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Passports, Private Choice, and Private Interests:
Regulatory Competition and Cooperation
in Corporate, Securities, and Bankruptcy Law
Frederick Tung*

INTRODUCTION

Generally speaking, nations regulate on a territorial basis. Each state regulates transactions and entities within its territory. Regulatory competition proponents are generally suspicious of the ability of government to regulate efficiently, asserting that regulatory regimes tend to be captured by private interests that manipulate regulation in order to redistribute wealth in their direction. Ideally for regulatory competition advocates, allowing regulated entities to choose the regulatory regime that will govern their affairs—"private choice"—will generate more efficient regulation. Private choice breaks the "regulatory monopolies" enjoyed by regulators under the dominant territorial approach.¹ In the areas of corporate, securities, and bankruptcy law, it forces governments and their regulators to compete to offer regulation that firms and their investors prefer. In the face of private choice, the argument goes, regulators *will* compete, since regulatory bureaucracies wish above all else to augment their own prestige. They do this by maximizing the number of firms and transactions under their regulatory purview.

Among scholars of international regulatory reform, harmonization is often viewed as the polar opposite—the nemesis—of competition.² While competition calls

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1. Unless the context otherwise implies, I use the term "regulator" generically, to refer to a government actor who makes or enforces legal rules.
2. See, for example, Roberta Romano, *The Need for Competition in International Securities Regulation*, 2 *Theoretical Inquiries L* 387, 396 (2001) ("The potential need for regulatory diversity as a justification for facilitating securities regulation competition, as is true of most arguments in support of competition, is also an argument against regulators' top-down efforts to effect international regulatory harmonization.").

for a diversity of regulatory regimes promulgated by rivalrous lawgivers from various jurisdictions, each striving to satisfy consumer demand in a global market for law, harmonization implies standardization of substantive rules across multiple jurisdictions. Far from putting competitive pressure on regulators, according to this view, harmonization merely extends across national borders the reach of regulators' stodgy monopolies.³

Harmonization and competition, however, may not necessarily be antipodal in all contexts. Far from incompatible, competition and harmonization may be complements in some circumstances. In particular, competition requires harmonization on choice of law. Competition requires states to allow private actors implicitly or explicitly to opt out of territorial regulation. A decision to exit must be respected in order for competition to emerge. From a political economy perspective, some degree of harmonization of substantive rules may also facilitate competition. Establishing a common baseline—a set of minimum requirements—among states may enable political deals that allow competition as to remaining aspects in an area of regulation.

In this article, I discuss regulatory competition in the related areas of corporate, securities, and bankruptcy law. As all of these areas address firms' relations with investors, they share an affinity that offers a natural focus of inquiry. I contrast two different forms that regulatory competition may take. The first is private choice, or what I call "direct competition." In this arrangement, firms are free to elect the regulatory regime that will govern their affairs, regardless of the location of a firm's assets, personnel, registered office, or transactions. The paradigmatic example is corporate charter competition among US states. The second form of competition I refer to as the "regulatory passport" arrangement, which has also been variously described as "mutual recognition" and "reciprocity."⁴ In this scenario, states agree to recognize the extraterritorial reach of firms' home country regulatory regimes, forswearing territorial regulation by host countries.

Harmonization over choice of law rules is necessary for both these forms—facilitating the competition that results. In the case of direct competition, states' agreed choice of law rule is to defer to each firm's private choice of regulation. In the

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3. See Enrico Colombatto and Jonathan R. Macey, *A Public Choice Model of International Economic Cooperation and the Decline of the Nation State*, 18 *Cardozo L Rev* 925, 951–53 (1996) (characterizing SEC efforts at international coordination of insider trading enforcement as attempt to preserve its own authority).
  4. See Howell E. Jackson and Eric J. Pan, *Regulatory Competition in International Securities Markets: Evidence from Europe in 1999—Part I*, 56 *Bus Law* 653, 662 (2001) (describing EU securities regulatory scheme of mutual recognition as "passport" system); Hal S. Scott, *Internationalization of Primary Public Securities Markets*, 63 *L & Contemp Probs* 71, 80 (2001) ("mutual recognition"); Stephen J. Choi and Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 *S Cal L Rev* 903, 918 (1998) ("normal reciprocity").

case of the regulatory passport, states agree to apply each firm's home country law. In addition, a regulatory passport system typically involves some harmonization of substantive rules as a condition to allowing extraterritorial effect to home country regulation.

These two forms of regulatory competition are distinguishable along several dimensions, however, a point that is sometimes obscured. Some analysts have tended to lump regulatory passport arrangements together with direct competition when discussing the promise and prospects of regulatory competition generally. Regulatory passport arrangements appear to be much more common than instances of direct competition, and some seem fond of characterizing passport systems as a step "toward" direct competition.⁵ Others do distinguish the two forms, recognizing limits to particular passport arrangements in terms of firm mobility and competitive pressure on regulators.⁶ In this article, I offer a general discussion of the competitive promise of regulatory passports, contrasting the ideal type with direct competition and with the regulatory passport arrangements that exist. Throughout the discussion, in keeping with the theme of this symposium on exploring the need for international harmonization, I highlight the role that harmonization plays in enabling competition.

Care should be taken not to conflate direct competition with regulatory passports. Not only are the competitive effects very different, but the politics are as well. Structurally, direct competition would likely be far more effective than a regulatory passport system at placing competitive pressures on lawmakers. However, questions exist concerning the prospects for achieving the choice of law harmonization necessary for direct competition, which must overcome entrenched interests of regulators and their important constituents. I suggest these political obstacles are likely to prevent development of the requisite choice of law cooperation. Direct competition among US states over corporate charters may be a peculiarity of the US federal system. Similar political considerations suggest that regulatory passport systems are more likely to emerge. Even with regulatory passports, though, political considerations in the negotiation and implementation of such arrangements will tend to blunt the competitive pressures meant to be focused on national regulators.

5. See Jackson and Pan, 56 Bus Law at 663 (cited in note 4) ("The principle of mutual recognition has been associated with regulatory competition since its inception."); Howell E. Jackson, *Centralization, Competition, and Privatization in Financial Regulation*, 2 Theoretical Inquiries L 649, 658 (2001) (referring to US-Canadian Multijurisdictional Disclosure System (MJDS) as "Delawarization" of US securities laws); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 Yale L J 2359, 2420 (1998) (relying on MJDS as "precedent" for private choice proposal).
6. See Choi and Guzman, 71 S Cal L Rev at 920 (cited in note 4) (noting theoretical possibility for competitive pressure from US-Canadian Multijurisdictional Disclosure System (MJDS) and other reciprocity arrangements, but also recognizing drawbacks); Scott, 63 L & Contemp Probs at 81-85 (cited in note 4) (critiquing MJDS and EU mutual recognition for securities offerings).

