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Interdisciplinary Research: Are We Asking the Right  
Questions in Legal Research?

Edited by Lécia Vicente and Hans-W. Micklitz



European University Institute  
**Department of Law**

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## **Abstract**

Legal research and legal writing are often informed by preconceptions closely tied to mainstream legal assumptions. Asking the right questions is a much needed exercise to expose ideological and methodological preconceptions in legal research. This compilation of texts draws upon some provocative questions such as: Why legal methodology? Why human rights? Why anti-discrimination? Why social justice? Why efficiency? Why democracy? Why the public / private law divide? Why should international law be law? Why socialise risks? These questions were asked during two popular editions of a seminar called the 'Why-Seminar' at the European University Institute. They ended up creating an 'experimental setting' where researchers discussed their methodological choices and were challenged to disclose their methodological preconceptions. Interdisciplinarity became an essential, and in many ways, surprising tool to deeply understanding legal phenomena or phenomena with legal reverberance. Interdisciplinary research revealed that serendipity can also be a good ally of the legal researcher.

## **Keywords**

Interdisciplinary research, legal methodology, legal research, research question, legal problem

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## INTRODUCTION

The Why Seminar – Questioning Mainstream Legal Assumptions was first created in 2011 as part of the curriculum of the doctoral and master’s program of the Law Department of the European University Institute, organised and run by Miguel Poiares Maduro and Hans-W. Micklitz. A second edition of this seminar took place in 2012. As the title suggests, this seminar was created to encourage researchers to question mainstream legal assumptions that inform legal research and legal writing. It was created to challenge legal researchers to question their ideological or methodological preconceptions regarding their understanding of law and their approach to it. This idea of preconceptions and the need for disclosure was heavily promoted by Josef Esser in his groundbreaking book on ‘*Vorverständnis und Methodenwahl*’, published in 1972 and unfortunately never translated into English.<sup>1</sup> The strong focus on policy driven research questions for PhD projects served as a trigger for the organisation of the seminars. The seminar was built around key questions taken from the political discourse underpinning legal research: Why legal methodology? Why human rights? Why anti-discrimination? Why social justice? Why efficiency? Why democracy? Why the public / private law divide? Why should international law be law? Why socialise risks? These were some of the ‘provocative’ questions researchers were asked and for which they were invited to provide answers that would go beyond what they assumed to be ‘good or ‘bad’, ‘right’ or ‘wrong’. A selection of texts providing arguments for and against human rights, democracy, the public private divide, international law, socialisation of risks served as a basis for discussion.

A legal researcher focusing on sensitive political questions is faced with an array of stimuli stemming from the contact with jurisdictions other than their own, and from the blurring of lines dividing disciplines in their own field. In the 21st century legal research is becoming increasingly interdisciplinary: First social legal research dominated the debate, now it is law and economics as well as law and behavioural economics. Lawyers have to be and have had to become aware of the need to find an adequate method for interdisciplinary research. They are looking at law and questioning why the legal method is so different, or whether there is a method at all. Moreover, globalisation has changed the world. It has changed the mindset of market participants, the needs of the consumer and the reach of laws. A social sciences approach to law and the phenomenon of globalisation with an emerging field of global law or global legal studies compels legal researchers to disclose their preconceptions and the values by which they are guided. The ‘Why Seminar’ inspired participants to do just that. It made researchers to articulate the deeper reasons for their underlying assumptions and to realise that each and every work of research is based on preconceptions; the only way out of the methodological trap is to disclose one’s preconceptions and to discuss them properly in the context of the relevant theoretical frameworks. There is no good or bad preconception in particular, the point to be made is much more about the awareness of the existence of a particular preconception and the consequences this brings for the project being undertaken. This allows for emergence of a different path of questioning and reasoning, and for new avenues of research.

This document is a selection of four papers that came out of lively debates held in the seminar sessions. They take an interdisciplinary approach and all aim at disclosing and discussing the particular method chosen. They do not seek to present final results, but rather - in line of the purpose of the seminar – to explore the consequences of the why-question. Alexandre Skander Galand writes on ‘Judicial Pronouncements in International Law: The Arrest Warrant Case *Obiter Dicta*’. He questions the manifestations of judicial maximalism in international law. By using the *obiter dicta* of the International Court of Justice in the Arrest Warrant Case as a case study, he dwells upon the idea of misuse of judicial pronouncements at the international level, which are ultimately to the detriment of the fundamental principles of international law. In ‘Of Democracy and Other Fables: The 2012

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<sup>1</sup> Josef Esser, *Vorverständnis und Methodenwahl in der Rechtsfindung*, Frankfurt am Main, 1970.

Greek Parliamentary Elections’, Anna Tsiftoglou looks to the 2012 Parliamentary Elections in Greece for to deal with questions of democracy, legitimacy and accountability at the national and EU levels at a time of crisis. Jan Zglinski asks ‘What Courts Do When They Do What They Do’, and discusses the ambiguity of legal reasoning undertaken by courts, including the Court of Justice of the EU. Lécia Vicente then inquires ‘Why Efficiency’. She uses game theory to set up a model that illustrates just how complex relationships between the members of a private limited liability company can be. Ultimately, she intends to provoke a discussion on the terms upon which corporate default rules can be designed according to a principle of Pareto optimality.

‘Why?’ is the common question in each of these papers, however perhaps what is most interesting is that by trying to strip their arguments of preconceptions the authors easily came to another question: ‘Why not?’. This musing too requires a disclosure of the arguments lurking behind it.

Florence, January 2015

Hans -W. Micklitz

Lécia Vicente

## JUDICIAL PRONOUNCEMENTS IN INTERNATIONAL LAW: THE *ARREST WARRANT CASE* *OBITER DICTA*

Alexandre Skander Galand\*

### **Abstract**

Courts often say more than required to reach their decisions. While these judicial pronouncements have been criticised at the national level, it has been argued by international judges and commentators that they are necessary in international law. International law is vague and undeveloped; judicial maximalism is in that sense to the benefit of international law. Nevertheless, the reason international judges write obiter dicta might be solely to mitigate the effect of the *ratio decidendi* of their decision. This paper argues that the obiter dicta of the International Court of Justice in the Arrest Warrant Case were given for just such a reason. Furthermore, while the International Court of Justice has done no more than mention in passing that immunities of Heads of State do not apply before certain international criminal courts, these *obiter dicta* became the *ratio decidendi* of many international criminal courts. This case study demonstrates that when the judicial pronouncements of one actor are used by other actors to fit their agenda, international law may develop to the benefit of certain institutions and possibly at the expense of the fundamentals of international law.

### **Introduction**

Why should a court append its reasoning to a decision it takes? This is one of the first questions the ‘Why Seminar’ asked us to consider. During the session where we discussed this issue my opinion was that “*la bouche de la loi*”, as Montesquieu portrayed the judge, must give his or her *motif* to reach the *dispositif* in order to entitle the parties to appeal the decision if erroneous. However, the coordinators of the ‘Why Seminar’ rapidly made me realise that it is not the motifs that form the base of the appeal, but the *dispositif*. Thus, a mainstream legal assumption was questioned: Why do courts give grounds to their judgments? Various answers were offered, but one in particular seemed to be more appropriate to adjudications in international law. The answer to my ‘Why question’ was that international courts develop rules by ‘grounding’ their judgments. In other words, what appeared to be a discursive judgment was actually a form of judicial law-making. This conclusion became even more evident when I started to turn over the justification of a case that was at the centre of my research: *Case Concerning the Arrest Warrant of 11 April 2000 (Democratic Republic of the Congo v Belgium)* (‘Arrest Warrant Case’).

On the 4<sup>th</sup> of February 2002, the International Court of Justice (ICJ) delivered its judgment in the *Arrest Warrant Case*. Since then, the *Arrest Warrant Case* has been the most oft-quoted judgment for any court, practitioner or academic who addresses the subject of immunities of state officials from foreign criminal jurisdiction. In its application instituting proceedings, Congo asked the ICJ to declare that: (1) The Belgian law on universal jurisdiction over international crimes violated the principle of sovereign equality; and, (2) the arrest warrant for war crimes and crimes against humanity against the Congolese foreign affair minister, Yerodia, violated the immunity to which this high ranking official was entitled under international law. During the proceedings, Congo changed its strategy and amended its application to challenge the arrest warrant against its foreign affair minister only. The ICJ decided that according to the rule *non ultra petita*, “it is the duty of the Court not only to reply to the questions as stated in the final submissions of the parties, but also to abstain from deciding points not included in

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those submissions.”<sup>2</sup> The ICJ added that “the *non ultra petita* rule nonetheless cannot preclude the Court from addressing certain legal points in its reasoning.”<sup>3</sup> As I will explain in this paper, the ICJ did not, indeed, restrict itself to deciding whether the arrest warrant against Yerodia violated the international law on immunities. It went beyond what was necessary to resolve the issue before it by stating that immunities do not bar proceedings before “certain international criminal courts, where they have jurisdiction.”<sup>4</sup> The reasons it provided for such an exception to immunity of State officials will be explored below. Moreover, I will attempt to demonstrate briefly that judicial *maximalism* can lead to unintended consequences. The state of law is never set for all perpetuity; it evolves and sometimes for the best, especially when it falls into the hands of an interested player.

### ***Judicial Maximalism***

Cass R. Sunstein, writing about US Supreme Court judgments, argues in favour of judicial *minimalism*, i.e. expressing only what is necessary to justify a decision and leaving undecided as many legal issues as possible.<sup>5</sup> According to Sunstein, “the constructive use of silence” by courts reduces the burden of judicial decisions, promotes democracy and makes judicial errors less frequent.<sup>6</sup> On the other hand, the particularity of international law might require another approach. Judge Fitzmaurice in the *Barcelona Traction Case* wrote a separate opinion where he explains that the duty of international judges – in a system lacking an international lawmaker – is not only to clarify the law but also to contribute to the development of international law.<sup>7</sup> In other words, international judges have the judicial burden to say more than what is required by in deciding the case at hand; this would result in judicial *maximalism*. International law, unlike municipal law, is not a democratic system whereby a government can enact specific legislative action with direct binding effect that reflects the choice of its electors. Nevertheless, it is true that international courts as much as national courts are at risk of making a judicial error when delivering a decision.

The ICJ Statute does not require that judgments be adopted unanimously;<sup>8</sup> judges are allowed to dissent from the majority judgment, in whole or in part. Moreover, any judge is entitled to deliver a separate or dissenting opinion, which is appended to the majority judgment. While separate opinions bear the value of *obiter dicta*, they can bring clarifications to the judgment which itself tends to be constrained by the need to express the consensus of the majority. Dissenting opinions, on the other hand, express judges’ reasons for not being part of the majority. These dissenting opinions can serve as a basis for changes in international practice, but can also help explain the critical issue that divided the bench. Altogether, these opinions contribute to elucidating and progressively developing

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<sup>2</sup> *Arrest Warrant of 11 April 2000 (Democratic Republic of the Congo v. Belgium)*, International Court of Justice, Judgment, I.C.J. Reports 2002, p. 3, par. 43 (Hereinafter the *Arrest Warrant Case*). Reference is made to *Asylum*, Judgment. 1. C.J. Reports 1950, p. 402.

<sup>3</sup> *Ibid.*

<sup>4</sup> *Ibid.*, par. 61.

<sup>5</sup> Cass R. Sunstein, *One Case at A Time: Judicial Minimalism on the Supreme Court* (Harvard University Press, 1999) p. 4-5.

<sup>6</sup> *Ibid.*

<sup>7</sup> *Barcelona Traction, Light and Power Company, Limited*, ICJ Report 1970, p. 64, par. 2, Judge Fitzmaurice. “In addition, there are a number of particular matters, not dealt with or only touched upon in the Judgment of the Court, which I should like to comment on. Although these comments can only be in the nature of obiter dicta, and cannot have the authority of a judgment, yet since specific legislative action with direct binding effect is not at present possible in the international legal field, judicial pronouncements of one kind or another constitute the principal method by which the law can find some concrete measure of clarification and development. I agree with the late Judge Sir Hersch Lauterpacht that it is incumbent on international tribunals to bear in mind this consideration, which places them in a different position from domestic tribunals as regards dealing with-or at least commenting on points that lie outside the strict ratio decidendi of the case.”

<sup>8</sup> International Court of Justice Statute, Article 55.

international law. Even though this plenitude of opinions might significantly diverge on a specific question and cast a certain uncertainty on the words of the majority judgment, the relativity it brings confirms that the state of international law on a certain issue is never carved in stone.

### ***The influence of the ICJ case law***

There is no rule of *stare decisis* at the ICJ. Moreover, other courts are not obliged to follow the precedents of the ICJ. Nevertheless, the ICJ case law bears significant importance in international law. It is accepted that the sources of international law are: (a) International conventions; (b) customary international law; (c) general principles of law; and (d) judicial decisions and teachings of the most highly qualified publicists of the various nations, as a subsidiary means for the determination of rules of law. The decisions of the ICJ are legally only binding on the States party to the case and in respect of the particular dispute.<sup>9</sup> Case law of the ICJ is not a legally binding source of law, but as the most specialised court for general international law matters, they serve as a good indicator of the state of international law.<sup>10</sup> Furthermore, for the sake of consistency, national and international courts are reluctant to go against a finding of the ICJ, especially when it appears to spell out customary international law.<sup>11</sup> This said, a court may feel more at ease disregarding an *obiter dictum* than a *ratio decidendi*. While a *ratio decidendi* is the point in a decision which determines the judgment, an *obiter dictum* is an opinion expressed by the Court unnecessary for the final decision.<sup>12</sup> The deconstruction of a judgment distinguishes the *obiter dicta* from the *ratio decidendi*.

### ***The Arrest Warrant Case - Ratio Decidendi***

The ICJ in the *Arrest Warrant Case* was asked to state whether the arrest warrant issued by Belgium against Yerodia for war crimes and crimes against immunity violated the immunity to which foreign affair ministers are entitled under international law. According to the ICJ, the functions of the Foreign Affairs Minister Yerodia qualified him as a high ranking State official entitled to immunity equivalent to that enjoyed by Heads of State and Heads of Government. For this reason, the ICJ found that Yerodia was entitled to immunity from foreign jurisdiction for his official acts as well as for his private acts for the entire duration he held this office. According to the ICJ, this full immunity applies regardless of whether the high ranking State official is on foreign territory for an official or private visit, or whether the acts were performed in an official or private capacity. As the Belgian arrest warrant prevented Yerodia from exercising the functions of his office, his full immunity from criminal jurisdiction and inviolability were violated. The immunity to which he was entitled protected him against “any act of authority of another State which would hinder him or her in the performance of his or her duties.” Finally, after reviewing national and international case law and instruments, the ICJ declared that customary international law does not provide any exception to the immunity of a foreign affairs minister before foreign criminal jurisdiction, even where suspected of war crimes and crimes against humanity. This is the *ratio decidendi* of the judgment. These were the Court’s grounds for deciding that the Belgian issuance of an international arrest warrant for war crimes and crimes against humanity against the Congolese foreign affairs minister “constituted a violation of an obligation of Belgium towards the Congo, in that it failed to respect the immunity of that Minister and, more particularly, infringed the immunity from criminal jurisdiction and the inviolability then enjoyed by him under international law.”<sup>13</sup>

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<sup>9</sup> International Court of Justice Statute, Article 59.

