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Articles

Marriage, Same-Sex Partnership, and the German Constitution

By Anne Sanders[*]

A. Introduction

Marriage today does not only involve private interests; it is also an important legal and political issue. The question of what marriage means today and whether it should be open to same-sex unions is under debate all over the world. In many countries, for example in Germany and the United States, such questions are not only debated in the political arena, but also in relation to constitutional law. This Article will trace the development of how marriage has been understood in relation to German constitutional law and critically discuss the law's approach to same-sex marriage.

The Federal Constitutional Court of Germany (*Bundesverfassungsgericht,* FCC) celebrated its 60th anniversary in September of 2011. Since 1951, the court has not only had a considerable influence on administrative and criminal law, but on family law as well. This might be surprising to a non-German reader as not all constitutions include rights concerning marriage and family as guaranteed human rights. The Basic Law, however, protects these rights in Article 6.

This article begins by applying a descriptive approach. First is an introduction to the history of Germany's constitutional protection of marriage and the drafting of Article 6. Next, this article introduces the reader to the German constitutional understanding of marriage as developed in the case law of the German Federal Constitutional Court. After supplementing this with a brief discussion of the court's approach to divorce, the article then stresses the importance of gender equality to the constitutional understanding of marriage and discusses the case law related to unmarried cohabitation and same-sex partnerships.

Next, this Article assumes a more critical approach in evaluating the reasons given by the FCC and academic commentators for denying same-sex partners Article 6 protection.

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Building on the case law of the FCC, this Article argues that marriage cannot be reduced to a heterosexual union with the purpose of producing children. Rather, marriage must be understood as a formally concluded partnership of mutual responsibility and support that is just as applicable to same-sex couples as it is opposite-sex couples.

B. The Origins of the Constitutional Protection of Marriage

The constitutional protection of marriage has not had a long tradition. Neither *marriage* nor *family* were mentioned in the classic constitutions of the United States or France; nor were they present in the German Constitution of 1849 (*Paulskirchenverfassung*), which never came into force, or the Prussian Constitution of 1850. The first constitutions to cautiously mention marriage appeared at the end of the 19th century.[1]

In Germany, the fear that traditional marriage might be lost in the turmoil of the First Republic led to its constitutional protection. The constitutional history of the protection of marriage started in Germany with Article 119 of the Constitution of the Weimar Republic of 1919 (*Weimarer Reichsverfassung*). The second part of this constitution included a section called "Basic Rights and Basic Duties of All Germans" ("*Grundrechte und Grundpflichten der Deutschen*").[2] The first chapter of this part, Articles 109–118, included under the heading "The Person" ("*Die Einzelperson*") rights such as freedom of speech, freedom of movement, and privacy of the home. The second chapter had the heading "Community Life" ("*Das Gemeinschaftsleben*") and listed freedom of assembly, the right of communities to self-governance, the right to vote, and laws concerning the education and protection of the young. This second chapter began, however, with Article 119, which concerned the protection of marriage and family. It read:

> (1) Marriage is protected especially by the constitution as the basis of family life and of the reproduction and preservation of the nation. It is based on the equality of the sexes.
> (2) To protect and enhance the purity, recovery, and social advancement of the family is a duty of the state. Families with many children can demand compensating public welfare.
> (3) Motherhood requires the protection and care of the state.[3]

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[1] Dieter Schwab, *Zur Geschichte des verfassungsrechtlichen Schutzes von Ehe und Familie*, *in* FESTSCHRIFT FÜR FRIEDRICH WILHELM BOSCH, 893 (Hans Gaul, Walther Habscheid & Paul Mikat eds., 1976).

[2] *See* Friedhelm Köster, ENTSTEHUNGSGESCHICHTE DER GRUNDRECHTSBESTIMMUNGEN DES ZWEITEN HAUPTTEILS DER WEIMARER REICHSVERFASSUNG IN DEN VORARBEITEN DER REICHSREGIERUNG UND DEN BERATUNGEN DER NATIONALVERSAMMLUNG (2003).

[3] WEIMARER REICHSVERFASSUNG [WVR] [CONSTITUTION OF THE WEIMAR REPUBLIC], Aug. 11, 1919, art. 119 (Ger.).

The drafting process of this article could not be properly replicated today. Apparently it was inspired by conservative parliamentarians who feared that communist politicians, who had had a strong influence after the revolution of 1918, might endanger the institution of marriage and the traditional middle class family.[4] During the National Convention, however, the protection of marriage discussion was not contentious. The only question raised was whether reforms of marital property law would require a constitutional amendment in the future. Apart from that, however, parliamentarians agreed on the value of marriage as the basis of society.[5] The protection of motherhood, even for children born out of wedlock, in Article 119(3) and the equality of both sexes in Article 119(1) became the basis for future modernizations of family law.[6] These inclusions were the work of both Social Democrats and politicians from the German Democratic Party (DDP), and ensured that the protection of marriage had a conservative as well as a progressive purpose.

Today, in the Basic Law of 1949, marriage and family are protected by Article 6(1).[7] Article 6 states:

> (1) Marriage and the family shall enjoy the special protection of the state.
> (2) The care and upbringing of children is the natural right of parents and a duty primarily incumbent upon them. The state shall watch over them in the performance of this duty.
> (3) Children may be separated from their families against the will of their parents or guardians only pursuant to a law, and only if the parents or guardians fail in their duties or the children are otherwise in danger of serious neglect.
> (4) Every mother shall be entitled to the protection and care of the community.
> (5) Children born outside of marriage shall be provided by legislation with the same opportunities for physical

[4] Schwab, *supra* note 1, at 895.

[5] *Id.* at 895–98.

[6] *Id.* at 904–06.

[7] For a discussion of the origin of the provision, see Peter Badura, *in* GRUNDGESETZ-KOMMENTAR, ¶¶ 40–43 (Theodor Maunz & Günther Dürig eds., 44th ed. 2005).

> and mental development and for their position in society as are enjoyed by those born within marriage.[8]

There are obvious similarities in the wording of Article 6 of the Basic Law and Article 119 of the Weimar Constitution. Article 6, however, was drafted with less ostentatious language, probably because the wording of Article 119, which embraced the "preservation of the nation," sounded problematic after the end of the Third Reich.

Like many of the provisions in the constitution, Article 6 was influenced by the horrible experiences in the Third Reich. Under the dictatorship of the Third Reich, it was not religious ideals that profoundly influenced the government's approach to marriage; rather, it was National Socialist ideology. Marriage was supposed to provide a legal framework for families with many "racially healthy" children who were intended for Hitler's armies and the colonization of occupied territories.[9] Marriage and sexual intercourse between Jews and Aryans were forbidden by the 1938 Nuremberg legislation "for the protection of German blood and honor."[10] Divorce was made easier in order to allow husband and wife to remarry and produce more children.[11] The legislature viewed a childless marriage as useless for the state and, thus, they wanted to make it as easy as possible to end such a marriage.[12] During the war, pregnant girls were married to the absent or even dead fathers of their children, while a helmet took the groom's place in the civil ceremony. To replace soldiers killed in action, the introduction of polygamy after the war was seriously discussed.[13]

After the war, Article 6 aimed to protect the private sphere of marriage and family against public intervention. Subsequent to the painful experience of an all-powerful state during

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[8] GRUNDGESETZ FÜR DIE BUNDESREPUBLIK DEUTSCHLAND [GRUNDGESETZ] [GG] [BASIC LAW], May 23, 1949, BGBl. I, art. 6 (Ger.).

[9] *See* Edouard Conte & Cornelia Essner, *Fernehe, Leichentrauung und Totenscheidung: Metamorphosen des Eherechts im Dritten Reich*, *in* 44 VIERTELJAHRSHEFTE FÜR ZEITGESCHICHTE 201, 201 (1996); Stephan Meder, *Der Unterhaltsverzicht im Spannungsfeld von Privatautnomie und öffentlichem Interesse*, *in* FAMILIE UND RECHT 12, 14–15 (1993).

[10] Gesetz zum Schutz des deutschen Blutes und der deutschen Ehre [Law on the Protection of German Blood and German Honor], Sept. 15, 1935, RGBL. I at p. 1146 (Ger.).

[11] Gesetz zur Vereinheitlichung des Rechts der Eheschließung und der Ehescheidung im Lande Österreich und im übrigen Reichsgebiet [Law to unify the laws of marriage and the. divorce in the land of Austria and the rest of the country], July 6, 1938, RGBL. I p. 807; Meder, *supra* note 9.

[12] *See* Mirja Schmidt, Abschluss-und Inhaltskontrolle von Scheidungsfolgenvereinbarungen 53 (Apr. 27, 2010) (Inaugural Dissertation, Westphalian Wilhelms University of Münster), *available at* http://miami.uni-muenster.de/servlets/DerivateServlet/Derivate-5562/diss_schmidt_mirja_buchblock.pdf; *see also* Meder, *supra* note 9.

[13] Conte & Essner, *supra* note 9.

the Third Reich, Article 6 stressed the importance of the responsible, self-determined individual.[14]

However, Article 6 could also be seen as the fruit of a universal longing to return to the safety of an idealized family after the war.[15] Post-war German politicians agreed that the family was in a deep crisis. Soldiers had died in the war, leaving widows, and children without parents. Some wives had been raped and others had found a new independence during the war by taking up a profession. But even those couples who were willing to make a new start faced great difficulties: Most had been separated for years, each having had extremely different and often horrible and shameful experiences during the war.[16] Perhaps in an attempt to fight the rocketing demands for divorce and preserve a bit of stability, a more traditional, religious notion of marriage reemerged.[17] For example, in 1951, the German Federal Supreme Court (*Bundesgerichtshof*), the highest authority for civil law cases, reinterpreted the divorce law drafted in 1938, which had allowed divorce after a separation of three years even if an adulterer demanded it.[18] Marriage, the Court held, was the most intimate human union and required that the couple stay together for life. Only in rare cases could a divorce, desired by a guilty party, be morally justified even if the letter of the law allowed it.[19] In this climate, Article 6 was drafted in 1949.

C. Marriage Case Law

Now that the development of the German constitutional protection of marriage has been explained, the case law of the FCC shall be discussed.

I. Defining and Protecting Marriage

According to the established case law of the FCC, marriage under Article 6 is the union of a man and a woman to an *all-embracing* and, in principle, indissoluble companionship for

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[14] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 4/54, Jan. 17, 1957, 6 BVERFGE 55, 71 (Ger.).

[15] Rolf Gröschner, *Ehe und Familie, Elternrecht, Mutterschutz, uneheliche Kinder (Art. 6)*, *in* 1 GRUNDGESETZ-KOMMENTAR n.16–19 (Horst Dreier ed., 2d ed. 2004).

[16] *See* MARGARETE DÖRR, "WER DIE ZEIT NICHT MITERLEBT HAT. . . ." FRAUENERFAHRUNGEN IM ZWEITEN WELTKRIEG UND IN DEN JAHREN DANACH 32–45 (1998); Kirsten Plötz, *Heimkehrer, die natürliche Ordnung und vollständige Familien*, *in* VATERSCHAFT IM WANDEL: MULTIDISZIPLINÄRE ANALYSEN UND PERSPEKTIVEN AUS GESCHLECHTERTHEORETISCHER SICHT 57, 57–60 (Mechthild Bereswill, Kirsten Scheiwe & Anja Wolde eds., 2006).

[17] Schmidt, *supra* note 12, at 53–54.

[18] Bundesgerichtshof [BGH - Federal Supreme Court], Case No. 4 ZR 73/50, Jan. 22, 1951, 1 BGHZ 87 (Ger.).

[19] *Id.* at 90–93.

life.[20] Family is defined as the *all-embracing* community of parents and children in which the parents have the right and duty to care for and educate their children.[21] The term "all embracing" (*allumfassend*) has not been explained by the FCC, but seems to mean that in constitutional law, marriage and family life concern all aspects of human existence and are thus of central importance.

The FCC distinguished early on between different aspects of the constitutional protection of marriage. To understand this, a short explanation of the doctrinal approach of German constitutional rights may be helpful.

First, German constitutional rights, like constitutional rights in other countries, protect citizens against unlawful actions of the government and the legislature. In this regard, constitutional rights guarantee, for example, the freedom to express one's opinion as in Article 5 and to exercise one's religion as in Article 4 of the Basic Law. This protection of individual liberties is the classic function of human rights.[22] The protection of marriage under Article 6 also functions as a classic individual human right and grants protection to the individual person against the legislature and the government.[23] According to the case law of the Federal Constitutional Court, Article 6(1) protects the freedom to conclude marriage with the partner of one's choice.[24] Thus, a law that forbids certain persons to marry, as for example the legislation during the Third Reich that forbade Jews to marry *Aryans*, would be unconstitutional.

Moreover, the Constitution guarantees that two people can live as a married couple protected from public influence and freely choose, for example, whether they want to have children, or whether to live together.[25] The couple is free to live a traditional

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[20] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 205/58, July 29, 1959, 10 BVERFGE 59, 66 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 136/78, Feb. 28, 1980, 53 BVERFGE 224, 245 (Ger.).

[21] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 205/58, July 29, 1959, 10 BVERFGE 59, 66 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 136/78, Feb. 28, 1980, 53 BVERFGE 224, 245 (Ger.).

[22] Bernhard Schlink, *Freiheit durch Eingriffsabwehr—Rekonstruktion der klassischen Grundrechtsfunktion*, 11 EUROPÄISCHE GRUNDRECHTE-ZEITSCHRIFT 457 (1984).

[23] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 4/54, Jan. 17, 1957, 6 BVERFGE 55, 71 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 636/68, May 4, 1971, 31 BVERFGE 58, 67 (Ger.).

[24] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 636/68, May 4, 1971, 31 BVERFGE 58, 67 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 719/69, Nov. 14, 1973, 36 BVERFGE 146, 161–62 (Ger.).

[25] Gröschner, *supra* note 15, ¶¶ 63–66.

marriage with the husband as the breadwinner, or to assume a lifestyle where both partners earn money and contribute equally to the expenses of the family.[26]

Apart from the protection of individual rights, however, the FCC stated that German constitutional rights constituted *objective values* (*objective Wertentscheidungen* or *Grundsatznormen*).[27] Human rights not only influence the state-citizen relationship but also, by establishing a value system, influence other areas of law, for example the interpretation of private law rules effective between citizens.[28] According to the case law of the FCC, the protection of marriage is one such fundamental value.[29]

Moreover, the constitutional protection of marriage guarantees the institution of marriage as such. The legislature may not abandon marriage altogether and must provide a legal framework allowing people to marry and to organize their life as a couple.[30] In the German civil code, the legislature created a legal framework for married life. In order to comply with the constitutional duty to protect marriage, the state is not only required to refrain from doing anything that could harm or hinder the institution but must also promote it by suitable measures.[31] Part of the *special* protection the state owes marriage is the duty not to permit a married spouse to enter into another legally binding partnership.[32]

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[26] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 683/77, May 31, 1978, 3 48 BVERFGE 327, 338 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 5/83, Jan. 10, 1984, 66 BVERFGE 84, 94 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 105/95, Feb. 5, 2002, 105 BVERFGE 1, 11 (Ger.).

[27] The development started with the famous *Lüth* decision. *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 400/51, Jan. 15, 1958, 7 BVERFGE 198, 205–07 (Ger.); *see also* Ernst-Wolfgang Böckenförde, *Grundrechte als Grundsatznormen*, 29 DER STAAT 1 (1990).

[28] For an English language introduction to this vast area, see Christian Starck, *Human Rights in Private Law in German Constitutional Development and in the Jurisdiction of the Federal Constitutional Court*, *in* HUMAN RIGHTS IN PRIVATE LAW 97–111 (Daniel Friedmann & Daphne Barak-Erez eds., 2003).

[29] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 4/54, Jan. 17, 1957, 6 BVERFGE 55, 71 (Ger.). See also Theodor Maunz, *Die verfassungsrechtliche Gewähr von Ehe und Familie (Art 6 GG)*, 1 ZEITSCHRIFT FÜR DAS GESAMTE FAMILIENRECHT (1956) (describing the right of marriage as multidimensional); *see also* Martin Burgi, *Schützt das Grundgesetz die Ehe vor der Konkurrenz anderer Lebensgemeinschaften?*, 39 DER STAAT 487, 495–97 (2000).

[30] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 636/68, May 4, 1971, 31 BVERFGE 58, 67 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 719/69, Nov. 14, 1973, 36 BVERFGE 146, 161–62 (Ger.).

[31] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 4/54, Jan. 17, 1957, 6 BVERFGE 55, 76 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 498/66 Mar. 18, 1970, 28 BVERFGE 104, 113; Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 136/78, Feb. 28, 1980, 53 BVERFGE 224, 248 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Joined Cases 2 BvR 1226/83, 2 BvR 101/84, and 2 BvR 313/84, May 12, 1987, 76 BVERFGE 1, 41 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 2 BvR 1057/91, 2 BvR

Moreover, Article 6 functions as a special equal protection law. Equal protection is regulated in Article 3 of the Basic Law. Article 3 contains a general equal protection right as well as special rules against discrimination:

> (1) All persons shall be equal before the law.
> (2) Men and women shall have equal rights. The state shall promote the actual implementation of equal rights for women and men and take steps to eliminate disadvantages that now exist.
> (3) No person shall be favoured or disfavoured because of sex, parentage, race, language, homeland and origin, faith, or religious or political opinions. No person shall be disfavored because of disability.[33]

According to the FCC, however, Article 6(1) prohibits discrimination against spouses, which means that Article 6(1) established an additional special rule of equal protection outside of Article 3.[34]

The constitutional protection of marriage faces unique problems. Other constitutionally protected values, such as life, physical integrity, opinions, and religion, have a fundamental basis outside of the legal system. While marriage may at times be viewed as a social or religious institution, it is, however, mainly a legal institution. Since the end of the 19th century, civil marriage has been the norm in Germany. A religious ceremony has no legal effect in Germany and in fact does not establish a marriage protected under Article 6.[35] Because marriage in Germany is so deeply connected to the legal system, constitutional interpretation of Article 6 requires a consideration of the law below the constitutional level. Moreover, the FCC has held that the constitutional concept of marriage should be developed in accordance with the predominant contemporary views as expressed in family

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1226/91, Nov. 10, 1998, 99 BVERFGE 216, 231–32 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 1164/07, July 7, 2009, 124 BVERFGE 199, 225 (Ger.).

[32] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvF 1/01, July 17, 2002, 105 BVERFGE 313, 343 (Ger.).

[33] GRUNDGESETZ FÜR DIE BUNDESREPUBLIK DEUTSCHLAND [GRUNDGESETZ] [GG] [BASIC LAW], art. 3 (Ger.).

[34] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Joined Cases 2 BvR 1226/83, 2 BvR 101/84, and 2 BvR 313/84, May 12, 1987, 76 BVERFGE 1, 72 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 2 BvR 1057/91, Nov. 10, 1998, 99 BVERFGE 216, 232 (Ger.); *see also*, Burgi, *supra* note 29, at 497–98.

[35] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 136/78, Feb. 28, 1980, 53 BVERFGE 224, 245 (Ger.).

law below the constitutional level.[36] Consequently, constitutional interpretation of marriage takes place in an intricate web of constitutional law, non-constitutional family law, and public opinion. In addition, the Federal Constitutional Court has stated that the legislature is also bound by Article 6 when formulating legislation concerning family law.[37] The danger of a circular reasoning[38] here is evident. A constitutional interpretation that is bound by the meaning of marriage as defined in family law would prevent constitutional law from exerting any meaningful influence on the law below it. In addition, if marriage is interpreted in this manner, this means that constitutional law would, in effect, impose no restrictions on the legislature.[39] Moreover, the courts and legislature are undoubtedly influencing public opinion on marriage, but in turn, public opinion itself is what influences legislation and, according to the FCC, the constitutional understanding of marriage.

II. Divorce

Section 1353(1) of the German Civil Code (*Bürgerliches Gesetzbuch*—BGB) states that marriage is closed for life, and the principle of the lifelong marriage has been accepted as a constitutional principle. Marriage, the FCC held, must be intended and promised by both partners as an enduring alliance, conceptualized to last a lifetime.[40] A marriage that is limited in time from the beginning would thus not be a marriage in the constitutional sense. However, according to the FCC, the Basic Law protects a secularized, legal conception of marriage, not a religious one.[41] Based on this secular notion of marriage, the FCC has concluded that spouses have a right to divorce and regain the freedom to remarry.[42] Moreover, the FCC permits divorce because forced perpetuation of a factually

[36] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 719/69, Nov. 14, 1973, 36 BVERFGE 146, 163 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvF 1/01, July 17, 2002, 105 BVERFGE 313, 345 ¶ 87 (Ger.).

[37] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 636/68, May 4, 1971, 31 BVERFGE 58, 69–70 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 78/86, Oct. 3, 1989, 81 BVERFGE 1, 6–7 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvF 1/01, July 17, 2002, 105 BVERFGE 313, 345 ¶ 87 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 10/05, May 27, 2008, 121 BVERFGE 175, 193 (Ger.).

[38] Gröschner, *supra* note 15, ¶ 36.

[39] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 719/69, Nov. 14, 1973, 36 BVERFGE 146, 161–62 (Ger.).

[40] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 136/78, Feb. 28, 1980, 53 BVERFGE 224, 245 (Ger.).

[41] *See Id.*; *see also* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 636/68, May 4, 1971, 31 BVERFGE 58, 82–83 (Ger.).

[42] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 636/68, May 4, 1971, 31 BVERFGE 58, 82–83 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 136/78, Feb. 28, 1980, 53 BVERFGE 224, 245 (Ger.).

dead relationship cannot be reconciled with the Court's opinion that marriage is a living partnership.[43] As a result, if a person divorces and remarries several times, each marriage would be of equal rank constitutionally.[44]

The discussion of a constitutional right to divorce leads to a discussion of the constitutional influence on divorce law. The FCC approached this subject in its decision of 21 October 1980 stating, "[t]he special protection of Article 6(1) is not limited to marriage in good order. Even when a marriage has failed, the legislature can be under a duty to provide divorce law that takes into account the ongoing mutual responsibilities of the partners and prevents unbearable hardship."[45] While acknowledging that the legislature has considerable discretion,[46] the FCC decided that Article 6(1) influences the right to spousal support[47] as well as the sharing of pension rights accumulated during marriage and matrimonial property law.[48] If spouses do not execute a nuptial agreement, they live in the marital property regime of the *Zugewinngemeinschaft.* The result is that during marriage, the property of the couple is kept separate, but at the time of divorce, profits accumulated by each spouse during marriage are compared and shared.[49]

III. Marriage and Gender Equality

The tension between traditional patriarchic marriage law and gender equality as a constitutional right under Article 3(2) has always been of considerable importance in the

[43] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 136/78, Feb. 28, 1980, 53 BVERFGE 224, 250 (Ger.).

[44] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 179/78, Oct. 21, 1980, 55 BVERFGE 114, 128–29 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 5/83, Jan. 10, 1984, 66 BVERFGE 84, 93 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 14/82, Nov. 14, 1984, 68 BVERFGE 256, 267–68 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 246/93, Oct. 7, 2003, 108 BVERFGE 351, 364 (Ger.).

[45] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 179/78, Oct. 21, 1980, 55 BVERFGE 114, 141–42 (Ger.).

[46] *Id.* at 141–43.

[47] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 136/78, Feb. 28, 1980, 53 BVERFGE 224, 250 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 5/83, Jan. 10, 1984, 66 BVERFGE 84, 94 (Ger.).

[48] *See* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 136/78, Feb. 28, 1980, 53 BVERFGE 224, 250; Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 1284/79, Oct. 21, 1980, 55 BVERFGE 134, 141–42 (Ger.).

[49] For a short introduction to German divorce law, see Anne Sanders, *Private Autonomy and Martial Property Agreements*, 59 INT'L & COMP. L.Q. 571, 575–77 (2010).

case law of the FCC on Article 6. Particularly with its early decisions, the FCC influenced family law in a progressive way.[50]

The "mothers of the Basic law," Elisabeth Selbert, Friederike Nadig, Helene Weber and Helene Wessel, the four women who participated in the drafting of the Constitution, fought for constitutional gender equality.[51] Though the Constitution of the Weimar Republic declared gender equality to be the foundation of marriage, this rule never influenced family law.[52] Article 1(3) of the Basic Law, however, states that individual constitutional rights bind all three branches of government. When Article 6(1), Article 3(2), and Article 1(3) of the Basic Law came into effect, much of German family law, which had largely remained unchanged since 1900, had to be considered unconstitutional. The default matrimonial property regime at that time gave the husband the exclusive right to use and administer his wife's property, forbade a wife from seeking employment without her husband's consent, and gave the husband the decisive voice in all decisions concerning the couple's children. It was only under the political pressure exercised by the draftswomen, especially Elisabeth Selbert and Friederike Nadig, that their male counterparts agreed to introduce gender equality as a constitutional right under Article 3(2) of the Basic Law. The legislature, however, was awarded a "grace period" until 31 March 1953 in Article 117 of the Basic Law to revise family law.

When the time had passed without reform, the FCC had to decide on the legal effects in its decision of 18 December 1953.[53] Although decisions of the FCC are far less personal than decisions from courts in common law systems, for example the US Supreme Court, it is likely that Dr. Erna Scheffler, the first female justice, took a decisive role in the drafting of the Court's unanimous decision. Dr. Erna Scheffler was one of the most interesting justices at the newly founded Court. She was of Jewish decent and had spent the last months of the war hidden in a garden shed in Berlin. After the war, before becoming a Justice at the FCC, Dr. Scheffler became active in the reform of German family law. At the Deutsche

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[50] For a discussion of gender equality and family law, see Christine Hohmann-Dennhardt, *Gleichberechtigung im Familienrecht*, 1 FORUM FAMILIENRECHT 15 (2006).

[51] For a short discussion of the legislative history in the *Parlamentarischer Rat,* see Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 205/58, July 29, 1959, 10 BVERFGE 59, 67 (Ger.). and Justice Jutta Limbach writing extrajudicially in Margarete Wohlan, DEMOKRATISCHE GESCHLECHTERVERHÄLTNISSE IM 21 JAHRHUNDERT 15 (Christine Kammerer ed., 1999). NEUE FORDERUNGEN—ALTE HERAUSFORDERUNGEN, ARBEITSHILFEN FÜR DIE POLITISCHE BILDUNG 15 (Bundeszentrale für politische Bildung ed., 1999).

[52] Individual constitutional rights had a very limited effect in the Weimar Republic and did not limit the power of the legislature. *See, e.g.*, Christoph Gusy, *Die Grundrechte in der Weimarer Republik*, 15 ZEITSCHRIFT FÜR NEUERE RECHTSGESCHICHTE 163 (1993); Michael Stolleis, *Weimarer Kultur und Bürgerrechte*, *in* WEIMAR UND DIE DEUTSCHE VERFASSUNG. ZUR GESCHICHTE UND AKTUALITÄT VON 1919, 89 (Andreas Rödder ed., 1999).

[53] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 106/53, Dec. 18, 1953, 3 BVERFGE 225 (Ger.).

Juristentag, the Annual Conference of German Lawyers in 1950, she presented a paper on the necessary reforms.[54] At the FCC, Dr. Erna Scheffler became responsible for the preparation of constitutional cases concerning family law.

The FCC determined that after the time limit in Article 117 had passed, Article 3(2) of the Basic Law had to be applied as binding constitutional law.[55] The Constitution had accepted that unconstitutional law became void if the legislature did not act in time.[56] The FCC overruled the objection that gender equality and the protection of family and marriage were incompatible.[57] Rather, under the Basic Law, gender equality provided the very basis of marriage. The Court stated that biological, as well as functional differences, could justify different regulations, for example to protect mothers.[58] Such rules should not be considered obstacles to gender equality but rather as means of its implementation. The FCC has noted that "[w]ith the right approach to Article 3(2) and Article 6(1) of the Basic Law one article will not endanger, but will rather, as the constitutional legislature intended, fulfill the other."[59] Until the legislature reformed family law, the lower courts had to interpret pre-constitutional law in a way that prevented a violation of Article 3(2).[60] The lower courts acted accordingly, assuming separation of property as the new default matrimonial property regime, despite the law in the Civil Code.[61] In order to enable the wife to participate in wealth accumulated by the joint efforts of the spouses, courts held that couples had created implied partnerships.[62] Moreover, the lower courts constructed rights to spousal support for both parties[63] and gave parental responsibility to both parents.

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[54] Erna Scheffler, Verhandlungen des 38. Deutschen Juristentages 1950 B. 3 (1951).

[55] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 106/53, Dec. 18, 1953, 3 BVERFGE 225, 239–40 (Ger.).

[56] *Id.*

[57] For the role FCC case law played in this development, see Renate Jaeger, *50 Jahre Artikel 3 Absatz 2 des Grundgesetzes: Die Rolle des Bundesverfassungsgerichts bei der Durchsetzung des Gleichberechtigungsgebotes*, *in* 50 JAHRE GRUNDGESETZ: MENSCHEN- UND BÜRGERRECHTE ALS FRAUENRECHTE 21 (Frauen & Geschichte Baden-Württemberg ed., 5th ed. 2000).

[58] Functional differences are not mentioned in the recent case law of the court.

[59] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 106/53, Dec. 18, 1953, 3 BVERFGE 225, 242–43 (Ger.).

[60] *Id.* at 243.

[61] Bundesgerichtshof [BGH - Federal Court of Justice], Case No. 5 ZR 97/52, July 14, 1953, 10 BGHZ 266 (Ger.).

[62] Bundesgerichtshof [BGH - Federal Court of Justice], Case No. 2 ZR 44/52, Dec. 20, 1952, 8 BGHZ 249 (Ger.); THOMAS HERR, KRITIK DER KONKLUDENTEN EHEINNENGESELLSCHAFT 39–60 (2008).

[63] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 106/53, Dec. 18, 1953, 3 BVERFGE 225, 242–43 (Ger.).

The constitutional principle of gender equality is still of great importance in FCC case law, especially with respect to the sharing of property and pension rights at the time of divorce, as illustrated by the following language in one of its cases:[64] "Pension rights accumulated during marriage have to be regarded as the joint achievement of the spouses. In the marital partnership, the husband's employment as well as the wife's homemaking are of equal rank and value."[65] In its 2001 decision on nuptial agreements, the FCC again stressed the importance of gender equality in marriage.[66] The Court held that the only constitutionally protected marriage was a partnership of equals.[67] A nuptial agreement that could in no way be regarded as an expression of such a partnership, but only as a reflection of the dominance of one partner over the other, did not deserve legal protection; rather, it necessitated court intervention for the protection of the weaker party.[68]

Thus, gender equality is a central element of the constitutional understanding of marriage. Gender equality must be respected by the legislature as well as by the lower courts.

IV. Marriage and Cohabitation

In Germany in 2010, 11.01% of couples cohabited without getting married or registering a civil partnership.[69] As in other European countries, for example France or the Scandinavian countries, cohabiting without being married is socially acceptable in Germany. The importance of the formal civil marriage ceremony must be discussed because the behavior of cohabitants does often not differ from married couples. The issue at hand is whether long-term cohabitation is enough to ensure the couple constitutional protection.