In part I, I describe direct competition and obstacles to its achievement. In particular, the assumed pursuit of private interests by regulators—so central to the case for regulatory competition—will likely drive regulators to block the emergence of direct competition. Part II discusses the regulatory passport arrangement. It first describes in ideal terms the more indirect competition offered by regulatory passport systems. It then discusses private interests and other factors that may often surface to blunt competitive pressures. As part of this analysis, part II also contrasts passport systems with direct competition. Part III turns to the political economy of regulatory passports, offering a private interest explanation for their popularity as compared to private choice. Throughout the analysis, I accept the basic public choice assumptions favored by regulatory competition proponents—that regulators generally pursue their private interests and those of important constituents, and that regulators' primary goal is to augment their regulatory authority by maximizing the number of firms and transactions under their purview.⁷ In addition, I assume away any problems on the demand side. For purposes of my discussion, I assume that firm managers are sufficiently motivated to seek regulation that maximizes firm value and that equity and debt markets can efficiently price regulatory regimes.⁸ My interest is in the supply side, in the role of private interests in affecting regulatory competition.

I. DIRECT COMPETITION AND CHOICE OF LAW HARMONIZATION

Corporate charter competition in the US probably offers the best example of direct competition, regulatory competition in its pure form. Each state offers its own corporation law, and the states share a choice of law rule—the so-called internal affairs rule—that enables competition among them. Under the internal affairs rule, a firm may incorporate under the corporation law of any state, and as to its internal affairs—the relations among the firm's shareholders and managers—the firm's chosen law will be respected by all the states, regardless of the location of the firm's headquarters, assets, or personnel, and regardless of where particular transactions occur or particular persons reside.⁹ The ability of corporations to operate nationwide under the state corporate law of their choosing in effect creates a common market for corporate law, with states acting as producers competing nationwide for consumers of corporate law. Because states may garner significant fees with successful sales of corporate charters, as well as benefit local constituents, they have some incentive to

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7. See Romano, 2 *Theoretical Inquiries* L at 393 (cited in note 2) ("[R]egulators prefer to have within their jurisdiction more rather than fewer regulated firms and transactions.").

8. Compare James D. Cox, *Regulatory Duopoly in U.S. Securities Markets*, 99 *Colum L Rev* 1200, 1234 (1999) (questioning whether securities markets can efficiently price differences among regulatory regimes).

9. A handful of states—California and New York most notably—impose their own local requirements on certain foreign corporations as to certain issues. See Cal Corp Code § 2115 (West 1990); NY Bus Corp Law § 1320 (McKinney 1986).

offer corporate law that firm managers and investors prefer. According to advocates of regulatory competition, this competition among states produces corporate law that maximizes firm values and investor returns.¹⁰

While scholars debate the merits of US corporate charter competition,¹¹ some also rely on it as a model for international regulatory competition, both in corporate law¹² and in areas related to corporate law, namely securities regulation¹³ and bankruptcy.¹⁴ However, in making this move from competition among US states over corporate law to global or regional regulatory competition among nations, proponents have paid insufficient attention to the choice of law cooperation among US states that enables US corporate charter competition. The internal affairs rule is a critical component in enabling competition for corporate charters. That an appropriate choice of law convention could emerge among US states in a federal system does not necessarily suggest the same dynamics will occur among nations. Not that they could not, but they have not, and there may be good reason to think they will not.

In order for competition to occur in similar form internationally, nation-states would have to harmonize their choice of law rules, agreeing to honor firms' private choices regarding applicable corporate, securities, or bankruptcy law. Considerations of international political economy suggest that obstacles exist to the achievement of the required harmonization. In particular, regulators and other private interests may have significant stakes in the territorial monopolies that comprise the status quo. Their influence may be sufficient to block the required choice of law cooperation.

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10. See Roberta Romano, *The Genius of American Corporate Law* 14–51 (AEI 1993).
  11. Compare id; Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law* 212–27 (Harvard 1991), with Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 Harv L Rev 1435 (1992); Lucian Arye Bebchuk and Allen Ferrell, *Federalism and Corporate Law: The Race to Protect Managers from Takeovers*, 99 Colum L Rev 1168 (1999); Marcel Kahan and Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 Cornell L Rev 1205 (2001); Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 Colum L Rev 1908 (1998).
  12. See Joseph A. McCahery and Erik P.M. Vermeulen, *The Evolution of Closely Held Business Forms in Europe*, 26 J Corp L 855 (2001) (discussing prospects for US-style regulatory competition over smaller business forms within EU). See also Simon Deakin, *Regulatory Competition Versus Harmonization in European Company Law*, in Daniel C. Esty and Damien Geradin, eds, *Regulatory Competition and Economic Integration: Comparative Perspectives* 190 (Oxford 2001) (discussing prospects for US-style corporate charter competition in EU).
  13. See Choi and Guzman, 71 S Cal L Rev at 936 (cited in note 4); Romano, 2 Theoretical Inquiries L 387 (cited in note 2). See also Romano, 107 Yale L J at 2359 (cited in note 5) (arguing that issuer of securities in the US should be able to choose securities regulatory regime from among the federal regime and those of the fifty US states, and that choice set for foreign issuer should also include its home country regime).
  14. See Robert K. Rasmussen, *A New Approach to Transnational Insolvencies*, 19 Mich J Intl L 1 (1997); Robert K. Rasmussen, *Resolving Transnational Insolvencies Through Private Ordering*, 98 Mich L Rev 2252 (2000).

Regulators' assumed incentives—the desire to augment their regulatory authority—would theoretically drive them to compete over substantive rules in the face of direct competition. But those same incentives would likely also drive them to resist competition in the first place. Regulators and their important constituents are likely to offer significant resistance to any attempt to create competitive regulatory markets. For a given area of regulation, within each country private interests are likely to exist that have a strong stake in maintaining territorial regulation. These private interests may enjoy increasing returns from their mastery of the regulatory regime at issue. Especially when a regulatory bureaucracy exists whose sole purpose is to administer the regulation, that bureaucracy is likely to be an effective opponent of choice of law harmonization that would enable firms' easy exit. The bureaucracy and its constituents are likely to be well organized, with high per capita stakes in opposing competition.¹⁵

For instance, securities regulatory commissions exist in most industrial countries with active securities markets. National securities regulators would be unlikely to support any policy that might impinge on their regulatory monopolies. If regulators care about bureaucratic aggrandizement, they would certainly oppose rules enabling firms' easy exit from their regulatory purview. Securities lawyers and securities industry professionals as well would likely have large stakes in maintaining territorial regulation. A US securities lawyer's expertise will be in US securities regulation. A Japanese securities lawyer will be an expert in her local regulatory regime. Each will be territorially bound. As with regulators, their interests will generally be in preserving the value of their territorial expertise, which may diminish in value with competition driven by private choice.