<sup>10</sup> Moreover, they may contribute to the development of international law, Hersch Lauterpacht, *The Development of International Law by the International Court*, (Cambridge University Press, 1982), p. 21.

<sup>11</sup> *Legality of the Threat or Use of Nuclear Weapons*, ICJ Report, p. 237.

<sup>12</sup> *Black Law Dictionary* (Sixth Edition, 1990).

<sup>13</sup> *Arrest Warrant Case*, par. 70, 71.

### ***The Arrest Warrant Case - Obiter dicta***

After stating its conclusion regarding the arrest warrant for Yerodia, the ICJ decided it needed to stress that “immunity from jurisdiction enjoyed by incumbent Ministers for Foreign Affairs does not mean that they enjoy impunity”.<sup>14</sup> In order to exemplify its rhetorical statement, the ICJ then enumerated four circumstances where the immunity of a sitting high ranking official would not represent a bar to criminal prosecution: (1) When proceedings are instituted by the national authorities of the State he or she represents; (2) when the State he or she represents or has represented waives the immunity; (3) when the high State official no longer holds office, other States may try him for acts committed in a private capacity; and (4) when the high ranking official is subject to proceedings before “certain international criminal courts, where they have jurisdiction.”<sup>15</sup> These are *obiter dicta* as they are not grounds or justifications for the Court to reach its final decisions. Now the question is why did the ICJ decide to write this *obiter dicta*? As pointed out above, international law – because of its particularities – is in need of clarification. Judges that adopt a *maximalist* approach when writing judgments are said to have this purpose in mind when making *obiter dicta*. But could these extra judicial pronouncements have other aims?

### ***The Four Circumstances of the Arrest Warrant Case Obiter Dicta***

The ICJ *obiter dicta* has – it should be pointed out – been severely criticised in literature as being inconsistent with international law. In the 1990s, the fight against the impunity of perpetrators of international crimes had increasingly become one of the most important values of the international community. In a lauded decision in March 1998, the United Kingdom House of Lords, upheld the finding that the former Head of State of Chile, Augusto Pinochet, was not immune from foreign criminal jurisdiction for the international crime of torture.<sup>16</sup> In 1993 and 1994, the Security Council (SC) of the United Nations (UN) established two *ad hoc* tribunals for the prosecution of the persons most responsible for the commission of international crimes in former Yugoslavia (ICTY) and Rwanda (ICTR). The ICTY dismissed the relevance of the former Head of State position of Slobodan Milosevic four months before the *Arrest Warrant Case*,<sup>17</sup> and in 1998 the ICTR sentenced Jean Kambanda, the former Prime Minister of Rwanda, to life imprisonment for crimes against humanity and genocide.<sup>18</sup> In the same year, the Rome Statute was adopted and Sierra Leone was negotiating with the Secretary General of the UN for the establishment of a hybrid court. Indeed, international law was reaching its peak in the fight against impunity. Nevertheless, the *Arrest Warrant Case* fails to concretely acknowledge this advancement, at least in respect of immunities from the criminal jurisdiction of foreign national courts. Let us briefly re-examine the four circumstances where immunity does not represent a bar to criminal prosecution.

The first and second circumstances, i.e. national proceedings and waiver of immunity, have not caused many disagreements. They rest upon two fundamental principles of international law: Sovereignty and consent. In this sense, they confirm principles that were well established in international law and that arguably did not need any clarification. However, the third and the fourth circumstances, namely prosecution of former officials for acts committed in a private capacity, and the prosecution before “certain international criminal courts, where they have jurisdiction” have been the subject of a hot debate between scholars and have given rise to varying interpretations by international courts.

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<sup>14</sup> *Ibid.*, par. 60.

<sup>15</sup> *Ibid.*, par. 61

<sup>16</sup> *Regina v. Bartle and the Commissioner of Police for the Metropolis and Others Ex Parte Pinochet Ugarte*, United Kingdom, House of Lords, 24 March 1999, reproduced in *International Legal Materials*, vol. 38 (1999), p. 581-663.

<sup>17</sup> *Prosecutor v Milosevic*, ICTY, Case No. IT-02-54, Decision on Preliminary Motion, 8 November 2001.

<sup>18</sup> *Prosecutor v. Jean Kambanda*, ICTR, Case No. IT-97-23-S, Judgment, 4 September 1998.

The third circumstance exists where the high State official no longer holds office; other States “may try the former high ranking officials in respect of acts committed prior or subsequent to his or her period of office, as well as in respect of acts committed during that period of office *in a private capacity*”.<sup>19</sup> In other words, the high ranking official is only immune from foreign criminal jurisdiction for the acts committed *in an official capacity*. Obviously, this is difficult to reconcile with the principle of individual criminal responsibility for international crimes committed in the name of the State. As Judge Van den Wyngaert<sup>20</sup> and many commentators argued,<sup>21</sup> most international crimes are committed on behalf of the State, and to negate the official character of such crimes would be “to fly in the face of reality.”<sup>22</sup> Furthermore, if the authorities of the home state remain in connivance with the former State official, it is highly unlikely that national proceeding will be instituted against the former official (first circumstance) or that a waiver of immunity from foreign criminal jurisdiction will be issued (second circumstance). Consequently, impunity is almost guaranteed. While Judges Higgins, Kooijmans and Buergenthal in their separate opinion underlined that international crimes cannot be regarded as official acts, the silence of the majority judgment on this point leaves the issue unsettled and at risk of being interpreted to the contrary.<sup>23</sup> To sum up, the third circumstance brings more confusion than clarification, and arguably is a judicial error or a regression of international law.

The *obiter dicta*'s fourth circumstance – “certain international criminal courts” – to some extent compensates for the ICJ's failure to spell out clearly whether international crimes committed in an official capacity can be prosecuted before foreign criminal jurisdiction. The Court enounces this fourth situation as the perfect solution against the impunity of perpetrators of genocide, crimes against humanity and war crimes. Indeed, the ICJ declares that the immunity of incumbent as well as former State officials is irrelevant when prosecuted by “certain international criminal courts”. In this situation, the distinction between acts committed in a private or official capacity is irrelevant. However, the formulation adopted brought with it a fair number of controversies as well.<sup>24</sup> Instead of leaving undecided what constitutes an international criminal court, and, consequently leaving places for new courts to be established, the *obiter dicta* lists three courts that it considers as being of an international character. The ICTY and ICTR figure as courts established by the SC as measures under Chapter VII of the UN Charter and the International Criminal Court (ICC), which is a treaty-based court containing in its statute an article asserting its jurisdiction over any official.<sup>25</sup> These courts are listed in the *obiter*

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<sup>19</sup> *Arrest Warrant Case*, par. 61 (emphasis added).

<sup>20</sup> *Ibid.*, Separate opinion of Judge ad hoc Van den Wyngaert, par. 34-36.

<sup>21</sup> See e.g. Antonio Cassese in *When May Senior State Officials Be Tried for International Crimes? Some Comments on the Congo v. Belgium Case*, 13 *European Journal of International Law* 853-875 (2002); David S. Koller, *Immunities of Foreign Ministers: Paragraph 61 of the Yerodia Judgment As It Pertains to the Security Council and the International Criminal Court*, 20 *American University International Law Review* 7-42 (2004); Marco Sassòli, *L'arrêt Yerodia: quelques remarques sur une affaire au point de collision entre les deux couches du droit international*, 106 *Revue belge de droit international* 791-818 (2002); Jan Wouters, *The Judgment of the International Court of Justice in the Arrest Warrant Case: Some Critical Remarks*, 16 *Leiden Journal of International Law* 253-267 (2003).

<sup>22</sup> Craig Barker, *International Law and International Relations: International Relations for the 21<sup>st</sup> Century* (Continuum, 2000), p. 153.

<sup>23</sup> *Arrest Warrant Case*, Joint separate opinion of Judges Higgins, Kooijmans and Buergenthal, par. 85.

<sup>24</sup> See e.g. Dapo Akande, *The jurisdiction of the International Criminal Court over Nationals of Non-Parties: Legal Basis and Limits*, 1 *Journal of International Criminal Justice* 634 (2003); Paola Gaeta, *Does President Al-Bashir Enjoy Immunity from Arrest?* 7 *Journal of International Criminal Justice* 315-332 (2009)

<sup>25</sup> Rome Statute, Article 27 reads as follows: “Irrelevance of official capacity

1. This Statute shall apply equally to all persons without any distinction based on official capacity. In particular, official capacity as a Head of State or Government, a member of a Government or parliament, an elected representative or a government official shall in no case exempt a person from criminal responsibility under this Statute, nor shall it, in and of itself, constitute a ground for reduction of sentence.

2. Immunities or special procedural rules which may attach to the official capacity of a person, whether under national or international law, shall not bar the Court from exercising its jurisdiction over such a person.”

*dicta* as having jurisdiction over incumbent high ranking officials. While the list is not exhaustive the criteria required to join this exclusive group can appear to be. The ambiguity here is whether there is a difference between courts established by the Security Council – which binds all UN Member States – and courts created by treaties – which bind only the signatory Member States – as is, allegedly, the case with the ICC. In fact, although the fourth circumstance is not crystal clear, it has definitely instigated a progressive development of international law.

### ***The Use of the Arrest Warrant Case Obiter Dicta by Other Courts***

Before the *Arrest Warrant Case*, it was doubted whether a treaty establishing an international criminal court could overrule the right to immunity of States not party. This uncertainty was understandable; the very core of international law rests on sovereignty and consent. The ICC was not yet in existence when the *Arrest Warrant Case* judgment was issued and, by the date of the judgment, had only had about 50 ratifications.<sup>26</sup> Moreover, other international or internationalised courts were about to be established and, much to their resentment, they were not named in the ICJ *obiter dicta*. The Special Court for Sierra Leone (SCSL) in its 2004 decision on the immunity of Charles Taylor – President of Liberia at the time of the indictment - is entirely focused on fitting within the parameters of the ICJ *obiter dicta*.<sup>27</sup> To put it briefly, the SCSL struggled to prove itself as a court established by the SC as a measure to restore international peace and security, even though it was established by an agreement between the Secretary General of the UN and Sierra Leone. As a court predicated on an SC resolution, the SCSL considered that, like the ICTY and the ICTR, it represented the will of the international community and could, therefore, overrule the immunity of the Head of State of any member of the UN. The SCSL *ratio decidendi* is that its legal basis fits within the *Arrest Warrant Case obiter dicta* requirements. On the other hand, the ICC in 2011, in the case against Omar Al-Bashir, President of Sudan, decided that “former or sitting heads of states not parties to the statute whenever the court may exercise jurisdiction” cannot invoke immunity “to oppose a prosecution by *an international court*”<sup>28</sup>. The contrast with the SCSL decision on the immunity of Charles Taylor is clear: Immunity of any Head of State is irrelevant before any international court, regardless of whether it is premised on SC measures or not. The ICC, as a court listed in the *Arrest Warrant Case obiter dicta*, inherently derives its mandate from the international community. At the end of the journey, the *Arrest Warrant Case* fourth circumstance moved from being a mitigating judicial pronouncement, to being a requirement, ultimately ending up as a justification for the exercise of jurisdiction over the immunity of high-ranking State officials.

### ***Conclusion***

The ‘Why Seminar’ was obviously aimed at developing our inquisitive reflex. By questioning the reason for judicial pronouncements, I learned not only to differentiate the necessary from the optional, but also to study why the optional was chosen. True, in an international legal system, where a proper lawmaker is absent, judgments play a crucial role in the clarification and development of international law. In order to avoid fragmentation of international law, tribunals try to adjust their reasoning to the judgments of other courts. However, these judgments can be divided into grounds to reach the decision and opinions on incidental points. Even though there are no rules of *stare decisis* amongst

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<sup>26</sup> Rome Statute, Article 126 (1) reads as follows: “This Statute shall enter into force on the first day of the month after the 60th day following the date of the deposit of the 60th instrument of ratification, acceptance, approval or accession with the Secretary-General of the United Nations.”

<sup>27</sup> *The Prosecutor v. Charles Ghankay Taylor*, Special Court for Sierra Leone, Appeals Chamber, Case No. SCSL-2003-01-I, Decision on Immunity from Jurisdiction, 31 May 2004.

<sup>28</sup> *The Prosecutor v. Omar Hassan Ahmad Al Bashir*, ICC, Case No. ICC-02/05-01/09 ,Decision Pursuant To Article 87(7) Of The Rome Statute On The Failure By The Republic Of Malawi To Comply With The Cooperation Requests Issued By The Court With Respect To The Arrest And Surrender Of Omar Hassan Ahmad Al Bashir, 13 December 2011 par 36.



international tribunals, both parts of the body of the decision play a persuasive role when it comes to making further decisions on the same issue. In order to find the answer to my Why question, I started to deconstruct judgments. This process led me to conclude that often the justification was not only unnecessary to reach the decision, but moreover that it was actually an excuse to mitigate the effect of the judgment. Nevertheless, statements to take the edge off the effect of this judgment may become fundamental for other courts that have to rule on the specific point addressed in passing. An analysis of the *Arrest Warrant Case* and the way it has been used by concerned actors brought me to this conclusion.

Through a critical inquiry about the various parts of judgments and their *raison d'être*, I came to understand that a case has to be read in line with the reception it will get from the actors involved. Legal scholarship, legal counsel, other courts and the same courts will read the justification for the judicial decision and will decide whether or not they adopt that justification as a rule. This form of global governance did not occur to me before. International law is not only clarified by international judges, but it also develops according to the institutional choice of the forum having to decide the new hard case it is facing. In this sense, an *obiter dicta* is in constant evolution.

## OF DEMOCRACY AND OTHER FABLES: THE 2012 GREEK PARLIAMENTARY ELECTIONS

Anna Tsiftoglou \*

### *The WHY Question: A Radical Approach to Law*

In an attempt to write a final pre-PhD publication of mine in a more radical manner, this is not intended as a typical ‘legal’ essay. Rather, my paper strives to study a public law topic through a non-conventional lens. My research guide will be the ‘why’ question, a sort of *behind-the-facts* investigatory query,<sup>29</sup> and one which is unusual for a lawyer educated and trained partly in a legal positivist environment. In fact, my ambition to write something original that challenges mainstream legal assumptions urges me to ask four different ‘why’ questions. My case-study will be the 2012 Parliamentary elections in Greece, a crisis-hit country with a long history of bipartisanship, going to the polls for the first time after receiving massive bailouts. Triggered by the ‘WHY Democracy’ session of the 2012 WHY Seminar in Florence, my paper deals with the wider questions of democracy, legitimacy and accountability on the national and EU levels in times of crisis. Interestingly, I find that these elections were pure evidence of the *political* more than *financial* crisis currently being faced by both Greece and Europe as a whole.

