EU Corporate Law: Time for Cutting Red Tape

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The sovereign debt-crisis requires affected countries to make debt- service sustainable in the short and the long term. There is no easy way to do it, but it is clear to all that fiscal discipline will not be enough. Spurring private-sector growth is imperative. Better conditions for private-sector growth require that red tape (broadly defined to include both the costs stemming from interaction with the State and those arising from rules with no countervailing benefits) be reduced. The obvious reason for this is that red tape lowers return on investment and therefore discourages investment. Because red tape costs are, at least in part, fixed, it discourages small businesses more than large ones. New entrants will be less in number, and competition less intense. The pressure in competitiveness will hence be lower as well. Red tape can be the outcome of national and international regulations. European regulations are often the ultimate, the immediate or the incidental source of red tape.[1] Ultimate: when new strings follow regulations devised at the European Union (EU) level for the first time. Immediate, as is more often the case: **when national regulations present here and there become petrified** by EU regulations applicable to all. Incidental: when implementation of EU rules are the occasion for local bureaucrats and vested interests to impose more red tape than the EU would strictly require.

Corporate governance is about how companies are directed and controlled. Lots of rules and regulations now dictate the terms of how this is done. And more are to come, judging from how active the Directorate General for Internal Market is being of late. Some of the existing and prospective rules are of course justified, but others would not withstand a rigourous and unbiased cost-benefit analysis. It is, of course, upto the individual Member States to revise their company laws to dispose of red tape rules and regulations that are not imposed by the EU. It would, however, greatly help individual countries if the EU itself revised its own set of corporate governance (company law and securities regulation) rules for the purpose. In doing so, the EU could even recommend a similar course of action by individual Member States. And, it could even prompt Member States to make their own company laws more flexible and business-friendly by itself introducing opt-in regimes in various areas. Group law could be one of these, although more flexibility in this area should not come at the expense of investor protection. A flexible regime for corporate groups, in this author's view, should be limited to relationships between wholly owned companies or between companies with minority shareholders and their own subsidiaries. Alternatively, the consent of all existing shareholders should be needed to opt into the flexible regime. If that means leaving controlled listed companies out, that should be fine. The potential for expropriation via intra-group (related party) transactions in listed companies is simply too great for the EU to run the risk of facilitating it.

There are plenty of areas where a red tape review of EU company law could be carried out, not exclusively for Small and Medium Enterprises, as the European Commission has already been trying. For instance, disclosure, financial reporting and audits are areas in which the costs for listed companies are significant and not always proportionate. A rethink of all the rules in these and other company law areas, subjecting each rule to a rigorous cost-benefit analysis and proportionality test is desirable. Of course, it is politically impracticable to propose, e.g., less rather than more transparency or a regulatory environment that while liberating resources, increases risk rather than reduce it. Political impracticability also follows from the fact that it is never easy to reshape rules in a way that reduces rents for private and public interest groups.

To succeed (or to go anywhere), a reassessment of European company law to cut red tape should come with two features. First, it should go together with an increase in the safeguards for investors against the risk of expropriation by managers and controlling shareholders, i.e. address the quintessential core of company law. Expropriation can come in many ways, the most typical being conflict-of-interest transactions and trading on the basis of inside information. Existing rules that directly tackle this kind of misbehaviour should remain in place and be strengthened. For instance, rules requiring disclosure of trades by insiders in the proposed Market Abuse

* Opinions expressed here are exclusively the author's and do not necessarily reflect those of Consob.

1 See Enriques, *EC Company Law Directives and Regulations: How Trivial Are They?* 27 U. Pa. J. Intl. Econ. L. 1, 46–49 (2006).

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Regulation should be extended to controlling shareholders. New rules could be devised in the area of conflict-of-interest transactions, e.g. by providing for a European whitewash procedure (approval by a majority of the minority) for very large self-dealing transactions. Such a development alone would not make the rethink of EU company law suggested here easier. Needless to say, controlling shareholders are a powerful lobby that would coalesce with other vested interests to oppose change. Therefore, and also to tackle the resistance of all interest groups extracting rents from current company law rules, the rethink should deal exclusively with companies that will become publicly listed in the future, while leaving existing companies (and those extracting rents from them) alone. Regulatory dualism, as Gilson, Hansmann and Pargendler call it,[2] could be the solution to enhance European capital markets without affecting existing rents. A new regime, lighter in terms of strings attached to ordinary course of business, non-conflicted decisions, and specifically and effectively addressing expropriation by managers and dominant shareholders, could be one way ahead. To avoid the possible stigma of a lighter regime in many areas, newly listed companies would not be exempt from existing EU rules and regulations, but rather free to opt out of them, whether selectively or as a whole. And, of course, they should be free to choose between the old (current) regime and the new (rent-averse) one.

2 Hansmann Gilson & Pargendler, *Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the United States, and the European Union*, 63 Stan. L. Rev 475 (2006).