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[64] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 105/95, Feb. 5, 2002, 105 BVERFGE 1, 11 (Ger.).

[65] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 818/81, Nov. 30, 1982, 62 BVERFGE 323, 330 (Ger.).

[66] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 12/92, Feb. 6, 2001, 103 BVERFGE 89, 101, 107 (Ger.).

[67] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 105/95, Feb. 5, 2002, 105 BVERFGE 1, 11 (Ger.).

[68] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 12/92, Feb. 6, 2001, 103 BVERFGE 89, 101 (Ger.).

[69] STATISTISCHES BUNDESAMT, STATISTISCHES JAHRBUCH tbl. 2.16 (2011) https://www.destatis.de/DE/Publikationen/StatistischesJahrbuch/Bevoelkerung.pdf?__blob=publicationFile (last visited July 30, 2012).

As previously mentioned, according to FCC case law, Article 6(1) of the Basic Law protects a secularized notion of marriage as developed in the 19th century that demands a civil rather than a religious ceremony.[70] Official participation in the marriage ceremony is an essential part of this conception of marriage. Cohabitation without the marriage ceremony is not a marriage in the constitutional sense.[71] Gröschner considered it a paradoxical result that the constitutional freedom to conclude and organize one's marriage guaranteed that the government, the judiciary, and the legislature observe a respectful distance to the institution of marriage while a marriage cannot be concluded without a civil ceremony or dissolved without a court order.[72]

However, according to the FCC, Article 6(1) does not prevent the legislature from granting certain benefits to cohabiting couples.[73] Like any other human action that is not protected by a special constitutional right, cohabitation is protected under Article 2(1), which guarantees that freedom can only be restricted by means of a proportionate law.

The FCC has held that an official marriage ceremony executed by a civil servant ensured the absence of impediments to marriage as well as the publicity and transparency of legal relationships.[74] Moreover, the FCC's case law shows that rights to spousal support are a central aspect of marriage.[75] If these duties of mutual assistance are a central part of the constitutional understanding of marriage, and cannot be modified at will by the parties, a marriage cannot be created by an act of the parties alone, but only with the involvement of a governmental institution. This then also explains why a religious ceremony alone is not enough in Germany to ensure the protection of Article 6(1) GG.[76]

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[70] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 636/68, May 4, 1971, 31 BVERFGE 58, 82–83 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 136/78, Feb. 28, 1980, 53 BVERFGE 224, 245 (Ger.).

[71] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 3/57, Dec. 16, 1958, 9 BVERFGE 20, 34–35 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 409/67, Oct. 7, 1970, 29 BVERFGE 166, 166 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 684/98, Nov. 11, 2004, 112 BVERFGE 50, 65 (Ger.); *see also* PETER BADURA, GRUNDGESETZ-KOMMENTAR Art. 6 Abs. 1, ¶ 56 (Theodor Maunz & Günther Dürig eds., 37th ed. 2000).

[72] Gröschner, *supra* note 15 at n.63.

[73] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 1186/89, Apr. 3, 1990, 82 BVERFGE 6, 15 (Ger.).

[74] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 409/67, Oct. 7, 1970, 29 BVERFGE 166, 176 (Ger.).

[75] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 5/03, Feb. 28, 2007, 117 BVERFGE 316, 327 (Ger.).

[76] Bundesverwaltungsgericht [BVerwG - Federal Administrative Court], Case No. 1 C 17/03, Feb. 22, 2005, 2005 NEUE ZEITSCHRIFT FÜR VERWALTUNGSRECHT 1191, 1192 (Ger.).

This, however, raises the question of whether a marriage, as recognized under Article 6, could be created if the parties contractually agree that all marital duties and rights will bind them, but do not participate in a marriage ceremony. Even though there is no FCC decision on this, the Court would likely not hold in favor of such a union. Apart from the fact that monogamy would be more difficult to guarantee if such unions were accepted, the parties could terminate and modify their contract whenever they wanted. Only the required official and legal participation in the marriage ceremony and in divorce proceedings can ensure that certain rights and duties are created and resolved independently from the spouses' wishes.

V. Civil Partnership and Marriage

The *eingetragene Lebenspartnerschaft*, civil partnership,[77] is a legal institution within family law for permanent same-sex relationships.[78] Unlike cohabitants, civil partners legalize their union in a civil ceremony. Civil partnerships were introduced in 2001, when a coalition of the Social Democrats and the Green Party under Chancellor Gerhard Schröder was in office.

According to the traditional definition of marriage, which is the union of a man and a woman to a companionship for life, same-sex civil partnerships are not considered marriages within the meaning of Article 6(1), even if they are concluded in a civil ceremony.[79] Such an approach considers civil partnerships to be fundamentally different from marriages. Two possible constitutional interpretations could be drawn from this characterization: Civil partnerships could be considered constitutionally permissible but unprotected by Article 6, or they could be regarded as violating the institution of marriage and thus as unconstitutional.[80]

The constitutionality of the civil partnership was hotly debated when it was introduced in 2001. Those who argued that it was unconstitutional concentrated on the word *special* in Article 6(1). The theory was that if the constitution granted *special* protection to marriage, no other union should be even remotely granted protection and benefits like marriage.

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[77] Civil Partnership is the term used in the United Kingdom. The literal translation of *eingetragene Lebenspartnerschaft* is "registered partnership for life."

[78] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 1164/07, July 7, 2009, 124 BVERFGE 199, 206, ¶ 35 (Ger.).

[79] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 640/93, Oct. 4, 1993, 1993 NEUE JURISTISCHE WOCHENSCHRIFT (NJW) 3058 (Ger.).

[80] *See, e.g.*, Badura, *supra* note 7, ¶ 58; Burgi, *supra* note 29 at 504–05; Roman Herzog*, Schutz von Ehe und Familie durch die Verfassung*, *in* BITBURGER GESPRÄCHE 15–16 (Gesellschaft für Rechtspolitik Trier ed., 1988).

There should be a considerable distinction between marriage and other unions, "*Abstandsgebot*"[81] it was argued.[82] To combat such resistance and ensure the constitutionality of civil partnerships, the legislature established a couple of differences between marriage and civil partnership in its legislation. Among others, civil partners had no right to adopt children, they were treated as single with respect to inheritance and income tax law, and they had no right to a pension if their partner died. Moreover, the Federal legislature, who has legislative competence for family law, allowed the states (*Bundesländer*) to assign the partnership ceremony either to private notaries or to the public office responsible for marriage ceremonies (*Standesamt*). Since 1 January 2012, however, partnership ceremonies are performed in all German Federal states at the *Standesamt.* The southern state of Baden-Württemberg was the last to assign civil partnership and marriages to the same public institution.

The verdict of the FCC on the constitutionality of the civil partnership was keenly awaited. In its decision of 17 July 2002, the Court held that the civil partnership was constitutional because it was fundamentally different from marriage.[83] Thus, the Court assumed the first of the two approaches mentioned above. Marriage was the lifelong union of a man and woman. However, the legislature was free to introduce a legally secured partnership for same-sex couples who could not marry. Marriage was not damaged by the introduction of a partnership that was not open to heterosexual couples.[84] Civil partnerships are thus not marriages but legal relationships that do not compete with marriage.[85] The Court rejected the claim that the wording of Article 6(1) demanded that there remain a significant distinction between marriage and other relationships.[86] Marriage should not be

[81] In literature, the terms *Privilegierungsgebot*, duty to privilege marriage, Detlef Merten, *Eheliche und nichteheliche Lebensgemeinschaften unter dem Grundgesetz*, *in* FREIHEIT UND EIGENTUM, FESTSCHRIFT FÜR WALTER LEISNER ZUM 70. Geburtstag 615, 619 (Josef Isensee & Helmut Lechler eds., 1999), and *Öffnungs- und Bezeichnungsverbot*, prohibition to open marriage to other unions or to call other unions marriage are used as well. Walter Pauly*, Sperrwirkungen des verfassungsrechtlichen Ehebegriffs,* 1997 NEUE JURISTISCHE WOCHENSCHRIFT 1955, 1956 (1997); Burgi, *supra* note 29, at 502–05.

[82] For a discussion of the Abstandsgebot, see Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvF 1/01 July 17, 2002, 105 BVERFGE 313, ¶¶ 19–20, (Ger.); *see also id.* at ¶¶ 125–27 (Papier, C.J., dissenting); *id.* at ¶¶ 128–47 (Haas, J., dissenting).

[83] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvF 1/01, July 17, 2002, 105 BVERFGE 313, 345–46 (Ger.).

[84] *Id.* at 346–48, ¶ 97.

[85] *Id.* at 348, ¶ 97.

[86] *Id.* at 348, ¶ 98. For an argument that civil partnerships violate Art. 6 of the Basic Law, see Ruper Scholz & Arnd Uhle, *"Eingetragene Lebenspartnerschaft" und Grundgesetz*, 2001 NEUE JURISTISCHE WOCHENSCHRIFT 393, 396–400 (2001).

discriminated against, but the constitution did not require that other relationships be treated less favorably than marriage, the court held.[87]

Relieved by the decision, the legislature responded and reformed civil partnerships to remove some of the differences between marriage and civil partnerships. Civil partners may now adopt the children of their partners, but they still cannot adopt children as a couple.[88]

Since then, in recent cases, the FCC has stressed the similarities between marriages and civil partnerships:

> Like spouses, registered civil partners live in a long-term, legally recognized partnership (see BVerfGE 124, 199 (225)). While both are alive they share the assets of their registered civil partner and expect to be able to maintain their joint standard of living in the event of the death of one of the civil partners. Not unlike a spouse, a civil partner also acquires assets not only for himself, but also for his civil partner and, when applicable, for the children living with the partners.[89]

The Court stated that "[t]here are no longer any relevant differences between civil partnerships and marriage regarding their asset situation, long-term bond, and mutual care for one another."[90] In its decision of 6 December 2005, the FCC even went a step further and stated that every person has a constitutional right protected under Articles 2(1) and 1(1), of the Basic Law the right to one's personality, and under that freedom, the right to establish a relationship with a partner of his or her choice and to secure that partnership legally by establishing an institution—marriage or civil partnership.[91]

Even after the majority of the justices of the FCC decided the question of whether Article 6(1) necessitates a distinction between marriage and other partnerships, the dichotomy of marriage and civil partnership poses an equality issue that remains unresolved. Some

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[87] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvF 1/01, July 17, 2002, 105 BVERFGE 313, 348–50 (Ger.).

[88] A case on this issue is pending at the moment.

[89] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 611/07, July 21, 2010, 126 BVERFGE 400, 400 (Ger.).

[90] *Id.* At 423, ¶ 54.

[91] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 3/03, Dec. 6, 2005, 115 BVERFGE 1, 24–25 (Ger.).

commentators assumed that the decision of 17 July 2002 meant that civil partners had no constitutional right to be treated like spouses.[92] The FCC rejected this notion in its decision of 7 July 2009.[93] The special protection of marriage in Article 6(1) was not enough to justify privileging a marriage over a civil partnership:

> If the privileged treatment of marriage is accompanied by unfavorable treatment of other ways of life, even where these are comparable to marriage with regard to the life situation provided for and the objectives pursued by the provisions, the mere reference to the requirement of protecting marriage does not justify such a differentiation.[94]

Even though the distinction between marriage and civil partnership was categorized according to gender and not sexual orientation, in practice, the decision to get married or establish a civil partnership has been inextricably linked to sexual orientation, the FCC stated.[95] Thus, the laws concerning the rights and duties of civil partners typically concerned homosexuals.[96] Since differentiations between marriage and civil partnership were thus based on sexual orientation, very substantial reasons were needed to justify them. In this decision, the FCC referred to the case law of the European Court of Human Rights (ECHR), which had already developed a high scrutiny test for distinctions based on sexual orientation.[97] The FCC argued that discrimination based on sexual orientation is comparable to discrimination based on gender, language, origin, or race, which are all forbidden by Article 3(3) of the Basic Law.[98] In all these cases, the victims of such discrimination have no opportunity to change the characteristic, even if they want to.

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[92] FRIEDHELM HUFEN, STAATSRECHT II 268 (2d ed. 2009).

[93] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 1164/07, July 7, 2009, 124 BVERFGE 199 (Ger.).

[94] *Id.* at 226, ¶ 105.

[95] *Id.* at 221, ¶ 90.

[96] *Id.* at 222, ¶ 92.

[97] Karner v. Austria (No. 40016/98), 2003-IX Eur. Ct. H.R., July 24, 2003. On the decision`s influence in Germany, see Lothar Michael, *Lebenspartnerschaften unter dem besonderen Schutze einer (über-) staatlichen Ordnung Legitimation und Grenzen eines Grundrechtswandels kraft europäischer Integration*, 63 NJW 3537 (2010).

[98] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 1164/07, July 7, 2009, 124 BVERFGE 199, 222, ¶ 87 (Ger.).

In 2009 and 2010, the FCC declared unequal treatment of marriage and civil partnerships in the contexts of survivors' pensions for employees in the civil service,[99] as well as inheritance taxes,[100] to be unconstitutional under the equal protection guarantee in Article 3(1). On 18 July 2012, the First Senate declared privileges for married couples in respect to taxes on purchase of real property unconstitutional.[101] The Second Senate held on 19 June 2012 that benefits for married civil servants must be given to civil partners as well.[102] A decision by the Second Senate of the Court concerning unequal treatment of spouses and civil partners under income tax law is still pending.

Michael[103] and Hillgruber[104] agree that this interpretation of Article 3(1) in effect extends the constitutional protection of Article 6 to civil partnerships. The court's approach, however, has been criticized: If the *special protection of marriage* that Article 6 requires was not enough to justify these privileges, nothing remained of marriage's special constitutional protection.[105]

Grünberger summarized the result of this case law concisely with the words that marriage and civil partnership were "separate but equal."[106] Marriage and civil partnership are regulated separately; however, FCC case law demands equal protection. When the U.S. Supreme Court decided the landmark case, *Brown v. Board of Education of Topeka*,[107]

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[99] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 1164/07, July 7, 2009, 124 BVERFGE 199 (Ger.).

[100] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Joined Cases No. 1 BvR 611/07 and 1 BvR 2464/07, July 21, 2010, 126 BVERFGE 400 (Ger.).

[101] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 16/11, July 18, 2012 (Ger.).

[102] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 2 BvR 1397/09, June 19, 2012 (Ger.).

[103] Michael, *supra* note 97, at 3539–42.

[104] Christian Hillgruber, *Anmerkung*, 65 JURISTENZEITUNG 41 (2010).

[105] *Id.* at 42. For more criticism, see Sebastian Hopfner, *Lebenspartnerschaft ist gleich* Ehe—Verfassungsinterpretation *oder Verfassungsänderung?*, BETRIEBLICHE ALTERSVERSORGUNG 772 (2009); CHRISTIAN VON COELLN, GRUNDGESETZ-KOMMENTAR ART. 6, ¶ 50 (Michael Sachs ed., 6th ed. 2011). For more approving treatment, see Michael, *supra* note 97, at 3537; Claus Dieter Classen, *Der besondere Schutz der Ehe—aufgehoben durch das BVerfG?*, 65 JURISTENZEITUNG 411, 412 (2010); Claus Dieter Classen, *Die Lebenspartnerschaft im Beamtenrecht*, FAMILIE PARTNERSCHAFT RECHT [FPR] 200 (2010); Tilman Hoppe, *Die Verfassungswidrigkeit der Ungleichbehandlung von Ehe und eingetragener Lebenspartnerschaft im Bereich der betrieblichen Hinterbliebenenrente (VBL)*, DVBl 1516 (2009).

[106] Michael Grünberger, *Die Gleichbehandlung von Ehe und eingetragener Lebenspartnerschaft im Zusammenspiel von Unionsrecht und nationalem Verfassungsrecht*, 5 FAMILIE PARTNERSCHAFT RECHT 203, 208 (2010).

[107] 347 U.S. 483 (1954).

schools were still discriminating; similarly, it remains an open question in Germany as to how the constitutional relationship of civil partnership and marriage will develop. The rest of this Article will attempt to answer to this question.

D. Same-Sex Marriage

The issue of whether marriage should be opened to same-sex couples is hotly debated not only in Germany, but also in the United States. More and more countries allow same-sex couples to marry—*e.g.*, the Netherlands (2001), Belgium (2003), Canada (2005), Spain (2005), South Africa (2006), Norway (2009), Argentina (2010), Iceland (2010), and Portugal (2010).

The ECHR concluded in *Schalk and Kopf v. Austria*[108] that because less than half of the member states to the European Charter of Human Rights had opened marriage to same-sex couples, the member states still moved within their margin of appreciation in not allowing same-sex couples to get married. Article 12 of the Charter, the right to get married, did not protect same-sex unions.[109] The Court held, however, that homosexual partnerships were protected under Article 8 as *family life* in addition to the protections afforded to *private life*.[110] A majority of 4 to 3, Judges Rozakis, Spielmann, and Jebens dissenting, however, denied a duty to introduce a legal framework for homosexual couples.

The final part of this article will discuss German constitutional law and ask whether a separation between civil partnerships and marriage is necessary in order to avoid a violation of Article 6(1). This view might be accurate if marriage in the constitutional sense was indeed limited to couples of different sexes. If, however, marriage under Article 6 is not limited to people of different sexes, civil partnerships would not only not violate Article 6 but would in fact be constitutionally protected in a manner that is similar to marriage. If this view proves to be correct, the separate status of civil partnership could actually be construed as a violation of Article 6(1). Rather than providing a separate institution for same-sex couples, the Constitution may require that marriage, as it is regulated in the German Civil Code, be open to same-sex couples in order to avoid discrimination.

I. Constitutional Interpretation

If all the other constitutional rights in the Basic Law are taken into account, the concept of marriage in Article 6(1) should include civil partnerships. This is because all the other

[108] Schalk & Kopf v. Austria (No. 30141/04), 2010 Eur. Ct. H.R.

[109] *Id.* ¶¶ 54–64.

[110] *Id.* ¶¶ 94–95.

articles of the Basic Law are interpreted in a way that guarantees the same rights regardless of a person's sexual orientation. An interpretation that excludes a group of people from a constitutionally protected right because of a characteristic, similar to those in Article 3(3), requires a very substantial reason. Despite this, the FCC has decided that because Article 6(1) is a special law for couples of mixed sex, it was constitutional to exclude homosexual couples from its protection.[111] This argument, however, begs the question of whether marriage in Article 6(1) really only means couples of mixed sex.[112]

It is true that if the interpretation of the German constitution was limited to its founders' original intentions, marriage in the constitutional sense would be limited to unions of men and women. However, the FCC decided early on that when interpreting laws below the constitutional level, the interpretation cannot be limited to the individual historical intentions of the legislature.[113] It would be strange if different rules of legal interpretation were to be used for constitutional law. More importantly, at the time of the drafting of the Basic Law, many of the laws that were in force would be considered unconstitutional today, which does not give much credibility to the founders' intentions. For example, until 1969, consensual homosexual acts between adult men were criminal offences according to § 175 of the Criminal Code.[114] The fact that the draftsmen and women of the Constitution could not imagine a world in which homosexual couples celebrated *tying the knot* like heterosexuals is not a basis for limiting homosexuals' constitutional protection.

Furthermore, the FCC has emphasized the importance that changes of social opinions have on the concept of marriage.[115] The FCC considers a change of society and consequently a change of the concept of marriage possible.[116] However, this approach is problematic. First, because constitutional rights are meant to protect against public opinion as

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[111] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 640/93, Oct. 4, 1993, 1993 NEUE JURISTISCHE WOCHENSCHRIFT (NJW) 3058 (Ger.).

[112] Kai Möller, *Der Ehebegriff des Grundgesetzes und die gleichgeschlechtliche Ehe*, Die öffentliche Verwaltung 64, 65 (2005).

[113] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 2 BvH 2/52, May 21, 1952, 1 BVERFGE 299, 312 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 898/79, Dec. 16, 1981, 59 BVERFGE 128, 153 (Ger.).

[114] After 1969, consensual male sodomy was only criminal when one partner was under 21 years old. In 1973, this was changed and it was a crime only if the partner was under 18. In 1994, special criminal rules for homosexual sex were completely abandoned.

[115] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 719/69, Nov. 14, 1973, 36 BVERFGE 146, 163 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvF 2/01, July 17, 2002, 105 BVERFGE 313, 345 ¶ 87 (Ger.).

[116] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 640/93, Oct. 4, 1993, 1993 NEUE JURISTISCHE WOCHENSCHRIFT (NJW) 3058 (Ger.).

expressed for example in the decisions of the democratically appointed legislature. Second, it is difficult to ascertain when such a change has actually taken place. Practically, such a change will be concluded when the FCC determines in a decision that the change indeed has occurred, which shows how much power the court has assigned itself by this understanding of constitutional law.

Moreover, the argument that Article 6 should be interpreted as excluding civil partnerships because the German public understands marriage as only the union of a man and a woman is not convincing for two reasons. First, in Germany, a civil partnership is commonly referred to as "*Homo-Ehe*," or "Marriage for Homosexuals." In addition, when homosexual celebrities establish civil partnerships, tabloids usually report on their "getting married." This suggests a strong link between civil partnerships and marriage in the public understanding. Second, even if public opinion could be reliably ascertained as not including same-sex unions, marriage is a legal term. Legal terms like *contract*, *ownership*, or *murder* are not interpreted according to public opinion either.[117] Put another way, the public would also consider a religious wedding to create a marriage even though the FCC only considers a civil marriage concluded by a registrar to be a marriage under Article 6.

II. Marriage and Religion

The exclusion of homosexual couples from the protection of marriage would certainly mirror the Christian and Jewish traditions that have strongly influenced the development of the values expressed in the German constitution. Nevertheless, a Christian conception of marriage cannot be of decisive importance for constitutional interpretation.

Some may find this surprising considering the FCC tends to be more favorable regarding religious expression in the public sphere than the U.S. Supreme Court.[118] For example, according to Article 7(3), religion is a regular course in public schools and Christian symbols are permissible in schools so long as those of a different faith have the opportunity to demand removal anonymously.[119] School prayers are permissible during school hours so

[117] Möller, *supra* note 112, at 66.

[118] There is not enough room here to provide a thorough comparison of the U.S. and the German constitutional interpretation of religion in the public sphere. *See* CAROLA RATHKE, ÖFFENTLICHES SCHULWESEN UND RELIGIÖSE VIELFALT: ZUGLIECH EIN BEITRAG ZUR DOGMATIK VON ART. 4 ABS. 1 UND 2 GG, ART. 7 ABS. 1 GG UND DER STAATLICHEN PFLICHT ZUR WELTANSCHAULICH-RELIGIÖSER NEUTRALITÄT (2005); BENJAMIN VOLLRATH, RELIGIÖSE SYMBOLE: ZUR ZULÄSSIGKEIT RELIGIÖSER SYMBOLE IN STAATLICHEN EINRICHTUNGEN IN DER BUNDESREPUBLIK DEUTSCHLAND UND DEN USA (2006).

[119] This is the way the Bundesverwaltungsgericht has interpreted the famous crucifix-decision of the FCC. Bundesverwaltungsgericht [BVerwG - Federal Administrative Court], Case No. 6 C 18–98, Apr. 21, 1999, 1999 NEUE JURISTISCHE WOCHENSCHRIFT (NJW) 3063, 3064 (1999) (Ger.); *see also* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 1087/91, May 16, 1995, 93 BVERFGE 1 (Ger.) (the crucifix decision).

long as a student or teacher has suggested them and everybody participates freely.[120] Additionally, churches that undergo a special public process have the right to direct fiscal authorities to collect certain taxes for them from people of their faith (*Kichensteuer*).

Nevertheless, the Constitution must be neutral and cannot identify with any religious creed.[121] To consider the Christian notion of marriage as decisive for constitutional interpretation would contradict the Constitution's guarantee of freedom of religion. According to FCC case law, the Basic Law embraces a secular notion of marriage.[122] If a Christian conceptualization of marriage were to be decisive, the constitutionality of divorce would be questionable, especially in regions in which the Catholic belief dominates. Moreover, marriages of non-Christian or non-Jewish couples would not be protected under the Constitution.

As was pointed out above, the importance of the public registration of the marriage ceremony is of decisive importance for the notion of marriage. Couples are free, however, to perform a religious ceremony and even to interpret their individual union in a way that excludes homosexual couples. This, however, does not shed light on the constitutionality of same-sex unions that have undergone a public legal ceremony similar to married couples.

III. Gender, Sex, and Marriage

At first glance, the distinction between sexes, which is at the heart of the traditional notion of marriage as a mixed sex union, seems natural. The FCC, however, has decided many cases concerning the legal position of transsexuals, thus acknowledging that the distinction between sexes is flexible.[123] The Court has held that gender is not necessarily a biological category fixed for life; rather, it can be changed. Transsexuals who feel they do not belong to the gender that law and society assigned them, have a constitutional right to change their legal gender and name.[124]

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[120] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 647/70, 1 BvR 7/74, Oct. 16, 1979, 52 BVERFGE 223, 237, 239 (Ger.).

[121] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 1087/91, May 16, 1995, 93 BVERFGE 1, 16–17 (Ger.).

[122] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 136/78, Feb. 28, 1980, 53 BVERFGE 224, 245 (Ger.).

[123] See Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 16/72, Oct. 11, 1978, 49 BVERFGE 286 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 3/03, Dec. 6, 2005, 115 BVERFGE 1 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 10/05, May 27, 2008, 121 BVERFGE 175 (Ger.).

[124] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 16/72, Oct. 11, 1978, 49 BVERFGE 286 (Ger.).

In a decision of 27 May 2008, the FCC had to decide a case concerning a transsexual who had been married to a woman for many years. [125] The transsexual person underwent the operation legally necessary at the time to obtain the legal status of a woman. However, the law required that this person get divorced before changing legal status from male to female in order to prevent a legally recognizable marriage between two people of the same gender. The transsexual in question argued that the couple's love had not died and that no force in the world could part them. The FCC objected to this de facto duty to divorce and held that even though the marriage was created as a union between a man and a woman, there was no need to continue the union as such simply to ensure ongoing constitutional protection.[126] Thus, same sex marriages are de facto possible already if one spouse is a transsexual.

In a decision of 11 January 2011, the FCC decided that the laws requiring a transsexual to undergo a severe and dangerous operation to change his or her genitals before he or she could obtain the right to change gender was unconstitutional.[127] This means that if two psychological experts agree that a person will remain convinced that he or she belongs to the other gender, a person with male genitalia may legally become a woman. This woman could then get married to a man or institute a civil partnership with another woman. This thus raises the question of whether a distinction, such as gender, that is so flexible and so much part of one's own individual conviction, can justify the constitutional protection of only a union of mixed sexes.

IV. Marriage and Procreation

In Greek and Roman tradition,[128] as well as in traditional Christian teachings, marriage served as the legal and social framework to create families and to raise children. Article 119 of the Weimar Constitution read: "Marriage is protected especially by the constitution as the basis of family life and of the reproduction and preservation of the nation." The Basic Law does not include a comparable sentence, probably for the previously mentioned reason that words such as "reproduction and preservation of the nation" sounded disturbing after 1945. Nevertheless, academics justifying a notion of marriage as the union of a man and a woman only, often refer to the ability of many heterosexual couples to have mutual children. According to Gröschner, the German legislature needs only to favor

[125] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 10/05, May 27, 2008, 121 BVERFGE 175 (Ger.).

[126] *Id.* at 198–99.

[127] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 3295/07, Jan. 11, 2011, 128 BVERFGE 109 (Ger.).

[128] Gröschner, *supra* note 15, ¶ 36.

and support this reproductive function in order to fulfill its constitutional obligations.[129] Marriage, von Coelln argues, is the legally protected pre-stage of the family.[130] This understanding views marriage as the basis of family life.

In its decision of 21 July 2010, the FCC stated cautiously that the reproductive abilities of a married couple may justify providing benefits for married couples that are not provided for civil partners.

> In its qualification as a starting point for a succession of generations, marriage differs in principle from civil partnerships. Because civil partnerships are limited to same-sex couples joint children in principle cannot come from the relationship. In contrast, marriage, as a bond between heterosexual partners, can be the starting point of their own generational succession. It also is a privileged legal area for building a family based upon multiple statutory provisions, regardless of the freedom of the spouses to choose parenthood.[131]

Likewise, the FCC considered it constitutional that public health insurance covered the costs of in vitro fertilization only for married couples. The Court held that the "legally secured responsibility and stability of marriage" justified drawing a distinction between married and unmarried couples.[132]

However, *family* as protected in Article 6 of the Basic Law, not only protects married parents, but also unmarried parents and their children.[133] In recent years, several decisions of the FCC have converged the rights and duties of unmarried parents with those of married parents.[134] A homosexual couple living with the child of one of the partners is a

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[129] *Id.* ¶ 50.

[130] Coelln, *supra* note 105, ¶ 50.

[131] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 611/07, July 21, 2010, 126 BVERFGE 400 (Ger.).

[132] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 5/03, Feb. 28, 2007, 117 BVERFGE 316, 328–29 (Ger.).

[133] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 265/75, June 6, 1977, 45 BVERFGE 104, 123 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Joined Cases 1 BvR 1493/96 and 1 BvR 1724/01, Apr. 9, 2003, 108 BVERFGE 82, 112 (Ger.); Michael, *supra* note 97, at 3538 ("[T]he constitutional family privilege is independent from the marriage privilege."

[134] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 420/09, July 21, 2010, 127 BVERFGE 132 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 9/04, Feb. 28, 2007, 118 BVERFGE 45 (Ger.).

family within the meaning of Article 6(1) as well.[135] If one accepts the FCC's analysis that marriage stabilizes the parent's relationship, which in turn ensures a healthy environment for the children, whether or not they are adopted,[136] one may conclude that a civil partnership would likewise stabilize a homosexual relationship and thus better aid child development than a homosexual couple who just cohabitates.[137]

Another argument against this focus on the reproductive function of marriage is that not all married couples want, or are able, to have children. The FCC has never held, and academics have never argued, that infertile married couples would not be protected by Article 6(1). Moreover, the constitutional right that allows the couple to live their marriage as the couple sees fit, [138] should protect against any pressure or duty to have children.

Yet, according to Gröschner and others, this does not diminish the notion of marriage as the union of a man and a woman for reproductive purposes. They argue that neither a person's individual capacity nor a couple's willingness to procreate should be considered in a discussion of the constitutional protection of marriage as an institution; it was the fact that children could be born into the union of a man and a woman that was relevant here.[139]

This position lacks merit.[140] Marriage does indeed provide a legal framework within which to create a family. It is doubtful, however, that this alone is enough to exclude homosexual couples from the protection of Article 6. First, for constitutional protection and support of marriage to be rationalized as encouraging reproduction of married couples, the birth of children to married couples would need to be considered a constitutional aim of some importance. This, however, is not necessarily the case, given that Article 6(5)[141] of the Basic law as cited above states that children born in and out of wedlock must have the same rights and opportunities in life.