### *WHY Elections: Could Greek Politics Survive the Crisis?*

The Greek General Elections of June 2012 came as the result of political deadlocks. Following a first round in May 2012 and the failure of major parties to form a coalition government, the June elections were called to put an end to instability; the question was how. With Greeks viewing this General election as the ultimate opportunity to punish the ‘austerity parties’, voting would turn to polarisation and extremes.<sup>30</sup> In such a political crisis, the outcome could hardly be predicted.

It was also the first time the Greeks went back to the polls since the two bailouts of 2010 and 2011.<sup>31</sup> By this time, things had changed: Whereas for the past three decades or so Greek politics had been dominated by two parties alternating in power by promising various benefits to the electorate, in 2012 Greece was (and still is) under international financial supervision and citizens can no longer expect

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<sup>29</sup> For the importance of the WHY Questions in legal scholarship see Rob van Gestel, Hans-W. Micklitz & Miguel Poiares Maduro, *Methodology in the New Legal World*, EUI Working Paper LAW 2012/13.

<sup>30</sup> Nikos Alivizatos, *How do we Vote in Times of Crisis?*, Kathimerini, May 27, 2012 [in Greek]. See also Elias Dinas and Lamprini Rori, *The 2012 Greek Parliamentary Elections: Fear and Loathing in the Polls*, West European Politics, Vol.36:1, April 2013, 270-282, Yannis Mavris, *Greece’s Austerity Election*, New Left Review, Vol.76, July-August 2012, and Gerasimos Moschonas, *The May 2012 Elections: The Breakthrough, the Trends and SYRIZA*, Syghrona Themata, Vol.116, pp.6-7 [in Greek].

<sup>31</sup> Greece signed two bail-out loan agreements (in May 2010 and October 2011) with the ‘Troika’ (EU/ECB/IMF) for the loan of €110 billion and €130 billion respectively. Both bail-outs were conditional on the implementation of reforms and harsh austerity measures (the so-called ‘austerity packages’). For a thorough account of the ‘Greek financial drama’ see the commentary of Yannis Drossos, *Greece- The Sovereignty of the Debt, the Sovereigns over the Debts & Some Reflections on Law*, IGLP WP 7/2011.

such treats. Instead, Greeks must learn to live with austerity. As such, it was anticipated that the two-party system would not survive the crisis and that new political players would soon emerge.

The 2012 elections turned out to be a breakthrough. Greece became the first crisis-hit country in which bipartisanship collapsed, leading to greater political fragmentation.<sup>32</sup> The June Round finished with a seven-party parliament, a massive defeat of the formerly-governing PASOK and a disproportionate empowerment of opposition parties. Former opposition party New Democracy (conservatives) won almost 30%. Polarisation drew many voters to extremists on both sides of the political spectrum. The far-left SYRIZA gained 27% of the vote, while far-right Golden Dawn gained an unprecedented 7% share and made its first entry into the Greek Parliament.

What do these figures tell us? They signal the de-stabilisation of the Greek political system following a serious blow to bipartisanship,<sup>33</sup> the rise of political extremism<sup>34</sup> and even signs of a 1930s ‘Weimar Republic-like’ revival.<sup>35</sup> The new economic reality has definitely affected politics: As Greece sinks into recession, we are witnessing the erosion of the political establishment.<sup>36</sup> And the transition is certainly not going to be smooth.

### ***WHY Reactions: Would Greek Elections Stir the World?***

So how did the markets and politicians react to the Greek General Elections results? When the polls projected victory for austerity parties, global markets rose again<sup>37</sup>. The German Finance Minister Wolfgang Schäuble, following the May Round results, stated that the June Elections in Greece should be “a referendum on whether the country stays in the Euro”<sup>38</sup>. This was apparently also the opinion of German Chancellor Angela Merkel, who purportedly suggested this to the Greek President of the Democracy, although she later refuted it.<sup>39</sup>

In October 2011, former Prime Minister George Papandreou’s idea to call a referendum on the Euro was met with outrage within and outside of Greece; this led to his resignation. The interim government of Lucas Papademos, set up shortly afterwards, deferred elections until certain Memoranda-of-Understanding (MoU) measures were agreed. The idea behind the referendum and the elections was the same: *Give Greeks the power to decide on Greece’s fate, whatever that may entail.*

However, things were not that simple. If Greece was not a Eurozone country and had not already agreed the biggest bailout in western history, Greeks could indeed go carelessly ahead with

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<sup>32</sup> The June 17, 2012 General Election Results are declaratory. Former governing party PASOK (socialists) won roughly 12% of total vote (down 31%), while SYRIZA (leftists) won a massive 27%, up 22% since the former General Elections in October 2009. Source: Ministry of the Interior, <http://ekloges.ypes.gr/index.html> [in Greek] (last visited July 18, 2014).

<sup>33</sup> The decline of dominant party systems and the popularity of anti-establishment parties find provenance in international economic integration. Mark Andreas Kayser, *How Domestic is Domestic Politics? Globalization and Elections*, Annual Review of Political Science, 2007, Vol.10, 341-362 (353-57).

<sup>34</sup> As shown in the recent 2014 European Parliament Elections in Greece, the far-right Golden Dawn party has become the *third* parliamentary power gaining more than 9% of the total share of votes. See <http://ekloges.ypes.gr/may2014/e/public/index.html?lang=en> (last visited July 18, 2014).

<sup>35</sup> Mark Mazower, *For Greece and Germany a Democratic Trial Looms*, The Guardian, June 11, 2012. As the prominent historian and expert on Greece, Mark Mazower, remarks, “With Neo-Nazis in Greece’s parliament and its two-party system buckling under austerity, are the bad old days returning?”

<sup>36</sup> Takis S. Pappas, *Why Greece Failed*, Journal of Democracy, April 2013, Vol.24:2, 31-45, 43 (pointing out that ‘the current financial crisis led to the demolition of the two mechanisms that, for decades, had supported Greece’s populist democracy’, namely political patronage and triumphant polarisation).

<sup>37</sup> *Stocks and Euro Gain on Optimism About Greek Elections*, The New York Times, May 28, 2012; See also the post-election endorsement, *Markets in Asia Get Greek Spark*, Wall Street Journal, June 17, 2012.

<sup>38</sup> *Greek Vote Escalates Crisis as Schäuble Raises Euro-Exit*, Bloomberg, May 15, 2012.

<sup>39</sup> *Merkel ‘Suggests Greek Referendum on Euro Membership’*, BBC News, May 18, 2012.

referendums and elections. As things turned out, and due to poor planning, Greeks went to the polls late and aggressively. The political destabilisation of a Eurozone country in such enormous debt was a *real threat* for markets and politicians alike. At any rate, Greece would pay the price for breaching the bailout agreements.<sup>40</sup>

Thus we saw the transplantation of the Latin proverb *Pacta Sunt Servanda*<sup>41</sup> into Greek politics. Whereas ‘Pacta’, according to civil law tradition, used to legally bind only contracting parties, the bailout agreements,<sup>42</sup> if breached, would have radiating effects upon current and future Greek generations. Greek citizens may have voted for or against the bailouts, but their vote has sent signs internationally. The legitimisation or rejection of the bailouts, which came *a posteriori*, certainly looked bizarre, but it has been externally judged<sup>43</sup> by our creditors with far reaching consequences. Greek voters may have had their say on a national scale, but their expulsion from the Eurozone and a possible default would be decided on the basis of an agreement. Greece has thus undertaken long-term obligations to resolve its sovereign debt crisis and it cannot easily breach them while still remaining in the Eurozone. Here is where moral considerations come into play: Could the Eurozone stability determine – *de jure* or *de facto* – the national elections? Can democracy be contingent on how markets will react? And why should Greece matter at all?

Due to its historical fate, Greece, through its parliament, *had* to be once again ‘in the forefront of Europe’s evolution’.<sup>44</sup> The Greek Elections stirred politicians and markets alike because a possible ‘negative’ outcome would have created large waves of protest around the continent, sending signals of disobedience to foreign parliaments and creditors. But what were the signals that were eventually sent?

### ***WHY Democracy: Can Greeks – or others – Take on the New EU Order?***

Thus we get to the heart of the matter: What did these elections signify?

Greece, like Europe, is ultimately facing an existential crisis. Its institutions, primarily its Parliament, seem incapable of providing any feasible exodus from the austerity measures decided externally. Ruling parties primarily sign and ratify foreign agreements, lacking the power or even the willingness to negotiate them. Such agreements may even encroach on a nation’s constitutional provisions or impose constitutional amendments in the course of their national implementation. Fiscal policy, for

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<sup>40</sup> In Schäuble’s words, “If Greece (...) wants to stay in the Euro, then they have to accept the conditions.. No responsible candidate can hide that from the electorate...”. See *Greek Vote Escalates Crisis*, as above.

<sup>41</sup> [Latin] Agreements are to be kept; treaties should be observed. *A Dictionary of Law*. By Jonathan Law and Elizabeth A. Martin. Oxford University Press 2009 *Oxford Reference Online*.

<sup>42</sup> The nature of the agreements signed between Greece and the troika (EU/IMF/ECB) has been disputed. According to a recent ruling of the Hellenic Supreme Administrative Court, they do *not* constitute ‘international agreements’. As such, they did not require ratification by the Greek Parliament with qualified majorities of 3/5 (180 out 300 MPs) under article 28.2 of the Greek Constitution. Rather, such agreements merely constitute “political” (soft law) agreements that are not legally binding per se. Nevertheless, it was on the basis of those agreements that Greece committed. See ΣΤΕ 668/2012 (plenary session).

<sup>43</sup> See the controversial interview of IMF Director *Christine Lagarde: Can the Head of the IMF Save the Euro?*, The Guardian, May 25, 2012. When asked if voters in Greece and France were wrong to elect anti-austerity politicians, Lagarde diplomatically responded “You are never wrong when you have voted because you’ve acted in accordance with your conscience and your beliefs, and you’ve exercised your democratic right, which is, you know, perfectly legitimate in our democracies”. Nevertheless, Lagarde admits that in countries like Greece and Italy, politicians who were ‘unwilling to play by the IMF’s rules’ were ultimately ‘replaced’ by technocrats like Mario Monti and Lucas Papademos. This was of course “gifting Euro-sceptics evidence for their charge that the EU is fundamentally anti-democratic”.

<sup>44</sup> Mark Mazower, *Democracy’s Cradle, Rocking the World*, New York Times, June 29, 2011 (‘[T]oday, after the euphoria of the ‘90s has faded and a new modesty sets in among the Europeans, it falls again to Greece to challenge the mandarins of the European Union and to ask what lies ahead for the continent..’).

instance – a core area of self-government and formerly a state prerogative<sup>45</sup> – will be decided on the basis of an international agreement.<sup>46</sup> Sadly then, national sovereignty is gradually becoming *the exception* to the power rule.<sup>47</sup>

The basic notion of representation seems to have changed in the new EU order. The principal-agent theory,<sup>48</sup> prominent in representative democracy, seems not to be properly applicable anymore. The Greek Parliament, in our case, cannot function as an agent of its voters since several powers originally conferred on it have been unremittingly transferred to the EU level. Thus to avoid collapse and international isolation, the Greek Parliament now serves more as a ratifier or executor of foreign decisions. This is the modern trend: We witness the decline in the role of national parliaments who are becoming less agile as decision makers.<sup>49</sup> At the same time, we view a growing demand for the transfer of decision making powers from the national to the EU level, with a parallel diminution of the state. National democracy is being eroded.

The paradox of the story is the issue of accountability. Greek politicians, especially members of the former government, have been held accountable by the Electorate for promoting harsh austerity policies. However, most – if not all – of the present reforms being pushed for are the products of external decisions.<sup>50</sup> Nevertheless, the actual decision makers, be it the IMF, the ECB or the EU bureaucrats, have not – and cannot – be held accountable in national elections. Accountability mechanisms have and will be restricted within Greek borders.<sup>51</sup>

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<sup>45</sup> See especially Kaarlo Tuori, *The European Financial Crisis: Constitutional Aspects and Implications*, EUI Working Paper LAW 2012/28, 45 (arguing about the erosion of national fiscal sovereignty).

<sup>46</sup> Bypassing traditional communitarian methods and altering the so-called ‘Maastricht architecture’ of the European Economic Constitution. *Another Legal Monster? An EUI Debate on the Fiscal Compact Treaty*, EUI WP LAW 2012/09 (Anna Kocharov, ed.), with very interesting contributions- see, amongst others, Bruno de Witte (discussing the nature of this fiscal regulation), Hans Micklitz (raising the input / output legitimacy issue) and Miguel Maduro (discussing the existential/political crisis of Europe).

<sup>47</sup> See, however, the rulings of the German Federal Constitutional Court of September 7, 2011 on the constitutionality of the Greek bail-out and the euro rescue package and of September 12, 2012 on the constitutionality of the German acts ratifying the European Stability Mechanism (ESM) and the Fiscal Compact Treaty, 2 BvR 987/10 and 2 BvR 1390/12 respectively, according to which there was no essential violation of national budget autonomy as safeguarded by the German Parliament. See the comments of Bruce Ackerman and Miguel Maduro, *Broken Bond*, Foreign Policy, September 17, 2012 (arguing that the Court’s preliminary findings on further economic-but not political-integration will jeopardise the Eurozone in the long run, if unchanged). Also, Kaarlo Tuori, *The European Financial Crisis...*, 41.

<sup>48</sup> For an introduction to this political science doctrine see Carina Sprung, *Even More or Even Better Scrutiny? Analyzing the Conditions of Effective National Parliamentary Involvement in EU affairs*, European Integration Online Papers (EIoP), 2010, 14:02, 5-10, <http://eiop.or.at/eiop/texte/2010-002a.htm>.

<sup>49</sup> This could be viewed as a ‘post-democratic’ symptom, in the sense that existing democratic institutions may not always correspond to the political reality. See Colin Crouch, *Post-Democracy*, Polity Press, 2004. Such symptoms raise moral questions, if e.g. the EU should be treated as ‘a higher good’ that could override the interests of national politics and their representatives in democratic parliaments. See the arguments of Patricia Springborg, *Sovereignty, Organized Hypocrisy, the Paradox of Post-9/11 International Relations*, Paper presented at the 4<sup>th</sup> Annual Conference, ‘Democracy and Law in Europe’, CoE in Foundations of European Law and Polity Research, Helsinki, Finland, September 27-28 2012.

<sup>50</sup> As Yannis Drossos puts it, ‘*The decisions asked... must pass through our constitutional institutions, mainly the Parliament and the Government, so that Greece will bear the ultimate political and legal responsibility for them. Thus, we offer our creditors warranties of constitutional eminence; they don’t need to come and occupy the country*’. Yannis Drossos, *The Sovereignty of the Debt...*, as above, 41-42.

<sup>51</sup> This paradox is prevalent in other crises-hit countries, where domestic politicians are held accountable for downturns in regional or international economies affecting their own – a domestic effect of globalisation on political process. Kayser, *How Domestic is Domestic Politics?...*, as above, 346-9.