With company law, the EU has been at the center of scholarly focus in terms of the potential for the development of direct competition, especially after the *Centros* decision of the European Court of Justice.¹⁶ But even optimistic analysts concede that professionals interested in the status quo may offer formidable resistance to reforms that threaten their livelihoods.¹⁷

In bankruptcy as well, both government and private actors may have significant nondiversifiable human capital investments in local regulation. In the US, for

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15. See Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Schocken 1965). Consider George J. Stigler, *The Theory of Economic Regulation*, 2 *Bell J Econ & Mgmt Sci* 3 (1971); Sam Peltzman, *Toward a More General Theory of Regulation*, 19 *J L & Econ* 211 (1976).

16. Case C-212/97, *Centros Ltd v Erhvervs-og Selskabsstyrelsen*, 1999 ECR I-1459, [1999] CMLR 551 (1999). See McCahery and Vermeulen, 26 *J Corp L* 855 (cited in note 12); Deakin, *Regulatory Competition versus Harmonization* (cited in note 12); Werner F. Ebke, *Centros—Some Realities and Some Mysteries*, 48 *Am J Comp L* 623 (2000).

17. See McCahery and Vermeulen, 26 *J Corp L* at 876 (cited in note 12) (discussing influence of notaries—lawyers specially qualified for incorporations, with a “well-entrenched position and proximity to the lawmaking process”—in blocking emergence of new business forms).

any harmonized company law that eliminates their participation,²⁰ and they would no doubt oppose private choice as well, which would allow German firms to opt out of the local company law that guarantees labor participation. Similarly, employees in France, Mexico, and South Korea enjoy priority in bankruptcy for their claims for unpaid prebankruptcy wages. These wage claims are senior to the claims of secured creditors.²¹ The existence of this bankruptcy priority suggests that labor interests in these countries might also enjoy political clout sufficient to resist any choice of law reform that would imperil it. While such distributional benefits of local law may or may not offer sufficient stakes to galvanize beneficiaries—in these examples, labor interests—to actively oppose private choice on their own, at the very least, they would provide allies for territorially bound regulatory experts intent on preserving the worth of their human capital.

What about corporate charter competition in the US? Why did private interests not frustrate the widespread acceptance of the internal affairs rule that enables competition among US states? Analysts disagree as to the relative importance of constitutional influences on the evolution of the internal affairs rule and the national market for corporate law.²² However, even on the most decentralized, bottom-up view of things—that each state unilaterally and independently arrived at the internal affairs rule—constitutional guarantees of unimpeded interstate commerce played a critical role. According to this view, without state-by-state trade barriers, firms could generally avoid unattractive corporate law by simply moving out of an unattractive jurisdiction, while continuing to sell products into the unfriendly jurisdiction.²³ This relatively easy exit option meant that a state had little to gain and something to lose—in terms of local tax base, business opportunities, employment, and other positive spillovers—by attempting to impose local corporate law in the face of a firm's election of another state's law. Therefore, local interests would have favored local recognition of out-of-state incorporation, supporting the internal affairs rule and precluding the

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20. See Deakin, *Regulatory Competition versus Harmonization* at 190 (cited in note 12).

21. See Soogeun Oh, *Creditor Rights in Insolvency Procedure 2*, prepared for presentation at *Insolvency Systems in Asia: An Efficiency Perspective*, OECD conference, Sydney, Australia (Nov 29–30, 1999), available online at <<http://www.oecd.org/pdf/M000015000/M00015678.pdf>> (visited Sept 15, 2002) (concerning South Korea); American Law Institute, *Transnational Insolvency Project: International Statement of Mexican Bankruptcy Law* 71 (tentative draft Apr 15, 1998) (concerning Mexico); Philip R. Wood, *Principles of International Insolvency* 24 (Sweet & Maxwell 1995) (concerning France).

22. See Bruce H. Kobayashi and Larry E. Ribstein, *Contract and Jurisdictional Freedom*, in F.H. Buckley, ed., *The Fall and Rise of Freedom of Contract* 325, 333 (Duke 1999).

23. Territorial application of local corporate law typically involves rules to protect local investors, and exercise of prescriptive jurisdiction is typically based on the predominance of firm assets, employees, sales, income, or investors in the prescribing jurisdiction. See Cal Corp Code § 2115; NY Bus Corp Law § 1320.

example, a separate bankruptcy court system exists—employing hundreds of bankruptcy judges, trustees, and court personnel—to administer US bankruptcy proceedings. Public company debtors and creditors employ legions of lawyers, accountants, investment bankers, and other consultants in order to navigate the US corporate bankruptcy process. The stock in trade of this bankruptcy “industry” is its expertise in the US system. If local firms were free to exit by selecting the bankruptcy regime of another jurisdiction, the local bankruptcy industry would suffer.

The government and private actors who deal in local regulatory expertise are likely to be powerful interest groups in each country. They will be concentrated, well organized, and well financed. Especially with the perceived complexity of securities regulation and bankruptcy law, regulators and administrators are likely to enjoy significant information advantages over legislators and are likely to wield significant influence with respect to any major reform proposals that affect their interests.¹⁸ By contrast, while firm managers and investors might appreciate the value-enhancing effects of private choice, their personal interests in private choice are not likely to be as concentrated as the interests of prospective opponents of direct competition. Firm managers have survived under the status quo in which they find themselves. Their livelihoods will not generally depend on securing new latitude to opt out of their local corporate, securities, or bankruptcy law. Firm managers may have personal stakes in *particular* aspects of regulation, namely, those provisions that affect the stability of their managerial positions.¹⁹ However, their willingness to dedicate resources and attention to securing private choice harmonization is unlikely to match that of its opponents to defeating it. Anticipating this mismatch, putative beneficiaries of private choice harmonization are unlikely to initiate efforts toward that goal.