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[135] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 666/10, 2011 NEUE JURISTISCHE WOCHENSCHRIFT (NJW) 988 (July 2, 2010).

[136] Burgi, *supra* note 29, at 500.

[137] The Second Senate adopted this argument in Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 2 BvR 1397/09, June 19, 2012 (Ger.). This article does not discuss the development of children who grow up in a family with homosexual parents. This question has to be answered by qualified scientists.

[138] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 683/77, May 31, 1978, 48 BVERFGE 327, 338 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 5/83, Jan. 10, 1984, 66 BVERFGE 84, 94 (Ger.); Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 105/95, Feb. 5, 2002, 105 BVERFGE 1, 11 (Ger.).

[139] Gröschner, *supra* note 15, ¶ 44; Burgi, *supra* note 29, at 499.

[140] *See* Möller, *supra* note 112, at 69–70.

[141] GRUNDGESETZ FÜR DIE BUNDESREPUBLIK DEUTSCHLAND [GRUNDGESETZ] [GG] [BASIC LAW] art. 5 (Ger.).

Moreover, if the reproductive function of married couples was at the core of the constitutional understanding of marriage, it would be constitutionally permissible to prevent anyone who does not want to or is unable to have children from getting married. In order to prevent all problems with data protection that governmental inquiries into a person's willingness or ability to procreate might cause, such a conception of marriage would allow the government to exclude women over sixty from getting married. Möller suggested sarcastically, such women could conclude an "old-age partnership" rather than a marriage.[142] Moreover, it should be constitutional to exclude people from marriage whose infertility is known or openly admit that they do not plan to have children.

However, according to the FCC case law, the ability to procreate is not a precondition to marry under Article 6(1).[143] Furthermore, despite the fact that the original intentions of the draftsmen and women of the Basic Law are difficult to ascertain today and should not be considered decisive, it is interesting to note that the drafting assembly (*Parlamentarischer Rat*) understood that adoptive parents and their children formed a family. Moreover, Theodor Heuss—who was eventually the first Federal President—emphasized that childless spouses deserved the same constitutional protection as married couples with children.[144] While the idea of a marriage between homosexual partners was inconceivable at the time, the idea that constitutional protection should not be limited to spouses with offspring was nothing new.

Additionally, if marriage is understood as the union of a man and a woman for reproductive purposes, the possibility to have a child through artificial insemination should not be enough. Gröschner, however, believes medically assisted childbirth is protected as part of the reproductive function of marriage in Article 6(1) of the Basic Law even when sperms and eggs of donors are used.[145] However, this approach is inconsistent. Under this theory, civil partnerships of lesbians must be understood as marriages given that both partners can have children with the help of a sperm donor; male homosexual partnerships, however, could not and could thus not get married. This result, allowing lesbian marriages but not gay marriages, surely cannot stand considering that Article 3(2) and 3 (3) forbid

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[142] Möller, *supra* note 112, at 69–70.

[143] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvR 16/72, Oct. 11, 1978, 49 BVERFGE 286, 300 (Ger.).

[144] 29. Sitzung Grundsatz-Ausschuss vom December 4, 1948 (Stenoprotokoll). On the discussions in the constitutional drafting proccess, see Eva Welskop-Deffaa, *Wahlverwandschaft und Verantwortungsgemeinschaft*, 55 HIRSCHBERG 525, 527–28 (2003).

[145] Gröschner, *supra* note 15, ¶ 66.

gender discrimination. If however, it was enough that a couple raise adopted children, marriage by homosexual couples should not be impossible.[146]

If marriage today is neither in fact nor in law the only place to raise children, the issue needs to be discussed as to how the concept of marriage should be interpreted. Because the sole basis for marriage is no longer the founding and raising of a family, our conception of marriage needs to focus on the relationship of the two partners.[147]

V. Marriage as a Partnership of Mutual Responsibility

If a reproductive notion of marriage is rejected, the concept of marriage must focus on the relationship of the couple. If, however, the reproductive function is considered as the sole or most important purpose of the institutional protection of marriage, the legislature would be free to abolish all duties of mutual support between the spouses during and after marriage as far as those duties have no connection to the birth or raising of mutual children. For example, the only form of spousal support that could not be abolished would be that for the time a divorced spouse takes care of the parties' children. However, the legislature could certainly abolish all claims to spousal support for ill or old divorced spouses who have not raised any children during their marriage. It is doubtful, however, if such a legislation would be constitutional. The FCC decided the legislature had to provide legislation that adequately took into account the personal responsibility of the spouses even after their divorce.[148] The compensation for any disadvantages caused by the raising of children was not mentioned in this context. As already mentioned, the internal organization of one's married life is the responsibility of the spouses alone. A duty to have children must thus be considered unconstitutional. Therefore, it is doubtful that the core of the constitutional understanding of marriage is based on a duty the legislature cannot enforce without violating Article 6 and other human rights. Other duties, however, which are considered to be at the heart of marriage, are enforced with public authority. Spouses can sue each other for spousal support. Not only spouses, even public authorities can sue a spouse for spousal support, if they had to provide social benefits because of the defendant's unwillingness to pay. In addition, the civil servant who performs the marriage ceremony can refuse to do so under Section 1310(1) of the German Civil Code in connection with Section 1314(2) if he or she is convinced that the couple does not intend to provide mutual support. There does not exist any right to refuse to perform the ceremony because the couple declares that they do not want any children.

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[146] Under German law, civil partners may adopt their partner's children. This Article does not discuss the question of whether adoption should be possible for same-sex couples under the same prerequisites as for heterosexual couples. This question must be decided according to what is best for the children, which may very well mean open adoption for civil partners. A case concerning the question is pending at the moment at the FCC.

[147] Michael, *supra* note 97, at 3538.

[148] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case No. 1 BvL 136/78, Feb. 28, 1980, 53 BVERFGE 224, 250 (Ger.).

The fact that such limitations of one's personal rights (a legal duty to pay spousal support is a restriction of the payer's freedom under Article 2 (1)) are justified because of Article 6 suggests that those duties of mutual support are at the core of the constitutional notion of marriage, and the reproduction of legally unified heterosexual couples is not. This understanding of marriage has the legally secured and enforceable mutual responsibility of the partners at its center. Such a conception puts marriage in between the constitutional rights that are exercised jointly by a group of people like the freedom to form co-operations and unions,[149] or the freedom of assembly,[150] and the individual constitutional rights like free speech[151] and freedom of religion[152] which essentially protect the free development of one's personality. Marriage under Article 6 of the Basic Law stands in the middle, protecting the development of the individual within a partnership of equals.

With their marriage vows, two people create a binding relationship of mutual assistance and encouragement that provides emotional and even limited financial support. This relationship can, however, be opened to others, for example when children are born or adopted, or when the couple offers help and support to relations or friends in difficulties. Marriages can thus create centers of solidarity, which have an effect on society. This function can be assumed irrespective of the partners' sexes.

Under this understanding of marriage, there are no convincing reasons to limit marriage's constitutional protections under Article 6(1) to mixed sex couples. The conceptualization of marriage suggested here encompasses the functions of both marriage and civil partnership. As a result, civil partners should be allowed to marry in order to avoid violations of Article 6(1).

E. Conclusion

Marriage, under Article 6(1) as it has been interpreted by the FCC, is created in the presence of public officials. It creates mutual duties of support. In certain situations, those duties surpass even divorce and cannot be fully abolished by nuptial agreements. The protected space of mutual solidarity that marriage creates does not only benefit the couple, but also third parties such as children, relatives, and friends. According to FCC case law, only couples of mixed sex can marry. However, this part of the FCC's concept of marriage is constitutionally doubtful. There are no convincing reasons against an understanding of marriage that includes same-sex as well as mixed sex couples. The FCC

[149] Grundgesetz für die Bundesrepublik Deutschland [Grundgesetz] [GG] [Basic Law] art. 9 (Ger.).

[150] *Id.* at art. 8.

[151] *Id.* at art. 5.

[152] *Id.* at art. 4.

should recognize this understanding; doing so would not only solve problems of equal protection but also finalize the acceptance of homosexual relationships whose partners have, different from mere cohabitants, created legally binding duties of mutual support and responsibility.

Articles

Freeze-Out Transactions in Germany and the U.S.: A Comparative Analysis

By Christian A. Krebs[*]

A. Introduction

A freeze-out is a transaction in which a controlling shareholder forces out the minority shareholders and compensates them in cash or stock.[1] A successful freeze-out transaction marks the end of the exchange-traded life of a corporation—it is a "going private" transaction. A freeze-out is therefore the counterpart to an initial public offering. Whereas the latter leads to the public listing of a corporation and thus a multiplication of shareholders, the freeze-out transaction aims at reducing the number of shareholders of a corporation to one.

Freeze-out transactions are subject to a wealth of case law and scholarly discussion, both in the US legal system, and in Germany. This does not come as a surprise. The rules on freeze-outs need to resolve the diametrically opposed interests of the controlling shareholder[2] and minority shareholders. The controlling shareholder, often after a tender offer, seeks to consummate her acquisition of the target corporation and to establish efficiency gains. The minority shareholders are excluded from their share of the future earnings of the company and are concerned that they may not receive full compensation for their shares. After all, if the compensation is ultimately set or at least influenced by the

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[1] *Cf.* Guhan Subramanian, *Fixing Freezeouts*, (Harvard Law Sch. John M. Olin Ctr. for Law, Econ. and Bus., Discussion Paper No. 501, 2004); Marco Ventoruzzo, *Freeze-Outs: Transcontinental Analysis and Reform Proposals* 2 (European Corporate Governance Inst., Working Paper No. 137, 2009). In the U.S. legal system, the term *squeeze-out* is used to refer to measures—whether legal or not—which confer benefits from the corporation on the controlling shareholder to the detriment of the minority shareholder, thereby creating a *de facto* incentive for the minority shareholders to leave the corporation. *See id.*; HOLGER FLEISCHER, GROßKOMMENTAR AKTIENGESETZ Vor §§327a–f mn.4 (4th.ed. 2007). In Europe and in Germany, however, the term *squeeze-out* has been established as the equivalent of the term *freeze-out*. *Cf.* Council Directive 2004/25/EC, art. 15, 2004 O.J. (L 142) (EU); FLEISCHER at §327a. In the following, the term *freeze-out* will be used to describe general principles and in relation to U.S. law. The term *squeeze-out* will be used in relation to European and German law and never in relation to its ambiguous meaning in the U.S. legal system.

[2] The terms *controlling shareholder* and *controller* are used interchangeably in this text.

controlling shareholder, it is evident that a strong element of self-dealing is involved. So the regulation of freeze-outs is caught in a zone of tension between the legitimate interest of the controlling shareholder to maximize the efficiency of her corporation, and the fears of minority shareholders of self-dealing by the controlling shareholder.

It is striking that the rules on freeze-outs differ significantly between the U.S.[3] and Germany. The regulation of freeze-out transactions in Germany is fairly new and quite restrictive by comparison with U.S. standards. This is remarkable, as the corporate and capital market laws of European and U.S. jurisdictions are generally converging as a result of the ongoing development of European capital markets.[4] In many instances, Delaware law has inspired the formulation of corporate laws in Germany and on the EU-level. The German squeeze-out rules, however, are remarkably different from those developed in Delaware. Although the general framework for squeeze-outs has meanwhile been firmly established in Germany, the courts and legal scholars are still engaging in lively discussions of certain aspects of the procedure. So while some aspects of the squeeze-out procedure are still crystallizing in Germany, the discussion is more mature in Delaware, where the last notable development dates back to 2002.[5] The current vitality of the German discussion invites a comparative analysis of the freeze-out procedures in Germany and the U.S., with a focus on Germany. The rest of the article is structured as follows: Part B of the article briefly discusses the economic rationale of freeze-outs. Part C describes the history and development of the rules on freeze-out transactions in Delaware through case law, up to the current state of the discussion. Part D illustrates the introduction of squeeze-out rules into German law in 2002 and the subsequent legal development in Germany. Part E sets out the general squeeze-out procedure in Germany, discusses the most relevant issues with this procedure, illustrates some empirical data on the use of squeeze-outs in Germany, and draws comparisons with the U.S. where appropriate. Part F explains the takeover squeeze-out procedure in Germany and explains, based on empirical data, why this procedure has not yet become popular in practice. Finally, Part G compares the U.S. and German approaches, analyzes some specific issues, and argues that the different systems are a result of path dependency, and that therefore the potential for further convergence between the German and U.S. freeze-out rules is limited.

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[3] As the state corporation law of the U.S. today is dominated by Delaware law, which is widely recognized as the most developed corporate law in the U.S. and which governs over 50% of U.S. corporations, Delaware will serve as a proxy for the U.S. for the purposes of this analysis. A reference to the U.S. in this article can therefore be understood as a reference to Delaware.

[4] *See* Reinier H. Kraakman & Henry Hansmann, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001).

[5] *See In re* Pure Res., Inc. S'holders Litig., 808 A.2d 421, 436 (Del. Ch. 2002).

B. Rationales for Freeze-Out Transactions

There are several economic reasons for a controlling shareholder to execute a freeze-out procedure. For listed companies, the freeze-out is a way to delist the company from a stock exchange.[6] A freeze-out, then, is the inverse of going public. Such a "going private" transaction can be desirable if the cost-benefit analysis that motivated the earlier decision to go public is no longer viable.[7]

A common reason for going private is the perception that the market price of the exchange-traded securities does not reflect the real value of the issuing corporation. In that case, going private can be desirable for the controller who thinks she is able to extract a hidden value from the corporation, and the minority shareholders who could expect to be paid a premium over the current market price for their shares.[8] The reduction of the cost of compliance with securities laws and regulations may be another reason for a delisting, which appears, however, to be more prevalent in the U.S. than in Germany.[9]

While the aforementioned considerations are mostly limited to listed corporations, there is also a more general reason that justifies freeze-outs, which is also valid for unlisted companies. The protection rights of minority shareholders are quite costly to the corporation. Shareholders have the right to participate at the general meetings of the corporation and they have certain rights of information and of access to the books of the company. These costs remain essentially the same, even if the proportion of minority shareholders diminishes greatly.[10] Also, the board of directors has a variety of fiduciary duties towards minority shareholders, particularly in cases of self-dealing transactions involving the controlling shareholder. These costs can be avoided by freezing out the minority shareholders.

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[6] A delisting is generally also possible without a freeze-out, but freeze-outs are a convenient way to achieve a delisting. The reduction of the number of shareholders to one means that no regular exchange trade is possible anymore, so that the admission to the securities exchange is void or will be revoked, depending on the regulations of the respective stock exchange. In Germany, such a measure which leads to the loss of the stock exchange admission is called "cold" delisting. FLEISCHER, *supra* note 1, at mn. 33.

[7] *See* Ventoruzzo, *supra* note 1, at 6 (giving a more detailed overview and additional reasons like reducing agency costs and reducing the corporation's tax burden by increasing the debt-to-equity ratio because of the tax deductibility of interest payments).

[8] *Id*.

[9] A reason for that may be the onerous obligations introduced with the Sarbanes-Oxley Act of 2002 in the U.S.

[10] KOMMENTAR ZUM AKTIENGESETZ: AKTG §327(a) mn. 2 (Gerald Spindler & Eberhard Stilz eds., 2d ed. 2010); FLEISCHER, *supra* note 1, at mn. 8.

Another concern for the controller that may lead her to consider a freeze-out is the permanent risk of disruptive legal disputes with minority shareholders. These claims often need to be settled, sometimes even regardless of their merits. The risk of illegitimate shareholder suits is very high both in the U.S. and in Germany.[11] However, the "nuisance value" of such claims is even higher in Germany, as pending shareholder lawsuits can effectively block the execution of structural changes of the corporation, such as mergers or capital increases.[12]

Finally, in Germany, the freeze-out rules are seen as the necessary counterpart to the mandatory tender offer under Sec. 35 of the German Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Übernahmegesetz—"WpÜG"), pursuant to which an acquirer must offer to buy all shares that are tendered if she acquires more than 30% of the outstanding share capital and voting rights.[13] As compensation for this potentially onerous duty, the acquirer shall be enabled to effectively become the sole owner of the acquisition target.[14]

This very brief discussion of the reasons for freeze-out transactions shows that the institution as such can increase social welfare, and is therefore an important and legitimate component of the toolkit of corporate structural measures. Every freeze-out, however, occurs in the zone of tension between the controlling shareholder's interest to maximize the efficiency of her investment, and the minority shareholder's interest to receive full compensation for the loss of their shares, which embody the right to a share in all future earnings of the issuer.

The problem is that every freeze-out is by its nature a highly conflicted transaction, as the controller determines the conditions of the freeze-out, and most importantly, the timing of the freeze-out and the price per share. Capital markets are highly volatile. Among other factors, there is hence the risk that the controller may use market timing to cash out the minority at a time when the market irrationally undervalues the target shares. Therefore, the bone of contention is almost invariably the question of whether the controller has offered a fair price for the minority shares.

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[11] While in U.S. law *derivative* lawsuits are prone to be abused to extract exorbitant legal fees, in Germany *direct* shareholder claims tend to be used illegitimately.

[12] *See infra* Part E.V.1.

[13] The mandatory bid rule is required by Art. 5(1) of the European Takeover Directive and therefore exists in all EU jurisdictions. However, the applicable threshold was left to be determined by the Member States.

[14] DEUTSCHER BUNDESTAG: DRUCKSACHEN UND PROTOKOLLE [BT] Begr RegE WpÜG, 14/7034, S. 32 (Ger.).

C. History and Development of Freeze-Outs in Delaware

I. Early Developments

Until the first half of the 20th century, the minority shareholder's property interest allowed them to thwart the efforts of controlling shareholders to freeze the minority out; they had the right to continue as shareholders of the acquiring entity.[15] In the 1950s, Delaware adopted a cash-out merger statute[16] after Florida had pioneered this type of statute in the mid-1920s. In a statutory merger freeze-out, the controller establishes a wholly-owned subsidiary of the controlled corporation. The target board, usually dominated by the controller, approves the merger and the shareholders of the target— *i.e.* the board of the controlling entity—approve the transaction. The target shareholders receive either cash or the controller's stock in exchange for their shares in the target.

As of *Singer v. Magnavox*,[17] Delaware courts established that self-dealing transactions of a controlling shareholder, such as cash-out mergers, would be subject to a judicial "entire fairness" review. During the stock market depression of the early 1970s, the level of freeze-out activity increased, which sparked concerns that the controlling shareholders were taking advantage of the low market prices to the detriment of the minority shareholders.[18] The SEC responded to these concerns with the enactment of Rule 13e-3 in 1979, which requires the controller to make various disclosures in relation to the freeze-out transaction to enable minority shareholders to make an informed decision about how to respond to the freeze-out.[19]

II. The Introduction of Procedural Safeguards in Statutory Freeze-Outs

Beginning in the 1980s with *Weinberger v. UOP*,[20] the Delaware courts started to shape procedural safeguards for the decision-making process regarding the freeze-out consideration, which, if observed, would relieve the transaction from entire fairness review. In *Weinberger*, the minority shareholders of UOP were frozen out by its 50.5% shareholder Signal Companies. The decisive fact in the case was that two directors served on the boards of both UOP and Signal and withheld an important feasibility study on the merger

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[15] This paragraph draws heavily on Subramanian, *supra* note 1, at 3.

[16] DEL. CODE ANN. tit. 8 , § 251 (2012).

[17] Singer v. Magnavox, 380 A.2d 969 (Del. 1977).

[18] Subramanian, *supra* note 1, at 3.

[19] *Id.* at 4.

[20] Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

from their fellow directors and the shareholders of UOP. Furthermore, "the entire transaction was presented to and approved by UOP's board within four business days."[21] The Delaware Supreme Court concluded that the freeze-out process was deficient in many ways which amounted to a breach of fiduciary duty by the defendant directors, and subjected the case to the court's entire fairness review.

The *Weinberger* court clarified that entire fairness consists of both fair dealing and a fair price and, in a now famous footnote, introduced the idea that the entire fair dealing element could be met by showing that the contending parties had bargained the terms of the freeze-out at arm's length.[22] This led legal practitioners to set up a Special Committee comprised of independent directors in freeze-out transactions, which would negotiate the terms of the freeze-out on behalf of the minority shareholders. These Special Committees get independent advice from investment bankers and outside legal counsel to enable them to negotiate with the acquirer at eye level. This new practice was viewed skeptically by many academics,[23] as it is questionable whether independent directors can ever be truly independent of a controlling shareholder. Even where no legal ties between director and controlling shareholder exist, there is always the possibility of informal influence by the controller[24] or social pressure by the inside directors.[25] These concerns culminated in the question of what deference courts should afford a freeze-out that was approved by a Special Committee of independent directors, or, put differently, how strict should the standard of judicial review of such a transaction be? The two competing views in the judiciary were either a restriction to business judgment review,[26] or a shifting of the burden of proof that the transaction was not entirely fair from the defendant to the plaintiff.[27]

In *Kahn v. Lynch*,[28] the minority shareholders of Lynch Communications were frozen out by Alcatel. The Lynch board of directors had established a Special Committee of independent directors to negotiate the deal. Alcatel initially offered $14 per share and the Special

[21] *Id*. at 711.

[22] *Id*. at 709 n. 7.

[23] Subramanian, *supra* note 1, at 7.

[24] *In re* Pure Res., Inc., S'holders Litig., 808 A.2d 421, 436 (Del. Ch. 2002).

[25] *See* Kahn v. Tremont, 694 A.2d 422, 428 (Del. 1997); William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. L.J. 1287, 1308 (2001).

[26] *Cf. In re* Trans World Airlines, Inc. S'holders Litig., CIV. A. No. 9844, 1988 WL 111271 (Del.Ch. 1988) (unpublished decision).

[27] Citron v. E. I. Du Pont de Nemours & Co., 584 A.2d 490 (Del. Ch. 1990); Rabkin v. Olin Corp., 1990 WL 47648 (Del. Ch. 1990) (unpublished decision).

[28] Kahn v. Lynch, 638 A.2d 1110 (Del. 1994).

Committee requested $17 per share. Finally, the Special Committee recommended, and the board endorsed, a price of $15.50 per share after Alcatel had threatened to initiate a hostile tender offer for a lower price. The court held that the Special Committee was not truly independent because it did not have the power to say "no" in the face of Alcatel's threat and remanded the case for entire fairness review with the burden on the defendant. The *Kahn* court also implicitly decided that the establishment of a Special Committee only reverses the burden of proof for the entire fairness review and does not reduce the standard of judicial review to business judgment.[29]

A second way to remedy the conflictedness of the share price negotiation is to get approval by a majority of the minority shareholders (*MOM approval*). The underlying logic of this approach is that the minority shareholders are acting on their own behalf (there is no principal-agent conflict), and therefore the approval of a majority of the affected shareholders should serve as an indication of an arm's length negotiation. After *Weinberger*, it was unclear if Special Committee negotiation and MOM approval would both need to be fulfilled to establish fair dealing, but the *Kahn* court clarified that either requirement would suffice. In *Rosenblatt v. Getty Oil Company*,[30] the deal was approved by a 58% majority of the 89% of minority shares that were voted. As in *Kahn*, the court decided that MOM approval would reverse the burden of showing the (lack of) entire fairness to the plaintiffs, but it did not defer to business judgment review.

As Guhan Subramanian notes, there is no incentive for the controlling shareholders to establish a Special Committee and subject the freeze-out to a MOM approval,[31] as the combination of both measures does not yield any additional benefit to them.[32]

III. The Tender Offer Freeze-Outs

In response to the high standard of review exemplified by *Weinberger*, beginning in the 1990s the statutory merger was complemented by a novel freeze-out technique: The two-

[29] Although the standard of review formally remains the same, it is noted by Rock, Davies, Kanda, and Kraakman that the standard as applied seems to be more lenient. *See* Edward Rock, Paul Davies, Hideki Kanda & Reinier Kraakman, *Fundamental Changes*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 183, 204 (Reinier Kraakman et al. eds., 2d ed. 2009).

[30] Rosenblatt v. Getty Oil Co., 493 A.2d 929 (Del. 1985).

[31] Subramanian does not mention that there is the benefit of marginally stronger transactional security: in case a court would find either one of the procedural safeguards deficient to reverse the burden of the fairness review, there would still be the other safeguard.

[32] In *In re* Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604 (Del Ch. 2005), Chancellor Leo Strine apparently reacted to Subramanian's concern with the proposal (*obiter dictum*) to defer to business judgment review if both an independent Special Committee and MOM approval were established, as was already proposed in Subramanian's paper. *See* Subramanian, *supra* note 1, at 55.

step freeze-out tender offer. Using this route, the controlling shareholder would first make a tender offer for all of the minority shares, usually conditioned on a tender that gets at least 90% of the total amount of voting shares. Next, the controller would effect a short-form merger pursuant to DGCL Sec. 253, which does not require a shareholder vote, in order to eliminate the remaining (non-tendering) shareholders.[33]

This technique became attractive after the Delaware Supreme Court held in *Solomon*[34] that a tender offer by a controlling shareholder to the minority (without freeze-out) was not subject to entire fairness control. This was contrary to the then common understanding that such a tender offer is an interested transaction. This view emphasizes the fact the board of directors of the target company negotiates the terms of the offer with the controlling shareholder.[35] The court, however, saw no conflict of interest, reasoning that the parties to the tender offer are the controller and the minority shareholders.[36] In other words, the minority shareholders cannot be forced to agree to the deal.

In *Siliconix*,[37] the Court rejected the application of the entire fairness review on the front-end tender offer of the two-step freeze-out in the absence of disclosure violations or a coercive offer. Shortly thereafter, the Court rendered judgment on the back-end short-form merger in a freeze-out transaction in *Glassman*,[38] where it also declined to apply an entire fairness review, noting that appraisal is the appropriate remedy for minority shareholders objecting to short-form mergers. The overarching policy argument for this lax standard of review was the *ratio legis* of DGCL Sec. 253: To provide a streamlined process for accomplishing a merger, which would be undermined if too many procedural safeguards were required.[39]

In the final case of interest for this analysis, *In re Pure Resources, Shareholders Litigation*,[40] Unocal, the controlling shareholder of Pure, launched a share-for-share tender offer on the common stock of its subsidiary, conditioned on reaching the 90% threshold necessary for the short-form merger. Unocal stated that it would proceed to the merger as soon as possible after completion of the tender offer, at the same exchange ratio as the front-end

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[33] Subramanian, *supra* note 1, at 11.

[34] Solomon v. Pathe Commc'ns, 672 A.2d 35 (Del. 1996).

[35] Ventoruzzo, *supra* note 1, at 26.

[36] Subramanian, *supra* note 1, at 12.

[37] *In re* Siliconix Inc. S'holders Litig., No. CIV. A. 18700, 2001 WL 716787 (Del. Ch. 2001) (unpublished decision).

[38] Glassman v. Unocal Exploration Corp., 777 A.2d 242 (Del. 2001).

[39] *Id*. at 247.

[40] *In re* Pure Res., Inc., S'holders Litig., 808 A.2d 421 (Del. Ch. 2002).

offer. The Special Committee instituted by Pure briefly considered the implementation of a *poison pill* to increase its bargaining power but ultimately only recommended the minority shareholders not to tender their shares. The plaintiffs filed a class action lawsuit and sought to enjoin the transaction based on entire fairness review.

The court declined to apply the entire fairness review but apparently attempted to close the gap between statutory merger and tender offer freeze-outs with the introduction of an additional requirement for the entire fairness review to be rejected. The tender offer shall not be coercive to the minority shareholders. Specifically, Vice Chancellor Leo Strine established three procedural conditions that must be met in order to defer to business judgment review: (1) the offer must be subject to a non-waivable condition of MOM approval; (2) the bidder must guarantee to promptly consummate a short-form merger at the same conditions as the tender offer regarding exchange ratio and/or share price; (3) and the bidder must make no "retributive threats" in dealing with the Special Committee.[41]

Strine's efforts to introduce additional procedural requirements for tender offer freeze-outs have been aimed to remedy the fact that, in the tender offer situation, the minority shareholders lack a genuine bargaining agent. Whereas in the *Weinberger* line of cases, the Special Committee has the power to say "no," the Special Committee in a tender offer situation only has the duty to make a recommendation to the shareholders. *Pure* therefore aims to increase the Special Committee's bargaining power by setting out the framework for a fair bargaining procedure, and requiring robust engagement of the Special Committee instead of passivity. This leveling of the playing field shall serve to prevent the controller from making low-ball offers to the minority.[42]

IV. Practical Consequences

It was noted, however, that these conditions were already met in most tender offer freeze-outs even before *Pure* was decided, and that they would thus have little practical impact.[43] The unequal treatment of statutory merger freeze-outs and tender offer freeze-outs has been widely debated, and many proposals on how to reconcile these apparently conflicting approaches to freeze-outs have been discussed. According to Subramanian,[44] one line of authors champions an equal treatment of both situations ("convergence up") through

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[41] *Id*. at 445.

[42] Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Shareholders*, 152 U. PA. L. REV. 785, 799 n.47 (2003).

[43] Christopher A. Iacono, Comment, *Tender Offers and Short-Form Mergers by Controlling Shareholders Under Delaware Law: The "800-Pound Gorilla" Continues Unimpeded—In re* Pure Resources, Inc., Shareholders Litigation, 28 DEL. J. CORP. L. 645, 668 (2003); Subramanian, *supra* note 1, at 51.

[44] Subramanian, *supra* note 2, at 16–23.

(re)introduction of entire fairness review for tender offer freeze-outs.[45] Another group of commentators defends the status quo,[46] while a third one suggests mixed approaches.[47] This article is not the place to delve into this debate. For the purposes of this analysis it shall be sufficient to note a few points.

The Special Committee has significantly less bargaining power in a tender offer freeze-out than in a merger freeze-out. In the latter, the Special Committee can effectively veto the transaction, whereas in the former, the Special Committee serves only to make a recommendation to the minority shareholders within ten days of the initiation of the tender offer and in accordance with Schedule 14D-9. Subramanian has found in an empirical study that, as a consequence, the share premiums in merger freeze-outs have been higher than in tender offer freeze-outs.[48] The study also found that in the period between 19 June 2001 (announcement of *Siliconix*) and 31 December 2003, there had been 96 freeze-outs of listed Delaware corporations. The percentage of tender offer freeze-outs increased from 6% pre-*Siliconix* to 28% post-*Siliconix*.[49] The answer to the obvious question of why controlling shareholders did not (yet?) prefer the two-step freeze-out after Siliconix remains somewhat unclear, but may be explained by path dependency and lesser experience of legal practitioners with the two-step procedure.[50] There is, however, contrasting empirical evidence offered by Bates et al. which renders Subramanian's findings inconclusive on the hypothesis that minority shareholders get lower payments in tender offer freeze-outs.[51]

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[45] Kimble Charles Cannon, *Augmenting the Duties of Directors to Protect Minority Shareholders in the Context of Going-Private Transactions: The Case for Obligating Directors to Express a Valuation Opinion in Unilateral Tender Offers After Siliconix, Aquila, and Pure Resources*, 2003 COLUM. BUS. L. REV. 191 (2003); Ely R. Levy, *Freeze-Out Transactions the Pure Way: Reconciling Judicial Asymmetry Between Tender Offers and Negotiated Mergers*, 106 W. VA. L. REV. 305 (2004); Brian M. Resnick, Note, *Recent Delaware Decisions May Prove to Be "Entirely Unfair" to Minority Shareholders in Parent Merger with Partially Owned Subsidiary*, 2003 COLUM. BUS. L. REV. 253 (2003).