Thus, we come to understand the popularity of the ‘anti-memorandum discourse’<sup>52</sup> in our politics. Unsurprisingly, a great number of voters supported the anti-memorandum front propagating even the renouncement of the bailout agreements and a Euro exodus.

In a sense, many Greek voters might have been willing to send signs externally.<sup>53</sup> Ultimately, the elections could be seen, as suggested, as a de facto referendum on the Euro and its deficiencies. By voting massively against austerity, Greeks’ economic despair and euro-scepticism transformed into protest against the EU as a whole, signalling a detachment<sup>54</sup> from its institutions, the rise of nationalist sentiments and a strong quest for legitimacy.<sup>55</sup> In deep recession, Greeks, like other Europeans, are turning cynical about the value of a common currency and even their commitment to the European project. The question is whether the Eurozone crisis could take us backwards, towards the re-engagement of the national polity as the ‘preferred sovereign’.<sup>56</sup> The recurring dilemma “euro or drachma” widely spelled out before the Elections sadly symbolised the tragic dilemma “Greece or Europe”.<sup>57</sup> This is hard to swallow three decades after the country’s accession to the Union!

The 2013 general election in Italy is yet another example of this rising trend. With the evolving popularity of politicians like Beppe Grillo and Silvio Berlusconi,<sup>58</sup> the Italian political arena resembled a true comedy or even a *théâtre de l’absurde*. Although situated on exact opposite sides of the political spectrum, Grillo and Berlusconi shared, besides populism, a common and dominant conviction: Rejection of foreign-driven austerity and the rebirth of national pride.<sup>59</sup> Voters who had lost faith in Monti’s technocratic government or the ‘elite political castes’<sup>60</sup> elevated former comedian Grillo’s

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<sup>52</sup> Elias Dinas and Lamprini Rori, *The 2012 Greek Parliamentary Elections*...., as above, 278.

<sup>53</sup> See, for instance, *Supporters of Bailout Claim Victory in Greek Election*, The New York Times, June 17, 2012, where a Greek voter declared that the election was “...a message to Europe that you are not the boss – Mrs. Merkel, or anybody (...) We want somebody from our country to oversee our economic system”. See also Alexis Tsipras, *The Greek Message for Angela Merkel*, The Guardian, October 8, 2012.

<sup>54</sup> See Peter Lindseth, “*Of the People*”: *Democracy, the Eurozone and Lincoln’s Threshold Criterion*, article based on author’s Daimler Lecture at the American Academy in Berlin, February 8, 2012 available online at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2056760](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2056760) (last visited May 31, 2013) (pointing out the “democratic disconnect” of Europeans from the EU institutions as the biggest issue in the EU).

<sup>55</sup> The same happening in other Eurozone-creditor and debtor-countries, like Finland, Germany, the Netherlands, France, Spain and most recently, Italy. See *The Euro Crisis: An Ever-deeper Democratic Deficit*, The Economist, May 26, 2012 (*‘With no other way to influence Brussels except through governments that seem not to be listening, the cynical politics of impotence easily takes hold’*).

<sup>56</sup> See Miguel Maduro, *Europe and the Constitution: What if this is As Good as it gets?* In *European Constitutionalism Beyond the State* (J.H.H Weiler/ M. Wind, eds.), 2003, CUP (navigating the possibilities for a new concept of constitutionalism that will allow transition from the ‘sovereignty of the state’ to the ‘sovereignty of the constitution’), and the counter-arguments of Giandomenico Majone, *Europe’s ‘Democratic Deficit’: The Question of Standards*, European Law Journal, 4:1, 5-28 (questioning the standards applied to EU institutions to assess EU legitimacy) and Andrew Moravcsik, *The Myth of Europe’s Democratic Deficit*, InterEconomics, Nov/Dec. 2008, 331 (deconstructing the deficit myth).

<sup>57</sup> Other EU countries may be facing this dilemma soon as well! See Francis Fukuyama, *The Two Europes*, The American Interest, May 8, 2012. The author brings back the ‘popular’ division of Europe between the ‘hard-working, Protestant disciplined Northern Europe’ against ‘a lazy, profligate Catholic-Orthodox South’ by further adding that ‘the real division is not a cultural one; it is between a clientelistic and non-clientelistic Europe’. Nevertheless, even countries of the North like Ireland have suffered from the crisis. Clientelism may indeed be one factor of the debt crisis but cannot be the only or the deciding one.

<sup>58</sup> *Send in the Clowns: How Beppe Grillo and Silvio Berlusconi Threaten the Future of Italy and the Euro*, The Economist, May 2, 2013: ‘Italy’s political convulsions underline the need for Mrs Merkel to adapt her prescription- So far it has been a lot of austerity and some reform; it should be the other way around’.

<sup>59</sup> Nikos Xydakis, *Italy Shakes Unstable Europe*, Kathimerini, February 26, 2013 [in Greek].

<sup>60</sup> Rocco Polin, *Reform or Perish: Assessing the Results of Italy’s Latest General Elections*, ELIAMEP Crisis Observatory Working Paper No4, April 2013 (also pointing out the institutional issues- like the inefficient bicameralism and the electoral system- that contributed to the political deadlock in Italy).

Five Star Movement to become the third political force in Italy. It took two months, President Napolitano's reappointment and Enrico Letta's formation of the first right-left coalition since World War II for Italy to finally have a government, however short-term it proved to be because of Matteo Renzi's rise to power a year later. Much more so than the Greek ones, the 2013 Italian Elections signified a popular backlash against the way Europe now works: Absent legitimacy, it won't make it on the long run.

The way things finally turned out in Greece shows only the Greek idiosyncrasy. Greek voters, at the end of the day, elected *the lesser evil*, avoiding dangerous outcomes. Despite the fierce opposition to bailouts, a large share of the electorate went for the party supporting them.<sup>61</sup> The fear of being expelled from the Eurozone drew all risk-averse voters to the conservatives at the very last minute. As such, they resembled their fellow Irish voters in their Fiscal Compact Treaty referendum.<sup>62</sup> With the fear of being barred from emergency EU funding in the near future,<sup>63</sup> the recent Irish 'yes' only signifies the fatality of direct democracy in Europe today.

### ***WHY a Tragedy: Greece as a Victim of whose Vices?***

The different narratives of the crisis are endless. Upon whom should we place blame? The irresponsible bankrupt states, the greedy markets or the unhealthy system as a whole?

Paul Krugman, in a well-versed op-ed written on the day of the June Elections,<sup>64</sup> talks about 'Greece as a Victim'. His argument is clear: It is not Athens and Greeks to blame for this situation, but rather Brussels, Frankfurt and Berlin. The Eurozone crisis is primarily a systemic crisis caused by early foundational errors, mainly the absence of centralised structures to support the common currency. Due to such incomplete EU federalisation, the origin of this crisis cannot be national but rather European.<sup>65</sup> Political integration hasn't been sufficient indeed to promote our common plans.

The European Union is not, however, like the United States of America – yet.<sup>66</sup> Without an American-style federal government<sup>67</sup> and still utilising hybrid models<sup>68</sup> of decision-making, the Monetary, but

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<sup>61</sup> The conservative party New Democracy won roughly 30% on Second Round and formed a tripartite coalition government with PASOK (12%) and the Democratic Left (DIMAR) (6%). Only a year later, in June 2013, a dispute over the abrupt closure of the national state broadcaster ERT, led DIMAR to leave the ruling coalition. See *Greek Party Quits Coalition Over State TV Debacle*, Reuters, June 21, 2013.

<sup>62</sup> *EU Leaders Welcome Poll Result*, Irish Times, June 1, 2012 (quoting the President of the European Council Herman van Rompuy, "With this vote, the Irish people have given their endorsement and commitment to European integration. This result is an important step towards recovery and stability").

<sup>63</sup> Compare President Rompuy's pompous endorsement of the referendum results above with Bridget Connolly's – an Irish who Voted 'Yes' – astonishing declaration: "The treaty will solve nothing, but [...] we're going to need European money next year, plain and simple [...] We can't afford to be thumbing our noses at Europe right now." See *Ireland Votes in Favor of EU Fiscal Pact*, BBC News, June 1, 2012.

<sup>64</sup> Paul Krugman, *Greece as a Victim*, The New York Times, June 17, 2012.

<sup>65</sup> Jacques Attali, *The Crisis is in Brussels, Not Athens*, The New York Times, June 19, 2011.

<sup>66</sup> Although, as well stated, it is an 'international organisation with elements of an embryonic federation'. Bruno de Witte, *The European Union as an International Legal Experiment* in JHH Weiler/ G. de Búrca, *The Worlds of European Constitutionalism*, 2012, Cambridge University Press (exploring the legal nature of the European Union as reflected on numerous historical judicial and doctrinal interpretations).

<sup>67</sup> And it does make sense to look at the EU through the US federal example. See the persuasive arguments of Sergio Fabbrini, *Revisiting Altiero Spinelli: Why to Look at the EU through the American Experience* in: *EU Federalism and Constitutionalism: The Legacy of Altiero Spinelli* (A.Glencross/ A.Trechsel, eds.), 2010, Lexington Books (viewing both the US and the EU as 'compound democracies'-as Unions of States).

<sup>68</sup> Guiliano Amato, *A New Inter-institutional Interplay after the Treaty of Lisbon?*, *Brown Journal of World Affairs*, Vol.17:2, Spring/Summer 2011 (discussing the possible de-'hybridisation' of the EU decision-making model- a mix of intergovernmental and supranational methods - after the Lisbon Treaty).

predominately the European Union seems doomed.<sup>69</sup> Nevertheless, the rhetoric of “more Europe” misses a big point: popular support. The difficult conciliation between the economic and the political view of the EU is grounded on its peculiar constitutionalisation process, its primarily economic orientation and thus, its unique nature.<sup>70</sup> The EU remains a union of asymmetrical – be it culturally or materially – independent states. In post-national Europe, federalism could be one, but not the only, suitable option.<sup>71</sup> The complexity of the present crisis requires more flexible solutions, taking into account the national divergences, interests and politics still prevalent today, especially among the economic leaders.

In a union of growing asymmetries, the financial crisis is only making things worse. The recent Cyprus bailout – the fifth in the Eurozone in only three years – was yet another expression of the deeper political rather than merely financial *chasm*<sup>72</sup> developing between the North and the South of Europe. With the latter losing competitiveness and the former gaining it, the division between creditors and debtors, and the disturbing absence of trust among Eurozone members coupled with poor decision-making mechanisms have created an explosive mix that is threatening the Union per se. The Eurozone crisis is only ringing initial warning bells and serves to expose the growing fragmentation that may end up dividing the European Union into Central and the Periphery.<sup>73</sup>

Greece is no saint itself, either. With decades of accumulated sins, despite its considerable achievements it remains a country with very big issues: Huge tax evasion, a persistent lack of reforms, an enormous counter-productive public sector, to name only a few. And, worst of all, impunity.<sup>74</sup> Such internal issues however cannot be handled more efficiently at the national level. Here is the tricky part: Greek negative externalities will be imposed on fellow Eurozone citizens who, until the spread of the financial crisis, benefitted from the Euro at no cost. Now German or Finnish taxpayers, far remote from Greece’s issues, are nevertheless being asked to assume its costs. As Krugman remarks, in a non-federation, financial issues of one state cannot be resolved by other states without a single government. The common currency cannot work without mutualisation of debt.

Thus the tragedy: Greece may be a victim of its own vices, but it is principally the victim of European failures. Greek citizens, young and old, when faced with unpredictable chaos voted for bailouts, avoided uncertainty and gave the green light to a short-term coalition government. Plunging into debt, the alternatives for the majority of Greek voters were nowhere to be seen. *A democracy with no alternatives is a fatal democracy*. The Greek elections were only a by-product of this tragedy.

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<sup>69</sup> Charles Grant, *Is Europe Doomed to Fail as a Power?*, Center for European Reform Essays, July 2009. Contra the overoptimistic views of the likes of Jeremy Rifkin, *The European Dream*, 2004, Polity, 197-233.

<sup>70</sup> Sergio Fabbrini, as above, 57, 37-42. According to Fabbrini, the EU lacks a founding political document and thus *a political justification*. It is a ‘compound democracy by necessity’, not a democracy ‘by design’.

<sup>71</sup> Giandomenico Majone, *Patterns of Post-National Europe: The Future of Integration after the Crisis of Monetary Union*, Paper presented at the 4<sup>th</sup> Annual Conference, ‘Democracy and Law in Europe’, CoE in Foundations of European Law and Polity Research, Helsinki, Finland, September 27-28 2012 (arguing that the traditional ‘one-size-fits-all’ philosophy of European governance led to the pathologies of the EMU).

<sup>72</sup> *Lessons from Cyprus: Euro Crisis Poses Graves Dangers to EU Unity*, Spiegel, March 25, 2013.

<sup>73</sup> Giandomenico Majone, *Monetary Union and the Politicization of Europe*, Keynote Speech at the EuroAcademica International Conference “The EU and the Politicization of Europe”, Vienna, Dec. 2011, who argues that, instead of uniting Europe, the Euro will sadly end up dividing it into four different camps (‘the members of the Eurozone; the *de jure* opt outs; the *de facto* opt outs; and the drop-outs’).

<sup>74</sup> As Takis Pappas puts it well, ‘For decades, Greeks were allowed to act illegally against the state’s interests with no punishment- through rampant tax evasion, unauthorized construction, pension fraud and legislative immunity’. See the insider’s analysis of Takis Pappas, *Why Greece Failed*, as above, 35.



***The Aftermath: WHY ask the WHY Question***

Finally, we get to WHY we are asking these WHY Questions to resolve this national political puzzle. What is the added value of these queries for our research in the midst of a crisis? The WHY questions, in our case, have aided us see the four different angles – some obvious, some not – of our subject, thus helping us investigate it more thoroughly.

The 2012 Greek Parliamentary elections had for us four different dimensions. First, there was an *internal political* dimension as the outcome of political destabilization and rising extremism in crisis-hit Greece. Second, there was an *external political* dimension because the results would send varying signals to other parliaments and to the country's creditors. Third, a *fundamental systemic* dimension: The elections showed national reactions to the legitimacy crisis of European democracy. And most importantly, it had an *ethical* dimension – the elections exposed the fatality of direct democracy in sovereign-debt-ridden countries.

The four dimensions are interconnected. European systemic problems influence, as shown, national political choices: Political destabilisation may go hand-in-hand with foreign-driven austerity and the European legitimacy crisis only strengthens national sentiments<sup>75</sup> previously neglected at the cost of pro-European ones.

But national political distrust predated the EU political distrust. That, we knew beforehand. Such distrust has to do with the modern crisis of representative democracy at all levels, from local to global. In an era where decisions are increasingly taken externally, beyond the state, the notion of democracy itself is challenged every day. As such, a wider politicisation of Europe<sup>76</sup>, though required, may not necessarily do the trick.

The act of voting is, at the end of the day, an act of citizenship. But it is also the most essential such act. How we vote denotes our choices in a specific historical moment. The outcome and significance of an election varies depending on the reality in which it takes place. That is why it made sense to ask the WHY questions: These questions made us more alert of that reality.