Particular interest groups may also have specific stakes in the distributional consequences of local law. Labor groups in Germany, for example, enjoy representation on the supervisory boards of public companies. This “co-determination” system has no counterpart under UK company law, and this critical difference between German and UK company law has been a significant impediment in the formulation of an EU company law. German labor organizations have opposed

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18. See William A. Niskanen, Jr., *Bureaucracy and Representative Government* 30 (Aldine 1971) (“Although the nominal relationship of a bureau and its sponsor is that of a bilateral monopoly, the relative incentives and available information, under most conditions, give the bureau the overwhelmingly dominant monopoly power.”); Bruce G. Carruthers and Terence C. Halliday, *Rescuing Business: The Making of Corporate Bankruptcy Law in England and the United States* 74 (Clarendon 1998) (describing conditions for “professional dominance” in financial lawmaking).

19. We would expect, for example, to see firm managers lobby in favor of rules facilitating takeover defenses and inhibiting tender offers. See Bebchuk and Ferrell, 99 *Colum L Rev* at 1168 (cited in note 11); David D. Haddock and Jonathan R. Macey, *Regulation on Demand: A Private Interest Model, with an Application to Insider Trading Regulation*, 30 *J L & Econ* 311 (1987) (offering public choice explanation for insider trading rules, including firm managers’ influence in obtaining passage of Rule 14e-3 to inhibit arbitrageurs from aiding hostile tender offers).

formation of interest groups favoring territoriality in corporate law.²⁴ On this view, put simply, the threat of firms' physical exit to avoid a state's undesirable corporate law forced each state to offer virtual exit—avoidance of the unattractive local law without the need for physical exit—through adoption of the internal affairs rule.²⁵

Interstate commerce and relations among states in a federal system are quite different from relations among independent nations. Within each independent nation, national regulation of firm-investor relations, combined with the historical difficulties of firms' physical exit from their home jurisdictions, would not surprisingly produce interest groups with stakes in territorial regulation. These interest groups will wish to preserve regulatory monopolies, making direct competition unlikely. The history of the US states is decidedly different.

II. REGULATORY PASSPORT SYSTEMS

The difficulties for direct competition described above do not mean that nations will not compete in terms of regulation. However, the competition is likely to take more indirect forms. One scenario that we already observe and that has generated scholarly commentary is the "regulatory passport" arrangement, which is essentially organized extraterritoriality.²⁶ Nations agree under this sort of arrangement that in a particular area of regulation, and under given conditions, a firm from Country A engaging in a transaction in Country B will come under the regulatory regime, not of Country B—as traditional territoriality would dictate—but of Country A, the firm's home country.²⁷ The Country A firm in effect carries a "regulatory passport" from its home country, allowing it to transact in host Country B while remaining under the regulatory purview of its home country. The firm's home country regulatory regime "travels" with the firm with respect to its activities in the host country.

In this part, I first describe in ideal terms the basic structure and competitive promise of the regulatory passport arrangement. I then discuss the role that private interests and other factors may play in shaping passport arrangements so as to blunt

24. See Kobayashi and Ribstein, *Contract and Jurisdictional Freedom* at 333 (cited in note 22); William J. Carney, *The Political Economy of Competition for Corporate Charters*, 26 J Legal Stud 303, 312 (1997).

25. States' other obvious alternative—reforming the unattractive aspects of their corporate laws—has apparently also been pursued. Scholars have noted the substantial uniformity across states' corporate law statutes. See Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J L, Econ, & Org 225, 235 (1985); Bernard S. Black, *Is Corporate Law Trivial?: A Political and Economic Analysis*, 84 Nw U L Rev 542, 588–89 (1990).

26. Others have also used the "passport" metaphor. See Jackson and Pan, 56 Bus Law at 662 (cited in note 4) (describing EU securities regulatory scheme of mutual recognition as "passport" system). This regulatory arrangement has also been referred to as "mutual recognition," see Scott, 63 L & Contemp Probs at 80 (cited in note 4), and "normal reciprocity," see Choi and Guzman, 71 S Cal L Rev at 918 (cited in note 4).

27. "Home country" is generally understood to mean the jurisdiction in which the firm's headquarters or principal place of business is located.

firm mobility and competitive pressure on regulators. Finally, I compare the regulatory passport system to direct competition as a structure for inducing competition. The regulatory passport offers firms some flexibility, and while it bears some family resemblance to direct competition, a closer look shows that benefits to firms—and competitive pressure on regulators—are likely to be decidedly narrower than under direct competition.

A. COMPETITIVE PROMISE

To take a simple two-country example from securities regulation, the postulated benefit to firms from a two-country passport arrangement is that each firm in both countries has only to comply with its own domestic regulatory regime—plus some harmonized rules—in order to be able to sell securities in both jurisdictions. Firms in each country are relieved from having to comply with the territorial regulation that would otherwise apply when issuing securities in their non-home country. A firm in effect relies on its regulatory passport to “exit” from the host country regulatory regime while engaging in economic activity there.

Examples of regulatory passport arrangements include (a) the Multijurisdictional Disclosure System (“MJDS”) between the US and Canada with respect to securities offerings;²⁸ and (b) two related EU directives on securities offerings: the newly adopted EU Listing Particulars Directive (the “New LPD”),²⁹ pursuant to which an issuer with securities listed on its home country exchange may list as well on the exchanges of other member states without full compliance with the listing requirements of those other exchanges; and the EU Public Offers Directive (“POD”),³⁰ under which a firm’s home country public offering documents may be used to make a public offering in other member states. In addition, universalism in bankruptcy, an arrangement that has been popular with scholars but not with

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28. See Multijurisdictional Disclosure and Modifications to the Current Registration and Reporting System for Canadian Issuers, 56 Fed Reg 30036 (1991) (hereinafter SEC MJDS Release); Notice of National Policy Statement No 45, 14 OSC Bull 2844 (1991) (hereinafter CSA MJDS Policy Statement).

29. The complete title is Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the Admission of Securities to Official Stock Exchange Listing and on Information to be Published on Those Securities. See Council Directive 2001/34/EC, 2001 OJ (L 184) 1 (repealing Council Directive 79/279/EEC, 1979 OJ (L 66) 21; Council Directive 80/390/EEC, 1980 OJ (L 100) 1; Council Directive 82/148/EEC, 1982 OJ (L 62) 22; Council Directive 87/345/EEC, 1987 OJ (L 185) 81; Council Directive 88/627/EEC, 1988 OJ (L 348) 62; Council Directive 90/211/EEC, 1990 OJ (L 112) 24; Council Directive 94/18/EC, 1994 OJ (L 135) 1).