[46] Jon E. Abramczyk et al., *Going-Private Dilemma? Not in Delaware*, 58 BUS. L.J. 1351 (2003); Thomas M. McElroy, II, Note, In re Pure Resources*: Providing Certainty to Attorney Structuring Going-Private Transactions, or Not?*, 39 WAKE FOREST L. REV. 539 (2004).

[47] Gilson & Gordon, *supra* note 42; Subramanian, *supra* note 1.

[48] Subramanian, *supra* note 1.

[49] Subramanian, *supra* note 1, at 15.

[50] Subramanian, *supra* note 1, at 10.

[51] Thomas W. Bates et al., *Shareholder Wealth Effects and Bid Negotiation in Freeze-Out Deals: Are Minority Shareholders Left Out in the Cold?* 81 J. FIN. ECON. 707 (2006). Bates et al. observe that "on average, minority claimants in freeze-out bids actually receive approximately 11% more than their pro-rata share of deal surplus generated at the bid announcement, an excess distribution of roughly $6.1 million. These results are inconsistent with the notion that controlling shareholders systematically undertake freeze-out transactions at the expense of the minority claimants of the target firm."

V. Brief Summary of Case Law and Conclusion

Freeze-out transactions in Delaware can be achieved by either statutory merger or front-end tender offer with subsequent back-end short-form merger. In contrast to the German system (discussed *infra*), there are no specific shareholding thresholds which the controlling shareholder must meet before a freeze-out can be executed. For a statutory freeze-out, a shareholder needs only as many voting shares to win the requisite shareholder vote by simple majority pursuant to DGCL Sec. 251 (which is the very definition of a controlling shareholder);[52] the controlling shareholding can thus be as little as 35%.[53] In case of a tender offer freeze-out, the controlling shareholder does not need to have any shares before the launch of the tender offer. Here, the relevant threshold is that the controller needs to own 90% of all outstanding shares after consummation of the tender offer in order to meet the threshold for application of the short-form merger statute.

Delaware law does not provide for any specific procedural safeguards to protect the interests of minority shareholders during the freeze-out.[54] The protective framework has been developed by the judiciary on the premise that freeze-outs are self-dealing transactions because the controlling shareholder has the power to influence the board of directors, which negotiates the purchase price of the shares on behalf of the minority shareholders (in case of a statutory merger freeze-out). Shareholders can therefore bring claims against directors based on breach of a fiduciary duty when they think the negotiating process or the negotiated share price was not fair. The Delaware courts will scrutinize the entire fairness of the transaction with the burden on the defendant, unless (1) a Special Committee comprised of truly independent directors with the power to say "no" had been established which negotiated the deal on behalf of the board; or (2) if the deal was sanctioned by a majority of the minority shareholders, in which cases the burden will be on the plaintiffs to show that the transaction was not entirely fair. The rationale for these two exceptions is that they approximate the conflicted transaction to an arm's length transaction, either because an (at least formally) independent actor negotiated the deal, or because the conflicted transaction was put to a market test by way of the minority shareholder approval.

The rendering of the *Siliconix/Glassman* judgments marked the advent of the two-step tender offer freeze-outs. The Delaware courts did away with entire fairness review in

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[52] At least in the absence of other control measures like influence on board members, shareholder agreements or special charter rights.

[53] *See, e.g.*, *In re* Cysive, Inc. S'holders Litig., 836 A.2d 531 (Del. Ch. 2003) (finding a 35% stockholder to be a controller).

[54] *See* Subramanian, *supra* note 1, at 48 n.226 (noting that the so-called "freeze-out statute," Del. Code Ann. tit. 8, § 203 (2007), is "generally not applicable to most 'real' freeze-outs").

tender offers, applying the deferential business judgment review and decided that the ratio of the short-form merger—providing a streamlined process for parent-subsidiary mergers—excluded entire fairness review of its terms. *Pure* confirmed this new doctrine and marginally increased the minority protection in two-step freeze-outs by requiring that the transaction may not be coercive.

The Delaware freeze-out regime therefore relies on an *ex post* court review that is regularly initiated by a class action of minority shareholders, based on breach of fiduciary duty by either the board of directors, or the Special Committee which negotiated the deal with the controlling shareholder. These procedural safeguards to protect the minority shareholders in Delaware were entirely evolved in the courtroom. It has been suggested that this fact may facilitate the development of management-friendly rules, because "case-law precedents are relatively free from interest group influence," and management is in a good position to control which litigation will be decided by the courts.[55]

VI. The Appraisal Remedy

In cases where entire fairness review is not available (such as in tender offer freeze-outs) the minority's only remedy is appraisal pursuant to DGCL Sec. 262. *Prima facie*, one might think that the appraisal remedy is actually more beneficial to the plaintiff than a breach of fiduciary duty claim, as the former does not require the showing of such a breach.[56] The appraisal remedy, however, is a less capable remedy for several reasons. First, "appraisal is not available to minority shareholders in the approximately 20% of tender-offer freeze-outs that involve stock consideration"[57] because of the "market-out" exception.[58] Second, unlike an appraisal, a fiduciary duty action can be brought before the effectuation of the merger and may result in a preliminary injunction, which potentially increases the plaintiff's bargaining power in settlement negotiations.[59] Third, fiduciary claims can be and mostly are brought as class actions, in which the legal fees are mostly paid from the settlement or the target company.[60] Lastly and most importantly, whereas the class in a fiduciary claim can consist of all public shareholders of the corporation,[61] the appraisal can only be

[55] Paul Davies and Klaus Hopt, *Control Transactions*, THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 232 (Reiner Kraakman et al. eds., 2d ed. 2009).

[56] WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 496 (3d ed. 2009).

[57] *See* Subramanian, *supra* note 1, at 24 n.133.

[58] DEL. CODE ANN. tit. 8, § 262(b)(2) (2010).

[59] ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 56.

[60] *Id.;* Subramanian, *supra* note 1, at 24 n.135.

[61] ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 56; SUBRAMANIAN, *supra* note 1, at 24 n.136.

pursued by shareholders who contested the cash-out.[62] The appraisal remedy, therefore, is considered to be "notoriously weak"[63] among scholars and practitioners. Consequently, minority shareholders seldom initiate appraisal proceedings.[64]

From a more doctrinal perspective, it should be noted that appraisal rights were originally introduced by the state legislatures between 1900 and the 1950s in response to the fact that mergers which initially required unanimous consent by all shareholders were now possible with approval of a simple or qualified majority of shareholders.[65] The purpose, therefore, was to give dissenting shareholders in arms-length mergers a possibility to leave the company at a fair price when the capital markets were not yet as well developed as today ("liquidity purpose").[66] The appraisal statute was never designed for self-dealing situations like a cash-out by a controlling shareholder, and as such, it is not a very effective remedy in this respect.

D. History and Development of the Legal Framework for Squeeze-Outs in Germany

The squeeze-out rules in Germany are fairly young. They came into force at the beginning of 2002 through an amendment of Sec. 327a–327f of the German Stock Corporation Act (Aktiengesetz—"AktG").[67] Before that, there was no direct way for controlling shareholders to freeze out the minority. The German Transformation Act (Umwandlungsgesetz) of 1934, however, had introduced a so-called "transferring conversion," through which the controlling shareholder, if she owned at least 90% (later reduced to 75%) of the share capital of the subsidiary, could transfer all assets of the subsidiary company into another entity and thereby freeze out minority shareholders against their will.[68] But this measure had been abolished in 1994[69] because the exclusion of minority shareholders against their will was considered to be contrary to the

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[62] DEL. CODE ANN. tit. 8, § 262(d)(1) (2010).

[63] SUBRAMANIAN, *supra* note 1, at 24 n.137.

[64] *Id*.

[65] Ventoruzzo, *supra* note 1, at 11–13 nn.29–30, 34–35.

[66] *See id.* at 13 (noting that this term was coined by Robert B. Thompson).

[67] Gesetz zur Regelung von öffentlichen Angeboten zum Erwerb von Wertpapieren und Unternehmensübernahmen [The amendment was introduced by the Act on the Regulation of Company Acquisitions and Public Offers to Purchase Securities], Dec. 20, 2001, BGBL. I at 3822 (Ger.).

[68] KRISTIAN STANGE, ZWANGSAUSSCHLUSS VON MINDERHEITSAKTIONÄREN (SQUEEZE-OUT) 30 (2010).

[69] Gesetz zur Bereinigung des Umwandlungsrechts [UmwBerG] [Law to Clean up the Transformation Law], Nov. 11, 1994, BGBL. I at 3210, as amended by Gesetz [G], Jan. 1, 1995, BGBL. I at 428 (Ger.).

government's aims of minority protection.[70] Since then, business lobbyists pointed out that a squeeze-out procedure is necessary.[71] Between 1994 and the implementation of the squeeze-out rules in 2002, the controlling shareholder could initiate one of several structural transactions which could indirectly lead to the exclusion of minority shareholders, such as a reverse stock split or a sale of all assets, but these transactions were onerous, might have had unwanted implications, and because of the lack of clear rules, there was generally some uncertainty about the level of minority protection in these transactions.[72]

Until the introduction of the squeeze-out rules, the most relevant of these measures was the "transferring conversion" (übertragende Auflösung),[73] by which a company sells and transfers all of its assets to the controlling shareholder or a subsidiary of the controlling shareholder and is subsequently dissolved and liquidated. This procedure requires shareholder resolutions with a 75% majority of the share capital of the company[74] and has been confirmed as a valid way to exclude minority shareholders, provided that a "full economic compensation" of the excluded minority is ensured and legally enforceable.[75] The transferring conversion, however, entails several disadvantages which render it undesirable in many cases. First, it can lead to the disclosure of hidden reserves with detrimental tax effects. Second, the asset transfer is a complex and laborious exercise and the following liquidation may take up to several years. Finally, the shareholder resolution to sell and transfer all assets of the company can be enjoined on the grounds that the consideration is not adequate (fair market value).[76]

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[70] DEUTSCHER BUNDESTAG: DRUCKSACHEN UND PROTOKOLLE [BT] Begründung zum Regierungsentwurf [Legislator's Explanatory Notes], 12/6699, 114 at 144 (Ger.).

[71] Eberhard Vetter, *Squeeze-Out in Deutschland*, ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 1817, 1818 (2000).

[72] *Cf.* FLEISCHER, *supra* note 1, § 327(a)–(f) n.34, n. 39 (providing a detailed account of the direct and indirect possibilities to exclude shareholders).

[73] Also known as "sale of assets squeeze-out" or "Moto Meter method."

[74] *See* Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at §§ 179(a), 262(1) no. 2 (Ger.).

[75] Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case Nos. 1 BvR 68/95, 1 BvR 147/97, Aug. 23, 2000, 2001 NEUE JURISTISCHE WOCHENSCHRIFT (NJW) 279 (2001) (Ger.).

[76] Bayerisches Oberstes Landesgericht [BayObLGZ - Bavarian Higher Regional Court] Case No. 3Z BR 37/98, Sept. 17, 1998, 1998 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 2002 (1998) (Ger.); Oberlandesgericht Stuttgart [OLG - Higher Regional Court], Case No. 8 W 43/93, Dec. 4, 1996, 1997 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 362 (1997) (Ger.). The arguably more suitable appraisal procedure is not applied by the courts.

Hence, the introduction of the squeeze-out rules in 2002 was welcomed by many practitioners and academics. The enactment of the European Takeover Directive[77] required Germany to allow for a specific squeeze-out procedure following a tender offer.[78] Instead of adjusting the general squeeze-out procedure to the requirements of this directive, the German legislature decided to leave the general squeeze-out rules untouched and to introduce a second squeeze-out regime which applies following a tender offer ("Takeover Squeeze-Out") pursuant to Sec. 39a and 39b WPüG. The Takeover Squeeze-Out aims to allow for a more expedient and cheaper way to exclude the residual shareholders.

E. The General Squeeze-Out Mechanism in Germany

I. General Procedure

In the following, I will set out the particular requirements and steps that need to be fulfilled to achieve a squeeze-out pursuant to Sec. 327a–f AktG.

1. Supermajority of Share Capital

The squeeze out procedure is available to all shareholders holding 95% or more of the share capital and can be initiated by the controlling shareholder through a shareholder resolution at a general meeting (Sec. 327a(1) AktG). The shareholdings of controlled subsidiaries in the target are attributed to the controlling shareholder in calculation of the 95% threshold (Sec. 327a(2), 16(2) and (4) AktG), so the top company of a group of companies does not need to hold all shares itself in order to reach the threshold.

Recently, the German Federal Court in Civil Matters (Bundesgerichtshof—"BGH") has also heard and condoned a case in which the controlling shareholder originally only owned 63% of the outstanding shares and later acquired an additional 33% of shares through a securities loan.[79] According to German law, a securities "loan" entails a transfer of title, but the lessor has the right to the transfer of title in stock of the same kind after termination of the loan agreement. In the case at hand, the loan was not to be terminated before the passage of three years, and the lessor kept her dividend rights. The decision was surprising and contrary to the views of many scholars, which had argued until then

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[77] *See* Council Directive, *supra* note 1 and accompanying text; Council Directive 04/25, art. 21, 2004 O.J. (L 142) 12, 23 (EC) (providing that, per Art. 21, the Directive was to be transposed into national law no later than 20 May 2006).

[78] The complementary sell-out right pursuant to Wertpapiererwerbs- und Übernahmegesetz [WpÜG] [Securities Acquisition and Takeover Act], Dec. 20, 2001, BGBL. I at 3832 (Ger.); Council Directive 04/25, art. 16, 2004 O.J. (L 142) 12, 23 (EC) and § 39(c) respectively, are beyond the scope of this analysis.

[79] Bundesgerichtshof [BGH - Federal Court of Justice], Case No. II ZR 302/06, Mar. 16, 2009, 180 BGHZ 154, 2009 (Ger.).

that a squeeze-out was abusive and therefore impermissible if the controller acquired stock above the 95% level only in the short term with a view to the squeeze-out.[80] This judgment has significantly eased the burden of the 95% shareholding threshold and appears to allow a controlling shareholder to combine his shareholdings with other block shareholders in order to meet the threshold.

2. Shareholder Resolution

The controlling shareholder has to ask the management board of the corporation to convene a shareholder meeting and propose the squeeze-out.[81] The requirement of a shareholder resolution can be seen as a peculiarity[82] of the German system. After all, what is the purpose of such a resolution if the controller must own a minimum of 95% of the share capital? Consequently, the requirement of a shareholder resolution was criticized heavily from the beginning.[83] The resolution seems to be an empty formality that gives the minority shareholders one last chance to obstruct the controlling shareholder through an action to enjoin the resolution.[84] Consequently, other European jurisdictions like the U.K., France, Italy, or the Netherlands do not require a shareholder resolution.[85]

The requirement of a shareholder resolution, however, is mainly a means to ensure that the minority shareholders get full disclosure about all relevant details of the squeeze-out and therefore serves the same purpose as SEC Rule 13e3. In preparation of the general meeting, the management board of the corporation must provide the shareholders with various information about the squeeze-out. The convocation to the general meeting must include the agenda to the meeting and must be received by the shareholders no later than

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[80] *See, e.g.*, HOLGER FLEISCHER, *Das Neue Recht des Squeeze Out,* ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT (ZGR) 757, 758 (2002).

[81] *See* Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at 1089, last amended by Gesetz [G], Aug. 24, 2004, BGBL. I at 2198, § 78 (Ger.) (noting that the management board is generally the competent corporate body to summon a shareholder meeting and set the agenda); *cf.* FLEISCHER, *supra* note 1, at § 327(a) n.57.

[82] Christoph Van der Elst & Lientje Van den Steen, *Balancing the Interests of Minority and Majority Shareholders: A Comparative Analysis of Squeeze-Out and Sell-Out Rights*, 6 EUR. CO. & FIN. L. REV. 391, 398 (2009).

[83] *Cf.* HARALD KALLMEYER, *Ausschluß von Minderheitsaktionären*, DIE AKTIENGESELLSCHAFT 59 (2000); Matthias Habersack, *Der Finanzplatz Deutschland und die Rechte der Aktionäre*, ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 1230, 1237 (2001); Vetter, *supra* note 71, at 1819; Eberhard Vetter, *Squeeze-Out nur durch Hauptversammlungsbeschluss?*, DER BETRIEB 743 (2001); Maximilian Schiessel, *Ist das deutsche Aktienrecht kapitalmarkttauglich?*, DIE AKTIENGESELLSCHAFT 442, 452 (1999).

[84] These are the actions used by predatory shareholders as illustrated below. See *infra* text accompanying note 102.

[85] *Cf.* Christoph Van der Elst & Lientje Van den Steen, *supra* note 82; FLEISCHER, *supra* note 1, § 327(a) n.64.

21 days before the meeting (Sec. 120 AktG). The agenda must already include the amount of cash compensation as determined by the controller (Sec. 327c(1) AktG).

The controller must make numerous documents pertaining to the squeeze-out available to the minority shareholders for inspection, among them the annual financial statements for the three previous financial years, a written report by the controller, and an audit report[86] (Sec. 327c(4) AktG). All these requirements aim to ensure that the minority shareholders can make an informed decision and that the squeeze-out can be subject to a comprehensive discussion at the general meeting.[87]

Informing the shareholders, however, could also be achieved without shareholder resolution. It appears that the requirement of a shareholder resolution is in the tradition of the procedure for other structural measures, but in cases involving squeeze-outs, it is just a superfluous formality.

3. Written Report and Auditor's Report

The adequacy of the cash compensation shall be ensured *ex ante* (before the squeeze-out takes legal effect) by two means: A written report of the controlling shareholder and a report of an independent auditor regarding the adequacy of the cash compensation (Sec. 327c(2) AktG), which in practice will often be one of the Big Four auditing firms.

Particularly the auditor's report appears to be another peculiarity of the German system.[88] The auditor is appointed by a court, although the controlling shareholder can make suggestions which will often be heeded by the court in practice.[89] The auditor has the duty to execute an impartial audit of the cash compensation offered by the controlling shareholder and to render a written report.

The rationale of the independent audit is threefold: It aims to (1) protect the interests of the minority shareholders; (2) increase their willingness to accept the cash compensation and thus reduce the number of claims against the valuation; and (3) facilitate subsequent lawsuits.[90] Considering the empirical evidence on the number of lawsuits regarding the valuation it is questionable whether the latter two aims have been achieved, though.[91]

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[86] *See infra* Part E.I.3.

[87] *Cf.* FLEISCHER, *supra* note 1, § 327(a) n.65.

[88] Van der Elst & Van den Steen, *supra* note 82, at 430.

[89] The controlling shareholder has a right of appeal if the court does not follow his suggestions pursuant to Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL I at §§ 327(c) ¶ 2, 293(c) ¶ 2 (Ger.).

[90] FLEISCHER, *supra* note 1, § 327(c) n.17.

[91] *See infra* Part E.IV.1–4.

4. Legal Effect Through Registration in the Commercial Register

The transfer of the minority shares to the controlling shareholder takes legal effect with the registration of the squeeze-out in the commercial register (Sec. 327e(2) AktG). This is not just a mere formality, as the competent register judge has to scrutinize the squeeze-out procedure before registration. This is a formal inspection, so the register judge may not contest the adequacy of the cash compensation.[92]

The registration, however, requires that no lawsuits to enjoin the squeeze-out resolution have been filed (Sec. 327e(2), 319(5) AktG). In principle, the registration is blocked as long as any lawsuits concerning the validity of the squeeze-out procedure are pending. This rule potentially gives minority shareholders the power to block the consummation of the squeeze-out procedure for months or possibly years.[93]

II. Empirical Data on the Practical Application of the General Squeeze-Out

The general squeeze-out procedure has very quickly become popular in Germany. In 2002 alone there already had been more than 100 squeeze outs executed; and this number increased to 289 by May 2007[94] and to 317 by the end of 2007.[95] About 70% of these companies were listed on a stock exchange.[96] The initial surge in squeeze-outs right after its introduction into the German legal system can be attributed mainly to cases in which a shareholder with an overwhelming majority (above 98%) wanted to streamline its holding structure, but did not have the legal means to do so before the enactment of the squeeze-out rules.[97] This process now seems to be mostly completed, shifting the focus of squeeze-outs to those following a control transaction.

However, there are also 27 listed companies which could have been subjected to a squeeze-out for several years—because a controlling shareholder owns more than 95% of their stock—but in which nothing has happened. This may be a sign that controllers have analyzed the costs and benefits of a squeeze-out and concluded that the future efficiency gain does not offset the squeeze-out costs.

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[92] SINGHOF ET AL., *supra* note 10, § 327(e) n.4.

[93] *See infra* Part E.V.1.

[94] SINGHOF ET AL., *supra* note 10, § 327(a) n.4.

[95] STANGE, *supra* note 68, at 279. The following empirical data is taken from Stange unless otherwise indicated.

[96] SINGHOF ET AL., *supra* note 10, § 327(a) n.4.

[97] *Id*.

141 of 260 (54%) of the general squeeze-out transactions have become legally effective through registration with the commercial register within three months, while the average time for registration was five months. However, a significant number of squeeze-outs (57 of 317 (18%) squeeze-outs in Stange's analysis) have not been registered yet (presumably because of actions to enjoin the squeeze-out).

137 of the 317 (43%) companies were not listed on any stock exchange. This shows that a demand for squeeze-outs also exists for non-listed companies. Out of the 180 listed companies that were subject to a squeeze-out, 62 (34%) had been involved in a tender offer beforehand.[98] The average time between the tender offer and the squeeze-out was 17.3 months.

III. Constitutionality Issue: Property Right Infringement?

The introduction of the squeeze-out regime was accompanied by many comments which voiced concerns about its constitutionality in light of the protection of property pursuant to Art. 14 of the German Basic Law (Grundgesetz—"GG"). Almost all lawsuits to enjoin specific squeeze-outs in the first years claimed the unconstitutionality of the measure.[99] According to the German Constitutional Court (Bundesverfassungsgericht—"BVerfG"), Art. 14 GG protects the economic rights and corporate membership rights of the shareholders.[100] That means that the BVerfG considers share ownership to be real property and not just a capitalized stream of income. Nevertheless, the BVerfG has ruled as early as 1962 that the limitation of the property right of minority shareholders (through the squeeze-out regime, for example) is justified by a legitimate interest to provide entrepreneurial freedom to investors, provided that the minority shareholders are adequately compensated. The court emphasized that the adequate compensation must be effectively protected. The squeeze-out regime provides several safeguards to ensure an adequate compensation of the minority[101]: (1) the cash consideration is scrutinized by a court-appointed auditor; (2) the controlling shareholder has to procure a bank guarantee to secure the claims of the shareholders to be excluded (Sec. 327b(3) AktG); and (3) the minority shareholders can file a claim to enjoin the squeeze-out or initiate an appraisal procedure. Drawing on its reasoning in earlier cases, the BVerfG explicitly declared the

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[98] *Id.* This number rises to 50% for the squeeze-outs conducted in the years 2004–2007. This rise can be explained by the fact that 2002 and 2003 a lot of companies with an over 95% shareholder took the opportunity to simplify their shareholder structure.

[99] MARTIN WEBER, *Die Entwicklung des Kapitalmarktrechts im Jahre 2006*, NEUE JURISTISCHE WOCHENSCHRIFT (NJW) 3685, 3693 (2006).

[100] Bundesverfassungsgericht [BverfG - Federal Constitutional Court], Case No. 1 BvL 16/60, Sept. 7, 2011, 14 BVERFGE 263 (Ger.).

[101] STANGE, *supra* note 68, at 84.

squeeze-out regime to be constitutional in 2007.[102] The court emphasized that the three essential prerequisites for constitutionality were fulfilled, namely an adequate compensation of the minority shareholders, effective legal remedies, and a legitimate interest in the exclusion of the minority shareholders. Regarding this latter point, the court pointed out that controlling shareholders generally can have an interest in a squeeze-out to avoid the administrative costs a minority creates. This is because, in particular, since the 1980s, the number of lawsuits from predatory shareholders[103] with minimal share amounts which try to block structural corporate decisions to create a hold-out situation—which thereby increases their settlement value—has increased. The court finally also argued the required quorum of 95% ensures that only shareholders who have no realistic possibility of influencing the firm management get excluded, or in other words, only shareholders with a purely financial interest and not a strategic interest.

According to this reasoning it is unclear whether the BVerfG would still consider a squeeze-out to be constitutional if the required quorum were reduced to a number below 90%.[104]

IV. The "Adequate Compensation": How to Evaluate the Minority Shares

The squeezed-out shareholders have a right to "adequate compensation" (Sec. 327a(1)(1) AktG). That means that the controlling shareholder has to evaluate the company and explain the evaluation in the required written report to the shareholders. In practice, the evaluation is done through advice similar to a "fairness opinion,"[105] which is rendered by an

[102] Bundesverfassungsgericht [BverfG - Federal Constitutional Court], Case No. 1 BvR 390/04, May. 30, 2007, 11 BVERFGK 253(Ger.).

[103] "Predatory" or "professional" shareholders are those who own only a minimal amount of shares (often as little as one share) and then use lawsuits to enjoin important corporate structural changes to induce the company to "buy out" their claims at a settlement value that reflects their "hold-out" or "nuisance" potential and not any actual damages to the shareholder.

[104] A 90% quorum is sanctioned by the Takeover Directive and therefore unlikely to be held unconstitutional. See *supra* notes 77–78 and accompanying text.

[105] Fairness opinions and audit reports by an independent expert need to be distinguished in Germany. Fairness opinions are neither required nor regulated by law. They have been introduced into German practice through international M&A transactions with the U.S. (where the practice to use fairness opinions for reasons of legal prudence has been established since the seminal judgment in *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985)). Their aim is to help the management of a company to ascertain and prove the fairness of a determined price in an M&A transaction or other corporate transaction which requires the determination of a company's value. Managers therefore use fairness opinions "voluntarily" to reduce transaction and liability risks. Audit reports by independent experts, in contrast, are an element of many corporate structural measures (like squeeze-outs, mergers, capital increases by contribution in kind and similar measures) which are required by German law to ascertain a certain adequacy of the price or share exchange ratio offered (a "gatekeeper strategy"). The goals of fairness opinion and independent audit report are therefore not completely congruent. Moreover, the independent auditor must be a professional auditor (bound by professional rules) and is appointed by the court for the specific task. In contrast, the drafters of fairness opinions are not necessarily bound by professional rules and are directly chosen by the company. In practice, fairness opinions are done by investment banks, M&A

external advisor (investment banks or audit companies), although in theory the controller could also do the valuation herself. In contrast to a fairness opinion, the written report is issued by the controlling shareholder, signaling that it is she who is ultimately responsible. An independent expert then audits the compensation offered by the controller in the written report.[106]

Four essential questions remain unanswered by academics: (1) Which valuation methodology is required?; (2) How should the reference period for the pre-squeeze-out stock price be calculated?; (3) Should the valuation be based on the company value or on the value of the specific minority shares?; and (4) Should the minority shareholders be benefitting from the synergies of an expected merger? I will address each of these questions in turn.

1. Valuation Methodology

The law does not provide guidance on the question of how a company is to be valued. Such guidelines, however, have been developed by case law in similar situations where minority shareholders are deprived of their "membership rights."[107] The commonly recognized[108] valuation method is the "Discounted Earnings Method" (Ertragswertmethode),[109] but the Discounted Cash Flow Method ("DCF") is getting ever more prevalent in practice.[110]

In pre-*Weinberger* Delaware, the courts used the *Delaware block* (or *weighted average*) method to determine the fair value of a company for appraisal purposes. This technique entailed a mix of factors including earnings, price/earnings multiples in the industry, asset

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advisors or audit companies. On the use of fairness opinions in Germany, see Klaus Cannivé and Andreas Suerbaum, *Die Fairness Opinion bei Sachkapitalerhöhungen von Aktiengesellschaften: Rechtliche Anforderungen und Ausgestaltung nach IDW S 8*, DIE AKTIENGESELLSCHAFT 317 (2011); Holger Fleischer, *Zur Rechtlichen Bedeutung der Fairness Opinion im Aktien- und Übernahmerecht*, ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 201 (2011).

[106] *See supra* Part E.IV.1–4.

[107] Such cases are: Controlling entity executes a domination agreement, a profit transfer agreement, or both, with the target company (Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at §§ 291, 305) or so-called "integration" (this rare measure is different from a merger pursuant to German law) of the target company into the controlling entity (Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at § 320(b)).

[108] *Cf.* Oberlandesgericht Düsseldorf [OLG - Higher Regional Court], Case No. I-26 W 7/06, Apr. 10, 2006, 2219 WM 2222 (2006) (Ger.).

[109] This appears to be a typically German valuation method. It is quite old and still commonly used pursuant to the audit standard IDW S1 set by the German Institute of Accountants (Institut der Wirtschaftsprüfer in Deutschland e.V.). "The standard calculates the net present value of the net profits accrued to the shareholders." Christoph Van der Elst & Lientje Van den Steen, *supra* note 82, at 430 n.101.

[110] *Cf.* FLEISCHER, *supra* note 1, § 327(b) n.13.

values and shares' market prices. The DCF method was considered to be too speculative.[111] In *Weinberger*, the court conceded that the "mechanistic procedure" of the block method had been outdated and thus permitted any methods generally accepted in the financial community, so that DCF soon became the standard valuation technique in appraisal cases.

So the German situation appears to arrive at the situation that was already achieved in Delaware in the 1980s: DCF valuation as the prevalent valuation technique. Whether this is the desired result from the perspective of legal certainty remains unclear. As Allen, Kraakman, and Subramanian pointed out, DCF valuations create "exceptionally wide differences in value,"[112] so the Delaware courts have begun to appoint their own expert witnesses—in addition to the parties' expert witnesses—in appraisal proceedings and actions for entire fairness review.

2. Calculation of the Reference Period

The BVerfG has held in *DAT/Altana*[113] that for listed companies, the stock price provides the floor for the calculation of the adequate compensation, so that the compensation may never be lower than the stock price of the target company during a reference period of three months before the squeeze-out, even if the fairness opinion determined a lower value. The court reasoned that the exiting shareholders must be compensated at least as highly as if they had autonomously decided to divest on the stock market.[114]

The BGH, implementing the parameters outlined by the BVerfG in *DAT/Altana*, ruled that the three-month period had to be casted backward from the day of the general meeting of shareholders which would approve the squeeze-out, since Sec. 327b(1)(1) AktG requires that the compensation shall take into account the condition of the company at the time of the shareholder resolution.[115]

This decision, however, quickly became the target of strong criticism. A general meeting must be announced at least 30 days before the meeting (Sec. 123(1)(1) AktG) and from this date the proposed cash compensation amount must be published (Sec. 327c(3) AktG). As a consequence of the efficiency of capital markets, the stock market will quickly incorporate the information about the proposed compensation payment into the share price.