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<sup>75</sup> And calls for the emergence of new forms of governance of the Eurozone. See, e.g., Stefan Collignon, *The Governance of European Public Goods*, June 2011, online at <http://www.stefancollignon.de>.

<sup>76</sup> See, e.g., Miguel Maduro, *A New Governance for the EU and the Euro: Democracy and Justice*, RSCAS Policy Paper 2012/11 (proposing a new political and social justification of the EU project through the emergence-and empowerment-of a European political space to complement the national ones).

## WHAT COURTS DO WHEN THEY DO WHAT THEY DO

Jan Zglinski\*

### *Introduction*

Courts take decisions. These decisions are based on reasons.

This conventional wisdom constitutes a proposition which sounds familiar to all of us, one we grew deeply accustomed to in the course of our legal socialisation. It is against this background that the thesis suggested by the course convenors of the WHY-seminar stirred up considerable perplexity among the participants: Perhaps courts should not provide any reasoning for their decisions at all.

The debate in the seminar room quickly revealed that a number of inconvenient problems arise from our seemingly innocent initial statement. If we are to believe that courts, *through* the exercise of legal reasoning, come to a certain conclusion (the decision), it might seem puzzling that they sometimes reason their decisions, but sometimes do not. Sometimes they give us all of their reasons to take a certain decision, sometimes they give us only some of them. Even more disturbingly, sometimes they explicitly give us a set of reasons that are not the true driving factor behind their decision, i.e. other reasons have determined the outcome.

Here, at the very latest, a shade of existential angst enters the stage. There seems to be something disturbing about this inconsistent practice of the judiciary. In a legal-therapeutical exercise, we might try to explore its foundations: Why does the reason-conundrum leave us so baffled?

Traditionally, we believe reasoning to be the necessary and essential middle part between facts and outcome. The work of courts, on this account, is a three-step exercise:

facts → reasoning → outcome

Reasoning means recognising all relevant legal sources, such as norms, customs and precedents, which are, by way of interpretation, translated into a rule that solves the legal problem at stake through application to the facts. Reasoning, thus, is a rational process which converts the more general legal sources into the answer for the concrete legal dispute.

When engaging in legal scholarship, we often mimic this process in reverse: We take the outcome of a case and examine whether, by means of reasoning, the relevant legal sources justify the transformation of the facts into the particular outcome. We pretend, in a way, to be the court in the relevant case, too.

Against this background, it becomes apparent why the ambiguities connected with legal reasoning (rightly) bother us. If courts do not treat reasoning as seriously as we do, or assign a different role to it, we face a major problem. We do not really understand the object of our study. The question is as simple as it is crucial: What do courts *really* do? Or, to re-formulate it in the context of the European Union: What does the Court of Justice really do?

The margin of appreciation doctrine in the Court's case-law on Member State restrictions of free movement rights will serve as an example for our inquiry. We will see that the answer to the above question has significant consequences not only for the methodology but also for the final result of an analysis of the phenomenon. Our starting point is the traditional view sketched above. To

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\* Jan Zglinski, MJur (Oxon), PhD candidate at the European University Institute. I would like to express my gratitude to the participants of the WHY II-seminar for an intense debate on the propositions advanced in this essay. Special thanks go to Miguel Maduro for insightful comments on an earlier draft and James Gerard Devaney for linguistic improvements. The usual disclaimer applies.

conceptualise the margin of appreciation, in accordance with that account, means to identify a set of legal criteria inherent to EU primary law that can explain the use of this doctrine by the Court in different factual scenarios.

Hereinafter, a sketch of how this approach must change once its foundations have been challenged will be drawn. In a first step, we will re-think our perception on the role of the Court as a mere reason-processor and stress its creational role for law (II.). Then, we will turn to examine the limited role of explicit reasoning within the work of courts (III.). Finally, we will make the case for an approach incorporating more than only legal reasons, which will help us to deal with judicial decisions more adequately (IV.).

### ***Discovering versus Creating: Court Action as Choice***

It is a truism that there is often more than one answer to a legal question. As lawyers, we know that this is due to several factors inherent to law such as the vagueness of legal language, the possibility of gaps in the legal system, and collisions of different norms.<sup>77</sup> It is instructive, in this regard, to note that legal vocabulary tends to speak about ‘persuasive’ rather than ‘right’ answers.<sup>78</sup>

Against this background, it seems surprising that one fundamental feature of the work of courts has, so far, only rarely been taken into account by European Law scholars: The element of choice. Mainstream legal thinking still perceives courts as *recognising* or *discovering* rather than *creating* law. This way of thinking is, in fact, deeply enrooted in our legal tradition, dating back as far as to the French Revolution’s distrust towards the adjudicative process (*‘le juge est la bouche de la loi’*), and has found its way to modern constitutional law reformulated in concepts such as the separation of powers and the rule of law. The logic is simple: Judges, by means of legal reasoning, discover the correct outcome of a case, i.e. the one embodied in the legal sources.

The European project and the Court of Justice as one of its central figures is just one example of how far from adequate this picture is. We have witnessed plenty of moments of choice in the Court’s case-law. Among the best-discussed ones are principles such as direct effect,<sup>79</sup> supremacy<sup>80</sup> and fundamental rights protection.<sup>81</sup> Why do these principles constitute instances of choice? The above decisions were only one of at least two equally possible outcomes (positive or negative); on the basis of the available legal sources and means of interpretation, the Court could have equally decided to *introduce* or *not to introduce* the relevant principle. The Treaties had remained silent on all of these matters, and different arguments could have been and were indeed advanced to back up either position. A choice, thus, had to be made. At least on a theoretical level, it seems far from impossible to imagine the EU working without the above features, which now form part of its constitutional DNA. When authors sympathetic to the Court’s case-law comment on these issues by saying ‘it was all in the Treaties’, this creates a fiction of logical deduction, i.e. it makes it sound as if, in fact, there was only one option and not two (or even more). This fiction, despite having the ‘noble’ purpose of legitimating highly contested decisions, has an unfortunate drawback: It denies the creative and creational role the Court of Justice has had throughout the past six decades

The term ‘judicial activism’ that pervades debates of this kind is therefore somewhat misleading. It makes it sound as if courts, by making a choice and thus creating law, stepped out of their regular role.

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<sup>77</sup> cf. Robert Alexy, *Theorie der juristischen Argumentation* (Suhrkamp 1983) 17.

<sup>78</sup> Ronald Dworkin’s ‘right answer thesis’ is, of course, a famous exception to this rule; cf. *A Matter of Principle* (HUP 1985). However, even Dworkin acknowledges that lawyers, including the most gifted among them, tend to disagree about many legal questions, a prime reason for him to actually create the infamous judge Hercules.

<sup>79</sup> Case 26/62, *Van Gend & Loos* [1963] ECR-I

<sup>80</sup> Case 6/64, *Costa v ENEL* [1964] ECR-585.

<sup>81</sup> Case 29/69, *Stauder* [1969] ECR-419.

The opposite is true. To think of courts as merely applying prefabricated solutions to legal disputes would fundamentally undervalue their place in the institutional construct. Miguel Maduro writes that ‘when the Court is called upon to hear a case it must make a *decision*’.<sup>82</sup> We might paraphrase this sentence to state our point: When the Court is called upon to hear a case it must (often) make a *choice*.<sup>83</sup>

The interplay between the margin of appreciation and the principle of proportionality illustrates this point. A lot of academic effort has been put into clarifying and delineating the tenets of proportionality analysis as used by the Court of Justice. The result is a fairly broad consensus on conceptualising proportionality as a four-stage inquiry: Legitimate aim, suitability, necessity and proportionality *strictu sensu* (balancing).<sup>84</sup>

Once provided with this relatively clear set of requirements, we might be tempted to use it as an explanation for the whole of the Court of Justice’s case-law. We will quickly discover that the Court – despite constantly invoking the above test<sup>85</sup> – occasionally does not engage in the balancing exercise,<sup>86</sup> refrains from double-checking the suitability of a national regulatory framework,<sup>87</sup> or leaves the decision regarding the necessity of a policy measure to the relevant Member State.<sup>88</sup> These deviations are symptoms of the margin of appreciation, and they lead to different levels of scrutiny. The fewer questions examined by the Court of Justice itself, the lower the intensity of judicial review. The divergence in use of the supposedly same test, i.e. proportionality analysis, might seem to be paradoxical at first sight. A common line of criticism has therefore been to point out that the Court is being inconsistent or, even worse, is simply wrong. As a mere processor of reasons it should have taken the facts and simply put them through the four stages of the proportionality-test identified above. We might, however, turn the vice into a virtue. The proportionality-hodgepodge shows all too well that the Court makes a choice every time it carries out the scrutiny of a Member State act. Even a seemingly clear and rigid test such as proportionality is, in fact, fairly flexible, and the Court uses this flexibility in order to vary its activity.

The choice-based perspective, this way, radically changes the approach to phenomena such as the margin of appreciation. Had we thought that the case law was an attempt of the Court of Justice to deduce a doctrine from the legal sources available to it, our focus must necessarily be altered now. The Court moves from being a mere mechanical device *discovering* the margin of appreciation to the *creator* and (*selective*) *user* of this tool; it is the institution which, when examining national regulations, chooses to apply or not to apply it.

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<sup>82</sup> Miguel Poirares Maduro, *We, the Court* (Hart 1998) 16.

<sup>83</sup> It is highly instructive to see how many instances of judicial choice Bengoetxea, a commentator well acquainted with the workings of the Court of Justice, identifies in preliminary reference procedures; cf. Joxerramon Bengoetxea, ‘Legal Reasoning and the Hermeneutic Turn in the Law – Remarks on the Court of Justice’ in Ulla Neergard, Ruth Nielsen and Lynn Roseberry (eds.), *The Role of Courts in Developing a European Social Model* (DJOF 2010).

<sup>84</sup> cf. Paul Craig, *EU Administrative Law* (OUP 2006), 665 et seq; Grainne De Burca, ‘The Principle of Proportionality and Its Application in EU Law’ (1994) *Yearbook of European Law*, 105; Mattias Kumm, ‘Internationale Handelsgesellschaft, Nold and the New Human Rights Paradigm’ in Miguel Poirares Maduro and Loic Azoulai (eds.) *The Past and Future of EU Law* (Hart 2010), 106.

<sup>85</sup> To be sure, the Court of Justice has, e.g. with respect to EU institutions, sometimes resorted to a different test (‘*manifestly inappropriate*’); cf. Case C-331/88 *Fedesa* [1990] ECR I-4023, para 14. In the context of Member State restrictions of free movement rights, however, the use of proportionality analysis has been surprisingly constant; cf. Case C-36/02 *Omega Spielhallen* [2004] ECR I-9609; Case C-42/07 *Liga Portuguesa* [2007] ECR I-7633, para 55; Case C-169/07 *Hartlauer* [2009] ECR I-1721, para 44.

<sup>86</sup> Case C-244/06 *Dynamic Medien* [2008] ECR I-505.

<sup>87</sup> Regarding the consistency and systematicity requirement, which the Court of Justice locates in its assessment of the suitability of the regulation at stake, cf. Case C-262/02 *Commission v France (Loi Evin)* [2004] ECR I-6569; Case C-429/02 *Bacardi France* [2004] ECR I-6613.

<sup>88</sup> Case C-42/07 *Liga Portuguesa* [2007] ECR I-7633.

### ***Reasoning versus Reasons***

Having explored the possibility of varying judicial outcomes, we can now turn to the question of legal reasoning. We had, at the outset, identified legal reasoning as the necessary middle part between facts and outcome.

If reasoning is so central to the work of courts, we might be baffled by the role and use of reasoning in judgments. Already in our introductory remarks, we have seen that reasoning is far from being a constant and coherently used element in legal decisions. Just as its extent varies (how many reasons are made explicit, how detailed is the reasoning etc.), the issue of whether reasoning is given at all varies from case to case.

We might feel dissatisfied with this situation. If law is supposed to be guiding social behaviour,<sup>89</sup> offering no reasons can seriously undermine this function. It would make a huge difference for me as a plaintiff to know what the courts – in similar cases to mine – have actually based their judgments on, i.e. which particular element of the facts has influenced the outcome. Reasoning makes it both possible to describe existing and predict future case-law.

In light of our findings in the previous part of this paper, we may find the sloppy handling of reasoning even more deplorable. If court action is characterised by choice, we should get to know how the relevant choices come about. If judges move from being mere legal craftsmen to part-time legislators, we should require even more from them than traditional legal reasoning. We might go with Neil MacCormick and call for ‘second-order justifications’, i.e. the justification for taking ‘choices between rival possible rulings’.<sup>90</sup> This would be a normative statement directed towards courts.

The problem with telling courts what they should do is that they might follow our advice, or they might not. A look at the case law relating to the margin of appreciation is instructive in this regard. When, in *Schmidberger*, the Court of Justice grants the Member States a ‘wide margin of discretion’<sup>91</sup> to reconcile the free movement of goods and the freedom of assembly, and thereby strongly modifies its standard proportionality test, it does not provide us with any reason for this move. While underlining the ‘moral, religious or cultural’ sensitiveness of gambling as an explicit reason for introducing a margin of appreciation in *Schindler*,<sup>92</sup> the Court does not even mention this aspect in many other cases turning on morally contested and culturally sensitive areas, such as collective action (*Viking Line*,<sup>93</sup> *Laval*<sup>94</sup>), national security (*Dory*<sup>95</sup>) or prostitution (*Jany*<sup>96</sup>).

As the Court of Justice proves not to be receptive to our suggestion, we might try another move. Instead of deliberating on the consequences of our choice-based view for courts and their reasoning, we might address the role of another actor: us, as legal scholars.

Let us take the extreme case of *Schmidberger* in which no reasoning was provided. Are we supposed to think that there simply were no reasons in this case regarding the question ‘strict proportionality *versus* margin of appreciation’? Did the Court simply flip a coin? Given the numerous examples of strict scrutiny of national free movement restrictions in previous case law, and the large amount of possible arguments for either option, it would be bizarre to think that the Court of Justice did not think at all about *why* to refrain from the balancing exercise and entrust it to the Member State authorities.

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<sup>89</sup> cf. Joseph Raz, *The Authority of Law* (OUP 1979).

<sup>90</sup> Neil MacCormick, *Legal Reasoning and Legal Theory* (Clarendon 1978) 101.

<sup>91</sup> Case C-112/00, *Schmidberger* [2003] ECR I-5659, para 82.

<sup>92</sup> Case C-275/92 *Schindler* [1994] ECR I-1039, para 60.

<sup>93</sup> Case C-438/05 *Viking Line* [2007] ECR I-10779.

<sup>94</sup> Case C-341/05 *Laval* [2007] ECR I-11767.

<sup>95</sup> Case C-186/01 *Dory* [2003] ECR I-2479.

<sup>96</sup> Case C-268/99 *Jany* [2001] ECR I-8615.