30. Council Directive 89/298/EEC, 1989 OJ (L 124) 8. See also Proposal for a Directive of the European Parliament and of the Council on the Prospectus to be Published when Securities are Offered to the Public or Admitted to Trading, 2001/280 final—2001/0117(COD), 2001 OJ (C 240 E) 272 (proposing to supersede Council Directive 89/298/EEC).

lawmakers in any nation,³¹ has a similar structure. Under universalism, the bankruptcy regime of the debtor's home country would govern the disposition of the debtor's assets on a worldwide basis, displacing the traditional territorial jurisdiction of the various states in which those assets are located. Regulatory passports are a staple of EU regulatory coordination in other areas as well. The Investment Services Directive ("ISD"), for example, which addresses the activities and regulation of investment firms throughout the EU, establishes a passport arrangement.³² While not directly related to firm-investor relations, ISD has had significant effects on securities market structure within the EU.³³

Regulatory passport arrangements involve competition and harmonization, but in a different relationship from the direct competition scenario described in part I above. Direct competition involves harmonization of choice of law rules honoring firms' private choice of regulatory regime. By contrast, with regulatory passport systems, harmonization typically occurs along a substantive dimension, as well as with respect to the choice of law rule honoring home country regulation. Agreement to honor the home country's extraterritorial regulation is typically conditioned on harmonization of minimum substantive standards. Countries negotiate to harmonize certain substantive rules deemed fundamental in an area of regulation. These shared substantive rules form a common baseline among participating countries, beyond which each country is free to deviate. Provided that the particular cross-border transaction complies with the agreed baseline regulations, participating nations agree to honor the extraterritorial reach of the home country's regulatory regime, which displaces the host country's territorial regulation.

The New LPD, for example, describes EU issuers' baseline disclosure requirements in order to be able to list with a foreign (non-home country) exchange in another member state. The directive itemizes the various types of information required, including identification of the parties responsible for preparing the listing particulars and auditing the financial statements; the issuer's capitalization; its principal business activities; certain financial information; information concerning the issuer's management; and the issuer's prospects.³⁴ Likewise, MJDS enables qualifying Canadian firms to issue equity and investment-grade debt securities in the US³⁵—and

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31. See Frederick Tung, *Is International Bankruptcy Possible?*, 23 Mich J Intl L 31 (2001) (applying simple game-theoretic analysis to show political infeasibility of universalism).

32. Council Directive 93/22/EEC, 1993 OJ (L 141).

33. Consider Guido Ferrarini, ed, *European Securities Markets: The Investment Services Directive and Beyond* (Kluwer 1998). One effect of ISD has been to enable brokerage firms to gain membership and access to foreign stock exchanges, thereby allowing investors to make cross-border investments through their local brokers. Investors' easy access to foreign exchanges has reduced the need for issuers to pursue foreign investors through cross-listings. See Jackson and Pan, 56 Bus Law at 677 (cited in note 4).

34. See New LPD at Annex I (cited in note 29).

35. See SEC MJDS Release (cited in note 28).

qualifying US firms to issue such securities in Canada³⁶—provided they comply with (a) the securities laws of their home country and (b) certain harmonized minimum standards.³⁷

In terms of competitive effects, a passport arrangement ideally puts pressure on national regulators to offer efficient legal rules. Returning to our two-country securities regulation example, assume that firms from both countries sell their securities into the two-country market. From the perspective of Country A regulators, competitive pressures arise from two sources. First, Country B firms may opt out of unattractive Country A regulation when issuing securities in Country A. The regulatory passport enables Country B firms' figurative exit from the local regulatory regime through compliance with their home country rules. Country A regulators, anxious to maximize the number of firms and volume of transactions under their regulatory purview, may modify their rules to entice foreign—Country B—firms to choose local regulation over home country rules.³⁸

In addition, juxtaposing two regulatory regimes in a common capital or product market may generate political pressure on national regulators. To the extent Country A's rules are suboptimal, firms from Country A will find themselves at a competitive disadvantage relative to Country B's firms in terms of capital raising in the common capital market. The disadvantaged Country A firms may then seek relief from their home Country A regulators. According to conventional wisdom, placing the two regulatory regimes side by side, as it were, highlights the inefficiencies in each regime, creating political pressure on regulators and forcing them to come to the aid of their own firms by remedying problematic rules.³⁹

The following sections take a closer look at these promised benefits from regulatory passports.

B. PROMISES REEXAMINED: EXIT BY FOREIGN FIRMS

Foreign firms' exit options—and competitive effects on host country regulators—may often be less significant than the preceding stylized account

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36. See CSA MJDS Policy Statement (cited in note 28).

37. In the case of MJDS, these harmonized minimum standards evolved informally, as Canadian regulators adopted disclosure standards similar to US standards over the course of the negotiation over MJDS. See Uri Geiger, *Harmonization of Securities Disclosure Rules in the Global Market—A Proposal*, 66 *Fordham L Rev* 1785, 1792 (1998).

38. See Jackson and Pan, 56 *Bus Law* at 663 (cited in note 4) (describing governmental responsiveness with EU Listing Particulars Directive and Public Offers Directive).

39. See Scott, 63 *L & Contemp Probs* at 85 (cited in note 4) (noting that both MJDS and EU POD passport systems create "a basic inequity for domestic issuers," who could be expected to lobby home country regulators for relief) ("Indeed, in the European Union, it was widely believed and accepted that the home-country approach would shortly lead to convergence of disclosure standards (to some optimal level) as domestic issuers pressured governments to change local rules.").

promises. To continue with our securities regulation example, consider one plausible scenario. Call one country HD for "high disclosure," and the other LD for "low disclosure,"⁴⁰ which characterizes the stringency of their national disclosure regimes for issuing securities. A regulatory passport enables an LD firm to issue securities in HD without incurring the costs of full blown compliance with HD's high disclosure requirements. However, the HD firm may enjoy no corresponding benefit from the passport system when issuing in LD. Because its home country rules are more stringent than in LD, when the HD firm goes to issue securities in LD, it is no better off than under territoriality. It prefers the less stringent LD rules when issuing in LD, and the passport system has not reduced its regulatory burden.⁴¹ The HD firm must comply with its more stringent home country rules in any event.⁴² In turn, because HD firms have no reason to exit LD's territorial regulation when issuing in LD, the passport arrangement has generated no competitive pressure on LD regulators to improve the efficiency of their rules.

In the other direction, for LD firms issuing in HD, even LD firms' exit option from HD regulation may be limited. If the disparity between HD and LD rules is large, HD regulators may attempt to reduce that disparity in the original negotiation over the harmonized rules of the passport system. Regulators in HD have private incentives to reduce politically sensitive differences by requiring certain of HD's

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40. These could be the US and Canada, respectively, or the UK and Spain.

