ECJ confirms validity of ESM

Introduction

Today, in a rich judgment of 28 pages[1], the European Court of Justice (ECJ) confirmed the compatibility of the European Stability Mechanism (ESM) with EU law. This judgment marks the first time that the ECJ gave a landmark ruling on pivotal provisions of the law concerning Economic and Monetary Union (EMU)[2] since its judgments on the Stability and Growth Pact in 2004[3] and on the independence of the ECB in 2003[4].

Background

The ESM is the permanent 'bail-out' fund established by the Member States of the euro area. It is funded by capital contributions of the participating States. The ESM is to provide financing to governments that are unable to access financial markets on their own when such support is indispensable to safeguard the financial stability of the euro area as a whole and of its Member States. Financing from the ESM is subject to strict conditionality which ensures that the economic policy of the Member State is in line with the requirements under EU law. These requirements derive from the coordination of economic policies and from the Excessive Deficit Procedure, a Treaty-based mechanism intended to ensure fiscal discipline. In order to make clear that the establishment of a permanent financial support mechanism is compatible with the Treaty, an amendment to the TFEU was adopted by the European Council[5]. This amendment inserts a third paragraph to Article 136 TFEU, allowing Member States whose currency is the euro to establish a stability mechanism that can be activated if indispensable to safeguard the stability of the euro area as a whole, with any financial assistance granted to be subject to strict conditionality[6]. The ESM[7] is to succeed a temporary bailout fund, the European Financial Stability Facility (EFSF)[8], a special purpose vehicle established under Luxembourg law, as well as the temporary European Financial Stability Mechanism (EFSM)[9], established under Article 122(2) TFEU.

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[1] Case C-370/12 (*Pringle*), judgment of 27 November 2012, www.curia.europa.eu.
[2] Not counting the numerous judgments on the free movement of capital, a basic element of EMU.
[3] Case C-27/04 (Commission vs. Council), judgement of 13 July 2004, [2004] ECR I-06649.
[4] Case C-11/00 (*Commission vs. ECB*), judgment of 10 July 2003, [2003] ECR I-07147.
[5] European Council Decision of 25 March 2011 amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro (2011/199/EU), OJ L 91/1, 6 April 2011.
[6] The amendment reads as follows:
"3. The Member States whose currency is the euro may establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality."
[7] Treaty establishing Tthe European Stability Mechanism, 2 February 2012, at: http://www.european-council.europa.eu/media/582311/05-tesm2.en12.pdf.
[8] See: http://www.efsf.europa.eu/about/index.htm.
[9] Council Regulation (EU) No 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism, OJ L 118/1, 12 May 2010.

Questions before the ECJ

Today's judgment originated from a request by the Irish Supreme Court to interpret EU law[10]. The Irish court was faced, in appeal, by a challenge by an Irish MP of the ratification of the ESM Treaty. Mr. Pringle had gone to court in Ireland arguing that the amendment to the TFEU had not been adopted by the European Council according to the appropriate Treaty revision procedure. He also argued that ratification by Ireland of the ESM Treaty would violate provisions in the Treaties on EMU and confer on the institutions of the Union powers that were incompatible with their Treaty-given functions.

Main findings

ECJ can monitor legality of simplified Treaty amendment

The Treaty amendment was put forward on the basis of the simplified amendment procedure, provided for in Article 48(6) treaty on the European union (TEU)[11]. This procedure allows the European Council to amend provisions of TFEU on EU policies and internal actions (Part Three of the TFEU). The ECJ first establishes that it has jurisdiction to decide on the validity of this piece of Union law: a Decision of the European Council amending the TFEU. Even though the ECJ has no competence to rule on the validity of *primary law* (that is, the Treaties themselves), here a *decision by a Union institution* (the European Council) is at issue, i.e. secondary law. This act of secondary law has, of course, been adopted to amend primary law. The ECJ finds that it can monitor compliance with the Treaty amendment procedure laid down in Article 48(6) TEU. To that end, the Court is to establish that the procedural rules laid down in that provision have been followed, that the amendment concerns only the part of the TFEU that the European Council can amend through this simplified amendment procedure, and that the amendment does not increase the competences of the Union.

These preliminary proceedings did not circumvent the requirements for direct action for annulment

The ECJ then determines the admissibility of the request for a preliminary ruling because Ireland had claimed that Mr. Pringle should have brought a direct action for annulment of the European Council

[10] *Thomas Pringle v The Government of Ireland, Ireland and the Attorney General*, [2012] IESC 47, Supreme Court Record Number: 339/2012, 31 July 2012. See: http://www.supremecourt.ie/ (in English and Gaelic).