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[111] ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 56, at 479.

[112] *Id*. (providing an example where one DCF valuation valued stock at $13 a share and the opposing valuation valued it above $60 a share).

[113] Bundesverfassungsgericht [BverfG - Federal Constitutional Court], Case No. 1 BvR 1613/94, Apr. 27, 1999, 100 BVERFGE 289, 307 (Ger.).

[114] ARNE KIEßLING, DER ÜBERNAHMERECHTLICHE SQUEEZE-OUT GEMÄß §§ 39A, 39B WPÜG 144 (2008).

[115] Bundesgerichtshof [BGH - Federal Court of Justice], Case No. II ZB 15/00, Mar. 12, 2001, 147 BGHZ 108 (Ger.).

Therefore from the date of the announcement the share price does not solely reflect the inherent value of the company anymore, but rather the expected discounted value of the compensation payment. In order to avoid this result it is necessary to cast the reference period backward from the date of the announcement of the squeeze-out. After extensive criticism from academics and many OLGs,[116] the BGH recently reversed its old judgment and decided to calculate the reference period from the date of the announcement of the transaction.[117] Most recently the OLG Frankfurt has further specified that the reference period starts at the time the management speaks publicly about the squeeze-out so that a reasonable person would expect it to happen in the near future.[118] That means the reference period can already start before an official announcement to the shareholders (convocation of general meeting). For example, if the CEO of the controlling shareholder speaks publicly about her intention to acquire 95% of the shares of the subsidiary and conduct a squeeze-out, at that time the capital markets will begin to impound the expectations about the squeeze-out into the market price. Such announcements, however, must be reasonably credible and the execution of the announced measure must be palpable, in order to distinguish relevant announcements from mere market rumors. For listed companies, the relevant announcement will often be the ad hoc disclosure pursuant to sec. 15(1) WpHG.[119]

The recent judgment of the BGH certainly was an important clarification for the appraisal of minority shares. This decision, however, introduced an additional rule for cases in which there is a considerable time-gap[120] between the public announcement of a squeeze-out transaction and the date of the shareholder resolution, during which the stock price

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[116] Oberlandesgericht Stuttgart [OLG - Higher Regional Court], Case No. 20 W 6/06, Feb. 16, 2007, 2007 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 682 (2007) (Ger.); Oberlandesgericht Düsseldorf [OLG - Higher Regional Court], Case No. I-26 W 13/06, Sept. 09, 2009, 2009 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 1427 (2009) (Ger.); Oberlandesgericht Stuttgart [OLG - Higher Regional Court], Case No. 20 W 2/08, Dec. 18, 2009, 2009 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 274 (2010) (Ger.).

[117] Bundesgerichtshof [BGH - Federal Court of Justice], Case No. II ZB 18/09, July 19, 2010, 186 BGHZ 229 (Ger.); *cf.* Olaf Müller-Michaels, *BGH Schafft ein Neues Feld für Diskussionen und Streitigkeiten*, *in* BETRIEBS-BERATER 1944 (2010).

[118] Oberlandesgericht Frankfurt [OLG - Higher Regional Court], Case No. 5 W 15/10, Dec. 21, 2010, 2011 ZEITSCHRIFT FÜR DAS GESAMTE FAMILIENRECHT (FAMRZ) 832 (2011) (Ger.).

[119] Hartwin Bungert & Carsten Wettich, *Neues zur Ermittlung des Börsenwerts bei Strukturmaßnahmen*, ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 449, 450 (2012).

[120] Even though the court did not define the time-gap further, the case law to date suggests that a time frame of up to six months does not qualify as considerable. *See* cases cited *supra* note 116 (7.5 months considerable); Bundesgerichtshof [BGH - Federal Court of Justice], Case No. II ZB 2/10, June 28, 2011, 2011 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 1708 (2011) (Ger.) (3.5 months not considerable); Oberlandesgericht Stuttgart [OLG - Higher Regional Court Case No. 20 W 3/09, Jan. 19, 2011, 2011 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 382 (2011) (Ger.) (up to 6 months not considerable); Oberlandesgericht Frankfurt a.M. [OLG - Higher Regional Court], Case No. 21 W 13/11, Apr. 29, 2011, 2011 AG 832 (Ger.) (4.5 months not considerable).

develops further. In such cases, the court requires the calculated average stock price to be adjusted in accordance with the current market trends up to the date of the shareholder resolution. So if the market goes up between the end of the reference period and the date of the shareholder resolution, the calculated average price would need to be increased in proportion with the general market trend.[121] Unfortunately, the court did not give more specific guidelines on how to calculate such an adjustment, so this question seems to invite future appraisal claims.

3. Value of the Company or Value of the Minority Shares?

A rather theoretical issue that shall only be briefly discussed is whether the valuation should look at the total company value and give each leaving shareholder a fraction of that value, or if the specific value of the minority shares should be determined. The minority shares can in theory have a value different from the company value because each share is tradable on a stock market. Looking at the value of the minority shares could lead to a situation where the fewer minority shares there are, the more valuable they get, as their holdup value would increase. This would not make sense and would infringe the rule of equal treatment of all shareholders. The value of the whole company, therefore, has to be evaluated, and a respective fractional value has to be attributed to each share.

4. Pre-Squeeze-Out or Post-Squeeze-Out Valuation?

The exit of the minority shareholders leads to efficiency gains in the administration of the company which will positively influence the firm value. It is questionable whether the minority shareholders should benefit from such "squeeze-out gains" which are difficult to determine and quantify.[122] The main argument for factoring in the "squeeze-out gains" is the following: The minority shareholders cannot influence whether they leave the company in case of a squeeze-out. The unilateral determination of the compensation by the controlling shareholder serves as a substitute for an arms-length negotiation between the controller and minority.[123] If the minority had the chance to negotiate the sale of their shares, then they would take the squeeze-out gains into account. Arguably, the minority should not fare worse than in a negotiation which they were deprived of by the legislature by reason of making the squeeze-out procedure more effective.[124] However, the German

[121] It is currently unclear if an adjustment below the calculated average price would also be permissible. *Cf.* Bungert & Wettich, *supra* note 119.

[122] *Cf.* HANS MORITZ, "SQUEEZE-OUT": DER AUSSCHLUSS VON MINDERHEITSAKTIONÄEREN NACH §§ 327 A FF AKTG 125 (2004).

[123] *Id.* at 126.

[124] *Id.*; STANGE, *supra* note 68 at 152.

courts rejected this reasoning in recent convincing judgments.[125] They argued that the squeeze-out gains are not part of the company at the time of the shareholders' resolution (the relevant valuation date) and that the squeeze-out gains are a result of the squeeze-out and therefore could never have been realized by the minority shareholders had they continued to stay in the company. Further, the courts stressed that the recognition of squeeze-out gains would reduce the incentives of the controller to affect a squeeze-out. This could prevent controllers in some cases from initiating squeeze-outs that would be socially efficient. This may be true, for example, because the controller will, *inter alia*, consider the court costs of a subsequent appraisal proceeding (which are in most cases entirely borne by her) in her cost-benefit analysis of an envisaged squeeze-out. Squeeze-out gains are thus to be disregarded in the valuation of the minority shares.[126]

In the U.S. context a similar yet different problem exists. The German squeeze-out procedure can be implemented irrespective of a following merger, so that the question of whether the minority would also participate in the merger synergies does not arise. In Delaware, a cash-out of the shareholders is only possible in the context of a merger. The question therefore arises of whether the minority should participate in the merger synergies.

DGCL Sec. 262(h) clearly states that the valuation of these shares should not include such a premium: "[T]he fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger." In *Weinberger*, the court clarified that the fair value "is to include all elements of future value that were present at the time of the merger, excluding only speculative elements of value,"[127] thereby narrowing down the exception of DGCL Sec. 262(h) significantly.

The *Weinberger* approach seems to be consistent with the German regime. In both jurisdictions, the courts prescribe the valuation of the minority shares including future elements susceptible to determination at the date of the merger, but excluding the gains to be expected from the very measure they are compensated for (the exclusion of the shareholders).

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[125] Oberlandesgericht Frankfurt a.M. [OLG - Higher Regional Court], Case No. 5 W 39/09 (June 17, 2010), http://openjur.de/u/305834.html (Ger.); Oberlandesgericht Stuttgart [OLG - Higher Regional Court], Case No. 20 W 9/08, Mar. 17 2010, 2010 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 1498 (2010) (Ger.); Oberlandesgericht Munich [OLG – Higher Regional Court], Case No. 31 Wx 12/06**,** Oct. 26, 2006, 2007 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 375 (2007) (Ger.).

[126] Equally Patrick Hohl, BETRIEBSBERATER 596 (2011), in a commentary on Oberlandesgericht Frankfurt a.M. [OLG - Higher Regional Court], Case No. 5 W 39/09 (June 17, 2010), http://openjur.de/u/305834.html (Ger.).

[127] ALLEN, KRAAKMAN, & SUBRAMANIAN*, supra* note 55, at 479.

V. Shareholder Remedies

Shareholders can bring two different kinds of lawsuits against a squeeze-out procedure: They can try to enjoin the whole transaction by claiming that certain aspects of the procedure were not in accordance with the law; or they can contest the adequacy of the cash compensation, which will be reviewed in a specific appraisal procedure. Both courses of action will be analyzed in turn.

1. Action to Enjoin Squeeze-Out

Every shareholder who contested a shareholder resolution during the general meeting of shareholders has the right to file a lawsuit to enjoin the execution of the resolution. German law distinguishes between the so-called action to void the resolution (Anfechtungsklage) pursuant to Sec. 243 AktG, and the so-called action for nullification (Nichtigkeitsklage) pursuant to Sec. 241, 249 AktG. The former action can be brought for every infringement of stock corporation law with respect to the content of the resolution or the procedure in the run-up to the resolution. This can occur within one month from the date of the resolution and as far as the shareholder has contested this resolution during the general meeting. The latter action is reserved for the most severe breaches of stock corporation law principles and can be brought without time limitation. A squeeze-out cannot be enjoined because of an alleged inadequate compensation of the minority.

The initiation of an action to enjoin creates significant hold-out leverage for minority shareholders, even if their suit would not ultimately succeed on the merits. As long as an action to enjoin is pending, the squeeze-out cannot be registered with the commercial register, and therefore the transaction cannot become legally effective.[128]

Recognizing this flaw and trying to improve the balance between minority and controlling shareholders, the legislature provided a "fast-track" procedure (Freigabeverfahren) to protect the controlling shareholder from (some of) the effects of frivolous claims or claims that the court otherwise considers to be of less relevance than the interest of the controlling shareholder in consummating the squeeze-out. The target company can apply for a court order to rule that the squeeze-out can be registered in spite of such actions to enjoin in certain cases,[129] such as: (1) when it is evident that the action is without merits; (2) the grounds for the action are de minimis compared to the interest of the company (and the controller) to finalize the transaction; or (3) when the plaintiff has owned less than

[128] This problem exists in all structural corporate measures which require a registration with the commercial register to take legal effect.

[129] Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at § 327e(2), 319(6) (Ger.).

EUR1000 in the share capital[130] of the company at the time of the announcement of the squeeze-out.[131] The fast-track procedure is not supposed to take longer than three months.[132]

In practice, however, the fast-track procedure is not always as efficient and quick as intended, and there remains a certain pressure on the controlling shareholder to settle all actions to enjoin. Therefore minority shareholders still have considerable hold-out bargaining power.

2. Appraisal Procedure

The appraisal procedure is governed by the Appraisal Procedure Act (Spruchverfahrensgesetz—"SpruchG") that was introduced in 2003 in order to increase the efficiency of appraisal proceedings.[133] Minority shareholders can initiate an appraisal proceeding against the controlling shareholder within three months from registration of the squeeze-out resolution with the commercial register.[134] In contrast to the action to enjoin and the Delaware appraisal procedure, shareholders do not need to have opposed the merger during the general meeting at which the resolution was passed. The appraisal has a class character insofar as the judicial determination of the adequate compensation is binding on all minority shareholders (*erga omnes* effect), including those who accepted the original compensation offer.[135] The court appoints a shareholder representative in order to duly represent the interests of the class of minority shareholders who are not direct claimants in the proceeding.[136] In practice this will be a representative of an investor protection organization. The presence of the representative shall prevent the controlling shareholder from buying out the plaintiffs with a high settlement to the detriment of the minority shareholders not participating in the appraisal. Should that situation occur, the representative would have the right to continue the appraisal proceeding.

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[130] German stock corporations almost always have shares with a nominal value of EUR 1., so that usually means that the plaintiff or group of plaintiffs needs to have held at least 1000 shares.

[131] This latter case was introduced recently with the Act on the Implementation of the Shareholders' Rights Directive, Gesetz zur Umsetzung der Aktionärsrechterichtlinie [ARUG], May 28, 2009, BGBL I at § 2479 (Ger.), in an attempt to further reduce the impact of predatory shareholders.

[132] Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at §§ 327e(2), 319(6) (Ger.).

[133] STANGE, *supra* note 68, at 256.

[134] Appraisal Procedure Act [SpruchG] [Spruchverfahrensgesetz], June 12, 2003, BGBL I at §§4(1)no.3, 5(1) no.3 (Ger.).

[135] Appraisal Procedure Act [SpruchG] [Spruchverfahrensgesetz], June 12, 2003, BGBL I at § 13 (Ger.).

[136] *Id.* § 6.

The downside of the appraisal procedure is that the dire prophecies regarding the expected wave of appraisal proceedings[137] came true. 214 of the 317 (68%) squeeze-outs from 2002 until the end of 2007 resulted in the initiation of an appraisal proceeding.[138] Another concern is the length of the proceedings. One of the goals of the SpruchG was to reduce the length of time appraisal proceedings take. Yet there has only been an insignificant improvement in the length of proceedings. Before promulgation of the SpruchG the average proceeding lasted for over five years, but today the average time for proceedings not terminated by settlement is still over three years.[139] A likely important factor regarding the length of the proceedings was that until recently, the cheap interest rate on the possible liability of the controller was only 2% (uncompounded) above the "base rate" (Basiszinssatz)[140] of the German Federal Bank[141]—a price well below the cost of capital of any corporation, which gave the controller an incentive to stall the proceeding for as long as possible. The legislature, meanwhile, has recognized this deficiency and has increased the interest rate to 5% above the base rate of the German Federal Bank.[142]

3. Empirical Data Regarding Shareholder Remedies[143]

Shareholders initiated lawsuits to enjoin the transaction in 107 out of 317 cases (34%). Since 2005, the number of such lawsuits has risen to 60–70% of all squeeze-outs; whereas almost all squeeze-outs of listed companies are being challenged.

In cases in which the squeeze-out was not contested, the registration of the squeeze-out resolution in the commercial register took an average of 68 days (median 54 days). However, the contested squeeze-out resolutions took an average of 286 days (median 240 days) for registration. This clearly shows the hold-out leverage which contesting shareholders can acquire. That the difference is not even more severe is owed to the fact that the overwhelming majority of lawsuits are settled—and thereby the contesting shareholders' compensation is increased. Even after settlement of the suit to enjoin, in many cases the minority shareholders go on to initiate an appraisal proceeding.

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[137] *Cf.* Maximilian Schiessl, *Fairness Opinions im übernahme- und Gesellschaftsrecht Zugleich ein Beitrag zur Organverantwortung in der AG*, ZEITSCHRIFT FÜR UNTERNEHMENS- UND GESELLSCHAFTSRECHT (ZGR) 814, 837 (2003).

[138] At the time the data was gathered in twenty-four cases, an initiation of the appraisal was not yet possible because of a pending action to enjoin, so the actual percentage of cases may well have been higher.

[139] STANGE, *supra* note 68, at 279.

[140] Currently 0.12%.

[141] *See e.g.*, THOMAS HEIDEL ET AL.,FESTSCHRIFT FÜR WIENAND MEILICKE 2268 (2003); STANGE *supra* note 68, at 259.

[142] Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at § 327b(2) (Ger.).

[143] This section draws on data from STANGE, *supra* note 68, at 279.

Appraisal proceedings were brought against 214 of the 317 squeeze-outs (68%). The appraisal proceedings ended by court decision lasted an average of 37.9 months (median 39 months). Including the cases that were settled, the disputes lasted an average of 31.4 months (median 30 months). 50–75% of the appraisal proceedings were settled.

F. Takeover Squeeze-Out

I. General Remarks

The new Sec. 39a–39c WpÜG regarding the Takeover Squeeze-Out have been in force since July 2006. Germany was required to transpose the EU Takeover Directive into national law, but German scholars were also of the opinion that the legal practice was awaiting a streamlined squeeze-out process for takeover situations.[144] The German legislature decided to introduce a new instrument separate from the general squeeze-out pursuant to Sec. 327a et seq. AktG instead of integrating the takeover situation in the framework of the general squeeze-out. Both forms of squeeze-out are non-exclusive, meaning that in a takeover situation the controller can choose freely between both procedures.

II. Scope of Regulation

The Takeover Squeeze-Out is only available when the relevant shareholding threshold of 95% is reached through a mandatory tender offer or a voluntary offer launched by a non-controlling shareholder to obtain 100%[145] of the target stock.[146] That means that, for example, a controller who owns 51% of the target stock and wants to acquire additional shares (stock-up) cannot take advantage of the Takeover Squeeze-Out.[147] The reason is that the Takeover Squeeze-Out was introduced to compensate the acquirer of a control stake for the cost and effort she incurs through the takeover regulation, and this rationale is not present in stock-ups.[148]

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[144] Philipp Rühland, *Der übernahmerichteliche Squeeze-out im Regierungsentwurf des Übernahmerichtlinie-Umsetzungsgesetzes (Regierungsentwurf)*, NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT (NZG) 401, 402 (2006).

[145] It is a general requirement of German Takeover law that partial tender offers which are limited to an acquisition of less than 100% of the target stock are not allowed. Wertpapiererwerbs- und Übernahmegesetz [WpÜG] [Securities Acquisition and Takeover Act], Dec. 20, 2001, BGBL. I at § 29 (Ger.).

[146] *Cf. id.* §§ 39a, 29.

[147] *Cf.* Ventoruzzi, *supra* note 1, at 50.

[148] Walter Paefgen, Z*um Zwangsausschluss im neuen Übernahmerecht*, WERTPAPIERMITTEILUNGEN (WM) 765 (2007).

III. Determination of Adequate Compensation

As is the case in the General Squeeze-Out, the controller has to adequately compensate the minority shareholders. The compensation shall have the same form as the consideration in the preceding tender offer; in case of a share for share tender offer the acquirer shall also offer cash compensation.[149] The acquirer will regularly ascertain the amount of compensation by way of fairness opinion.[150] In order to facilitate the Takeover Squeeze-Out, Sec. 39a(3)(4) WpÜG presumes that the compensation is adequate if the bidder has acquired more than 90% of the share capital included in the triggering tender offer. That means that the presumption applies if at least 90% of the outstanding shares are tendered. Such a market test indicates that the offer was fair.

It is hotly disputed whether this presumption is rebuttable or unrebuttable by contesting minority shareholders. The legislature initially wanted to create an unrebuttable presumption for the sake of an efficient procedure.[151] However many legal commentators raised concerns that such a rule, which deprives contesting minority shareholders of the possibility of legal recourse, would infringe the protection of property by the German Constitution (Art. 14 GG),[152] the European Convention of Human Rights, and the European Takeover Directive.[153] It was argued that legal redress must be possible at least in exceptional cases, such as insider dealing or securities fraud by publication of misleading information.[154] However the prevailing opinion prioritizes the public interest in an efficient procedure that cannot be stalled after it has passed the market test.[155] Proponents of this view emphasize that market manipulations in these cases are all punishable by law and that empirical evidence from the UK suggests that such cases would be extremely rare, and should not be the reason to prevent an efficient squeeze-out regime.[156] This issue has not yet been decided by the BGH, though.

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[149] Wertpapiererwerbs- und Übernahmegesetz [WpÜG] [Securities Acquisition and Takeover Act], Dec. 20, 2001, BGBL. I at § 39a(1).

[150] Ulrich Noack & Dirk Zetzsche, *Vor §§ 39a bis 39c WpÜG*, *in* KAPITALMARKTRECHTSKOMMENTAR 19 (Eberhard Schwark & Daniel Zimmer eds., 4th ed. 2010).

[151] DEUTSCHER BUNDESTAG: DRUCKSACHEN UND PROTOKOLLE [BT] Begründung zum Regierungsentwurf [Legislator's Explanatory Notes], 16/2003 at 22 (Ger.); STANGE, *supra* note 68, at 271.

[152] Rühland *supra* note 144, at 405; Noack & Zetzsche, *supra* note 150, at Sec. 39a mn. 28.

[153] *See e.g.*, Silja Maul, *Die EU-Übernahmerichtlinie – ausgewählte Fragen*, NEUE ZEITSCHRIFT FÜR GESELLSCHAFTSRECHT (NZG) 151 (2005) at 157; Noack & Zetzsche *supra* note 150, Sec. 39a mn. 28.

[154] Noack & Zetzsche, *supra* note 150, Sec.39a mn. 28.

[155] Oberlandesgericht Stuttgart [OLG – Higher Regional Court], Case No. 20 W 13/08, May 5, 2009, 2009 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 1059 (2009) (Ger.); Noack & Zetsche *supra* note 150, Sec. 39a mn. 28.

[156] *Id.*

From a doctrinal perspective it is very remarkable that the public interest in an efficient procedure is given priority here, as German courts and scholars generally attribute superior importance to the human right to an effective judicial review (Art. 19(4) GG), which is construed very broadly. However I support the view that the presumption should be unrebuttable with the arguments set out above—a majority of the minority of 90% is a very high burden. This market test substitutes the procedural protections that otherwise prevail in German law. From a comparative perspective, it must be conceded that this situation is similar to the one decided in *Rosenblatt*,[157] where the Delaware court considered MOM approval to be sufficient to shift the burden of showing the fairness of the transaction, but insufficient to defer to business judgment review. However, the Delaware MOM approval requirement is already fulfilled at the level of a simple majority (>50%), whereas Sec. 39a(3)(4) WpÜG requires at least a 90% majority. This yardstick is sufficiently high to justify a complete deference to the market test.

If less than 90% of minority shareholders tender their shares, then the adequacy of the share price will be determined by the court. Yet the law does not set out specific procedures about how to determine the value. Legal practitioners fear the imponderability of this procedure, which has not yet been applied in practice, and so they avoid the Takeover Squeeze-Out in the vast majority of cases where a 90% MOM approval of the minority is uncertain from an *ex ante* perspective.[158]

IV. Legal Effect by Court Decree

In the interest of an efficient procedure the Takeover Squeeze-Out—in contrast to the general squeeze-out—does not require a shareholder resolution approving the transaction. Instead, if the shareholder owns at least 95% of the voting share capital of the target company, she can file a motion with the court to apply for the transfer of the remaining outstanding voting shares.[159] The substitution of the shareholder resolution with a court procedure is sensible. The shareholder resolution would be a pure formality and almost all squeeze-outs are contested in court anyway.[160] The minority shareholders may file a motion and have the right to be heard, although the court may decide to do so in a written procedure without oral arguments.[161]

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[157] *See* Rosenblatt v. Getty Oil Co., 493 A.2d 929 (Del. 1985).

[158] *See infra* Part F.IV.

[159] Wertpapiererwerbs- und Übernahmegesetz [WpÜG] [Securities Acquisition and Takeover Act], Dec. 20, 2001, BGBL. I at § 39a(1)(1) (Ger.). The Regional Court (*Landgericht* – "LG") Frankfurt has exclusive jurisdiction for Takeover Squeeze-Out applications. *See id*. § 39a(5).

[160] STANGE, *supra* note 68, at 274.

[161] Noack & Zetsche, *supra* note 150, at Sec.39b mn. 11.

The squeeze-out becomes legally effective once there is no further legal recourse against the court decree ordering the transfer of the minority shares to the controller. This is the case when the time for appeal has elapsed or when OLG Frankfurt denies the appeal.[162]

V. Empirical Data on the Practical Application of the Takeover Squeeze-Out

Although the Takeover Squeeze-Out option has been available for six years, there are only four known cases in which the procedure has been invoked.[163] One reason could be the uncertainty regarding the procedure which is inherent in untested laws. Most importantly, the law does not specify how the adequacy of the compensation shall be evaluated if the 90% threshold is not reached.[164] Because the legal effect of the Takeover Squeeze-Out is pending until the final determination of the adequacy of the offer price by the court, the legal practice is wary of a possible never-ending procedure, and therefore favors the general squeeze-out procedure, which becomes legally effective at an earlier stage , namely with registration of the transaction in the commercial register.[165]

G. Analysis

I. Convergence or Path Dependence?

US law and German law on freeze-outs have the same goal: To protect the minority shareholder from the risk of an unfair treatment by the controlling shareholder when they are cashed out. Despite this common goal and a global tendency of convergence of corporate laws,[166] I submit that this is not an area of the law where the prophecy of "the end of history for corporate law" will hold completely true. While the general lines and ideas of how to protect minority shareholders will continue to converge—for example, the idea of MOM approval or the idea of a facilitated cash-out for controllers owning at least 90% of a company—many of the formal aspects of the freeze-out procedure will remain different in the two analyzed countries. More specifically: The rules governing freeze-outs in Germany and the U.S. were developed on the basis of different roots and traditions in the respective legal systems and, more specifically, their corporate laws. American law has

[162] *Id.* at Sec.39b mn. 21.

[163] *Cf. Noack & Zetzsche, supra note* 150, at *mn. 3* (accounting for data until May 2010 and found two cases). Two additional cases occurred in 2011: After successful takeovers, Nordfrost GmbH & Co. KG squeezed out the minority shareholders in Kuehlhaus Zentrum AG, and Engine Holding GmbH squeezed out the minority shareholders in Tognum AG.

[164] *See supra* Part F.III.

[165] Kai Hasselbach, *Verfahrensfragen des übernahmerechtlichen Squeeze out,* BETRIEBSBERATER 2842 (2010); Noack & Zetzsche, *supra* note 150, at mn. *3*.

[166] *Cf.* Reinier Kraakman & Henry Hansmann, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001).

a tradition for preferring to defer the resolution of issues to market forces instead of regulatory intervention. Germany (and Continental Europe, more generally) has the tendency to regulate possible issues between market participants by laws and regulations. This dichotomy is also recognizable in the different approaches of U.S. and German law towards the regulation of freeze-outs. The American system uses a system of *ex post* protection: The controlling shareholder can cash out the minority, but at the risk that they can (and will) bring fiduciary duty claims to force an entire fairness review of the transaction. The specter of class action litigation is supposed to induce the controller and the board of directors of the target company to negotiate a fair cash-out price. The requirement of having a truly independent Special Committee to negotiate the deal with the controller in order to release him from the burden of showing the entire fairness of the transaction shows that US law aims to remedy the conflict of interest with the simulation of an arms-length transaction.

The German system, in contrast, relies on *ex ante* procedural safeguards on the squeeze-out procedure through the introduction of third parties, which impose checks and balances on the controller. The most notable of these checks and balances are the requirements that the cash-out price be audited by an independent expert, and that the transaction must be registered in the commercial register, which checks that all formal requirements of the procedure have been complied with (a *gatekeeper strategy*).[167] The high threshold of 95% shareholding to cash out the minority is also based on the European tradition of seeing share ownership as essentially equivalent to real property, instead of just as a financial security to invest in capital markets. Although German courts have meanwhile recognized that shareholders owning 5% or fewer shares in a corporation are purely financial investors,[168] the German jurisprudence still does not seem to have arrived at quite the liberal capital market definition of share ownership that prevails in the U.S.

The different approaches of US and German law towards freeze-outs therefore seem to be a result of path dependency,[169] which limits the extent to which future convergence of these systems can be expected.

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[167] Rock et al., *supra* note 29, at 202.

[168] *See* Bundesverfassungsgericht [BverfG - Federal Constitutional Court], Case No. 1 BvR 1613/94, Apr. 27, 1999, 100 BVERFGE 289, 302 (Ger.); *see also* Bundesverfassungsgericht [BVerfG - Federal Constitutional Court], Case Nos. 1 BvR 68/95, 1 BvR 147/97, Aug. 23, 2000, 2001 NEUE JURISTISCHE WOCHENSCHRIFT (NJW) 279 (2001) (Ger.).

[169] *Cf.* Mark J. Roe & Lucian A. Bebchuk, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127 (1999).

II. The Uselessness of Fairness Opinions and "Independent" Audits, or Why the Fair Cash-Out Price Is Ultimately Determined by the Court

Both approaches to ensure a fair cash-out price work well, but also have deficiencies. What is striking is, for example, that in both jurisdictions, practically every freeze-out gets challenged in court, either by fiduciary duty action in Delaware or by appraisal action in Germany, so that the final arbiter in practice is always the court, which regularly will appoint yet another auditor to evaluate the fair cash-out price. This result seems to be inevitable. There is bound to be at least one shareholder who is willing to take on the risk of losing in court in exchange for the chance that the court determines a higher cash-out price. This situation is reinforced by the fact that the Delaware class action lawsuit automatically spreads legal fees among many investors, while in the German appraisal procedure the court fees are generally borne by the controller; the remaining legal fees are borne by the plaintiffs, but can be imposed on the controller for reasons of equity.[170]

Empirical evidence also suggests that the independent auditor in the German general squeeze-out procedure may not be truly independent after all. That is at least one way to explain Stange's findings that in many[171] cases the court ultimately determined a higher compensation than the independent auditor did. This result is not very surprising considering that the auditor's fees are paid by the controller. Of course, every auditor is bound by professional duties to act objectively, but although the auditor is ultimately appointed by the court, the court generally follows the suggestion of the controller.[172] Hence, the auditor may have an incentive to ingratiate herself with the management of the controller to improve their business relationship. Interestingly, this conclusion seems to be in line with New York's experience with independent court-appointed appraisers that they serve "no useful purpose but add considerably to the expense and time involved."[173]

Consequently, it seems sensible to abolish the requirements of shareholder approval and independent audit report in the general squeeze-out procedure and substitute it with a

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[170] Appraisal Procedure Act [SpruchG] [Spruchverfahrensgesetz], June 12, 2003, BGBL I at § 15.

[171] Stange found that in over 40% of cases the ultimate compensation was higher than the one initially offered by the controller. However, this result includes cases where the ultimate compensation was determined by the court or (in the majority of cases) by settlement. The valuation agreed upon in a settlement is not an accurate indicator for the intrinsic value of the shares, however, as the controlling shareholder will also consider the "nuisance value" of the claim and the legal fees she will save (for example, for an additional expert testimony by a court-appointed auditor), considering that she has to bear all legal court fees pursuant to Section 15 of the Appraisal Procedure Act.

[172] See *infra* Part E.I.3.