41. The HD firm might be better off leaving its HD passport at home and simply complying with LD's more lax rules. As a practical matter, however, having already incurred the costs of complying with HD's high disclosure rules, the HD firm might as well make the same information easily available in LD, if it is not already available by virtue of the firm's existing disclosures in HD. The lion's share of disclosure costs is more likely to be in the gathering and assembling of the information, rather than in the distributing to investors. And disclosure in LD in excess of LD's legal requirements might lower the firm's capital costs in LD by enticing investors to pay more for the firm's securities than they would without the information.

42. Firms typically issue and list securities in their home countries first, thereby subjecting them to the securities laws of their home countries. This makes sense. A firm's capital costs are likely to be lowest in its home country, since investors in the home country are likely to enjoy informational advantages over foreign investors with respect to assessing the firm's value and prospects. See Romano, 107 Yale L J at 2397 (cited in note 5) ("Resort solely to foreign capital markets for financing is not a viable option for publicly traded US firms."); Merritt B. Fox, *The Political Economy of Statutory Reach: U.S. Disclosure Rules in a Globalizing Market for Securities*, 97 Mich L Rev 696, 770-71 (1998) ("Despite the burden of compliance, avoiding the U.S. market traditionally has not made sense for U.S. issuers since the United States is the residence of a large portion of their most likely potential investors."). Under the New LPD, a firm could choose a regulatory regime other than that of its home state by making its initial offering in another member state. But "[i]n reality, very few issuers apparently choose to list outside of their home country given that issuers often find the warmest reception for their securities in their home markets." Jackson and Pan, 56 Bus Law at 679 n 70 (cited in note 4). This may not be universally true, however, if other aspects of the local market make it unattractive for local firms. See Amir N. Licht, *Managerial Opportunism and Foreign Listing: Some Direct Evidence*, 22 U Pa J Intl Econ L 325, 336 (2001) (describing Israeli firms' strategy of raising capital in US, bypassing Israeli market and its regulatory burdens).

higher standards as part of the harmonized rules. This may preserve some authority for HD regulators by creating a policing function with respect to LD firms' compliance with the harmonized rules. In addition, forcing LD firms to meet certain important requirements on par with HD firms reduces possible political pressure from HD firms to lower HD regulatory standards. MJDS offers one example of this phenomenon of a regulatory passport arrangement that includes significant harmonization.⁴³

Finally, even though the LD firm offering securities in HD would have no legal obligation to disclose more than required under its home country rules plus the harmonized rules, market forces may force higher disclosure. Investors in HD may demand from LD firms the same high disclosure they enjoy from HD firms.⁴⁴ If so, the LD passport has not reduced disclosure requirements for LD firms issuing in HD, and has generated no competitive pressure on HD regulators.

In our simple example, then, the passport arrangement offers HD firms no useful exit option from host country regulation, and possibly limited exit for LD firms. Competitive pressure on host country regulators is correspondingly blunted. Of course, not all passport arrangements will involve regulatory asymmetries among states such that firm exit matters in only one direction. Likewise, harmonized standards will not always erase differences across regulatory regimes so as to minimize the value of the passport. However, these phenomena do suggest that passport arrangements may not always offer much firm mobility or competitive pressure on host country regulators, as the stylized account might otherwise suggest.

C. PROMISES REEXAMINED: EXIT AND VOICE BY HOME COUNTRY FIRMS

What about competitive pressure on home country regulators? In this section, I discuss the behavior of home country firms under regulatory passport arrangements

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43. Some have claimed that MJDS hardly effects mutual recognition but instead institutionalizes the Americanization of Canadian securities law. Not only has most of the "harmonization" involved simply Canadian adoption of US standards, see Geiger, 66 *Fordham L Rev* at 1793 (cited in note 37), but even more importantly, MJDS affects only disclosure standards, not liability rules. Canadian offerings in the US are still subject to US civil liability rules, thus forcing some convergence of Canadian prospectuses to the US "look," as well as driving due diligence practices toward US conventions. See Cally Jordan, *Regulation of Canadian Capital Markets in the 1990s: The United States in the Driver's Seat*, 4 *Pac Rim L & Pol J* 577, 591 (1995).

44. HD investors may severely discount the prices they are willing to pay for securities of LD firms that are not accompanied by high disclosure. So LD firms may lower their overall costs of capital by voluntarily disclosing at a higher level. Some evidence of this phenomenon exists in the EU, as "International-style Offerings" routinely include disclosures in excess of formal legal requirements. See Jackson and Pan, 56 *Bus Law* 685-86 (cited in note 4) (noting influence of US and UK disclosure standards on disclosures to institutional investors as part of International-style Offerings).

and the prospects of such behavior for generating competitive pressures on their national regulators. As part of this discussion, I contrast passports with direct competition. Even with a best case passport system, competitive pressures on home country regulators may be relatively weak. The basic shortcoming of a passport arrangement is that unlike direct competition, it does not allow for firms' easy exit from home country regulation. While regulatory passports might offer firms some flexibility with respect to their activities in host countries, firms remain tied to home country regulation.

1. Exit

For home country firms under a passport system, the home country regulatory regime is much like any other home country factor endowment that may affect a firm's cost structure—like transportation infrastructure or energy resources, for example. Regulation is similar to these other factor endowments insofar as they all “come with the territory.” A firm is stuck with these factor endowments unless it physically exits the territory. The HD firm cannot escape unattractive HD regulation unless it relocates.

When physical exit is not easy or cheap, home country regulators may have no strong incentives to provide optimal rules. To the extent suboptimal home country regulation imposes costs on firms, it makes their capital more expensive and their products less competitive. On the other hand, other territorial endowments may be especially attractive, so that firms may be willing to endure suboptimal law while enjoying a country's well-developed capital market or telecommunications infrastructure, for example. In those situations, regulators may enjoy some slack in terms of not being pressed to offer optimal regulation, since firms will not exit.

This is not to say that regulatory exit is entirely unavailable. With securities regulation, for example, a firm with headquarters and significant operations in HD could theoretically escape HD regulation by simply offering securities only outside of HD. This approach is exceedingly rare, however.⁴⁵ A firm could also move from HD to LD in order to have LD's less stringent regime govern its offerings in both countries. However, firms are not generally so mobile. They have headquarters and key operations, employees, relationships, goodwill, and assets that are not readily transplanted without significant loss of value. The same goes for corporate law. Similar considerations would impede firms' exit from company law regimes based on territorial notions of *siège réel*,⁴⁶ principal place of business, or firm headquarters.⁴⁷

45. See note 42 and accompanying text.

46. A number of EU member states, Germany and France among them, espouse a “real seat” rule for corporations, under which the location of a firm's principal place of business determines the applicable company law. See Ebke, 48 Am J Comp L at 624–25 (cited in note 16).