[11] Which reads as follows:

"*Simplified revision procedures*

6. The Government of any Member State, the European Parliament or the Commission may submit to the European Council proposals for revising all or part of the provisions of Part Three of the Treaty on the Functioning of the European Union relating to the internal policies and action of the Union.

The European Council may adopt a decision amending all or part of the provisions of Part Three of the Treaty on the Functioning of the European Union. The European Council shall act by unanimity after consulting the European Parliament and the Commission, and the European Central Bank in the case of institutional changes in the monetary area. That decision shall not enter into force until it is approved by the Member States in accordance with their respective constitutional requirements.

The decision referred to in the second subparagraph shall not increase the competences conferred on the Union in the Treaties."

Decision amending the TFEU. The Irish MP brought proceedings on 13 April 2012 against the Decision adopted on 25 March 2011, i.e. beyond the time-limit for a direct action for annulment. The ECJ confirms the right of any party to plead the invalidity of an act of the EU in proceedings before a national court and to request that court to put the issue of the validity before the ECJ (the only court that has jurisdiction to declare a Union act invalid). There is no circumvention of the direct action for annulment after the expiry of the time limit for bringing such proceedings under Article 263 TFEU as "it is not evident that [Mr. Pringle] had beyond doubt standing" to bring the direct action for annulment. Actually, Mr. Pringle very probably has no such standing.

Treaty amendment on ESM is valid as it does not encroach upon monetary policy competences….
The procedural question whether the Treaty amendment concerns the part of the TFEU that the European Council can amend by simplified procedure, is easily answered. Article 136 forms part of Part Three. But, the Irish Supreme Court also wanted to know whether the amendment encroaches upon the exclusive EU competence for monetary policy and on EU competences on the coordination of economic policies of the Member States.

The ECJ considers that the TFEU does not contain a definition of monetary policy and refers to the *objectives* rather than the *instruments* of monetary policy. It examines whether the objectives of the ESM and the instruments given to it fall within monetary policy, as described in the TFEU. The Court finds that the objective of the ESM, *to safeguard the stability of the euro area as a whole*, is clearly distinct from the objective of *maintaining price stability*, the primary objective of monetary policy. Admitting that "the stability of the euro area may have repercussions on the stability of the currency used within that area", the ECJ finds that "an economic policy measure cannot be treated as equivalent to a monetary policy measure for the sole reason that it may have indirect effects on the stability of the euro". Turning, then, to instruments, the ECJ reads the granting of financial assistance in the Decision amending the TFEU as the sole instrument. In a sentence that may become relevant for an assessment of the ECB's extraordinary crisis measures, the ECJ continues: "The grant of financial assistance to a Member State however clearly does not fall within monetary policy." The ECJ sees the ESM as complementary to the so-called 'six-pack', the raft of EU legislation to strengthen economic governance which the Court sees as "intended to consolidate macroeconomic stability and the sustainability of public finances". The Court considers the newly adopted legal acts and the TFEU provisions, notably those prohibiting monetary financing and the so-called no bailout clause (Articles 123 and 125) as "essentially preventive", with *reduction of the risk* of public debt crises as their objective, and contrasts this with the objective of the ESM, which is *management* of financial crises that may nonetheless arise. On the basis of the objectives of the ESM, its instruments and the close link between the ESM and the economic policy framework of the EU, the Court concludes that *the ESM falls within the area of economic policy*. A slight problem is the ECB Opinion on the draft

Decision amending the TFEU[12]. The ECB is to be consulted on Treaty amendments which imply institutional changes in the *monetary* area. The ECJ brushes this point away by saying that the European Council consulted the ECB on its own initiative and not because it is required to do so under Article 48(6) TEU and, anyway, a consultation of the ECB cannot affect the nature of the ESM. Thus, the Decision amending the TFEU and envisaging the establishment of the ESM does not affect the exclusive competence of the Union in the area of monetary policy for the <in> Member States.

…nor on economic policy competences of the Union

Having thus decided that the establishment of the ESM does not impinge on the Union's monetary policy powers, the Court continues with an inquiry into the EU's economic policy powers. It begins with a broad statement on the role of the Union in the area of economic policy. The ECJ sees this as "restrict[ed] to the adoption of coordinating measures". Doing so, the Court seems to overlook Article 122(1) TFEU which grants the Council a power to adopt measures appropriate to the economic situation. The Court furthermore interprets the economic policy provisions rather meekly, possibly undermining the far-reaching competences attributed under the economic governance legislation recently adopted (the aforementioned 'six-pack').

