our theoretical predictions that reducing the costs of registering LLCs fosters incorporations as well as general start-up activity irrespective of legal form. Cutting regulatory costs of incorporating increases the expected value of doing business. . . . [W]hat our evidence shows is that lower incorporation costs accomplish more than just inducing would-be entrepreneurs to switch to the private LLC in order to enjoy limited liability; they succeed in fostering overall start-up activity.[137]

In other words, the study by Braun and others clearly countenances "the conclusion that facilitating private LLC incorporations leads to a net growth in start-up activity."[138] Simply speaking, using the EU case, their study proves a positive claim that "regulatory competition increases entrepreneurial activity."[139] Meanwhile it might validate the normative claim that "'law matters': If the opportunity to opt out of a restrictive legal regime causes more new firms to be set up then, apparently, cutting regulation is a way to foster entrepreneurship."[140] Nonetheless, given that their study exhibits the mere EU case under a federal system similar to the US[141] that jurisdictional competition promoted a tendency towards less strict regulation on entry (including minimum capital requirements) and then increased entrepreneurial activity, future research may be needed to focus on whether a pure "international" jurisdictional competition (where nations or jurisdictions are not bound in a federal system) forcing the abolishment of statutory minimum capital in Taiwan would further facilitate Taiwan's actual incorporations in particular and economic development in general.

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[137] Braun et al., *supra* note 3, at 31. *See also* KRAAKMAN ET AL., *supra* note 36, at 130-31 ("[T]he reduction or abolition of minimum capital rules throughout Europe appears to be associated with an increase in entrepreneurship."). To the World Bank, it may also be its original intention and desired outcome in publishing "Doing Business" surveys that slashing regulatory costs of incorporating would increase the expected value of doing business.

[138] Braun et al., *supra* note 3, at 28.

[139] *Id.* at 3.

[140] *Id.*

[141] O'HARA & RIBSTEIN, *supra* note 1, at 224 ("[T]he distinguishing feature of a federal system is the existence of a federal government to maintain balance among the subordinate jurisdictions.").