47. With bankruptcy, the question of exit from home country rules is a bit more complicated because of endgame issues. Physical exit from the home country may be as cumbersome and costly as described

By contrast, a private choice, direct competition system would create a common market for law. In our securities law example with HD and LD, all firms of both countries could choose the regulatory system of *either* nation to govern their securities activity in both jurisdictions. HD firms could choose LD regulation even when issuing in HD. And with *multiple* nations involved in a private choice arrangement, firms would enjoy even wider options. In particular, the HD firm would not be limited to the home or host country in its choice of regulation. It could select the law of a *third country* that would entitle it to issue securities in HD and LD, as well as in every other country in the system. HD firms could easily exit from the stringent HD regime, and they would have multiple options in terms of regulatory regime. This arrangement would in effect allow each jurisdiction to sell “passports” to “citizens” of other jurisdictions, placing each jurisdiction in direct competition with others in a market for passports.

Moreover, including additional states in a private choice arrangement increases not only the number of options for firms but also the size of the common market for law. As this common market grows, so do the potential spoils available from successful sales of regulation. Regulators’ incentives to compete may therefore increase with the addition of states and the increasing size of the market.

By contrast, a regulatory passport arrangement among multiple nations is more like a set of separate bilateral recognition agreements, linked possibly by some common harmonized rules. Adding a state to this system gives each firm an additional jurisdiction in which to travel with its home country passport. As in the simple two-country case, however, a firm venturing outside its home country still only has the simple—and perhaps not very meaningful—choice of home or host country rules. On the other hand, one competition enhancing effect of adding states is that it makes physical exit marginally more attractive. Physical relocation to the state in the system with the “best” regulation, while still costly, becomes more attractive the larger the passport system gets, because the “market opening” effect of the “best” passport becomes more valuable to more firms. In this way, adding states to a passport system may create marginally more competition among regulators. This effect, of course, may

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above with respect to securities regulation and company law. However, if a firm is insolvent, managers are spending the creditors’ money, not equity holders’. Therefore, the financial and operational costs of exit may not deter firms’ eleventh-hour exit. In other words, physical exit may be too easy. See Lynn M. LoPucki, *Cooperation in International Bankruptcy: A Post-Universalist Approach*, 84 Cornell L. Rev. 696, 722 (1999) (discussing debtor firms’ eve-of-bankruptcy law- and forum-shopping). This manipulability of the home country choice of law rule may explain why universalism—essentially a proposal for a regulatory passport arrangement for international bankruptcy—has found no concrete policy enactments. The indeterminacy of the “home country” choice of law rule may deter states from committing to such an arrangement. See Tung, 23 Mich J Intl L at 75 (cited in note 31) (describing how indeterminacy in home country standard frustrates states’ reciprocity strategies).

be blunted to the extent the value of the "best" passport is diminished by strategic harmonization and the other factors earlier discussed.

Ultimately with passport arrangements, no common market for law exists from which consumers might freely choose the legal product that best meets their needs. Absent the possibility of physical exit by firms, national regulators are not forced to compete with each other for consumers across the market. Instead, each national regulator enjoys a territorial monopoly with respect to home country firms. What makes the "passport" metaphor especially apt is that, as with real passports, firms in a regulatory passport system can only obtain passports from their home countries. While the passport allows the firm to travel with its home country regulatory regime, it does nothing to enable the firm's exit from that regime. Instead, it preserves the territorial regulatory monopolies at the heart of the complaint of regulatory competition advocates.⁴⁸ In fact, with comfortable monopolies preserved,⁴⁹ regulators may also feel little urgency to compete for foreign firms traveling on their passports.

2. Voice

To be sure, even if exit is unlikely, this is not to say that political pressure may not force regulators to streamline regulation. Firms unable to exit their home jurisdictions may instead turn to political action to spur regulatory reform.⁵⁰ Passport arrangements might facilitate political action by highlighting particularly galling regulatory burdens imposed by home country rules. Home country firms and foreign firms may be subject to wildly disparate rules while engaged in the same activity in the home country, assuming such disparities were not eliminated in the structuring of the harmonized rules. HD firms in our previous example may find themselves disadvantaged vis-à-vis their counterparts from LD, who may raise capital in HD at lower cost. A stark disparity may make it difficult for HD regulators to resist demands of HD firms to lower regulatory burdens to lessen or eliminate the disparity.

On the other hand, even if stark or politically charged disparities existed, lobbying would be worthwhile only if coalition costs for HD firms were lower than the costs of the disparate regulations. The potential return on political investments by HD firms—in effect the potential cost savings from elimination of disparate regulatory burdens—would also have to be discounted by the possibility that their lobbying efforts might come to naught. Other more concentrated interests may have a

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48. In fact, the scope of the home country regulator's monopoly over home country firms expands under a passport system as compared to territoriality. See part III.

49. Not all monopolies are equally comfortable, of course. The SEC's monopoly over US issuers is much more stable than the Israeli Securities Agency's over its local firms. See Licht, 22 U Pa J Intl Econ L at 325 (cited in note 42).

50. On the inverse relation between exit and voice, see Albert O. Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States* (Harvard 1970).

greater stake in defending high disclosure for HD firms,⁵¹ so that political action by HD firms would be deterred. In the US, for example, foreign issuers enjoy lower securities regulatory burdens in certain areas than domestic issuers,⁵² and to date, domestic issuers seem not to have been willing to organize against these disparities.

Finally, even if political pressure demanded the elimination of disparities as between HD and LD rules, there is no a priori reason to believe the result would be less regulation, the desired outcome for regulatory competition proponents. Regulators from HD and LD would no doubt have an important if not leading role in any negotiation over harmonization of their disparate rules. Lowering HD regulatory requirements to match LD's would diminish HD regulators' prestige and importance, a move that HD regulators would likely resist. On the other hand, raising LD regulatory requirements to match HD's might augment the prestige of LD's regulatory bureaucracy. So regulators may have some stake in upward harmonization, and this may also satisfy HD firms' demand for regulatory parity.

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In any event, competitive pressures on regulators under regulatory passport systems seem a far cry from the private choice, direct competition model. Given the mobility of firms that characterizes US corporate charter competition, a market exists in which corporate law is the product.⁵³ Not so for regulatory passport systems. Though firms may enjoy some limited reprieve from host country regulation by relying on their home country passports, the strong tie to home country regulation remains, and with it, home country regulators' monopolies.