[173] Michael R. Schwenk, *Valuation Problems in the Appraisal Remedy*, 16 CARDOZO L. REV. 649, 679 (1994) (citing Senator Jess J. Present, in his Memorandum in Support of Chapter 202, reprinted in 1982 New York State Legislative Annual, 96, 97).

court procedure to determine the adequate compensation, as it is in the Takeover Squeeze-Out.

III. The German 95% Threshold

The threshold of 95% of the share capital that a controlling shareholder must meet in order to squeeze-out the minority exemplifies the fundamentally different approach that Germany takes towards cash-outs as opposed to Delaware, where every controlling shareholder can cash out the others. As already set out, I believe that this difference has its roots in the different perceptions of share ownership. The German view seems to be closer to the Delaware view of 1920 than it is to today's prevailing views in Delaware.[174] Whereas in Delaware a share is primarily a financial investment that should be secured, in Germany the share ownership is still viewed as being closer to real ownership.

However, Germany is not alone with its threshold requirement. Indeed, a recent study of EU squeeze-out procedures has shown that many European countries[175]—including the U.K.—have similar thresholds for squeeze-outs, ranging from 90%[176] to 95%.[177] This shows that the 95% threshold is an expression of a European legal tradition. Still, the threshold seems to be overly restrictive. German law provides for other measures that effectively cash out the shareholders and only require a shareholder resolution with a 75% majority. Management can sell all assets of the company and then dissolve the company.[178] However this procedure is rarely used in practice, *inter alia*, because shareholder actions challenging the price for the transfer of assets can delay the transaction significantly.[179] Another way of economically cashing out the minority is a peculiarity of German group law (*Konzernrecht*). The controller can implement a so-called domination and profit and loss transfer agreement (*Beherrschungs-und Gewinnabführungsvertrag*) with the subsidiary. The most salient effects of such an agreement are that (1) shareholders lose their right to dividend payments, which is substituted with a perpetual compensation payment;[180] (2) the subsidiary has to follow all instructions of the controller;[181] and (3) the balance-sheet

[174] *Cf.* Allen, Kraakman & Subramanian, *supra* note 54, at 485.

[175] The study focused on Belgium, France, Germany, the Netherlands and the U.K.

[176] This threshold is predetermined by Article 15 of the European Takeover Directive. However, the scope of this provision is so small that member states could have created or maintained a separate squeeze-out procedure with differing thresholds without infringing on the Directive.

[177] Van der Elst & Van den Steen, *supra* note 82, at 404.

[178] Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at § 179a (Ger.).

[179] Rock, Davies, Kanda, & Kraakman, *supra* note 29, at 207 n. 117.

[180] Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at § 304 (Ger.).

[181] *Id.* § 308.

profit or loss of the subsidiary is automatically attributed to the parent company, which allows for a tax consolidation at the parent level.[182] That means, *inter alia*, for the minority, that they economically cease to participate in the business risks and opportunities of the company, and that they instead receive a perpetual fixed rent payment as compensation. The implementation of a domination and profit and loss transfer agreement also only requires a shareholder resolution with 75% majority.

Consequently the German legislature should consider reducing the threshold for general squeeze-outs to 75%, as well. This demand seems particularly reasonable in light of the recent decision of the BGH, which allows crossing the 95% shareholding threshold by way of securities loans.[183] This judgment has already initiated the retreat from a strict application of the 95% rule. Yet for reasons of legal tradition, path dependency, and because of the question at which threshold the squeeze-out would run the risk of being qualified as unconstitutional by the BVerfG it is unlikely that the threshold will in fact be lowered below a 90% threshold in the near future.[184]

IV. The 90% Threshold in Merger Situations

In mid-July 2011, the German legislature enacted a law to streamline the squeeze-out procedure in connection with upstream mergers in group constellations.[185] If a controller intends to merge a subsidiary into itself, then a squeeze-out in connection with this parent-subsidiary merger shall only require a 90% ownership in the subsidiary (instead of the usual 95%).[186] Additionally, the merger shall not require a shareholder resolution of the target company. The German legislature felt compelled to adjust the applicable threshold in this specific case in order to conform with EU directive 2009/109/EC,[187] but decided against a

[182] KÖRPERSCHAFTSSTEUERGESETZ [KStG] [Corporation Tax Act], Oct. 15, 2002, BGBL. I at 1444, § 14 (Ger.).

[183] See infra Part E.I.1.

[184] Compare, on the one hand, the somewhat reserved comments of several members of Parliament in the *Bundestag* regarding the 90% threshold in Bundestag Plenarprotokoll 17/111, 12754, and on the other hand the judgment of Oberlandesgericht München *infra*, note 186.

[185] DRITTES GESETZ ZUR ÄNDERUNG DES UMWANDLUNGSGESETZES [3. UmwGÄndG], BGBL. I 2011, 1138 [Third Act Amending the Transformation Act], July 11, 2011, BGBL. I at 1138 (Ger.).

[186] As a precursor during the financial crisis a squeeze out procedure for holders of 90% of the share capital of a company was established by Finanzmarktstabilisierungsbeschleunigungsgesetz [FMStBG] [The Financial Market Stabilization Acceleration Act], Oct. 17, 2008, BGBl. I at 1982, §§ 12(3) no.1, 12(4) (Ger.), in order to allow for the measures necessary to rescue or "stabilize" financial institutions. The – apparently – only time this procedure was used to date was in the case of the distressed Hypo Real Estate Holding AG. The squeeze-out was held valid and constitutional by the Oberlandesgericht München [OLG - Higher Regional Court], Sept. 28, 2011, 2011 NZG 1227 (2011) (Ger.).

[187] Directive 2009/109/EC of the European Parliament and of the Council of Sept. 16, 2009, amending Council Directives 77/91/EEC, 78/855/EEC and 82/891/EEC, and Directive 2005/56/EC in regards to reporting and documentation requirements in the case of mergers and divisions.

general lowering of the threshold.[188] It should be expected that the limitation of these new rules to merger situations will not hamper their popularity. In cases where the controller does not want the subsidiary to be merged into herself, she can easily transfer her shares to an intermediary holding company and have the subsidiary merge into this holding company.[189]

The new German legislation bears a striking resemblance to the Delaware short-form merger pursuant to DGCL Sec. 253. Both instruments aim to provide to controlling shareholders who hold at least 90% of the shares of a company, a simplified procedure to merge with their subsidiary without needing to let the minority shareholders of the subsidiary participate in the equity of the controller. In this respect, the German squeeze-out system seems to converge towards the Delaware position.

It is noteworthy that the 90% threshold also emerges in many EU jurisdictions, as well as in Art. 15 of the European Takeover Directive. Across many jurisdictions, therefore, there seems to be a mutual understanding that a 90%-controller has legitimate interests to undertake a business combination, such as a merger, without participation of the minority in the new legal entity.

H. Conclusion

The analysis of German and U.S. freeze-out rules has shown profound differences, but also striking similarities. The similarities concern the 90% short-form merger and the tender offer freeze-out rules. The Delaware jurisprudence in *Pure* has been subjected to substantial critique,[190] as empirical evidence has shown that shareholders in statutory cash-out mergers get higher compensation on average than shareholders in tender offer freeze-outs. The German system also favors tender offer freeze-outs by requiring fewer procedural protections. As Ventoruzzo eloquently notes: "[T]he very fact that very different systems, moving from distinct perspectives and characterized by dissimilar law-making processes have converged toward a common framework is not only an interesting theoretical observation, but offers some support to the soundness of Delaware jurisprudence in *Pure* and its progeny."[191] However, German rules require a 90% MOM

[188] DEUTSCHER BUNDESTAG: DRUCKSACHEN UND PROTOKOLLE [BT] Begründung zum Regierungsentwurf [Legislator's Explanatory Notes], 17/3122 at 12 (Ger.). Reducing the threshold to 90% was necessary because the legislator was reluctant to introduce a sell-out right for minority shareholders, which would have been an alternative way to implement the directive.

[189] This procedure is considered not to be an abuse of a legal position by most German scholars. *Cf*. Stephan R. Göthel, *Der verschmelzungsrechtliche Squeeze Out*, ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT (ZIP) 1541, 1549 (2011) (Ger.), *available at* http://zip-online.de/b8c99a914d25a8e135632f4037ee771c (last visited 10 Aug. 2012).

[190] *See e.g*., Subramanian, *supra* note 1.

[191] Ventoruzzo, *supra* note 1, at 61.

approval, whereas *Pure* only requires a simple MOM approval, i.e. over 50%. It makes intuitive sense to believe that the increase of the MOM threshold would increase the value of the cash-out payment the controller will offer in order to get the required approval rate. Delaware should therefore not fall back to entire fairness review in tender offer freeze-outs, but rather increase the MOM approval requirement to a supermajority of e.g. 66%, if the legislature wants to increase payoffs of minority shareholders.[192]

For Germany, in contrast, it would be desirable to reduce the general shareholding threshold from 95% to 75% in order to make the squeeze-out rules more attractive and bring them into line with other corporate measures which achieve a similar economic effect to a squeeze-out. This would improve the consistency of the German legal system in this area and would eliminate the incentive to use other (more complex) measures to circumvent the high 95% threshold. It is submitted, however, that for the reasons set out above in Part G.III, this is unlikely to be realized in the near future.

Germany should also abolish the requirements for shareholder approval and an audit report by an independent expert in the general squeeze-out procedure in favor of a court procedure which will determine the fair cash-out compensation. The court is the place where this question will end up eventually, anyway.

In conclusion, we can see a tendency toward convergence regarding several specific elements of the freeze-out procedures, but also continued differences in the system which are owed to path dependency.

[192] *Id.* at 62.

Articles

Negative and Positive Integration in EU Economic Law: Between Strategic Denial and Cognitive Dissonance?

By Pedro Caro de Sousa[*]

A. Introduction

It is a generally held assumption that the EU economic free movement rights[1] are tools in the creation of a European internal market; and that their main goal is the (negative) market integration of different national markets. Yet these freedoms do not determine how market integration is to proceed, or which kind of integrated European market will emerge. The resulting market may be more or less regulated, and the creation of the relevant regulatory rules may be allocated to a variety of sources. These options are reflected in the different proposed tests used to determine whether a national measure prima facie infringes one of the market freedoms.[2] The proposed tests fall into two main categories—broad tests and narrow tests—and each type has its own implications for European integration. Broad tests, usually associated with obstacle tests or even with economic due process clauses, tend to be seen as having three main outcomes. One result of broad tests is centralization, implying that ultimate decisions concerning the legitimacy of national law rests with EU institutions, and particularly with the Court of Justice of the European Union ("the Court" or "CJEU"). Another outcome of broad tests is the possible harmonization of national laws through the European political process by increasing the amount of national legislation susceptible to being harmonized under Articles 114 to 118

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[1] These are the Treaty rules concerning the free movement of goods, services, establishment, capital and workers. They are usually also known as fundamental freedoms, but I call them market or economic freedoms so as to expressly exclude from the scope of this paper European Citizenship, which deals with non-economic free movement.

[2] As has been noted elsewhere, these tests have normally been put forward from both a normative and a descriptive standpoint, assuming that they are not just normatively correct but also descriptively true. Part of what this paper attempts is to disentangle the normative justifications from the descriptive claims.

on the Treaty on the Functioning of the European Union[3] ("TFEU").[4] A third consequence of broad tests is deregulation through the elimination of national rules creating obstacles to trade.[5] Alternatively, narrow approaches—usually associated with discrimination or typological tests—are usually coupled with regulatory pluralism via a greater degree of control of the harmonization competences of the EU, decentralization through the protection of a greater sphere of Member States' autonomy, and economic agnosticism.[6] Views on the potential outcomes of broad and narrow tests are, in turn, related to normative debates about the ideal levels of centralization, harmonization, and regulation in the internal market.

The main argument that follows is that these normative debates about the nature of the economic freedoms tend to be insular in relation to each other while also disregarding relevant institutional considerations. The goal here is not to disparage the relevance of such normative debates; it is merely to argue that, if the proponents of certain positions adopted under a specific normative framework considered the impact of their suggestions on other normative debates, while also taking into account the existence of certain institutional realities, these debates would be richer from a normative standpoint and would eventually lead to better descriptive frameworks. The first advantage of this approach is that it allows us to focus squarely on the question of what roles negative and positive integration should play in European integration[7] and to make clear that behind that question lie serious constitutional concerns about both models of integration and the allocation of competences within the EU.[8] The second advantage is that by recognizing the specific limitations of courts (particularly the CJEU) in pursuing negative integration and

[3] Consolidated Version of the Treaty on the Functioning of the European Union, Sep. 5, 2008, 2008 O.J. (C115) 47 [hereinafter TFEU].

[4] *See* Matej Avbelj, *European Court of Justice and the Question of Value Choices* 19 (N.Y.U. Law Sch. & The Jean Monnet Program, Working Paper No. 06/04, 2004).

[5] *See* ELEANOR SPAVENTA, FREE MOVEMENT OF PERSONS IN THE EUROPEAN UNION 85 (2007).

[6] *See* Nicolas Bernard, *Discrimination and Free Movement in EC Law*, 45 INT'L & COMP. L.Q. 82, 102–08 (1996*); see also id.* at 85–86.

[7] Integration theories distinguish between positive and negative integration. Positive integration is where common rules are provided by a higher authority to iron out regional and other inequalities. Negative integration refers to the removal of barriers between countries. The balance between these types of integration is a question which any trade system must face. *See* JOSEPH WEILER, MUTUAL RECOGNITION, FUNCTIONAL EQUIVALENCE AND HARMONIZATION IN THE EVOLUTION OF THE EUROPEAN COMMON MARKET AND THE WTO IN *THE PRINCIPLE OF MUTUAL RECOGNITION IN THE EUROPEAN INTEGRATION PROCESS* 25 (Fiorella Kostoris & Padoa Schioppa eds., 2005); *see also* TAMARA PERISIN, FREE MOVEMENT OF GOODS AND LIMITS OF REGULATORY AUTONOMY IN THE EU AND WTO 9 (2008).

[8] MIGUEL POIARES MADURO, WE, THE COURT: THE EUROPEAN COURT OF JUSTICE AND THE EUROPEAN ECONOMIC CONSTITUTION 67 (1998).

dealing with these questions, we should be better able to understand the nature and logic of judicial tests.

This paper begins with descriptions of the implications of adopting a certain test to determine whether a national measure restricts economic free movement[9] and of the mainstream normative debates concerning such a test.[10] It then analyzes how these normative debates are limited by their de-contextualization and lack of concern for institutional realities[11] and describes how the incorporation of these elements could enrich those debates.[12]

B. What Do the Market Freedoms Do?

What is the impact of adopting a specific test to determine whether a national measure infringes a market freedom? Most obviously, such a test identifies the national measures that will be subjected to a proportionality assessment by courts, particularly the CJEU, to establish whether they are justified. But this apparently simple consequence has a variety of implications for State autonomy, for the EU's competence to legislate, and for the level and kind of regulation left in the market. It is to these implications, and to their usual understanding in the literature, that this section is devoted. A framework will be developed which incorporates both these implications and the relevant literature, starting with a description of what the consequences are usually understood to be from a static perspective, and then reviewing the implications of adopting a more complex dynamic model.

I. Static Perspectives

Through the market freedoms, a large number of State actions become subject to review by the Court. This review can occur regardless of whether those national measures fall within the scope of Union legislative competences.[13] When the Court decides that a national rule falls within the scope of the market freedoms, it makes an institutional choice: the Court takes the rule away from the ordinary national legislative process and subjects it to the jurisdiction of the courts.[14] Even if a prima facie restrictive measure is

[9] *See infra* Part B.

[10] *See infra* Part C.

[11] *See infra* Part D.

[12] *See infra* Part E.

[13] *See*, *e.g.*, Case C-438/05, Int'l Transp. Workers' Fed'n and Finnish Seamen's Union v. Viking Line ABP and OU Viking Line Eesti, 2007 E.C.R. I-10779.

[14] *See* Gregory Shaffer, *A Structural Theory of WTO Dispute Settlement: Why Institutional Choice Lies at the Centre of the GMO Case*, 41 N.Y.U. J. INT'L L. & POL. 1, 4 (2008).

deemed to be justified, the Court will have the ultimate say about its validity, thereby centralizing the ultimate decision-making power at the EU level. This has consequences both vertically, concerning the division of regulatory competences between the Union and Member States, and horizontally, concerning the level of regulatory options left open both to Member States in non-harmonized areas and to the Union in harmonized ones.

Vertically, the market freedoms are instrumental in granting competences to the Union: the broader the concept of restriction applied, the larger the number of rules susceptible of being deemed contrary to EU law or of being harmonized under TFEU Articles 114 to 118.[15] Nonetheless, it should be noted that deciding that a national rule falls within the scope of the market freedoms does not per se lead to the replacement of national measures with EU measures, nor does the adoption of Union measures depend only on the finding that national measures present forbidden obstacles to economic free movement.[16] To begin with, the Union has a variety of legislative competences that are not related to the market freedoms or even to the internal market. But even if Article 114 TFEU was the only positive competence rule in the Treaty, allowing for re-regulation at a European level of what the market freedoms deregulated, this provision would also seem to have within its scope the power to remove obstacles to trade which do not fall under the remit of the market freedoms, such as those arising from non-restrictive discrepancies between national laws.[17] Even a perfect correspondence between the provisions on negative and positive integration would not automatically lead to harmonization, as the Union's political process must intervene and Article 5 TFEU requires that a harmonizing measure must respect both proportionality and subsidiarity. Whatever similarities between the scope of market freedoms (i.e., the potential for centralization) and the extension of Union competences under Article 114 TFEU (i.e., the potential for harmonization) seem to result from both the absence of ex ante restraints by Member States and EU institutions in adopting harmonized rules and from the Court's timid approach to reviewing Union legislation under the principles of proportionality and subsidiarity set forth in Article 5(3) of the Treaty on European Union ("TEU")[18] ex post.[19] The scope of the market freedoms is

[15] *See* Avbelj, *supra* note 4, at 19. Evidence that litigation and negative integration led to an increase in EU legislation, presumably to replace regulatory holes left in the Member States by the negative integration that preceded it, has been empirically observed. *See* Alec Stone Sweet & Neil Fligstein, *Institutionalizing the Treaty of Rome*, *in* THE INSTITUTIONALIZATION OF EUROPE 45–53 (Alec Stone Sweet et al. eds., 2001).

[16] *See* Loïc Azoulai, *The Court of Justice and the Social Market Economy: The Emergence of an Ideal and the Conditions for Its Realization*, 45 COMMON MKT. L. REV. 1335, 1341 (2008); *see also* Allan Erbsen, *Horizontal Federalism*, 93 MINN. L. REV. 493, 494–502 (2008).

[17] *See* Gareth Davies, *Can Selling Arrangements Be Harmonised?*, 30 E.L. REV. 370, 375–78 (2005). This is also apparent from Case C-380/03, Germany v. Parliament, 2006 E.C.R. I-11573 [hereinafter *Tobacco Advertising II*].

[18] Consolidated Version of the Treaty on European Union, Mar. 30, 2010, 2010 O.J. (C83) 1.

[19] *See* Stephen Weatherill, *Better Competence Monitoring*, 30 E.L. REV 23, 25–28 (2005); *see also* PERISIN, *supra* note 7, at 91-108. *See also* Case C-376/98, Germany v. Parliament, 2000 E.C.R. I-8419 [hereinafter *Tobacco*

instrumental to the vertical allocation of competences because a finding that a national measure is restrictive is a sufficient, but not necessary, trigger for harmonization. Nevertheless, centralization and harmonization—in particular, the impact of the scope of the market freedoms on Union competences and on any increased recourse to Article 114 TFEU—must be distinguished, even if the Union's legislative competence is triggered each time a measure is deemed restrictive.[20]

Horizontally, the market freedoms set substantive limits on the exercise of legislative powers, at both the national and the Union levels.[21] At the national level, when a measure is caught within the scope of the market freedoms, the ultimate decision as to its legitimacy falls to the Court, which may, by means of a proportionality test, determine whether the manner by which the measure protects a legitimate State interest is acceptable. Furthermore, in certain cases—namely those concerning justifications not provided for by the Treaties—the Court may even determine what public interests a State may legitimately pursue. The result is that a Member State loses part of its autonomy to legislate, and Member States other than the one subject to the Court's decisions that have similar measures in place will find themselves under the "shadow of the law" and under pressure to amend their out-of-step rules in accordance with the Court's case law.[22]

In short, when determining the scope of the market freedoms and the legitimate justifications to their restrictions, the Court's decisions have two major types of

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Advertising I], Case C-491/01, The Queen v. Sec'y of State for Health, ex parte British American Tobacco (Investments) Ltd and Imperial Tobacco Ltd, 2002 E.C.R. I-11543 [hereinafter *British American Tobacco*]; Case C-210/03 The Queen v. Sec'y of State for Health, ex parte Swedish Match, 2004 E.C.R. I-11893 [hereinafter *Swedish Match*]; *Tobacco Advertising II*; Case C-58/08 Vodafone Ltd and Others v. Sec'y of State for Business, Enterprise, and Regulatory Reform, 2010 E.C.R. I-04999 [hereinafter *Vodafone*].

[20] This explains why there is no equivalence between a test where a market freedom would have a vast scope and be subject to light review at the justification stage, and a test imposing a stricter scope for the market freedoms but applying a stricter review at justification stage, even when the final decision of the cases by the Court would be the same.

[21] *See* Michael Schillig, *The Interpretation of European Private Law in the Light of Market Freedoms and EU Fundamental Rights*, 15 MAASTRICHT J. EUR. AND COMP. L. 285, 296–97 (2008). In practice, Union legislation is seldom reviewed—and even more seldom invalidated—under the market freedoms. *See* Joined Cases 80 and 81/77, Commissionnaires Réunis v. Receveur des douanes, 1978 E.C.R. 927; Case 41/84, Pinna v. Caisse d' Allocations Familiales de la Savoie, 1986 E.C.R. 1 [hereinafter *Pinna*]; Case 20/85 Roviello v. Landesversicherungsanstalt Schwaben, 1988 E.C.R. 2805 [hereinafter *Roviello*]; Piet Eeckhout, *The European Court of Law and the Legislature*, 18 Y.B. EUR. L. 1, 12–14 (1998). Nonetheless, Union legislation can be indirectly reviewed by the Court assessing whether a national measure compliant with Union legislation still infringes upon the fundamental Treaty provisions. *See* Case C-208/07, Petra von Chamier-Gliszcinski v. Deutsche Angestellten-Krankenkasse, 2009 E.C.R. I-06095 [hereinafter *Chamier-Glisczinski*].

[22] *See* Alec Stone Sweet & James Caporaso, *From Free Trade to Supranational Polity: The European Court and Integration*, *in* EUROPEAN INTEGRATION AND SUPRANATIONAL GOVERNANCE 128 (Wayne Sandholtz & Alec Stone Sweet eds., 1998).

implications. From a vertical perspective, the market freedoms act as positive competence rules, with the Court being instrumental in the allocation of competences between the Union and the Member States. From a horizontal perspective, the market freedoms operate as negative competence rules: What matters is not the allocation of competences within the EU and the States, but the scope of EU law itself, and here the Court's role looms even larger as it becomes the ultimate decider of what regulatory options are available within the Union. From the interplay of vertical and horizontal outcomes arises the functional consequence that the market freedoms have inherently deregulatory effects, since the Court can only strike down legislative measures but cannot legislate itself. In other words, the greater the degree of centralization, the greater the prospect of deregulation of national markets becomes. On the other hand, this also creates a possibility for the EU political process to step in, so that the prospect of re-regulation at the EU level also increases. This re-regulation, however, will be different from national regulation, inasmuch as the participants in the regulatory process are more numerous and diverse, including previous market outsiders, leading to a potential change in regulatory goals and methods.[23]

II. A Dynamic Perspective

The recent importation of American teachings on economic federalism concerning "regulatory competition" created an opportunity to analyze the impact of the market freedoms through a dynamic perspective that accounts for the existence of the internal market itself and for the possibility of the free movement of economic agents between jurisdictions.[24]

Regulatory competition depends on federal or quasi-federal entities creating and enforcing exit and entry rights for products and production factors without interfering with the regulatory autonomy of States, so that regulators are able to react to competition in the market for legal rules. In the EU, the market freedoms create the conditions for the existence of regulatory competition, namely by making available comparative information and creating the ability for economic agents to both exert their voices and exit within different jurisdictions. This allows consumers to show their preferences in products and services (voting with their wallets), businesses to relocate to more favorable environments (voting with their feet), and private agents to vote or lobby their public authorities for

[23] This might paradoxically lead to greater formal regulation, since as the social distance and distrust between regulators and regulated actors in liberalized markets increases, laws and regulatory processes tend to become more formal, transparent, and legalistic. *See* DANIEL KELEMEN, EUROLEGALISM: THE TRANSFORMATION OF LAW AND REGULATION IN THE EUROPEAN UNION 23 (2011).

[24] This theory originates from Charles Tiebout, *A Pure Theory of Local Expenditures* 64 J. POL. ECON. 416 (1956). *See* Simon Deakin, *Reflexive Governance and European Company Law*, 15 EUR. L.J. 224, 231 (2009) (arguing that this pure theory is too abstract even for the U.S. reality).

different rules (voicing their concerns). In turn, this forces different rule-making entities to compete in a market for legal rules, which may theoretically lead to a convergence of standards.[25] Some argue that this convergence results in a race-to-the-bottom in regulation—effectively, deregulation—while others argue that it leads to optimal levels of regulation.[26]

The dynamic perspective adds to the static perspective in a variety of ways. It points to the fact that the market freedoms change the incentives of market and political agents within Member States, and thus affect State autonomy in ways unforeseen from a static perspective. It demonstrates that a dynamic process of regulatory competition may lead to the creation of common rules throughout the internal market, which do not come down from European institutions at the top, but arise instead from the bottom up, as a result of competitive pressures in the market for legal rules that lead to (a different kind of) harmonization of national rules. Additionally, it focuses on the fact that, even if the adopted tests seek to protect existent levels of regulation put in place by States, deregulation may still emerge as a consequence of economic agents searching for the least onerous regulatory regime, and subsequent race-to-the-bottom.

C. What Ought the Market Freedoms to Be Doing?

The above review of the practical implications of the market freedoms allows us to map out three different ways to approach them from a normative perspective—concerning, respectively, the desirability of centralization, deregulation and harmonization.

First, one can focus on the impact of the market freedoms on centralization at the EU level and on State autonomy at the national level. From this perspective, normative positions vary in a continuum between defending extreme centralization of ultimate regulatory competences with EU bodies, and particularly the CJEU,[27] proponents of which will usually

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[25] *See* Jeanne-Mey Sun & Jacques Pelkmans, *Regulatory Competition in the Single Market*, 33 J. COMMON MARKET STUDS. 67, 69–77 (1995); Catherine Barnard & Simon Deakin, *Market Access and Regulatory Competition* (N.Y.U. Law School and The Jean Monnet Working Program, Working Paper No. 9/01, 2-4, 2001). On the origin of these concepts, see ALBERT O. HIRSCHMAN, EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES (1970).

[26] This is an empirically debatable question, particularly in the EU context. *See, e.g.*, Fritz Wilhelm Scharpf, GOVERNING IN EUROPE: EFFECTIVE AND DEMOCRATIC? 86–101 (1999); Catherine Barnard, *Social Dumping and the Race to the Bottom: Some Lessons for the European Union from Delaware?*, 25 EUR. L. REV. 57 (2000).

[27] *See* Laurence W. Gormley, *Actually or Potentially, Directly or Indirectly? Obstacles to the Free Movement of Goods*, 9 Y.B. EUR. L. 197 (1989); Anthony Arnull, *What Shall We Do on a Sunday?*, 16 EUR. L. REV. 112 (1991); Wouter Wils, *The Search for a Rule in Article 30 EEC: Much Ado About Nothing?*, 18 EUR.L. REV. 475 (1993).

favor a broad approach, and arguing for decentralization and the maximization of State autonomy, which will usually lean towards a narrow test.[28]

Secondly, one can look into the deregulatory effects of the market freedoms, with the normative positions varying from defending the market freedoms as neo-liberal tools protecting the unencumbered pursuit of economic activity by eliminating unjustified rules at the national level, which would point towards a very broad test, or seeing them merely as a means to remove obstacles to inter-State trade and protectionist measures that are otherwise economically agnostic, a position traditionally associated with a narrower test.[29]

A third perspective, which seems to have replaced the second debate in the literature, concerns the balancing of the virtues of regulatory competition when compared to harmonization.[30] One side of the argument is that regulatory pluralism is more desirable than centralized regulations, because centralized regulations are more distant from regulated entities, tend to reduce opportunities for meaningful political participation, are more subject to capture by particular groups, imply severe procedural costs inherent to implementing common rules in a large, heterogeneous space, and pre-empt regulatory competition in the areas in which they are adopted.[31] Regulatory pluralism is said to allow the content of rules to be matched more effectively to the preferences of citizens by taking into account local specificities, and to promote diversity and innovation in legal solutions, flows of information on effective law-making, and competition between legal orders.[32] Against this it is argued that regulatory competition can be sub-optimal, not only because of the risks of a race-to-the-bottom and concomitant deregulation, but also because it can lead to market failures being left unattended.[33] Furthermore, since governments regulate

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[28] *See* Gustavo Marenco, *Pour une Interprétation Traditionelle de la Notion de Mesure d'Effet Equivalent à une Restriction Quantitative*, 20 CAHIERS DE DROIT EUROPÉEN 291 (1984); Bernard, *supra* note 6. It should be noted that this perspective also overlaps with debates on the value of judicial review as opposed to legislative autonomy. I thank Damian Chalmers for his comments on this point.

[29] A question first faced by the Court in Advocate General Tesauro's Opinion in Case C-292/92, Hünermund v. Landesapothekerkammer, 1993 E.C.R. I-6787 [hereinafter *Hünermund*]. On broad tests leading to deregulation, see SPAVENTA, *supra* note 5. On the debate, see WOLF SAUTER & HARM SCHEPEL, STATE AND MARKET IN EUROPEAN UNION LAW: THE PUBLIC AND PRIVATE SPHERES OF THE INTERNAL MARKET BEFORE THE EU COURTS 4–15 (2009).

[30] Following the express disavowal of ordoliberal views advocating deregulation and economic freedoms as normative goals of the market freedoms in Advocate General Tesauro's Opinion in *Hünermund* and by the Court in Joined Cases C-267/91 and 268/91, Criminal Proceedings Against Keck and Mithouard, 1993 E.C.R. I-6097 [hereinafter *Keck*].

[31] *See* GIANDOMENICO MAJONE, DILEMMAS OF EUROPEAN INTEGRATION: THE AMBIGUITIES AND PITFALLS OF INTEGRATION BY STEALTH 145 (2005); JUKKA SNELL, GOODS AND SERVICES IN EC LAW: A STUDY OF THE RELATIONSHIP BETWEEN THE FREEDOMS 38–40 (2002).