Ad hoc financial assistance versus a permanent mechanism – compliance with EU law

The ECJ then draws a distinction between *ad hoc* financial assistance, which the Union can give under Article 122(2) TFEU, and a more permanent mechanism. The ECJ sides with the European Council in finding this provision not an appropriate legal basis for the establishment of the permanent stability mechanism and it refers to the relevant recital of the Decision amending the TFEU[13]. The Court adds that "such action cannot be taken by the Union on the basis of [Article 122(2) TFEEU]". The ECJ finds that the Member States are entitled to conclude an agreement for the establishment of the ESM. It adds that the Member States may not disregard their duty to comply with EU law. After this shot across the bow for any future assessment of the so-called Fiscal Compact Treaty[14], the Court considers that the strict conditionality required under the newly added paragraph 3 of Article 136 TFEU will ensure that the ESM operates in compliance with EU law, notably with measures adopted in the context of economic policy coordination. Thus, the Court concludes that the Decision amending the

[12] Opinion of the European Central Bank of 17 March 2011 on a draft European Council Decision amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro (CON/2011/24), OJ C 140/8, 11 May 2011.

[13] "At its meeting of 16 and 17 December 2010, the *European Council* agreed that, as this mechanism is designed to safeguard the financial stability of the euro area as whole, Article 122(2) of the TFEU will no longer be needed for such purposes. The *Heads of State or Government* therefore agreed that it should not be used for such purposes." (italics added, RS) Note that this quote from recital 4 to Decision 2011/199/EU distinguishes between the *European Council* (the Heads of State or Government of the 27 Member States and the President of the European Commission) and the *Heads of State or Government* without the Commission President.

[14] Officially, the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, see: http://www.european-council.europa.eu/eurozone-governance/treaty-on-stability.

Treaty has been appropriately adopted under the simplified amendment procedure. In a few brief paragraphs, the ECJ then also finds that the amendment does not confer new competences on the Union.

Interpretation of EMU provisions of the TFEU

The Irish Supreme Court also wanted to hear the ECJ's interpretation of a long list of provisions of the TEU and the TFEU on EMU in order to establish whether these provisions preclude an <in> Member State from concluding and ratifying the ESM Treaty. The Irish Supreme Court further referred to the general principles of effective judicial protection and legal certainty.

The ECJ first throws out several of these requests for interpretation as inadmissible. The referring court gave so little explanation as to the relevance of the ECJ's requested interpretation to the outcome of the dispute before it, that the ECJ does not want to rule on the interpretation of Articles 2 and 3 TEU nor on the general principle of legal certainty.

The Court then gives an interpretation of (1) the provisions of the TFEU on the Union's exclusive competence for monetary policy and for the conclusion of an international agreement in an area of exclusive competence, of (2) the provisions on EU economic policy and of (3) TEU provisions on the obligation of loyal cooperation (*Gemeinschaftstreue*)[15] and on the institutional set-up of the Union, and on the general principle of judicial protection.

ESM Treaty does not infringe exclusive competence for monetary policy and for concluding international agreements in an area of exclusive competence

The ECJ finds that the activities of the ESM do not fall within the monetary policy of the EU. The ESM's purpose is to meet the financing requirements of Member States, not to maintain price stability, which is the primary objective of the Eurosystem, i.e. the ECB and the NCBs of the <in> Member States. Recalling what it said before, the ECJ states that any effect of the ESM's activities on price stability "is not such us to call into question" the finding that the ESM's role does not concern monetary policy. On the Union's exclusive competence to conclude international agreements that may affect common rules or alter their scope, the ECJ finds that Member States are prohibited from

[15] Article 4(3) TEU, which reads as follows:

"3. Pursuant to the principle of sincere cooperation, the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties.

The Member States shall take any appropriate measure, general or particular, to ensure fulfilment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union.

The Member States shall facilitate the achievement of the Union's tasks and refrain from any measure which could jeopardise the attainment of the Union's objectives."

concluding an agreement between themselves which might affect common rules or alter their scope. However, the ESM may not have such effects. The very fact that the EFSF was established outside the Union framework implies that the assumption by the ESM of the tasks conferred on its predecessor may not affect common rules of the Union, or alter their scope. The same holds for the assumption of temporary tasks of the EFSM. Furthermore, the EU can still grant *ad hoc* financial assistance on the basis of Article 122(2) TFEU. Reiterating its earlier finding that no provision of the Treaties confers a specific power to establish a permanent stability mechanism such as the ESM, the Court finds that the Member States are entitled to act themselves. Thus, by finding that there is no competence under the EU Treaties for a permanent stability mechanism, the Court permits its establishment outside the Union framework.