III. POLITICAL ECONOMY OF REGULATORY PASSPORTS

Under a regulatory passport system, then, vigorous competition among regulators to offer optimal regulation seems much less likely than under direct

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51. Some have argued, for example, that in the US, it is the lawyers, accountants, and securities professionals who most benefit from mandatory disclosure. Their combined influence makes deregulation unlikely.

The prospects for substantial cost-reducing modification in our corporate disclosure system are [ ] slim when viewed from the perspective of the economics of regulation. Two relatively small, well-organized groups have strong and understandable interests in seeing that the SEC corporate system is preserved and expanded, namely, professionals who produce the disclosure documents and who receive them free.

Susan M. Phillips and J. Richard Zecher, *The SEC and the Public Interest* 51 (MIT 1981).

52. Alan R. Palmiter, *Toward Disclosure Choice in Securities Offerings*, 1999 Colum Bus L Rev 1, 44-54 (1999) (enumerating various reduced regulatory hurdles for foreign issuers); Jackson and Pan, 56 Bus Law at 666 (cited in note 4) (same).

53. Whether this market is competitive or not is a separate issue that has generated much scholarly debate. See note 11.

competition. The foregoing discussion of the role of private interests and other factors in blunting competitive effects of passport arrangements allows us now to speculate a bit on why we observe regulatory passport systems implemented internationally, but not direct competition. It may be that this absence of severe competitive pressure on regulators explains the relative popularity of regulatory passports.

Direct competition imperils the private interests of regulators and their important constituents. Passports may not. Far from forcing regulators to compete or "go out of business," a passport system may preserve and actually enhance regulators' positions and prestige. First of all, a passport system may extend the scope of regulators' monopolies over their own local firms. Regulators are left to regulating their own firms, not only at home but abroad as well. Passports facilitate more cross-border activity by firms of each country. So while each national regulator forgoes territorial regulation of foreign firms, its regulatory purview is still enhanced overall because it extends to the increased international activity of its own firms. After MJDS, the SEC's reach encompasses securities activities of US firms not only in the US, but in Canada as well.⁵⁴ The same is true for the Canadian Securities Administrators with respect to Canadian firms' activities in the US.⁵⁵ Rather than competing in a common market for law, regulators from various jurisdictions essentially effect market sharing agreements through passport arrangements, carving up regulatory jurisdiction not along territorial lines but along home country lines.⁵⁶

Besides retaining regulatory jurisdiction over home country firms, national regulators in a passport system may also play a significant role when their country is the host country. When foreign firms seek to engage in activities in the host country relying on their passports, host country regulators must police compliance with the harmonized baseline rules that are part of the passport system. For example,

54. See CSA MJDS Policy Statement (cited in note 28) (describing role of SEC in reviewing US issuers' disclosure documents under MJDS).

55. See SEC MJDS Release (cited in note 28) (noting that Canadian issuer's disclosure documents submitted under MJDS would generally only be subject to customary Canadian review); Scott, 63 L & Contemp Probs at 85 (cited in note 4) ("The MJDS basically relies on Canada to monitor and enforce compliance with initial and ongoing disclosure requirements."). A similar phenomenon occurs under universalist bankruptcy. The bankruptcy law of the debtor firm's home country would apply to decide disposition not only of local assets but all debtor assets worldwide. Judges and other professionals expert in the bankruptcy law of their home country might therefore support universalism more readily than they would support direct competition over bankruptcy law. The former augments the reach and value of their expertise, while the latter may not. In other work, I express skepticism that universalist bankruptcy could ever emerge. See Tung, 23 Mich J Intl L 31 (cited in note 31). The point here, however, is that reasons of political economy suggest that universalism is more plausible than private choice in bankruptcy.

56. See Gérard Hertig, *Regulatory Competition for EU Financial Services*, in Esty and Geradin, eds, *Regulatory Competition and Economic Integration* at 234 (cited in note 12). ("[M]ainly due to the EU requiring cooperation among regulators, the latter have developed strong ties across jurisdictions, which facilitates cartel-like behavior.").

European firms desiring to list securities throughout the EU must first meet the baseline requirements of the New LPD, with compliance being policed by national regulators in the various host countries. This host state policing function not only further augments national regulators' bureaucratic powers, but may also allow national regulators some leeway to interpret and apply the harmonized rules in a way that benefits local constituents.⁵⁷

Given these significant functions for national regulators under regulatory passport systems, it is small wonder that regulators have been able to reach international accommodation on these arrangements, but have made no similar progress on the direct competition model. Public choice considerations also suggest that in terms of trends, regulatory passports may signal not a move toward greater competition, but toward greater harmonization. Especially for regulators from the relatively more stringent jurisdictions, upward harmonization of standards may help preserve these regulators' territorial authority by reducing the attractiveness to firms of relocating to more lax jurisdictions.⁵⁸ International negotiations are likely to be complicated and technical affairs, placing national regulators at the center of international reform that is to a great extent insulated from political accountability.⁵⁹ The harmonized minimum standards that are already part of most passport systems could easily expand to swallow whatever diversity remains in local regulation. Any political pressure to eliminate disparities in rules applicable to home- versus host-country firms may as easily result in more regulation rather than less.

IV. CONCLUSION

In this article, I have compared two approaches to international regulatory coordination—direct competition and regulatory passport arrangements—and have suggested a tradeoff between them. While conceptually direct competition may be a more effective way to spur competition among regulators, for this very reason, it is also less feasible politically. Regulators will not easily relinquish their territorial monopolies to the whims of consumers. Regulatory passport arrangements are likely to become more popular over time, as they seem to offer the alluring prospect of sensible international coordination of national regulatory regimes. With respect to firm-investor affairs, it seems at least plausible that the home country would be the

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57. Compare Jackson and Pan, 56 *Bus Law* at 682 n 85 (cited in note 4) (discussing differing scope of "professionals exemption"—required by POD—across member states).

58. For example, Jon Macey characterizes SEC efforts at international coordination of insider trading enforcement as an attempt to preserve its own authority. See Colombatto and Macey, 18 *Cardozo L Rev* 925 (cited in note 3).

59. See Paul Stephan, *The Futility of Unification and Harmonization of International Commercial Law*, 39 *Va J Intl L* 743 (1999) (describing work of international private legislatures).

appropriate regulator.⁶⁰ On the other hand, while passport arrangements present a structure that promises competitive benefits, these may be frustrated by the influences of private interests.

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60. Compare Merritt B. Fox, *Securities Disclosure in a Globalizing Market: Who Should Regulate Whom*, 95 Mich L Rev 2498 (1997) (describing issuer nationality approach to international securities regulation).