[32] Although some authors have pointed to discrepancies between economic models and empirical results, see Sun and Pelkmans, *supra* note 25, at 83–85.

a number of economic activities not handled satisfactorily by competitive markets in the first place, it has been argued that regulatory competition may lead to the re-emergence of market failures that were previously solved by corrective regulation at national level.[34] Normative arguments for harmonized rules emanating from the EU institutions tend to be based not only on these arguments, but further hold that harmonization is useful as a means of reducing transaction costs and better-placed to deal with natural monopolies, systemic risks, and regulatory drift.[35]

One can thereby, for heuristic purposes, develop a taxonomy of the mainstream debates on the scope of the market freedoms as concerning themselves with the balancing of centralization versus decentralization, deregulation versus economic agnosticism, and harmonization versus regulatory pluralism. These debates about the ideal form of negative integration are, in turn, part of wider debates about the more general goals and ideal models of European integration. For simplification and exposition purposes, this paper will have recourse to a taxonomy of three different models of integration which have been identified in the literature, each carrying its own implications as to the preferred ideology of European integration and institutional allocation of competences:[36] (1) A centralized constitutional model, essentially concerned with the allocation of competences within the EU, which reacts to the perceived deregulation at the national level by defending centralized positive integration; (2) a competitive constitutional model defending the constitutionalization of negative integration as a means of limiting unnecessary regulation of the market and thereby of protecting economic liberty by leaving the market to its own self-regulatory devices; and (3) a decentralized constitutional model that sees the legitimacy of EU law as deriving from States and thus defends the notion that the regulatory autonomy of States should be maximized by limiting the scope of EU integration and minimizing the impact of EU law in national systems.

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[33] These can traditionally be distinguished among externalities, market power, and asymmetric information. *See* JOHN KAY & JOHN VICKERS, REGULATORY REFORM: AN APPRAISAL IN DEREGULATION OR RE-REGULATION, 225–30 (Giandomenico Majone ed., 1990); CASS R. SUNSTEIN, AFTER THE RIGHTS REVOLUTION: RECONCEIVING THE REGULATORY STATE, 47–73 (1990); ANTHONY I. OGUS, REGULATION: LEGAL FORM AND ECONOMIC THEORY 30–46 (2004); Andrew Johnston & Phil Syrpis, *Regulatory Competition in European Company Law After* Cartesio, 34 EUR. L. REV. 378, 392 (2009).

[34] Hans-Werner Sinn, *The Selection Principle and Market Failure in Systems Competition*, 66 J. PUB. ECON. 247 (1997).

[35] Simon Deakin, *Legal Diversity and Regulatory Competition: Which Model for Europe?* 12 EUR. L.J. 440, 441–43 (2006); Neil Fligstein & Alec Stone Sweet, *Constructing Polities and Markets: An Institutionalist Account of European Integration*, 107 AM. J. SOC. 1206, 1312 (2002).

[36] MADURO, *supra* note 8, at 108–49. *See also* Alan O. Sykes, *The (Limited) Role of Regulatory Harmonization in International Goods and Services*, 2 J. INT'L ECON. L. 49 (1999) (distinguishing between models advancing regulatory harmonization, mutual recognition and policed de-centralization in international economic law); Armin von Bogdandy, *Legitimacy of International Economic Governance*, *in* INTERNATIONAL ECONOMIC GOVERNANCE AND NON-ECONOMIC CONCERNS (Stefan Griller ed., 2003) (identifying a federal model, a coordinated interdependence model, and a liberal model).

These overarching heuristic models incorporate views on the ideal extent of both positive and negative integration. When dealing with the latter, they tend to be connected to a specific understanding of what the concept of restriction should be and what it should achieve. The centralized constitutional model allows for political and economic stability by defusing horizontal friction between Member States through the creation of mechanisms for the peaceful resolution of disputes and the creation of centralized, harmonized rules.[37] It will tend to side with broad tests, which catch as many national rules as possible and imply that the ultimate decision as to the legitimacy of an increased number of national laws rests on the EU, particularly with the Court, and that the area where EU harmonization is possible increases proportionally.[38] The de-centralized constitutional model favors the maintenance of Member States' autonomy, arguing that this would be the best approach to co-ordinate national systems by allowing for regulatory pluralism. From this perspective, only protectionist rules should be removed, and the Court's tests should be economically agnostic and focus on ensuring that products from other Member States are able to compete on truly equal terms with domestic products. This would point towards a more decentralized system where Member States' competences are preserved and the quest for regulatory uniformity through European courts and institutions is abandoned.[39] This model thus sides with a narrow anti-protectionist test, on the grounds that it would prevent the Court from adopting decisions under a proportionality test which are best left for national legislatures, while reducing the positive competences of the Union to override the choices of those same legislatures. Lastly, the competitive constitutional model is subject to a sub-distinction as to whether it favors competition at the national or at the EU level.[40] The former model advocates deregulation of national markets and accordingly tends to be associated with broad tests through which the basic tenets of ordoliberalism—increasing individual autonomy, controlling abuses of government, and maximizing economic welfare—can be enforced by courts through the elimination of unnecessary national regulation.[41] The latter model favors regulatory competition and will tend to prefer a narrow test that protects regulatory pluralism,

[37] Erbsen, *supra* note 16, at 534–72.

[38] Avbelj, *supra* note 4, at 19.

[39] Bernard, *supra* note 6, at 102–08.

[40] This version of the model is not developed by Maduro, but I add it here because it helps fill what I perceive to be a gap in his taxonomy, which seems to result from an assumption that regulatory competition will lead to a race-to-the-bottom and thereby equates it with deregulation.

[41] *See* SPAVENTA, *supra* note 5, at 85. On the influence of ordoliberals at the inception of the European project, see Miguel Poiares Maduro, *Reforming the Market or the State? Article 30 and the European Constitution: Economic Freedom and Political Rights*, 3 EUR. L.J. 55, 55–56 (1997); David J. Gerber, *Constitutionalizing the Economy: German Neo-Liberalism, Competition Law and the "New" Europe*, 42 AM. J. COMP. L. 25 (1994).

similarly to the decentralized model, but only as long as it ensures that free movement, and the conditions for the creation of regulatory competition is possible.[42]

D. Towards a Contextualized Perspective

This section critically analyzes the traditional understandings of the implications of the market freedoms reviewed in Part A and their influence on the normative positions reviewed in Part B. It begins with a critical review of the static and dynamic models presented above, followed by an attempt to deconstruct how the different normative models of European integration interact with the judicial formulas developed to identify national measures that restrict free movement.

I. Refining Our Understanding of the Impact of the Market Freedoms

The above analysis of the impact of the market freedoms from both static and dynamic perspectives offers important insights. In particular, the static perspective allows us to understand that choices concerning the concept of restriction will be relevant in determining the level of centralization of powers at the EU level and the deregulatory impact of the market freedoms in national markets. The dynamic perspective, in turn, points to the impact of the market freedoms in the development of common European standards and illustrates the parameters of the choice between harmonization and regulatory competition.

Nonetheless, these perspectives seem to be somewhat lacking. From a static perspective, we have seen above that the market freedoms may be seen as deregulatory because the Court can strike down but not create regulations *ex novo*; but they may also be looked at as favoring harmonized regulation, whereby the market freedoms effectively become re-regulatory instruments. If there are good reasons behind arguments for the market freedoms being both deregulatory and re-regulatory devices, the prevailing element seems to be the result of specific institutional realities. When the Court replaces the parameters of acceptability of a certain regulatory scheme, this will have a deregulatory effect if the different options for re-regulation at both the national and EU level are blocked, as occurred commonly prior to the adoption of the Single European Act.[43] If this is not the case and the re-regulatory channels are open, the preponderant effects of a prima facie deregulatory decision may well be re-regulatory.

What is more, a closer look at the way the market freedoms operate demonstrates that the market freedoms need not be deregulatory at all even if the channels for re-regulation

[42] *See* Bernard, *supra* note 6, at 102–08; SPAVENTA, *supra* note 5, at 85–86. *But see* MADURO, *supra* note 8, at 109 (arguing that it tends towards a broad test).

[43] Single European Act, Feb. 17, 1986, 1987 O.J. (L169) 1, 25 I.L.M. 506.

are closed. It was in such a context where the mechanisms of re-regulation were foreclosed that the Court first developed a tool for changing the criteria for acceptability of regulation in Member States without deregulating national markets: mutual recognition. The concept of mutual recognition was first adopted in the *Cassis de Dijon* case, where a national measure prohibiting the importation of "Cassis de Dijon" liqueur from France into Germany, on the grounds that it had an alcoholic content less than the minimum allowed for the marketing of alcoholic beverages in Germany, was deemed restrictive.[44] The Court held that disparities between national laws concerning a product's technical standards were contrary to the free movement of goods because they could hinder trade between Member States, and that the host-State should recognize the technical standards set by the home-State unless the host-State's rules were justified.[45] On the one hand, this extended the concept of restriction to encompass disparities in national laws concerning products' technical requirements, a vast extension on the scope of that concept as understood until then, but in a way that did not lead so much to deregulation as to the transfer of regulatory authority from one jurisdiction to another. As stated by Nicolaïdis:

> If a professional can operate, a product be sold or a service provided lawfully in one jurisdiction, they can operate, be sold or provided in any other participating jurisdiction, without having to comply with the regulations of those other jurisdictions. The "recognition" involved here is the "equivalence," "compatibility" or at least "acceptability" of the counterpart's regulatory system; the "mutual" part indicates that the reallocation of authority is reciprocal and simultaneous.[46]

In the context of the internal market, the principle of mutual recognition typically means that an economic agent is only subject to the rules of its home State, even when in a host State, and is thereby freed from the onus of complying with two or more sets of rules.[47] Underlying this is the idea that if the standards of different Member States are functionally equivalent, there is no good reason to exclude products coming from another State. By mandating that standards of a home-State be accepted as functionally equivalent to its

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[44] *See* Case 120/78, Rewe-Zentrale AG v. Bundesmonopolverwaltung für Branntwein, 1979 E.C.R. 649 [hereinafter *Cassis de Dijon*].

[45] *See id.* at para. 8.

[46] *See* Kalypso Nicolaïdis, *Globalization with Human Faces: Managed Mutual Recognition and the Free Movement of Professionals*, *in* THE PRINCIPLE OF MUTUAL RECOGNITION IN THE EUROPEAN INTEGRATION PROCESS 133 (Fiorella Kostoris & Padoa Schioppa eds., 2005).

[47] *See* DAMIAN CHALMERS, GARETH DAVIES & GIORGIO MONTI, EUROPEAN UNION LAW 764 (2010).

own by a host-State, the Court replaced the deregulatory effects of the freedoms with the imposition of different regulatory standards coexisting in the market of each State depending on the origin of the products marketed there.[48]

In other words, whatever simple equivalence one may find between the scope of judicial tests and deregulatory or re-regulatory effects will tend to be the result of ignoring the relevant institutional context. Looking at the application of the market freedoms by the Court and seeing judicially mandated deregulation of national markets as a tool for increased EU-dictated harmonization would not, strictly speaking, be wrong, but by overlooking the diverse consequences of negative integration and the complex mechanisms and triggers of positive integration, it would grossly misunderstand the case law's true effects.[49] The Court's role may be better described as overruling Member States' value choices for its own and creating a framework for re-regulation than leading to either deregulation or re-regulation per se.[50]

The dynamic model is obviously more sophisticated, inasmuch as it takes the existence of a federal or quasi-federal system as a relevant consideration in attempting to identify the effects unleashed by the market freedoms. However, it is still insufficiently contextualized, taking as a given the existence of an ideal federal system without looking into the specific characteristics of the EU. Any complex market system effectively requires the establishment of a system of rules that ensures at least a minimum degree of order and security, allowing for the enforcement of market arrangements. Rules promote and facilitate certain kinds of exchange, but may also raise costs or prevent other types of exchange.[51] As Deakin stated:

> All markets rest on institutional foundations. These "rules of the game" are not solely concerned with protecting existing markets, by enforcing contracts and penalizing collusion. At a more basic level, they constitute markets by defining the elements of

[48] *See* Kalypso Nicolaïdis, *Mutual Recognition of Regulatory Regimes* 2–14 (Jean Monnet Working Papers, 1997). Even if it may, occasionally, lead to harmonization through regulatory competition, see Miguel Poiares Maduro, *So Close and Yet So Far: The Paradoxes of Mutual Recognition*, 14 J. EUR. PUB. POL'Y 814 (2007).

[49] On similar terms concerning international economic laws, see Alan O. Sykes, *Regulatory Competition or Regulatory Harmonization? A Silly Question?*, 3 J. INT'L ECON. L. 257 (2000).

[50] Stephen Weatherill, *Recent Case Law Concerning the Free Movement of Goods: Mapping the Frontiers of Market Deregulation*, 36 COMMON MKT. L. REV. 51 (1999).

[51] DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE, AND ECONOMIC PERFORMANCE 47 (1990). In effect, most systems require much more than this. *See* OGUS, *supra* note 33, at 16–28. On the other hand, in an ideal neoclassical world without information costs, rules would be largely irrelevant, as per the Coase Theorem.

> exchange, and in so doing inevitably frame the process of competition. The market for laws is no different.[52]

In particular, "pure" regulatory competition requires that all relevant products and production factors be equally mobile—or at least be able to credibly threaten to move—to a State which better meets their preferences, and that market failures be aptly dealt with.[53] This ideal framework does not actually occur in practice; since ideal parameters are almost never met, they cannot be assumed but must be assessed in each particular case.[54] Optimal results, even if their content could be agreed upon under ideal conditions, would not be reached in the real world.[55] The abstract model of regulatory competition is a heuristically useful device, but idealized abstract models, even in their more complex, dynamic versions, necessarily fail to identify some relevant characteristics of the institutional framework. For example, traditional regulatory competition debates focus on whether decentralization, ensuring regulatory heterogeneity, and protecting local peculiarities are preferable to centralization through judicial or legislative balancing. But should a market failure (re-)emerge in the EU by means of regulatory competition, it could be dealt with not only through harmonization, but also by ensuring that national standards of protection are equivalent through mutual recognition. Mutual recognition not only created the conditions for wider regulatory competition in the EU, but also set forth mechanisms to prevent the re-emergence of the market failures that national measures were dealing with in the first place.[56] Also, it is generally accepted that labor is far less mobile than capital in the EU, which would seem to indicate that centralized action might be required in this field because the requirements for the proper functioning of the market for rules on the free movement of workers are not met.[57]

II. Contextualizing Normative Debates

The taxonomy presented above of "ideal" models of European integration also constitutes a useful heuristic device that identifies different visions present in EU integration.

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[52] Deakin, *supra* note 35, at 440; *see also* Neil Fligstein, *Markets as Politics*, 61 AM. SOC. REV. 656, 658 (1996).

[53] *See* Deakin, *supra* note 35, at 442 (pointing out that Tiebout's work was an application of theories of general equilibrium typical at the time, where ideal conditions were assumed and institutional considerations ignored).

[54] Joel Trachtman, *Regulatory Competition and Regulatory Jurisdiction*, 3 J. INT'L ECON. L. 331, 332 (2000).

[55] On particular rules defining and limiting regulatory competition in the EU, see MADURO, *supra* note 8, at 133–35.

[56] *See* Deakin, *supra* note 35, at 452; *see also* Jacques Pelkmans, *Mutual Recognition in Goods and Services: An Economic Perspective, in* THE PRINCIPLE OF MUTUAL RECOGNITION IN THE EUROPEAN INTEGRATION PROCESS 92, 115 (Fiorella Kostoris & Padoa Schioppa eds., 2005).

[57] Johnston & Syrpis, *supra* note 33, at 392. For a general criticism of adopting any ideal measure for the EU as being based on unreal assumptions, see OGUS, *supra* note 33, at 100–01.

Simultaneously, we should acknowledge that, on its own, each model can be criticized as descriptively inapt, inasmuch as each fails to take into account some realities of EU integration, in particular those present in the other models.[58] The centralized constitutional model disregards that the Treaties merely provide the Union with a limited set of competences. The competitive constitutional model in its ordoliberal version ignores the fact that the Union does not have a strictly deregulatory bent, which is made clear by the existence of derogations to the Treaty freedoms and of harmonization competences attributed to the Union. In its regulatory competition guise, in turn, it fails to recognize both the relevance of the political goals of the Union beyond efficiency or market integration and the role of centralized rules in both creating the possibility of regulatory competition and remedying its defects. Finally, the de-centralized constitutional model sees the Treaties and the EU as little more than free-trade agreements, which is given the lie not only by the extent of Union's competences, but also by political developments, particularly since the Single European Act and the Maastricht Treaty[59].

Naturally, the descriptive limitations of these "ideal" models are at least partially the result of their purity. On its own, each normative "ideal" may still be valid and attractive. But we must question how helpful they may be in helping us find the normative underpinnings of market freedoms developed and applied in the real world. To begin with, while these models partially overlap, inasmuch as they agree on the desirability of some sort of European integration, they answer different questions concerning the nature of European positive and negative integration. This can be exemplified by bringing together these models with the different normative debates identified above concerning the scope of the market freedoms. The centralized constitutional model takes a position on the harmonization versus regulatory pluralism debate in favor of harmonization, and on the centralization versus decentralization debate in favor of centralization, but none on the deregulation versus economic agnosticism debate. The competitive constitutional model in its "ordoliberal" mode takes a position on the deregulation versus economic agnosticism debate in favor of deregulation, and on the centralization versus decentralization debate in favor of centralization, but none on the question of harmonization versus regulatory pluralism. In its "regulatory competition" variant, this model takes a position on the harmonization versus regulatory pluralism debate with a presumption in favor of pluralism, and on the centralization versus decentralization with a presumption in favor of decentralization, but does not take any express position on the deregulation versus economic agnosticism debate. Lastly, the de-centralized constitutional model takes a position on the deregulation versus economic agnosticism debate in favor of economic

[58] MADURO, *supra* note 8, at 109.

[59] Treaty on European Union (EU), Feb. 7 1992, 1992 O.J. (C191) 1, 31 I.L.M. 253.

agnosticism, and on the centralization versus decentralization debate in favor of decentralization, but on the harmonization versus regulatory pluralism, while it is arguable that it would favor regulatory pluralism,[60] it seems completely oblivious to the question of how regulatory competition may impact the relevant choice.

This partially overlapping pattern reflects the fact that, like the "ideal" models of European integration, the normative debates about the scope of the market freedoms—centralization versus decentralization, deregulation versus economic agnosticism, and harmonization versus regulatory pluralism—themselves overlap partially but are effectively autonomous. They are heuristic simplifications of a much more complex reality, developed to try to make sense of specific questions raised during the process of European integration that reflect the different cognitive frameworks available to those looking into those questions at the time.[61] This shows that the main problem of trying to find a single normative underpinning for the various tests proposed by the Court is that these tests are effectively no more than crude types of shorthand allowing courts and lawyers to pursue their activity, while carrying with them a multiplicity of possibly conflicting meanings and normative concerns.[62] To illustrate this, remember that broad tests are usually related to centralization, harmonization, and deregulation; while narrow tests, on the other hand, are associated with State autonomy, regulatory pluralism, and economical agnosticism. Concerning the ideal models of European integration, we have also pointed out that the centralized constitutional model can and is usually connected with broad tests; the de-centralized constitutional model tends to be associated with narrow tests; and the competitive constitutional model does not necessarily favor either a broad or a narrow test, even if its ordoliberal version was traditionally associated with broad tests, while its regulatory pluralistic version was associated with narrow, economically agnostic tests. In short, this means that tests are adopted as reflections of specific positions in each of the centralization versus decentralization, harmonization versus regulatory pluralism, and deregulation versus economic agnosticism debates; and they are usually also used as projections of a certain "ideal" model of European integration. However, as we have seen, these debates are autonomous, and they only partially match the "ideal" models of

[60] This seems to be because this model expressly defends the maintenance of the maximum State autonomy possible, and the different normative debates focus precisely on the impact of negative integration on State autonomy.

[61] On the concept of cognitive frameworks as interpretive systems through which individuals process information and make sense of their experiences, see KARL E. WEICK, MAKING SENSE OF THE ORGANIZATION (2001). For a review of current research on this topic, see Judith A. Howard & Daniel G. Renfrow, *Social Cognition*, *in* HANDBOOK OF SOCIAL PSYCHOLOGY 262–69 (John Delamater ed., 2006).

[62] This is related to the indeterminacy of any concept. As remarked by Joseph Raz, explanations such as normative theories may strive to replicate the indeterminacies of the concepts they explain, but it is almost impossible to achieve a perfect replication. *See* Joseph Raz, *The Problem of Authority: Revisiting the Service Conception*, 90 MINN. L. REV. 1003 (2006).

European integration. The result is that tests carry different, sometimes conflicting, normative concerns.

This mix of normative foundations is further complicated by the fact that the institutional context matters for the normative connotations of each test. Should the context change, someone's position concerning the relevant test could change as well, even if the underlying normative position did not. For example, broad limits to national regulation can be argued in favor of either a nationally deregulated or a European re-regulated market. This means that some supporters of deregulation would support broad tests because they saw them as leading to the advancement of economic liberalization, while those same tests could also be defended by someone who would favor them as a means to centralization—say, as a proponent of a unified European State—but did not care particularly about the level of regulation in the internal market. Ordoliberals and proponents of a centralized European State could find common ground when most or all regulation was produced at State level and the EU's political process was blocked. But when Treaty amendments resuscitated the EU's political process and started propounding a European social model, leading to an increase in EU legislation, ordoliberals might have found that deregulatory approaches could be more successfully pursued at the national level and started to support a restrictive reading of the market freedoms, while centralizers would have suddenly found themselves in the company of proponents of a well-regulated market in supporting a broad test.

This shows that debates on judicially activity are related to, and influenced by, the overall context in which the Court operates. This can be seen, for example, in the change from a deregulation-based to a regulatory, competition-based debate. With the Single European Act and the Maastricht Treaty, the channels for re-regulation at EU level were facilitated, and a multiplicity of EU legislation started being produced; furthermore, the Court itself explicitly disavowed that the market freedoms had a purely deregulatory purpose in *Keck and Mithouard*.[63] Since a broad test was suddenly no longer susceptible to being expressly used as an ordoliberal tool while also becoming much more susceptible to creating EU-wide rules, the regulation versus deregulation debate changed into focusing on whether harmonized rules should be adopted or not, and in particular on whether regulatory competition—with its potential deregulatory effect—or EU-wide harmonization were to be preferred.[64]

[63] *See Keck*, 1993 E.C.R. I-6097; Case C-276/91, Comm'n v. French Republic, 1993 E.C.R. I-4413 n.30, paras. 13–17.

[64] This would explain the recent dearth of normative arguments for using the market freedoms as de-regulatory tools compared to the pre-Maastricht era. *See, e.g.*, Manfred Streit & Werner Mussler, *The Economic Constitution of the European Community*, 1 EUR. L.J. 5 (1995). On the impact of *Keck*, see Case C-292/92, Hünermund v. Landesapothekerkammer Baden-Wurttemberg, 1993 E.C.R. I-6787 n.29 (Advocate General Tesauro's Opinion); *infra* notes 108–11.

Specific approaches thus seem to be sustained by a coalition of persons and agents with different normative agendas coalescing around a test in a specific context. Underlying each normative concern is a theory—on protecting international trade, on the constitutional division of competences in the EU, or on the appropriate level of regulation in the market—that is a heuristic simplification of reality requiring transposition into legal criteria through the judicial interpretation and application of rules. Different normative goals will tend to be compatible in certain settings, and will give rise to coalitions of proponents for a common approach even though those proponents have disparate normative concerns, but the world may change, and it might be found that apparently compatible goals are in fact contradictory after all. In other words, the same test can be used to defend completely different, usually unrelated, and sometimes contradictory normative concerns. Defending a specific normative position in terms of the test to be adopted by the Court ignores the limitations of a specific formula in encapsulating a whole normative theory. More importantly, it also prevents a reflection on how multiple normative concerns interact in practice, leading to a misunderstanding of the case law, inasmuch as it ignores other relevant historical and institutional settings under which a decision was adopted by focusing on the supposed economic or ideological factors found in the case law.

E. Towards a Context-Sensitive Concept of Restriction?

This section contextualizes the normative debate on the concept of restriction of free movement by placing that debate within a specific institutional environment. It will not suggest what that concept should be, nor will it try to sketch a full picture of how a contextualized approach might look, which would require a full-fledged book. It will merely try to demonstrate that adding some institutional considerations to the picture helps make sense of the overall normative debate, and actually enriches it.[65] I do not propose to provide a comprehensive list of relevant institutional constraints, but merely an illustration of the insights that can be provided by taking some oft hem into account. For definitional purposes, institutional constraints are those constraints in a certain time and space arising from the existence of:[66]

> • Rule-systems, or institutions per se. These include formal rules, such as constitutions, statutes, common law, regulations and even contracts; but they also include informal rules, such as: "(1) extensions, elaborations and

[65] In using the concept of institutional consideration, I follow Howard B. Kaplan, who argues that the measure of a concept is not its truth, but its usefulness in relating data to each other and in orienting the researcher to profitable modes of gathering and organizing the data. *See* Howard B. Kaplan*, The Concept of Institution: A Review, Evaluation, and Suggested Research Procedure*, 29 SOC. FORCES 176 (1960).

[66] I here follow the systematization developed by Sweet, Sandholtz and Fligstein. *See* Sweet & Fligstein, *supra* note 15, at 6–8.

> modifications of formal rules; (2) socially sanctioned norms of behavior; and (3) internally enforced standards of conduct."[67] Informal rules tend to be disregarded in legal discussions, but they are arguably as important as formal rules (if not more), containing socially transmitted information resulting from a common culture. Local cultures contain cognitive elements which allow for the definition of social relationships and the creation of interpretative frameworks rendering meaningful to actors the actions of others while letting them interpret their own position in social relationships.[68] Informal rules are instrumental to the existence of these shared cognitive frameworks by providing the structure in which social interaction occurs, and they make purposive action possible by providing individuals with a framework of shared expectations.[69]
>
> • Organizations, meaning groups of individuals more or less formally constituted in specific times and places that pursue a set of collective purposes. They coordinate between individual actors and the rule setting in which they operate;
>
> • Actors, or those individuals who act with some purpose in mind within a specific institutional framework.

The starting point of this exercise is to acknowledge that the Court is a very specific kind of organization. Like other judicial bodies, the Court is simultaneously empowered and constrained by both formal rules—the Treaties and the Court's specific procedural rules—and informal rules. These rules constitute the framework of constraints and opportunities for actors who want to enhance their social, economic, or political positions.[70] On the other hand, the Court is a skilled social actor, able to

> generate or manipulate frames that make sense of institutional or policy problems and offer persuasive solutions. Frames can help mobilize cooperation among diverse actors by linking their interests and identities to a set of ideas—symbols, theories, models—that allow for further institutional development. We see skilled action, and sometimes new frames, in many situations, such as [when] the

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[67] *See* NORTH, *supra* note 51, at 40; *see also* Fligstein, *supra* note 52, at 658.

[68] *See* NEIL FLIGSTEIN, THE ARCHITECTURE OF MARKETS: AN ECONOMIC SOCIOLOGY OF TWENTY-FIRST CENTURY CAPITALIST SOCIETIES 15 (2001).

[69] *See* Edward L. Rubin, *The New Legal Process, the Synthesis of Discourse, and the Microanalysis of Institutions*, 109 HARV. L. REV. 1393, 1414 (1996). On the concept of cognitive frameworks, see *supra* sources cited note 51.

[70] *See* Sweet & Fligstein, *supra* note 15, at 10.

> Court finds principles of mutual recognition in the Rome Treaty.[71]

This description of the Court goes beyond the traditional legal perspective that distinguishes between political and judicial domains, and acknowledges the Court's role as a rule-maker. In effect, when trying to understand how different normative positions end up coexisting in the same judicial test in the first place, it is fundamental to understand that the choice between these normative positions is a political act of the utmost importance, implying value judgments with constitutional implications. The Court was set as the authoritative interpreter of EU law in the Treaty of Rome, many of the original provisions of which were very loosely worded in order to enable political agreement, and is thus empowered to judicially clarify the rules ex post.[72] Furthermore, for a long time the Court operated in an environment where EU rules had to be adopted by unanimity.[73] Even today, the reversal by political means of the Court's interpretation of Treaty articles can be achieved only by Treaty amendment, allowing the Court to develop Treaty provisions, and particularly the market freedoms, in such a way that their study is now to a large extent the study of the relevant case law.[74] This rule governing the reversal of the Court's interpretations of the Treaty is a weak form of control favoring the Court's dominance over the constitutional development of the EU, particularly in light of the limited threat posed by other potential court-curbing mechanisms.[75]

Counterbalancing this is the fact that the Court's decisions have to be applied by national courts and administrations. In effect, it does not matter what the Court may say if its decisions are not followed.[76] As Weiler once noted:

> Constitutional actors in the Member States accept the European constitutional discipline not because, as a matter of legal doctrine, as is the case in the federal state, they are subordinate to a higher sovereignty and authority attaching to norms validated by the federal

[71] *See id.* at 12.

[72] *See* Takis Tridimas, *The Court of Justice and Judicial Activism*, 21 EUR. L. REV. 199, 204 (2006).

[73] *See* CHALMERS ET AL., *supra* note 47, at 20–21.

[74] FRITZ SCHARPF, LEGITIMACY IN THE MULTI-LEVEL EUROPEAN POLITY IN THE TWILIGHT OF CONSTITUTIONALISM? 93 (Martin Loughlin & Petra Dobner eds., 2010).

[75] Such as withdrawing resources, jurisdiction stripping, court packing, and judicial selection and reappointment, which all face the same difficulties as those inherent to overriding Court decisions. *See* R. Daniel Kelemen, *The Political Foundations of Judicial Independence in the European Union,* 19 J. EUR. PUB. POL'Y 43 (2012).

[76] *See* KAREN ALTER, THE EUROPEAN COURT'S POLITICAL POWER 92–109 (2009).

> people, the constitutional demos. They accept it as an autonomous voluntary act, endlessly renewed on each occasion . . . [t]he French or the Italians or the Germans are told: in the name of the peoples of Europe, you are invited to obey . . . [t]his process also operates at the Community level. Think of the European judge . . . who must understand that, in the peculiar constitutional compact of Europe, his decision will take effect only if obeyed by national courts . . . . This, too, will instill a measure of caution and tolerance.[77]

Since it is the Court's legitimacy, and that of EU law, that generally ensures the cooperation of national courts and administrations—alongside the empowering effect EU law has on lower courts that are granted a prima facie legitimate tool with which to contradict higher courts and national legislatures—concerns about this legitimacy feed into the institutional incentives for the Court to strictly abide by the commonly accepted precepts of legal reasoning.[78] It is a common understanding of a shared "story" about the contents and existence of a legal order which makes such an order authoritative within a community; similarly, it is the abeyance to social practices and shared understandings by a legal community, which is in turn in accordance with the more general common understanding of what is legitimate law, that determines what and how judges can legitimately decide.[79] If courts, and particularly higher courts, can generate and manipulate the institutional frames in which they operate, the way they do so is effectively constrained by that same institutional framework. Judicial decisions are not valid because they are issued by a judge, but because they are issued by a judge within a specific setting in a duly reasoned manner.[80] In this cognitive setting, judicial decisions are arrived at through deliberation and analogical reasoning and presented as relatively redundant, self-evident, incremental extensions of available legal materials. Control of whether the relevant parameters of legal reasoning have been complied with in a legal decision is ensured by the interactive nature of law practice. Such control takes place both ex ante, because cases are brought and argued before courts by lawyers trained in and imbued with the spirit and grammar of

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[77] *See* Joseph Weiler, *In Defence of the Status Quo: Europe's Constitutional Sonderweg*, *in* EUROPEAN CONSTITUTIONALISM BEYOND THE STATE 7, 21–22 (Joseph Weiler & Marlene Wind eds., 2003).