ESM Treaty does not infringe economic policy provisions of the TFEU

The ECJ also does not agree with the argument of Mr. Pringle that an amendment to establish the ESM "fundamentally subverts the legal order governing [EMU]" and is thus incompatible with EU law. The power of Member States to conclude an agreement for the establishment of the ESM is conditional upon the consistency of this agreement with EU law. The ECJ considers that the ESM is not concerned with economic policy coordination but constitutes a financing mechanism. It will be interesting to see how the Court assesses the Fiscal Compact Treaty, if it comes to this, in a subsequent case, having now spoken out that an agreement outside the Treaty framework needs to be consistent with EU law.

Conditionality: no coordination of economic policies but ensuring consistency with EU law

The ECJ finds the conditionality prescribed under the ESM Treaty not an instrument for the coordination of economic policies, but a mechanism to ensure that the activities of the ESM are compatible with the 'no bailout clause' and with economic policy coordination by the Union. The Court emphasises the express provision in the ESM Treaty that the conditionality should be fully consistent with economic policy coordination measures within the EU.

No inconsistency with prohibition of monetary financing

There is no inconsistency with Article 122 TFEU either, so the Court finds on the basis of scrutiny of its text. Similarly, establishing the ESM does not violate the prohibition of monetary financing, laid down in Article 123 TFEU. This provision is addressed to the ECB and the NCBs and, therefore, does not cover financial assistance by Member States.

No inconsistency with 'no bailout clause'

In 22 paragraphs, the ECJ elaborates that the ESM does not breach the 'no bail out clause' of Article 125 TFEU. The Court begins by saying that this provision "is not intended to prohibit either the EU or

the Member States from granting any form of financial assistance whatever to another Member State". A different reading of Article 125 would conflict with Article 122(2) which allows financial assistance to a State in difficulty caused by natural disasters or exceptional occurrences beyond its control. Also, the wording of the prohibition of monetary financing (Article 123 TFEU) is stricter than the 'no bailout clause'. The Court then examines the objective pursued by the 'no bailout clause'. It finds that its aim is to ensure that Member States follow sound budgetary policies. Article 125 "ensures that the Member States remain subject to the logic of the market when they enter into debt, since that ought to prompt them to maintain budgetary discipline". Compliance with discipline contributes to the attainment of a higher objective, namely the financial stability of the monetary union. The Court finds that Article 125 TFEU "prohibits the Union and the Member States from granting financial assistance as a result of which the incentive of the recipient Member State to conduct a sound budgetary policy is diminished". By thus interpreting the 'no bailout clause' according to its objective, the Court sets strict limits on the financing of State budgets by the ESM. Article 125 TFEU permits Member States to assist another Member State which remains responsible for its own commitments towards its creditors "provided that the conditions attached to such assistance are such as to prompt that Member State to implement a sound budgetary policy".

The ECJ then investigates whether the different forms of financial assistance that the ESM can give would apply assuming the debts of the recipient Member State, finding that this is not so. Rather, the financial assistance "amounts to the creation of a new debt, owed to the ESM by that recipient Member State, which remains responsible for its commitments to its creditors in respect of its existing debts". Also, the fact that financial assistance can only be obtained in case of *severe* financing problems and when it is *indispensable* to safeguard the financial stability of the euro area as a whole and of its Member States, whereas support is *subject to strict conditionality*, is relevant in this context. Neither does the provision in Article 25(2) ESM Treaty imply that one ESM member guarantees the debt of another member. (Article 25(2) ESM Treaty provides how to replenish a shortfall in an additional capital call due to non-payment by an ESM member. Other ESM members are called upon to provide the deficit but the member not paying in remains liable for its share.) Thus, the 'no bailout clause' does not preclude the conclusion or ratification of the ESM Treaty.

No other inconsistencies with EMU provisions

The ECJ equally rejects the other arguments of Mr. Pringle, finding that the establishment of the ESM does not infringe the provisions on EMU and indicating that the ESM Treaty ensures compliance with EU law by the permanent financial assistance mechanism.

Role of EU institutions under ESM Treaty acceptable

When it comes to the role of the institutions, which have been given functions under the ESM Treaty, the Court considers that the Commission and the ECB have been given duties that are consistent with its previous case law on the use of institutions outside the framework of the Union. Also, the role of the Court itself is consistent with the TFEU. The ECJ sees the allocation to itself of a dispute resolution function under Article 37(3) ESM Treaty as an agreement in advance, in respect of a whole class of pre-defined disputes, to submit to the jurisdiction of the Court pursuant to Article 273 TFEU. Here again, the Court's findings on the role of the institutions will be relevant for the assessment of their role under the Fiscal Compact Treaty.

Ratification of the ESM Treaty prior to amendment of the TFEU permissible

Finally, the Court finds that Member States were permitted to ratify the ESM Treaty prior to the entry into force of the amendment to the TFEU on the ESM. This amendment merely confirms the existence of a power possessed by Member States, and does not confer any new power on either the Union or the Member States.

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