To be sure, this would not sit easily with our basic assumptions about the adjudicative process in general either. Taking a decision in a legal dispute is, to a large extent, a *reflected* act. Facts and outcomes are not randomly cobbled together; if we did not care about a certain type of link between them, we might also entrust the work of judges to slot machines. Although many academic commentators seem to think so occasionally, court decisions, even if not accompanied by formal reasoning, are not *reasonless*. Only looking at the formal reasoning might, however, mean not looking wide enough.

The bottom line of our findings is simple: Reasoning does not necessarily equal reasons. Underneath the explicit line of arguments which appears in the judgment (*reasoning*), there might be a variety of other factors the court found to be relevant for the determination of its decision (*reasons*). To put it differently, there is a world beyond reasoning. This transforms legal scholarship into the observer of a play, parts of which take place behind the scenes. The challenge is: We do not have a backstage pass.

### ***Taking Courts Seriously***

Leaving the realm of explicit or formal reasoning creates an important follow-up problem for us. If we had dwelled safely in the relatively clearly delineated universe of legal reasons as determinants of court decisions before, we need to face the question of boundaries now. We can think of various factors – political, social and psychological, just to name a few – that might possibly be relevant for the outcome of a judgment taken by a court. But which are the ones of possible significance for us? At what features could and should our inquiry be directed?

A first, obvious possibility might be to conceive of reasons, even those not made explicit in the relevant judgment, as being limited to what are commonly held to be *legal* reasons, i.e. legal sources and methods of interpretation. On this account, courts, even if they did not always tell us about it, would be engaging in a fully-fledged reasoning exercise including, but also limited to the legal reasons relevant to the case at play. They would consider and weigh arguments such as the wording of a provision, the intention of the legislature and the coherence with other norms within the legal system. Any factor beyond the sphere of the strictly legal would have no role in this picture.

A conception along these lines would strongly overestimate the importance of the legal (so defined). A famous study conducted by *Segal and Spaeth* – exemplary for many of its kind – has shown a 71 % correlation between political views of U.S. Supreme Court judges and their opinions in selected areas.<sup>97</sup> We might argue that 71 % means that this factor alone cannot account for all decisions taken<sup>98</sup>; it would, however, be presumptuous to think we could simply ignore it. When the Court of Justice in *Keck and Mithouard* almost explicitly communicates that it feels overloaded with the amount of cases it needs to deal with under the provision of free movement of goods,<sup>99</sup> we are outside the realm of classic legal argumentation.<sup>100</sup> When in *Grogan*<sup>101</sup> the case is dismissed on the basis of a very narrow the scope of application of the freedom to provide services, it is almost tangible that factors other than

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<sup>97</sup> Jeffrey Segal/Howard Spaeth, *The Supreme Court and the Attitudinal Model* (CUS 1993).

<sup>98</sup> cf. Brian Leiter, *Naturalizing Jurisprudence* (OUP 2007), 192.

<sup>99</sup> Cases C-267 and 268/91, *Keck and Mithouard* [1993] ECR I-6097, para 14. The Court of Justice justifies his move on the basis of ‘the increasing tendency of traders to invoke Article 30 of the Treaty as a means of challenging any rules whose effect is to limit their commercial freedom even where such rules are not aimed at products from other Member States’.

<sup>100</sup> This is demonstrated by the fact that the issue of the judiciary’s workload, although permanently present and of crucial importance for the way in which the adjudicative process operates, is hardly ever addressed in court decisions in a direct way. Workload seems to be outside the socially acceptable in standard legal argumentation.

<sup>101</sup> Case C-159/90, *Grogan* [1991] ECR I-4685.

legal ones have determined the outcome. There is a lesson to be learned from this: If we want to take courts seriously, we must move beyond the strictly legal.<sup>102</sup>

Having said this, let us return yet another time to *Schmidberger*. Against the background of the above, we might re-think the possible determinants for the Court's decision. Within the sphere of standard legal reasoning, the following reasons can be recognised: The objective of the Treaties to create an internal market tells us to interpret derogations from free movement rights narrowly; the established case-law on free movement speaks in favour of a strict proportionality-test; on the other hand, the Treaties make clear that fundamental rights protection is equally important in the EU; also, national diversity has a standing under European Law to some extent.

All of these reasons are valid and should be taken into account by us. However, our inquiry cannot stop at this point. We need to go further and include other possible factors: Did the Court think that the national authorities were better equipped to assess the question? Was it convinced that they were, in general, doing a good job in protecting fundamental rights? Did the Court trust the referring court in this respect? Would it have had the time and resources to substantially examine the question? Who rendered the decision, the Great Chamber or a 5-judge chamber (and which judges were involved)? And perhaps we should, even in continental Europe, go as far as asking: have the judges been predominantly right-wing or left-wing, euro-sceptic or euro-enthusiast?

With great certainty, not all of these factors had an equal role in determining the outcome of this particular case and in shaping the doctrine of the margin of appreciation in general. The relative significance of issues such as the judges' political attitude or workload is likely to substantially vary on different occasions. Also, we should not fall into the trap of over-correction: More traditional legal arguments and considerations might have a significant role in many cases. The relationship between legal and extra-legal reasons should therefore be thought of as being one of heterarchy rather than of hierarchy. In the end, it is this patchwork picture we have to face when analysing the activity of the adjudicative process. Despite the complexity caused by this, the important point is that both realms are, to a variable extent, relevant for the outcome of judicial decisions, and must therefore be taken into account.

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We have come a long way. Let us recapitulate. We had started off by believing that we could logically deduce a doctrine such as the margin of appreciation from the available and relevant legal sources by means of legal reasoning. By abandoning the view of the Court's role as a mere reason-processor, and ceasing to limit our inquiry to the explicit reasoning given in the case-law, we ended up with an approach which equally recognises legal and extra-legal reasons as potential determinants of court decisions of diverging relative significance. It seems we have come full circle: Our initial statement is valid, but in a different way from how we might have expected it to be. Courts *do* take decisions, and these decisions *are* based on reasons. Their range, however, is much broader than the formal reasoning provided in most judgments could make us believe, a fact which must have implications for our work as observers, commentators and critics of the judiciary.

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<sup>102</sup> Alternatively, our concept of the legal must be redefined. This approach, however, will work better for some aspects and less well for others. The question of judicial workload, for example, could relatively easily be translated into standard legal terms. The German Federal Constitutional Court holds the 'functionality' (*Funktionalität*) of an institution, of which the workload is a central part, to be an element of the principle of the rule of law (as the creation and application of law requires institutions which function reasonably well). Other issues, however, will be much more difficult to incorporate into a re-shaped vision of the legal; the above-mentioned divergences in acquittals before and after lunch, decision-making according to the judges' political views, and the existence of race or social class biases can serve as examples.

It is this very issue which seems to have raised the biggest controversy among the participants of the seminar. If all of the above is true, should we perhaps inquire into what judges had for breakfast rather than into which statute book they apply? Although we might venture the guess that food habits of judges are unlikely to influence the outcome of court decisions in a considerable way, the crucial point of this essay was to show that we would be wrong in categorically ruling out their relevance and that of other extra-legal factors. This surely makes our task more complicated given the sheer width of possible determinants. There is, however, no reason to believe that legal scholarship would be in principle unfit for this project and could not, on the basis of a trial-and-error approach which is common to many other disciplines, progressively identify the most relevant factors in this respect. If we long for the most adequate picture of what courts do, this burdensome exercise is unavoidable.



# **‘WHY EFFICIENCY?’: A RESEARCH AGENDA FOR AN EXPLORATORY ACCOUNT OF DEFAULT RULES AS ‘CHOREOGRAPHERS’ AND A TENTATIVE CONCEPT OF REGULATORY CONTRACTUALISATION**<sup>103</sup>

*Lécia Vicente\**

‘...no matter how free and independent man had been previously, there he was now, because of a multitude of new needs, subject, as it were, to all of nature and, above all, to his fellow men, to whom he has, in a sense, become a slave, even in becoming their master: if rich, he needs their services; if poor, he needs their help, and being between the two does not enable him to do without them. Thus, he must seek without pause to interest them in his lot and to make them discover a real or apparent profit for themselves in working for his’.

Jean Jacques Rousseau

*Discourse on the Origins of Inequality, II.*

## ***Abstract***

This essay is an exercise that fitted into a broader research work the author conducted for her own PhD dissertation. At that time, doctoral researchers at the European University Institute were challenged to think thoroughly about methodology in law. I accepted that challenge. As a consequence, this essay was first and foremost an attempt to conciliate law and economics from the spectrum of game theory. In this essay, I argue that existing default rules often fail to either protect shareholders from collective action problems inside private limited liability companies, or that they prevent shareholders from being able to unload their shares when desired. In other words, the weakness of particular corporate default rules is two-sided. Here, I focus mainly on the first side, that is to say, I address the collective action problem. This is demonstrated with the model of shareholders’ coordination I present herein. With this model, I illustrate how a collective action problem can force shareholders to sell lower than their total valuation of the company because they believe others will sell and, thus, they will lose power over the company’s future policies. At the end, I propose solutions that are meant to stimulate discussion about which design of default rules is more likely to overcome ownership problems deriving from the inefficiency of transfer of shares in private limited liability companies (PLLCs) – the most commonly used private units of economic development.

## ***Introduction***

This essay stems from a challenge I was given while I still was a doctoral researcher at the European University Institute. This challenge consisted of thinking about methodology in law. I began this task by inquiring about the method that lawyers effectively use in legal research, but in fact I was challenging myself to disclose my preconceptions and the values by which I was guided. This was not an easy task to accomplish, since mainstream ideas shape many of our preconceptions, such as those

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<sup>103</sup> An earlier version of this paper was presented at the 29th Annual Conference of the European Association of Law and Economics (EALE) which was held on September 20-22, 2012 in Stockholm, Sweden at Stockholm University. I thank the participants for their comments.

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informing the debate about efficiency in law and economics. I would not say that this sort of ‘herd behaviour’ that has characterised legal research in recent years is necessarily good or bad. Rather, it should not prevent us from asking the right questions like the following: Why efficiency? Why law and economics? Why should a legal researcher who has been used to the restrictive language of entitlement, rights and duties in contracts, rather consider assumptions of costs, benefits and tradeoffs in transactions? Why should one take efficiency seriously? The need to ask the right questions is relevant in particular because of the rising interdisciplinary scope of legal research. This is already a reality in countries such as the United States, where law is undertaken as a subject of postgraduate study.<sup>104</sup> This means that students, researchers, professors and academics in general perceive it from different disciplinary standpoints such as business, economics, engineering, biology, psychology, mathematics, political sciences, history, and philosophy, among others. Additionally, there is an interesting phenomenon of disciplinary exchange. Legal scholars are increasingly embracing interdisciplinary research. In this context, not only law, but also business departments become a forum for discussing key contributions of legal scholars, research strategies and methodological tools. Ideas turn out to be versatile and are discussed in different contexts through different conceptual frameworks. The crux of the matter, however, is to discover the right methodological approach that is most likely to unveil the essence of a particular problem. In the absence of a self-sufficient legal method, interdisciplinary research has successfully help strip ideas from their conceptual frameworks and shed light on the essence of legal institutes so often crystallised in legal codes and common law.

This situation is becoming increasingly true of legal research in Europe and the outcome is often fairly good. Therefore, discussing efficiency and tools normally used by law-and-economics advocates, can shed some light on different types of discourse fleshing out the law. Why is this important? First, it is important to help us overcome prejudices regarding other forms of normative arguments. Second, it is important because once we understand these arguments we are then freer to make our own choices as to how to convincingly approach our own research.

Efficiency is a multifaceted and accordingly a complex subject. Notwithstanding the complexity of and the debate about the subject, I am not sceptical of conceiving efficiency as a normative standard for legal policy, rules and argumentation. However, I am not a worshiper of this approach either as I am ready to put into question the reasons normally advanced in favour of efficiency-based reasoning.<sup>105</sup> I believe that the key point is honesty and, therefore, to state clearly that an underpinning concept of efficiency motivates a particular research. In this essay, I adopt a particular concept of efficiency regarding the transfer of shares of private limited liability companies (PLLCs) when there are problems of collective action inside such companies. These problems can force shareholders to sell their shares at a value lower than that at which the shares are worth. This occurs because shareholders believe that others will sell and, as a consequence, if they do not subsequently also sell, they will lose power over the future policies of the company. Thus, for me, a transfer of shares improves efficiency if it increases the combined players’ utilities under new ownership, or in other words, the overall utilities in the company. I claim that efficient ownership rules maximise utility in the economy. I ask: why efficiency as a normative legal standard? Because, according to the ownership model I am presenting, efficiency matters.

My analysis is based on a number of case-studies that I collected to write my PhD dissertation. They are decisions regarding un-consented transfers of shares adjudicated by high courts in two Southern

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<sup>104</sup> See Garoupa, Nuno and Ulen, Thomas S., ‘The Market for Legal Innovation: Law and Economics in Europe and the United States’, *Alabama Law Review*, vol. 59, 2008, pp. 1555-1633.

<sup>105</sup> For instance, see Coleman, Jules L., ‘Efficiency, Utility and Wealth Maximization’, *Hofstra Law Review*, vol. 8, 1979, pp. 509-551 (criticising the various normative strategies for defending the pursuit of Pareto efficiency standards. Furthermore, Coleman states that even if Paretianism constitutes an adequate moral theory, it does not follow from the adoption of efficiency as a goal that every agent or actor, regardless of his or her institutional role and the conditions or facts that determine his or her course of action, has the obligation or authority to promote efficiency).

European countries, Italy and Portugal. Research undertaken thus far has revealed that ownership rules do not efficiently regulate transfers of shares in PLLCs. Most of these rules are default rules, that is, rules designed by legislatures and from which investors may opt out when drafting their firms’ contractual framework. This contractual framework is often referred to as the articles of association or articles of incorporation. At a certain point, shareholders of these firms have problems combining their actions. First, there is an inherent status quo that shareholders desire to maintain in PLLCs. Shareholders, therefore, do not contract around default rules regulating their ownership rights, even when that would be desirable. Second, shareholders often do not understand or know the rule-set they have chosen (probably because they have been badly advised). As a result, shareholders frequently transfer their shares in breach of their firms’ contractual framework that is based on the default rules they have not opted out from. My goal is, by making considerations about the efficiency of these ownership rules, to set up a research agenda in corporate law that thinks of default rules as nudging mechanisms or ‘choreographers’.<sup>106</sup> They would have the ability – as choreographers – to make shareholders coordinate their actions in an organic fashion, and in this way, improve the efficiency of ownership of shares held in these companies.

This essay is organised as follows. Section two relates the research agenda proposed with the debate on economic efficiency. It also includes an account of Olson’s theory and the collective action problems it addresses, and applies that theory by analogy to PLLCs, especially when they have a considerable dimension. Section three presents a model of a game to illustrate the problem of shareholders’ coordination in these companies. Section four suggests a new concept of regulatory contractualisation to overcome inefficient regulatory alternatives preserved by national legislation. This concept is closely linked to the exploratory account of defaults as choreographers I additionally present in this essay. I claim that, as choreographers, ownership rules with the legal form of default rules should have an enabling capacity to coordinate actions of the members of these firms, particularly when they act simultaneously or also are part of the firm’s management body. Section five concludes.