[78] *See* KAREN ALTER, ESTABLISHING THE SUPREMACY OF EUROPEAN LAW (2003). This is not to say that all that motivates lower courts is legitimate legal reasoning and concern for the law; there are a number of empirical studies pointing to lower courts referring questions when they hope it will help reverse national rules and refusing to do so when they wish to shield national systems. *See* LISA CONANT, JUSTICE CONTAINED: LAW AND POLITICS IN THE EUROPEAN UNION 86–87 (2002).

[79] *See* Gerald Postema, *Implicit Law*, 13 L. & PHIL. 361, 369–71 (1994).

[80] Adjudication is thus a device giving formal and institutional expression to reasoned argument. *See* Lon Fuller, *The Forms and Limits of Adjudication*, 92 HARV. L. REV. 353, 366 (1978).

a specific legal community, and ex post, through systems of appeal and as a result of criticisms from an interpretive community recognizing a number of commonly accepted parameters as to the correctness of legal interpretation.[81]

The above elements represent the constraints usually identified in the literature as interacting to determine the institutional ability of the Court's adjudicative process (i.e., the institutional barriers to the overturning of the Court's decisions, how those decisions empower national courts against national administrations, and the Court's need to operate within the accepted parameters of legal reasoning).[82] The fact that, to a large extent, the Court creates EU law, regulates litigants' access to it, and makes decisions subject only to a weak form of political control, creates a "zone of discretion" where it can operate.[83] But even within this zone, the Court must operate in a specific environment which limits its discretion through formal and informal constraints, such as the fact that the Court must operate under the "mask of law."[84] One way to minimize the implicit political impact of judicial decision-making within this institutional environment is for courts to focus narrowly on the outcomes of individual cases, producing "incompletely theorized agreements on particular outcomes."[85] These will be solutions which are acceptable on results and on low-level principles without expressly taking sides in large-scale controversies, setting forth rules of such limited normative content that individuals with different normative backgrounds may agree to them, but also strong enough for any discussion abiding by them to be acknowledged as rational and therefore legitimate by the ideal (legal) audience.[86] If adopting certain normative positions implies taking sides on potentially controversial issues of constitutional importance, one should not be surprised to find the Court eschewing fully theorized decisions while leaning heavily on anchors to its legitimacy, such as abiding by recognized forms of legal reasoning and devotion to precedent, in order to ensure its decisions are found persuasive and obeyed by the relevant agents.

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[81] *See* Gerald Postema, *"Protestant" Interpretation and Social Practices*, 72 L. & PHIL. 283, 310–12 (1987). For the EU, see Ham Schepel & Rein Wesseling, *The Legal Community: Judges, Lawyers, Officials and Clerks in the Writing of Europe*, 3 EUR. L. J. 165 (1997).

[82] *See* CONANT, *supra* note 78, at 38–45.

[83] *See* ALEC STONE SWEET, THE JUDICIAL CONSTRUCTION OF EUROPE 23–26 (2004).

[84] Walter Mattli & Anne-Marie Slaughter, *Constructing the European Community Legal System from the Ground Up: The Role of Individual Litigants and National Courts* (Jean Monnet Center, Working Paper No. 6/96, 1996); *see also* Alec Stone Sweet, *The Politics of Constitutional Review in France and Europe*, 5 INT'L J. CONST. L. 69, 79 (2007).

[85] *See* CASS SUNSTEIN, LEGAL REASONING AND POLITICAL CONFLICT 4–5 (1996).

[86] *See* Owen Fiss, *Objectivity and Interpretation*, 34 STAN. L. REV. 739, 743–45 (1982); *see also* ROBERT ALEXY, A THEORY OF LEGAL ARGUMENTATION: THE THEORY OF RATIONAL DISCOURSE AS THEORY OF LEGAL JUSTIFICATION 19, 288 (Ruth M. Adler & Neil MacCormick trans., 1989).

The relevance of taking these institutional constraints into account in order to produce a better descriptive model of the concept of restriction is exemplified by reference to mutual recognition. Mutual recognition is usually ignored as such in debates about the concept of restriction, being either associated with normative theories advocating broad, obstacle-based tests, in particular economic due-process clauses,[87] or with narrow tests, such as discrimination-based approaches.[88] Concerning the latter, it should be noted that discrimination is associated with purely anti-protectionist clauses, but that mutual recognition eliminates obstacles to trade which go well beyond the traditional conception of a liberal trade regime. In effect, the "dual-burden" thesis is wholly alien to classic trade law: it requires the assumption, unnecessary under classic trade law, that a set of regulations in a State provides adequate protection for consumers in a second State. This means, innovatively, that obstacles resulting from disparate rules restrict free movement and can be challenged. Mutual recognition effectively increased the scope of measures deemed to have a detrimental effect on intra-Union trade way beyond the traditional normative scope of discrimination tests. But even the most extreme form of mutual recognition—a country-of-origin principle requiring all goods produced in accordance with home-State rules to be able to be sold in host-States regardless of the latters' national rules—, does not lead to the extreme centralization of powers in the EU and its courts that results from the adoption of an economic due-process clause—which requires virtually all national rules to be subject to review by courts, which will then assess whether their restrictive effect on free movement is justified.

Mutual recognition is better understood as an under-theorized judicial tool that refuses to decide between opposing normative concerns while producing a pragmatic solution acceptable by all parties on the facts. Nonetheless, it is arguable that, descriptively, the application of the mutual recognition test led to an economic due-process clause, at least in the field of goods.[89] Is this an argument for the normative underpinning of mutual recognition being the same as for economic due-process clauses? The answer is: Not really. The reality is more complicated than that.

For purposes of access and rationalization of the case law, participants in a legal community will tend to develop propositions that will serve as classification devices framed in such a way as to explain the underlying logic of previous case law and predict the

[87] Understandable, since both mutual recognition and the economic due-process clause originated in the same two cases. *See* Case 8/74, Procureur du Roi v. Benoît and Gustave Dassonville, 1974 E.C.R. 837; *Cassis de Dijon*, 1979 E.C.R. 649.

[88] Marenco, *supra* note 28.

[89] Starting with the evolution from *Cassis de Dijon* to the *Sunday Trading* cases, see Case 145/88, Torfaen Borough Council, 1989 E.C.R. 765 [hereinafter *Torfaen*]; Case C-312/89, Union Departmentale des Syndicats CGT de L'Aisne v. Sidef Conforama, 1991 E.C.R. I-00997; Case C-332/89, Beglium v. Marchandise, 1991 E.C.R. I-1027; Joined Cases 60/84 and 61/84, Cinéthèque SA v. Federation Nationale des Cinemas Francaises, 1985 E.C.R. 2605.

outcome of hypothetical future cases.[90] This, however, only holds if the legal system develops a principle akin to stare decisis by adopting a case-by-case adjudication method.[91] This is arguably the situation the Court finds itself in regarding the market freedoms.[92] The empowerment of the Court was, to a large degree, a story of the correlated empowerment of private litigants to plead in EU law: legal actors had to be able to identify the type of dispute in which they were involved, the potentially applicable legal rules, and the consequences of their application. Argumentation frameworks provided a measure of stability and certainty allowing for this.[93] Even in the absence of a formal stare decisis rule, legal principles vaguely defined by the Court were then given full effect in decisions following those in which they were first identified, thereby grounding them in settled precedent.[94] This reflects not only the Court's tendency to adopt incompletely theorized outcomes but also the tension between the judge's law-making role and the need for certainty and law-abeyance, which the existence of precedent helps resolve: precedent arises as an inherently legal constraint on discretion and law-making while also allowing judges to portray their decisions as self-evident, redundant, deductive extensions of pre-existing law.[95] Thus, incomplete theorization of decisions leads to a case-by-case adjudicative strategy which has the advantage of assuaging misgivings about granting too much discretion to courts by hiding and minimizing the impact of the exercise of that discretion. At the same time, precedent effectively entrenches the jurisdiction a court may have obtained by deciding a previous case, by both providing a reason for such powers and restricting the reasons which can be used by its opponents.[96]

This is not without its consequences, as precedent-based systems tend to be path-dependent.[97] Legal rules gradually build upon one another over time, with the consequence that an earlier decision influences the later decisions of courts. A cognitive framework favoring precedent and allowing for path-dependency generates adaptive expectations with litigants arguing within the bounds of existent law. Simultaneously, it

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[90] *See* GEORGE CHRISTIE, PHILOSOPHER KINGS? 133–34 (2011)

[91] *See id.* at 132.

[92] On how the Court, even though not de jure bound by precedent, mainly acts as if it was in practice, see ANTHONY ARNULL, THE EUROPEAN UNION AND ITS COURT OF JUSTICE 627 (2006).

[93] *See* SWEET, *supra* note 83, at 35.

[94] *See* MADURO, *supra* note 8, at 10, 20.

[95] *See* SWEET, *supra* note 83, at 10.

[96] In the US context, see Barry Friedman & Erin F. Delaney, *Becoming Supreme: The Federal Foundation of Judicial Supremacy*, 111 COLUM. L. REV. 1137, 1188–92 (2011).

[97] For a discussion of different models of path-dependency, see Oona A. Hathaway, *Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System*, 86 IOWA L. REV. 601, 606–23 (2001).

may also give rise to positive feedback for certain lines of case law by creating incentives for potential beneficiaries of new precedent to push the law further in certain directions.[98] This can be said to lead to three autonomous, if not interconnected, phenomena which are observable in the case law of the Court.[99] The first phenomenon is non-ergodicity, meaning that the development of the case law is not necessarily incremental and that not all developments are equally likely, but that instead small, early events can have a disproportionate impact on the eventual direction the case law takes. In short, apparently irrelevant decisions may have large, unexpected consequences.[100] The second effect is lock-in, or inflexibility.[101] Once the Court has taken a decision on a legal question, precedent and other informal rules lock in that legal rule, even if there are ways for judges to eschew precedent within the accepted scope of judicial reasoning, such as relying on different precedents, on linguistic imprecisions, and on factual distinctions.[102] The third consequence is indeterminacy of outcome:[103] A decision choosing between different solutions which were possible at an initial stage is adopted on the basis of imperfect information as to its consequences and ends up affecting the subsequent development of the case law.[104] Even if a certain line of case law has been kick-started by accident, or as a result of work pressure, lack of communication between different chambers, or of genuine disagreements within the Court, path dependence and lock-in are still bound to kick in.

Moreover, the path adopted will depend on the type of questions reaching the Court, and this will in turn depend on who the litigants are and what questions the referring courts decide to send the Court. Litigants will usually be those who can prospectively benefit from the case law and possess sufficient resources to spend in litigation. It is to be expected that the existence of different rates of participation and representation of interests in litigation will push the case law in a direction that benefits repeat players who have both the means and the incentives to participate in it. In this regard, it has been noted that the Court serves as a battleground for States, corporate actors—particularly the wealthier industry players—and societal interest organizations, a result of their resources

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[98] *See* SWEET, *supra* note 83, at 35, 627–30. On the role of litigants in shaping the development of the European economic freedoms, see MADURO, *supra* note 8, at 25.

[99] Susanne K. Schmidt, *Who Cares About Nationality? The Path-Dependent Case Law of the ECJ from Goods to Citizens*, 19 J. EUR. PUB. POL'Y 8, 10 (2012); *see also* Hathaway, note 97, at 630–34.

[100] *See* Hathaway, *supra* note 97, at 629–30.

[101] *See id.* at 631–32.

[102] *See* Clayton P. Gillette, *Lock-In Effects in Law and Norms*, 78 B.U. L. Rev. 813, 824–25 (1998); *see also* Hathaway, *supra* note 85, at 624–25.

[103] *See* Hathaway, *supra* note 85, at 633–634.

[104] On the fitness of these phenomena to describe the evolution of the case law on the market freedoms, in particular the free movement of goods, see SWEET, *supra* note 83, at 118–44.

and organizational capacity to pursue litigation and obtain information on EU law when compared with other groups pursuing diffuse and widely distributed interests.[105]

This model seems to fit the development of the case law and the transformation of mutual recognition in *Cassis* into an economic due-process clause. In *Cassis*, the outcome was an incompletely theorized mix of traditional normative ideas about anti-protectionism and innovative ideas about European integration. This decision was rationalized in accordance with certain classificatory frameworks ex post by the European Commission,[106] by legal academics, by potential litigants, and finally by the Court itself when deciding similar cases. The case law developed from a relatively small change of the traditional anti-protectionist underpinnings of the law in *Cassis,* and became locked in in subsequent cases.[107] Nonetheless, the case law was still normatively under-theorized, allowing litigants to argue, and the Court to conclude, that a judgment such as *Cassis* requiring that national measures preventing the sale of products coming from one State in another State on the basis of non-compliance with the latter's product requirements further implied that all national measures prohibiting the marketing of certain products, regardless of them being imported or not, needed to be justified.[108] Subsequently, this development allowed fort he Court to move on to the conclusion that any measure which could potentially restrict the volume of sales of imported and domestic products alike was a restriction unless justified,[109] and thereby to turn from mutual recognition into an economic due-process clause.[110]

More than any specific normative underpinning, these developments can be seen as a result of litigants arguing within the bounds of existing law, with the potential beneficiaries of new precedent generating further positive feedback by following through on incentives to push the law within a context of normative under-determination towards broader tests. A similar observation can be made for the development of the market access test in *Alpine*[111] and its subsequent drift into something akin to an economic due-process

[105] *See* CONANT, *supra* note 78, at 21, 28–29.

[106] See, famously, Communication from the Commission concerning the consequences of the judgment given by the Court of Justice on 20 February 1979 in *Cassis de Dijon* and the Commission's White Paper, *Completing the Internal Market* (1985)

[107] For a famous example, see Case 178/84, Commission v. Germany, 1987 E.C.R. 1227, the so-called "German beer purity law" case.

[108] Joined Cases 60/84 and 61/84, Cinéthèque SA v. Federation Nationale des Cinemas Francaises, 1985 E.C.R. 2605, *see also* cases cited *supra* note 89.

[109] *See* Case 145/88, Torfaen Borough Council, 1989 E.C.R. 765, para. 12.

[110] As acknowledged by the Court in *Keck*, 1993 E.C.R. I-6097 at paras. 13–14.

[111] Case C-384/93, Alpine Investments, 1995 E.C.R. I-01141.

clause,[112] and for the case law on goods post-*Keck.*[113] It is perhaps arguable that the reason why the case law seems to evolve towards broader tests is that the entities more likely to plead on the basis of the market freedoms are those benefitting from increased inter-State movement and economic freedom and also have the means to pursue their preferences in the adjudicative arena. Not all possible paths are, after all, as likely to be followed: litigants only follow those paths that are likely to benefit them. Those entities enjoying direct benefits from free movement are more likely to plead in court and try to extend those benefits. Simultaneously, it is arguable that the costs of increased free movement are likely to be diffuse, with those suffering from reduced freedom of movement not having sufficient incentives to start judicial actions. Such diffuse costs are arguably better addressed by political processes, and particularly by States; hence, the relevant interests would tend to be protected through national laws. And even if States reflect these interests by intervening in procedures before the Court to try to limit what they perceive to be unjustified extensions of the market freedoms, these interventions are merely reactive and are not the same as consistent attempts to advance stricter tests *motto proprio*. If this description of the existing system of judicial incentives is accurate—and it is at the very least consistent with findings that corporations, public interest groups, and enforcement agencies tend to be repeat players in starting legal procedures under the market freedoms[114]—it points toward a situation where a stream of cases arguing for the market freedoms' extension will take place without any equivalent counterbalancing pressure at the judicial level other than those resulting naturally from the institutional environment in which the Court operates.

This focus on path dependence need not blind us to the role of the law and legal communities in creating a cognitive framework, and on the impact of that framework in the development of the law independently from path-dependency. Normative theories rationalizing the case law influenced developments in free movement law by providing greater levels of theorization in the form of normative and explanatory theories to the concept of restriction to free movement, which could then be adopted—alongside theories of normative unity or disunity of the freedoms and related requirements of systemic interpretation—by courts and litigants when deciding and pleading cases.[115] Normative theories and proposals can, in effect, be so relevant as to buck established path-dependencies. The case law on goods again provides a good example. The adoption of an

[112] *See, e.g.*, Case C-442/02, CaixaBank, 2004 E.C.R. I-08961.

[113] *See* Case C-265/95, Comm'n v France, 1997 E.C.R. I-6959.

[114] *See* CONANT, *supra* note 78, at 21, 28–29.

[115] For the most relevant examples of these theories, see Marenco, *supra* note 28 (discrimination); Gormley, *supra* note 27 (economic due-process); Eric L. White, *In search of the Limits to Article 30 of the EEC Treaty*, 26 COMMON MKT. L. REV. 235 (1989) (in setypological approaches); Stephen Weatherill, *After Keck: Some Thoughts on How to Clarify the Clarification,* 33 COMMON MKT. L. REV. 885 (1996) (market access).

economic due-process clause was subject to severe criticism from a normative standpoint.[116] The main question, as Advocate General Tesauro put it, was:

> Is Article [34] of the Treaty a provision intended to liberalize intra-Community trade or is it intended more generally to encourage the unhindered pursuit of commerce in individual Member States? . . . [The latter option] means that any measure which might potentially reduce the volume of trade, however minimally, would be prima facie a restriction on the free movement of goods . . . . [In the former option, on the other hand] the purpose of Article [34] [would be] to ensure the free movement of goods in order to establish a single integrated market, eliminating therefore those national measures which in any way create an obstacle to or even mere difficulties for the movement of goods; its purpose is not to strike down the most widely differing measures in order, essentially, to ensure the greatest possible expansion of trade.[117]

Following Advocate General Tesauro's lead, a number of tests were proposed with the goal of distinguishing between measures that merely reduce the economic attractiveness of pursuing a given activity and those measures that effectively restrict the free movement rights within the framework of the Treaty.[118] The Court eventually adopted one of these tests, first proposed by White and then seemingly followed by some Advocates General,[119] restricting the scope of the free movement of goods in *Keck and Mithouard*[120]. This test is built on a distinction implicit in some interpretations of *Cassis* between rules concerning product requirements—meaning "rules that lay down requirements to be met by [goods coming from other Member States where they are lawfully manufactured and marketed]

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[116] *See* Marenco, *supra* note 28; Bernard, *supra* note 6; *see also* White, *supra* note 115.

[117] *See Hünermund*, 1993 E.C.R. I-6787 at paras. 1, 10, 28 (Advocate General Tesauro's Opinion).

[118] *See* White, *supra* note 115; *see also* Kamiel Mortelmans, *Article 30 of the EEC Treaty and Legislation Relating to Market Circumstances: Time to Consider a New Definition?*, 28 COMMON MKT. L. REV. 11 (1991); Jo Steiner, *Drawing the Line: Uses and Abuses of Article 30 EEC*, 29 COMMON MKT. L. REV. 749, 769–72 (1992); *and* Norbert Reich, *The "November Revolution" of the European Court of Justice:* Keck, Meng *and* Audi *Revisited*, 31 COMMON MKT. L. REV. 459, 467 (1994).

[119] *See* White, *supra* note 115; *see also Torfaen*, *supra* note 89 (Advocate General van Gerven's Opinion); *Hünermund*, *supra* note 29 (Advocate General Tesauro's Opinion).

[120] *See Keck*, 1993 E.C.R. I-6097.

(such as those relating to designation, form, size, weight, composition, presentation, labelling, packaging),"[121] which were deemed restrictive regardless of being indistinctly applicable to national and foreign products alike—and rules concerning certain selling arrangements, which did not infringe the rules on free movement of goods unless they discriminated, in law or in fact, between the marketing of domestic and foreign products.[122] In the Court's view, measures that respect these principles "do not prevent access to the market, nor impede access any more than it impedes the access of domestic products."[123]

Keck was expressly presented as a reaction against litigant pressure towards an ever-expansive test and as a reversal of precedent, which indicates that this case was a retrenchment not due to institutional pressures such as prior precedent or pressure by litigants.[124] It is rather plausible that the Court may have been instead reacting to academic criticism by the legal community focusing on the lack of normative anchoring of the case law. This lack of normative anchoring may have led to concerns about the Court's ability to control its docket and about the increased scope of the Court's jurisdiction and possible reactions by politically powerful entities.[125] Normativity, in other words, does seem to have its pull.

On the other hand, a case such as *Keck* is not likely to create a positive feedback in what concerns litigation, with the result that the case law is likely to remain static or, as it arguably happened, renewed pressure for the extension of the free movement of goods will surface under new guises as litigants continue to try to increase the scope of their free movement rights.[126] This, alongside the decision's normative indeterminacy, can help explain the growing expansion of the scope of the free movement of goods in the post-*Keck* case law, which can be seen in: (1) the concept of product requirements being

[121] *See id.* at para. 15

[122] *See id*. at para. 16.

[123] *See id*. at para. 17.

[124] The Court stated that "[i]n view 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, the Court considers it necessary to re-examine and clarify its case law on this matter," before going on to decide that"contrary to what has previously been decided." *See id.* at paras. 14, 16.

[125] Arguably, the best (anecdotal) evidence that all of these elements had a role to play is that the Court reacted to increased academic and judicial criticism about its case law, particularly in light of being flooded with identical cases during the *Sunday Trading* saga, by adopting a theory which was advanced in an academic journal by one of the Commission's agents with the Court while justifying its actions as needed to check the amount of cases reaching its docket. To verify this empirically would be, assuming it is possible, outside of the scope of this study.

[126] *See* sources cited *supra* note 86; *see also* CONANT, *supra* note 78, at 19, 21–38; Schmidt, *supra* note 99, at 11.

extended beyond its original boundaries, to the point where it includes certain measures regulating the marketing of a product that may have an impact on its actual content or packaging;[127] (2) the use of discrimination in what concerns selling arrangements in an extremely controversial manner, such as when dealing with general restrictions on advertising or requirements of presence in local markets;[128] (3) the *Keck* typology being avoided in a variety of cases where it arguably did not fit the measures at issue,[129] such as rules on inspections of imported products,[130] restrictions on transport,[131] obligations to collect data for statistics[132] and State omissions[133]; and finally (4) a number of cases where the focus was on the effects of a measure instead of trying to apply the *Keck* typology[134]. Eventually, under pressure from systemic developments in what concerns the other market freedoms that had adopted a "market access" test as they developed from non-discrimination towards obstacle approaches, a number of recent decisions on restrictions on the use of goods implicitly acknowledged the overcoming of *Keck* by adopting an access to market test for goods as well.[135]

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[127] *See* Case C-315/92, Verband Sozialer Wettbewerb eV v. Clinique Laboratoires SNC et Estée Lauder Cosmetics GmbH, 1994 E.C.R. I-00317; *see also* Case C-470/93, Verein Gegen Unwesen in Handel und Gewerbe Koln eV v. Mars GmbH, 1996 E.C.R. I-1923; Case C-368/95, Vereinigte Familiapress Zeitungsverlags-ud vertirebs GmbH v. Henriech Bauer Verlag, 1997 E.C.R. I-3689; Joined Cases C-158/04 and C-159/04, Alfa Vita Vassilopoulos AE v Greece, 2006 E.C.R. I-8135 (arguably related).

[128] For restrictions on advertising, see Joined Cases C-34/95, 35/95, and 36/95, De Agostini, 1997 E.C.R. I-3843. *See also* Case C-405/98, Gourmet Int'l Products, 2001 E.C.R. I-1795; Case C-239/02, Douwe Egberts NV v. Westrom Pharma, 2004 E.C.R. I-7007. For requirements of presence in local markets, see Case C-254/98, Schutzverband v. TK-Heimdienst, 2000 E.C.R. I-151; Case C-322/01, Apothekerverband v. DocMorris NV, 2003 E.C.R. I-14887; Case C-141/07, Comm'n v. Germany, 2008 E.C.R. I-06935. *See also* Daniel Wilsher, *Does* Keck *Discrimination Make Any Sense? An Assessment of the Non-Discrimination Principle Within the European Single Market*, 33 EUR. L. REV. 3 (2008).

[129] For an instance where it did fit but the Court nevertheless ignored the typology, see Case C-337/95, Parfums Christian Dior BV v. Evora, 1997 E.C.R. I-6013. *See also* Case C-358/95, Tommaso Morellato v. Unita sanitaria locale (USL) n. 11 di Pordenone, 1997 E.C.R. I-1431.

[130] *See* Case C-105/94, Ditta A. Celestini v. Saar-Sektkellerie Faber, 1997 E.C.R. I-2971.

[131] *See* Case C-350/97, Wilfried Monsees v. Unabhangiger Versaltungssenat Fur Karten, 1999 E.C.R. I-2921.

[132] *See* Case C-114/96, Criminal Proceedings Against Kieffer and Thill, 1997 E.C.R. I-3629.

[133] *See* Case C-265/95, Comm'n v. France, 1997 E.C.R. I-6959.

[134] *See* Case C-189/95, Criminal Proceedings Against Franzén, 1997 E.C.R. I-5909.

[135] *See* Case C-110/05, Comm'n v. Italy, 2009 E.C.R. I-519; Case C-142/05, Mickelsson and Roos, 2009 E.C.R. I-4273; Case C-108/09, Ker-Optika bt v. ÀNTSZ Dél-dunántúli Regionális Intézete, 2010 E.C.R. I-____; *see also* Niamh Nic Shuibhne, *The Free Movement of Goods and Article 28 EC: An Evolving Framework*, 27 EUR. L. REV. 408, 411 (2002); Jukka Snell, *The Notion of Market Access: A Concept or a Slogan?*, 47 COMMON MKT. L. REV. 437, 460 (2010). For a more extensive discussion of the use of market access in what concerns goods, see my Pedro Caro de Sousa, *Through Contact Lenses, Darkly: Is Identifying Restrictions to Free Movement Harder Than Meets the Eye? Comment on* Ker-Optika, 37 EUR. L. REV. 79 (2012).

A retrenchment such as the one in *Keck* seems to be an outlier, and arguably it will tend to be so whenever a decision cannot lead to positive feedback in litigation. But if nothing else, it is an outlier that expresses the continuing relevance of normative considerations alongside institutional ones.

F. Conclusion

Arguing that adding institutional insights improves the descriptive adequacy of existing, purely normative models should not be understood as dismissive of those "pure" models. It is also not being argued that institutions must be considered to have normative value in themselves, even though that may very well be the case, as results from the imperatives of legal certainty and security arising from the mere existence of stable rules. What is being submitted is merely that, while classic legal normative theorization is relevant to the development of the law, the prevailing theories on this topic can be enriched by the addition of institutional insights. As we have seen, a variety of normative questions on the nature and course of European integration are implicit in the choice of any concept of restriction. On the other hand, there is no pre-determined best normative outcome that the Court must apply. When choosing a test, the Court arbitrates between various models of European integration, on which the Treaties provide no greater guidance than the goal of creating an internal market.[136] But there is nothing fixed about an internal market; most sovereign States have one, and the models vary as much as the patterns of regulation and centralization that underpin them differ. When Article 3(3) TEU sets about the creation of an internal market which is supposed to contribute, simultaneously, to balanced economic growth and price stability, a highly competitive social market economy, a high level of protection for and improvement of the quality of the environment, and social justice, *inter alia*, it should be clear that, apart from the different meanings which can be attributed to expressions such as a "competitive social market economy", the exclusive pursuit of one goal, such as economic growth, might undermine the achievement of goals of social justice or protection of the environment.[137] Their balancing, a task of the utmost political significance, is thereby required, but no information is provided as to the division of competences between the Member States and the EU or between the Court and the EU legislature in doing so.[138]

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[136] Treaty on the Functioning of the European Union, art. 26(2) December 2007, 2010 O.J. (C083) 1 ("The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties.").

[137] *See* Kamiel Mortelmans, *The Common Market, the Internal Market and the Single Market: What's in a Market?*, 35 COMMON MKT. L. REV. 101, 118 (1998).

[138] I thank Stephen Weatherill for having pointed this out to me.

From a descriptive standpoint, it follows the Court must choose between one of multiple and contentious normative views on what the EU and its internal market should be. If these normative views are contested, however, a preliminary question must be asked: Why should the Court make that choice to begin with? The answer to this question is comparative. Courts need not be perfect to be the preferable organization to make a certain political choice; they merely need to be better than any other institution available. Deciding when the Court should have jurisdiction is thus not a question that can be answered in the abstract: The specific context in which the Court operates is relevant; and what is more, that context not only changes, but it also does so by Court action, by reactions to such actions, and by autonomous initiatives of other relevant actors. The introduction of institutional elements into traditional normative debates on the concept of restriction enriches them not only by forcing them to look into other normative concerns disregarded by specific approaches, but also by incorporating realities that the Court, as a decision-making body, must face.

The Court operates in an institutional environment which might dispute the Court's assessment and react to it. The historical interaction between Member States, the Court, and other EU institutions and the result of tensions between positive and negative integration determines the on-going and ever-(slightly)-changing balance of powers in the EU. The level of regulation and the attribution of competences in the internal market is thereby the result of a discursive process between all the relevant institutional agents and the normative theories they defend over time. It is the very nature of this discursive process that may make the Court an apt forum to take decisions in certain situations but not in others. The Court is institutionally inept in taking into account all the relevant public interests in the way more representative political bodies can, but it may provide a forum for voices unable to be otherwise adequately represented in national and European political processes, and thereby serve an important corrective role to processes which are prima facie more representative.[139] The Court has formal legitimacy granted by the Treaties, but it cannot effectively impose its views on the rest of the European Union, since it is arguably its least dangerous branch.[140] Its institutional limitations may point towards the Court being a better comparative option for allocating competences between the relevant decision-makers, including itself, since those same limitations prevent it from obtaining excessive power as a result of the abuse of this role. And the Court's decisions, as incompletely theorized agreements, are not the last word in the development of European integration, but merely a voice in the conversation, which require, for procedural reasons, reasoned argument, and which usually lead to a possible consensus solution. This does not point to any specific concept of restriction, but it does allow the normative

[139] *See* MADURO, *supra* note 8.

[140] In the context of the Union, however, it is doubtful whether such a distinction should not be granted to the European Parliament.

approaches that purport to find such a concept to think contextually about how to better fit their proposals for what the law should be within their specific normative agendas.