### ***The Efficiency Debate: Some bread-and-butter considerations and the Olson problem in private limited liability companies***

There are several definitions of efficiency of which the Pareto and the Kaldor-Hicks standards are the most relevant.<sup>107</sup> Additionally, the so-called Coase theorem, which has been subject to countless academic studies,<sup>108</sup> forms the fundamental basis of the theoretical analysis of efficiency of legal policy and rules. I will not define each of these efficiency-related concepts. This essay will not focus on matters referring to the philosophical foundations of law and economics. Further, I will not treat the opposition between positive and normative economics; neither will I take a position on the debate about the normative justification of efficiency as a criterion to analyse legal rules. This debate is mostly jurisprudential. It has been dividing authors for at least thirty years and a position cannot be sufficiently taken without a relevant theory of adjudication.<sup>109</sup> I am inspired by the work of authors

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<sup>106</sup> See Gintis, Herbert in idem, ‘Bayesian Rationality and Social Epistemology’, *The Bounds of Reason: Game Theory and the Unification of the Behavioral Sciences*, Princeton, Princeton University Press, 2014 (referring to social norms as choreographers).

<sup>107</sup> For a reference to at least four concepts of efficiency - productive efficiency, Pareto optimality, Pareto superiority and Kaldor-Hicks efficiency, see Coleman, Jules L., cit., in particular pp. 512-514.

<sup>108</sup> See Polinsky, A. Mitchell, ‘The Coase Theorem’ in idem, *An Introduction to Law and Economics*, 3<sup>rd</sup> ed., Aspen Publishers, 2003, pp. 13-16.

<sup>109</sup> See Posner, Richard, ‘Utilitarianism, Economics, and Legal Theory’, *The Journal of Legal Studies*, vol. 8, 1979, pp. 103-140 (119-127); Dworkin, Ronald, ‘Is Wealth a Value?’, *The Journal of Legal Studies*, vol. 9, 1980, pp. 191-226 (196-201); Kaplow, Louis, and Shavell, Steven, ‘Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income’, *Journal of Legal Studies*, vol. 23, 1994, pp. 667-681 (667-674); Kennedy, Duncan, ‘Law-and-Economics from the Perspective of Critical Legal Studies’, in Peter Newman (ed.), *The New Palgrave Dictionary of*

such as Polinsky and Shavell and, therefore, I am interested in determining in the abstract what type of default rules would be efficient in overcoming problems of combining action of shareholders in PLLCs.<sup>110</sup> Certainly, my analysis will have positive and normative implications as to the organisation of PLLCs, especially when shareholders act simultaneously in the context of a proposed acquisition of a share. In these circumstances, Pareto optimality is a necessary condition, but it is not the only one.

For the purposes exposed above, I use thirty Portuguese and ten Italian court decisions as case-studies. These cases are related to the un-consented transfer of shares (*quotas*)<sup>111</sup> in the Portuguese PLLC (*sociedade por quotas*) and the un-consented transfer of shares (*partecipazione*) in the Italian PLLC (*società a responsabilità limitata*).<sup>112</sup> A transfer of shares is un-consented if the holder of that share sells it without the consent of the company required by the default rule provided by the legislature and introduced by shareholders in the firm's articles of association. A transfer is also un-consented if its holder sells the share in breach of the articles of association, which foresee the consent of the company to that transfer, even when the law establishes a default principle of free transferability. The legal framework is the following. Article 228 (2) of the Portuguese Commercial Companies Code states that the transfer of shares between parties is binding but has no effect on the company unless it consents to the transfer. This means that if a purchaser buys a share in a Portuguese PLLC without the company's consent, they have property rights in the share, but no rights in the company. Differently, Article 2469 of the Italian Civil Code (*Codice Civile*) provides that one can freely transfer shares unless otherwise established by the articles of association.

Court decisions in Italy and Portugal on disputes brought to courts by non-transferring shareholders against the shareholder who transferred their share without the consent of the company (or in breach of a particular clause of the articles providing other restrictions on the transfer) present interesting facts. In the Portuguese case, parties to the articles of a company often copy the default and, therefore, introduce restrictions on transfer of shares, namely the requirement of consent of the company and pre-emption rights, or rights of first refusal. In the Italian case, despite the principle of free transferability, shareholders normally introduce the same sort of restrictions (the requirement of consent or *clausole di gradimento*, and pre-emption rights or *clausole di prelazione*). Additionally, under the principle of free transferability, other restrictions are introduced in the articles of Italian PLLCs such as clauses prohibiting the pledge of shares and their usufruct (*clausole impeditive e limitative del pegno e che limitano il godimento*), and *in limine* clauses absolutely prohibiting any kind of transfer (*clausole di intrasferibilità assoluta*). The case law selected suggests that Italian and Portuguese cases have something in common. At a certain point, shareholders seem to lack incentives to stay in the firm and just sell their shares in breach of the restrictions imposed by the articles of association or contractual framework of the firm. Often, shareholders do not hold much knowledge about the articles and frequently do not understand them.<sup>113</sup> But often shareholders still breach the

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*Economics and the Law*, New York, 2002, pp. 469-473; Kaplow, Louis and Shavell, Steven, 'Fairness versus Welfare', *Harvard Law Review*, vol. 114, 2001, pp. 961-1388.

<sup>110</sup> The assumption that shareholders have problems combining their actions is based on empirical work I conducted for my own PhD dissertation. See Vicente, Lécia, *The Requirement of Consent for the Transfer of Shares and Freedoms of Movement: Toward the Liberalization of Private Limited Liability Companies - A Comparative Study of the Laws of Portugal, France, Italy, Spain, the United Kingdom and the United States and its Interplay with EU Law*, URL: <http://cadmus.eui.eu/handle/1814/7088>.

<sup>111</sup> Portuguese PLLCs' shares are called *quotas*. Some writers refer in English to the private limited liability company's owners as quotaholders. Nevertheless, for ease of reference, I shall refer to quotas as shares and quotaholders as shareholders.

<sup>112</sup> Using as a case study of regulatory dualism offered by another Portuguese speaking country, Brazil's New Market (*Novo Mercado*), see Gilson, Ronald J. et al., 'Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the U.S., and the European Union', *Stanford Law Review*, vol. 63, 2001, pp. 475-538.

<sup>113</sup> It is intriguing that shareholders, despite ignoring the articles of the company, still endeavour to create the business association and work out their relations as members of the same company by sharing profits and taking collective decisions.

articles as a result of strategic behaviour and due to high transaction costs undermining successful bargaining. The rub lies in the fact that these ownership rules, that is, default rules regulating transfers of shares have a weak enforceability, jeopardising property rights of shareholders, namely non-transferring shareholders, shareholders who end up unloading their shares or selling them without consent and at a lower market price,<sup>114</sup> and the shareholder who acquires such shares.<sup>115</sup> The questions are the following. Can default rules be structured in such a way to strengthen shareholders’ property rights? How much autonomy do shareholders of PLLCs need?

Corporate law in its contractual nature has a regulatory function.<sup>116</sup> In this paper, we explore the extent to which law can be structured to steer the actions of shareholders or members of these firms toward efficient solutions. By efficient solutions we mean those that are likely to overcome collective action problems upon a sudden change of ownership through un-consented transfer of shares. This is particularly important in the context of the firm, defined as a relational vehicle that has been historically capable of overcoming the dichotomy between ‘promise’ and ‘market’.<sup>117</sup>

Let us suppose that one of the shareholders of a PLLC wishes to sell her share to a potential buyer without the company’s consent. Both parties have full information of the terms and conditions of the sales contract. Nevertheless, although the contract may be entered into, the fact is that the transfer of the share will have an effect on the company and on its shareholders, in particular because parties may collude to achieve the purposes established with the execution of the contract. It is paradoxical that shareholders who drafted the articles of association upon the incorporation of the company, and agreed to the introduction of the respective transfer clause in those articles, later sell their shares without the consent of the company. Why?

It is assumed that members of a group of individuals or firms who share a certain interest would seek to further that interest. Nevertheless, as it is claimed by Olson, ‘...large groups, at least if they are composed of rational individuals, will not act in their group interest’.<sup>118</sup> This paradox not only applies to governments or societies but also individuals and associated firms. Under certain circumstances, individuals no longer have incentives to voluntarily contribute to the support of the group or institutions that they belong.<sup>119</sup> When incentives are present, members of groups, such as labour unions, professional associations, farm organisations, cartels, lobbies or collusive groups with no formal organisation will contribute to lobbying efforts and strive for power and control of policies for

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<sup>114</sup> It is up for discussion whether there is a real market for shares of private limited liability companies due to their lack of liquidity as opposed to the shares of corporations.

<sup>115</sup> If shares are sold without consent it is questionable whether the buyer is liable to become a legitimate shareholder.

<sup>116</sup> See Micklitz, Hans-Wolfgang, ‘The Visible Hand of European Private Law’, *Yearbook of European Law*, vol. 28, 1, 2009, pp. 3-59.

<sup>117</sup> See Macneil, Ian R., ‘The Many Futures of Contracts’, *Southern California Law Review*, vol. 47, 1973, pp. 691-816 (760). Additionally, see Bernstein, Lisa, ‘Social Norms and Default Rules Analysis’, *Southern California Interdisciplinary Law Journal*, vol. 3, 1993, pp. 59-90 (arguing that economic theory should consider the importance of relational theory in its approach to default rules).

<sup>118</sup> See Olson, Mancur, *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities*, New Haven and London, Yale University Press, 1982, p. 18. Also see Grundmann, Stefan, *European Company Law: Organization, Finance and Capital Markets*, Antwerpen; Oxford, Intersentia, 2007, p. 48 (affirming that ‘The mechanisms of collective action can [...] lead to a situation in which action (useful to all) is not taken although its costs are lower than the accrued welfare effects because they are nevertheless higher than the welfare effects of each single actor’). For a reference to collective action problems regarding the exercise of the right to vote, see Bebchuk, Lucian Arye, ‘Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments’, *Harvard Law Review*, vol. 102, 1989, pp. 1820-1860 (1837), footnote 28.

<sup>119</sup> People act in accordance with the incentives they have. This is one of the most essential ideas of economics. This idea is embodied in the concept of Nash Equilibrium, which is noted in a later stage of this paper. See Aumann, Robert J., ‘What is Game Theory Trying to Accomplish?’, in Arrow, Kenneth J. and Honkapohja, Seppo (eds.), *Frontiers of Economics*, Oxford, Basil Blackwell, 1985, pp. 5-46 (43).

their benefit.<sup>120</sup> These policies tend to be protectionist of a certain status quo, many times against or preventing institutional development. The outcome – institutional sclerosis,<sup>121</sup> institutional apathy<sup>122</sup> or institutional aversion to modernisation and risk – is often a pronouncement of institutional death.<sup>123</sup> The same is true of PLLCs. For instance, managers – who in PLLCs can also be and usually are partners– make sure to properly safeguard their interests and prevent the dissolution of the commercial association or the alteration of its structure of power through the inclusion of a new member in the corporation.

The convergence of interests and promotion of homogeneity in PLLCs, made possible by the freedom of contract shareholders enjoy, also forms the basis for establishing restrictions on entry and innovation. Restrictions, including the requirement of consent, mostly ensure internal stability but end up contributing to the slowness of a company to make decisions and efficient bargains. These restrictions also facilitate demonstrations of path-dependence within the company's structure, reduce the dynamism and vivacity of the company, and slow its adaptation to new market challenges demanding 'new blood', talent, capital formation and technological change.<sup>124</sup>

Both Article 228(2) and 2469 are default rules. In this sense, freedom of contract plays an essential role, especially empowering shareholders to design the company's contractual framework in light of their interests. However, in transfers of shares to a third party where both vendor and purchaser have full information of the terms and conditions of the contract, the vendor and the purchaser are more likely to be better off, while this makes the company and the remaining shareholders worse off.<sup>125</sup> There is no unanimity of interests on this matter. In situations such as this, whenever they occur the transaction will always cause damage. And, so, this scenario begs the question: Are default rules, by means of which parties regulate their internal and external relationships and impose restrictions on the entry of third parties, really efficient?

In this paper, (in)efficiency is an assumption and not a fact.<sup>126</sup> I assume that simple default rules, such as Article 228(2) and 2469, are rules that are not difficult to contract out of<sup>127</sup> and cannot provide an

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<sup>120</sup> See Holmstrom, Bengt, 'Moral Hazards in Teams', *The Bell Journal of Economics*, vol. 13, 1982, pp. 324-340.

<sup>121</sup> See Gilson, Ronald J. et al. use this term in their article referring to public limited companies. However, I do not consider that the reasons inherent to the use of this expression by the authors are vested with particular features that would turn impracticable its use regarding PLLCs of greater dimensions.

<sup>122</sup> For an account of what has been called shareholder apathy and with relevant bibliographic references on this expression, see Grundmann, Stefan, cit., pp. 48-49 and note 54.

<sup>123</sup> Roberts, John, *The Modern Firm: Organizational Design for Performance and Growth*, Oxford, Oxford University Press, 2004 (making an interesting account of the organisational design of the firm for the purposes of performance and growth as the title of his book reveals. The author claims that 'Firms that manage to be both innovative and efficient are rare'. (p. 254). Although this is not a statement referring to the company, the author also realizes (p. 271) that conflicts inside firms may shift to the corporate level and the costs resulting therefrom may be much greater. Thus, besides considerations of organisational design which involves an active attitude of the management and strong leadership, it is essential to have a close look at the nature of the legal institutions which give form to the company's legal regime and ascertain how can they fit the interests of the individuals and make the corporate structure as immune as possible to situations of conflicts, apathy or aversion to risk).

<sup>124</sup> As Bebchuk, Lucian Arye cit., p. 1830 puts it, 'Corporations are long-living creatures functioning in ever-changing environment. New needs, novel situations, and additional information may well make somewhat different arrangements more efficient than those initially established'.

<sup>125</sup> This may not be the case, however, because it not always is possible to learn whether the sale value of the share is less as a result of the fact that the buyer has fewer rights in the firm.

<sup>126</sup> See Bratton, William W. and MacCahery, Joseph A., 'An Inquiry into the Efficiency of the Limited Liability Company: Of Theory of the Firm and Regulatory Competition', *Washington & Lee Law Review*, vol. 54, 1997, pp. 629-686, (630) (suggesting that: 'In an ideal world inquiry into the efficiency of a legal regime would require the collection and analysis of empirical information concerning costs and benefits').

answer to the problem Olson addresses in his theory. Furthermore, the alternatives of enforcement chosen by companies often undercut interpretation and contractual enforcement. In fact, there is no institution other than the company that will police the application of default rules.<sup>128</sup> On the contrary, these rules are subject to the bargaining power of the shareholders, in particular the majority or activist shareholders, who use the necessary contractual tools to amend the relevant clauses or to accommodate their interests. Still, requirements of unanimity or qualified majorities to amend these rules – which favour tacit collusion, coalition or the conduct of (unwritten) best practices inside the company – block the company’s development and openness, in addition to transforming those rules into outdated and costly ones.<sup>129</sup>

Hence, the research agenda presented here includes the proposal of a concept of default rules as ‘choreographers’ to surmount problems of combining action inside PLLCs.<sup>130</sup> To this I now turn.

### ***Playing the Game: The move for shareholders’ coordination***

Olson’s theory of collective action is an extension of game theory. He argues that large numbers of agents involved in what are, in fact, various non-cooperative games (including the prisoner’s dilemma) will not have powerful enough incentives to cooperate. This is also true of PLLCs and their respective shareholders, especially if they are in considerable numbers.

Problems of non-cooperation in PLLCs may be fairly illustrated with a basic game regarding transfer of ownership rights in shares.

#### Model overview 1

The setting is formed by a company owned by some of the players. The fundamental valuation of the company varies across players and can be high (H), medium (M) or low (L) where  $H > M > L$ . In addition, the company pursues one of two policies A or B. The player who prefers policy A (B) obtains utility A (B) (abusing notation) if this policy is pursued, and 0 from the other policy. A player type is denoted by her fundamental valuation and preferred policy is denoted through a subscript. At

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<sup>127</sup> For a reference to ‘strong default rules’, i.e., rules fulfilling determined corporate formalities and which are therefore hard to contract out of, see Ayres, Ian and Gertner, Robert, ‘Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules’, *The Yale Law Journal*, vol. 99, 1989, pp. 87-130 (120), footnote 141.

<sup>128</sup> This institution could be the legislature, a national or a European institution such as the Court (promoting jurisdictional competition), agencies or even delegated professional bodies, which would supply and provide for the interpretation of standard-form articles of association of PLLCs, including the transfer clause, to face the costs resulting from the applicability of default rules. Referring to the legal institution responsible for designing limits on midstream opt-outs (e.g. legislatures – federal or state – courts or agencies), see Bebchuk, Lucian Arye, cit., p. 1851, note 50. Referring to the delegation to a third party – the state – the task to reform public traded companies’ articles (although these articles are formed by default statutory rules) through statutory amendments or court decisions whenever it is necessary to assure the readjustment of long-term relational contracts which form the basis of company law, see Hansmann, Henry, ‘Corporation and Contract’, *American Law and Economics Review*, vol. 8, 2006, pp., 1-19. Hansmann considers that this theory of ‘delegated contracting’ explains why public traded corporations in the U.S. hardly ever deviate from default statutory law in their articles of association although they are free to do so. Strangely enough, legal provisions seem to be far better at adapting to new circumstances than contract terms.

<sup>129</sup> See Gilson, Ronald J. et al., cit., pp. 44-45.

<sup>130</sup> See Alchian, Armen A. and Demsetz, Harold, ‘Production, Information Costs, and Economic Organisation’, *The American Economic Review*, vol. 62, 1972, pp. 777-795. These authors propose a theory of the firm in which one would assume the position of a monitor induced by the desire to have efficient means to reduce shirking and make team production economical. For a theory of defaults, it is also worth reading the ground-breaking article of Ayres, Ian and Gertner, Robert, cit. at 126, and more recently Ben-Shahar, Omri, ‘Bargaining Power Theory of Default Rules’ *Columbia Law Review*, vol. 109, 2009, pp. 396-430. The author proposes a criterion – the ‘bargaining-mimicking gap filler’ – to create defaults based in the mimic of the will of the party with the power to dictate.

the outset, there are three shareholders (potential sellers) who prefer policy A given by HA; MA; LA. There are also three (potential) buyers who prefer policy B given by HB; MB; LB.

#### Model overview 2

At any given time all shareholders and buyers meet randomly in pairs (simultaneous exogenous matching process). Everybody observes who meets whom. Buyers simultaneously make offers to shareholders who simultaneously decide to accept or reject their respective offers. If the offer is accepted, property rights in the share are transferred to the buyer who becomes a shareholder (B type shareholder). If the offer is rejected, no property rights in the share are transferred and the potential seller remains a shareholder (A type shareholder). I also assume that the company policy chosen by its members automatically becomes the preferred policy of the majority expressed by majority vote. It is assumed that types prefer their policy type, that is type A<sub>s</sub> prefer policy A and vice-versa. As to the players' strategies, the buyer's strategy is to pay a price for the share that can be conditioned on the shareholder type. The seller's strategy is a mapping from the space of all possible offers into a decision set given by 'accept' or 'reject'. If a player receives an offer that makes her indifferent as to whether sell or not sell her shares, I assume that she sells. The equilibrium concept is Nash Equilibrium. In other words, equilibrium in this game is given by a set of strategies under which each player type is weakly better off than from any other possible strategy given the strategies used by the other players.

#### Model overview 3

The player's utilities are equal to the valuation plus policy of the company (where applicable) if a player owns a share. No ownership implies utility equal to zero regardless of the policy. When shares are traded, the player who sells gets a utility equal to the sale price and the buyer gets utility equal to valuation plus policy minus the purchase price. As stated above, I assume that a transfer of shares is efficiency improving if the combined players' utilities are increased under new ownership.

I now provide three examples illustrating the problem with default rules.

*Example 1: In Nash Equilibrium the company policy changes to B.*

The company valuation assumptions are the following:

$$HA = 5; MA = 3; LA = 1; HB = 6; MB = 4; LB = 2.$$

The policy valuations are as follows:

$$A = B = 2.$$

The matching assumptions are:

$$LA \leftrightarrow MB, MA \leftrightarrow HB, HA \leftrightarrow LB.$$

The equilibrium offers by buyers are:

$$MB \text{ offers } 3, HB \text{ offers } 5, LB \text{ offers anything below } 5.$$

The equilibrium shareholder responses are:

$$LA \text{ and } MA \text{ sell, } HA \text{ does not sell.}$$

This implies that the company policy becomes B. This also means that the transfer is efficiency improving since the total utility increases from 15 to 19. Lemma: above matching assumption implies



that any share transfer is always efficiency improving as long as buyers’ fundamental valuations exceed shareholders’ combined valuation (fundamental valuation plus policy).<sup>131</sup>

*Example 2a: Efficiency increasing policy shift to B*

The company valuation assumptions are as follows:

$$HA = 5; MA = 3; LA = 1; HB = 5; MB = 3; LB = 1.$$

Policy valuations are:

$$A = B = 3$$

The matching assumptions are the following:

$$LA \leftrightarrow MB, MA \leftrightarrow HB, HA \leftrightarrow LB$$

In equilibrium offers by buyers are:

$$MB \text{ offers } 4, HB \text{ offers } 6, LB \text{ offers anything below } 5.$$

In equilibrium shareholders’ responses are:

$$LA \text{ and } MA \text{ sell, } HA \text{ does not sell.}$$

The outcome is efficiency improving since the overall utility is increased from 18 to 19.

*Example 2b: Efficiency decreasing policy shift to B*

The company valuation assumptions are:

$$HA = 5; MA = 3; LA = 1; HB = 5; MB = 3; LB = 1$$

Policy valuations are the following:

$$A = 5; B = 4$$

The matching assumptions are as follows:

$$LA \leftrightarrow MB, MA \leftrightarrow HB, HA \leftrightarrow LB$$

In equilibrium, offers by buyers are: MB offers 6, HB offers 8, LB offers anything below 5.

In equilibrium, shareholders’ responses are:

$$LA \text{ and } MA \text{ sell, } HA \text{ does not sell}$$

In this situation, the outcome is inefficient since the overall utility decreased from 24 to 21.

*Example 3: 2 types of equilibria*

In this case, the company valuation assumptions are as follows:

$$HA = 5; MA = 3; LA = 1; HB = 5; MB = 3; LB = 1$$

Policy valuations are:

$$A = B = 2$$

Matching assumptions are the following:

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<sup>131</sup> Since HA never sells in equilibrium she ‘anchors’ the share price above fundamental share valuation.

$$LA \leftrightarrow LB, MA \leftrightarrow MB, HA \leftrightarrow HB$$

In equilibrium, offers by buyers are:

$$LB \text{ offers } 1, MB \text{ offers } 3, HB \text{ offers } 5$$

In equilibrium, shareholder's responses are: 1) all shareholders sell; 2) no shareholders sell. In these circumstances efficiency remains unaffected regardless of response.

In examples 1 and 2a,  $M_A$  and  $L_A$  completely disregard  $H_A$ 's benefits, since the overall benefits arising from the transactions are much higher. In such circumstances, default rules are of little use, since both  $M_A$  and  $L_A$  will act as rational individuals so as to maximise their personal benefits, regardless if  $H_A$  evaluates the company so high. In both situations,  $H_B$  and  $M_B$  have a dominant action, which is to offer  $M_A+A$  and  $L_A +A$  respectively. This implies that the company will be under control of B types and policy B will be chosen in stage 2.

Example 2b illustrates an efficiency decreasing policy shift to policy B, which makes the general economy worse off. This is the case because all buyers are offering below the total valuation of their counterparties (valuation plus policy). This, however, does not prevent MA and LA from selling. They sell because they are indifferent to the choice between selling and not selling. The problem is that HA is left with her shares but does not value the new policy (B).

Revisiting example 3, I could make other choices about this model, such as endogenise a matching protocol so that buyers could freely decide which shareholder to make an offer to. For example, let us assume an offer structure exactly as in example 3. Would any player have a unilaterally profitable deviation? Take, for instance, player HB. If she decides to make an offer to another shareholder, she faces a higher minimum price because it is now common knowledge that HA will not sell since she has no offer. This implies that MB's offer will be rejected and company policy will remain A. These two effects make HB indifferent to keeping her proposed offer to HA and making an offer to LA because deviation to his initial offer to HA will not be profitable. Using the same type of argument for MB implies that there is no profitable deviation from the initially proposed buyer offers. This argument does not rule out the existence of other equilibria though.

For instance, let us imagine that  $M_A$  does not want to sell her share. As a result she commits not to sell her share (perhaps through a deposit of some type) to convince the other shareholders to hold on and wait for the offer of a better price or not to sell their shares at all. If she – the coordinator<sup>132</sup> – can convince others in advance that she will not sell, then the only equilibrium outcome is one where all type As retain ownership of their shares. It may be that the signal she is sending is disregarded, and all type A owners decide to sell because they have alternatives with higher payoffs. But it may also be that no type A owners sell their shares because they decide to follow that signal, especially if the alternatives are equally valuable. This is the essence of a correlated equilibrium.<sup>133</sup>

I have tried to show with the examples above (e.g.  $HB > MA +A$  and  $MB > LA + A$ ) that defaults are not efficient regulatory instruments. They cannot prevent owners from selling. However, this does not mean that the role of the legislator is sterile. It depends on whether the way defaults are designed will determine costs owners are not willing to bear if they breach them.

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<sup>132</sup>I call her coordinator because MA coordinates in these circumstances simultaneous collective action.

<sup>133</sup>This concept was first created by Aumann in 1974. For a later development of his theory and the well-known theorem of Aumann, see Aumann, Robert J., 'Correlated Equilibrium and an Expression of Bayesian Rationality', *Econometrica*, vol. 55 1987, pp. 1-18.

### ***A Tentative Concept of Regulatory Contractualisation and an Exploratory Account of Default Rules as Choreographers***

To overcome situations in which shareholders’ property rights are weak and enforceability of default rules is not strong, this paper presents a tentative concept of regulatory contractualisation. With this concept, I try to address not only the cases where shareholders want to overcome barriers preventing them to leave the company, but also the cases where shareholders do not want to sell their shares but have to. This regulatory alternative is drawn as a component of an overall concept of contract, or in other words, it forms the basis to induce the formation of distinct subtypes of contracts or contractual arrangements.<sup>134</sup> The legislature would assume the role of a choreographer when providing default rules; it would know what challenges shareholders have to deal with in the set of PLLCs and the hurdles they have to overcome when their property rights are not strongly defined. The choreographer, according to the circumstances, knows what will be the probable move of the other players<sup>135</sup> and sends out a public signal to boost a consistent investment in these companies. This public sign could be given in the form of adjusted corporate default rules with the ability to play the role of choreographers themselves. Nevertheless, it is not clear that legislatures can devise optimal default rules for all situations.

### ***Concluding Remarks***

When the contractual framework of firms, which often assumes the form of articles of association or articles of organisation, is incomplete, shareholders can always design other contractual frameworks and adapt them to their interests and needs. However, because contracting is costly – and investors in these companies may not have enough funding or may not want to spend it on better contracts – shareholders often opt to govern their contractual relationship through simple defaults, which may be more profitable for them, but can also bring negative effects for the company.<sup>136</sup> In general terms, law aims to effectively address problems of combining action, promote benefits of coordination inside institutions and, consequently, to guarantee access of the community to efficient rules. This, I believe, justifies the conception of stronger defaults and the construction of new models of contract, such as the one of regulatory contractualisation. A central point of this scheme is the conception of corporate default rules as choreographers. From the game-theoretical model I have presented, two ways follow in which defaults could be readjusted. One option could be that the law gives space to the figure of the coordinator. She is a shareholder who credibly commits to not to sell her shares and convince the other members of the best strategy for the company. Another option is to give members of these companies the possibility to forbid one shareholder to sell at any given time. In these circumstances, the other shareholders (potential sellers) no longer face the prospect of the worst possible outcome, since they can themselves decide to retain the majority of the company as they are sure that one other shareholder will not sell. In this case, reducing a shareholder’s flexibility or freedom to sell, even randomly, makes other shareholders better off, at perhaps the cost of the shareholder who cannot sell. This idea begs some additional protection to compensate the potential seller if the others, in fact, end up selling. It also requires a broader discussion of the ways to better protect entitlements in PLLCs beyond property rules such as liability rules or prohibitive rules. Explaining which of these alternatives is more suitable

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<sup>134</sup> The existence of inefficient alternatives of contractual regulation enshrined by national legislation, and the safeguard of functional conditions of the market are the two main reasons why the alternative of regulatory contractualisation resists a fully-fledged operation of the principle of freedom of contract.

<sup>135</sup> As to players of the game, I am referring not only to shareholders but also to other stakeholders such as creditors.

<sup>136</sup> As it is interestingly put by Macaulay, Stewart, ‘Non-Contractual Relations in Business: A Preliminary Study’, *American Sociological Review*, vol. 28, 1963, pp. 55-67 (62), footnote 11 ‘[...] at times it is clear that businessmen fail to plan because of a lack of sophistication; they simply do not appreciate the risk they are running or they merely follow patterns established in their firms years ago without re-examining these practices in light of current conditions’.

to surpass problems of collective action in these companies goes beyond the scope of this paper.<sup>137</sup> I, however, wish to unveil the question that will nurture further research work.

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<sup>137</sup>See Calabresi, Guido, and Melamed Douglas, 'Property Rules, Liability Rules, and Inalienability: One View of the Cathedral', *Harvard Law Review*, vol. 85, 1972, pp. 1089-1128.



