NEWSLETTER NO. 44
THE GERMAN CONSTITUTIONAL COURT AGAINST THE ECB: A THORNY PRELIMINARY REFERENCE BEFORE THE COURT OF JUSTICE

1. Background

1.1. The German Constitutional Court is once again tackling the issue of limits of action of European Institutions, in light of the German federal system and European Union ("UE") Treaties.

With the decision published on 7th February 2014[1], concerning an appeal filed by representatives from the "*Die Linke*"[2] parliamentary group and tens of thousands of private citizens[3], the Court of Karlsruhe has submitted two *preliminary references* to the EU Court of Justice, expressing grave doubts on the compliance with EU law of the European Central Bank ("ECB") programme concerning the purchase of government bonds from distressed countries in the secondary market (Outright Monetary Transaction programme, "OMT".)

It is the first time that the German Constitutional Court has submitted a preliminary reference to the European Court pursuant to Art. 267 of the TFEU, overcoming its traditional reluctance to refer to "external" authorities for a centralised interpretation of EU laws on matters so closely related to the sovereignty and constitutional identity of the country.

1.2. The judgment is part of wider action relating, once again, to the limits established by the German Constitution on Germany's participation in the European integration process.

[1] The decision was approved by majority, with six constitutional judges voting in favour, and two (Mr Lübbe-Wolff and Mr Gerhardt) against.

[2] The parliamentary group "*Die Linke"* filed an *application for a ruling in Organstreit proceedings* (proceeding aimed at solving conflict issues between constitutional bodies) for an alleged violation of Art. 23 of the BverfGG (Federal Constitutional Law Court Act) by the German Parliament. Notably, according to the appellants' claim (which has been endorsed by the Constitutional Court) the *Bundestag* should not fail to protect its freedom of action when unduly stripped of it by an EU Institution. According to the Court, in the event that the *Bundestag* fails to comply with its "integration responsibility", individual parliamentary groups can act on its behalf in order to remedy such situation.

[3] The legal basis for said individual petitions is provided by Art. 38(1), 1st paragraph, of the BVerfG, which protects "universal suffrage elections that are direct, free, equal and secret" and thus guarantees the right of vote and, according to the Court, constitutes the suitable element for the purposes of a verification of constitutional identity (the so-called *Identitätskontrolle*). Many academics have raised objections as to the admissibility of appeals filed by citizens under the aforesaid rule, which would be intended to protect an objective principle of German legal system (i.e. the principle of democracy) rather than a violation of any fundamental subjective rights. This view is also shared by Constitutional Judge Gerhardt in his dissenting opinion.

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Most notably, in the interim decision adopted on 12th September 2012, the German Constitutional Court, while declaring the Treaties on the *European Stability Mechanism* ("ESM") and *Fiscal Compact* compatible with the German Constitution, deemed itself unable to rule on the appeals filed in connection to the OMT programme[4], an aspect that had been separated from the proceeding that will be defined *on the merit* on 18th March 2014[5].

The main concern of the appeal regards the challenge proposed by applicants against the German Government and Parliament for *not having acted* before the competent authorities against the ECB's decision, on the basis of the "responsibility for integration" (*Integrationsverantwortung*) that is incumbent on them.

1.3. In its referral, the German Court adopted an articulate critical position towards the ECB's intervention, challenging the arguments, including those of a technical nature[6], presented in defence of the decision adopted by the German Government and the ECB. The decision, containing a plethora of arguments *a contrario* taken from the judgment of the Court of Justice in the Pringle case[7], thus reveals the *scepticism* of German Judges regarding the role played by the ECB in the most critical phase of the economic crisis, and more generally, the tools established by the EU in order to save the Euro and the financial stability of the Euro zone.

However, the German constitutional judges stopped short of passing a ruling that might have had explosive consequences on the entire system, turning to the European Court of Justice for an interpretation of the provisions that they deem to have been violated, thus postponing their decision to a later stage, after the decision of the European Court.

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[4] See press release No. 67/2012.

[5] On the measures adopted in order to face the Euro crisis and, more in general, the origin and criticalities of the Economic and Monetary Union see A. SANTA MARIA, *European Economic Law*, 3rd edition, 2014, Kluwer Law International, chapter IV, pages 271 and following.

[6] See, for instance, the approach adopted by the German Constitutional Court with respect to the nature of spreads. In contrast to the view expressed by the ECB, according to which the increase of spread in certain countries would be due to unjustified and irrational fears as to the stability of the Euro, the Court, fully in alignment with the opinion expressed by the *Bundesbank*, states that the spread is exclusively an indication of the expectations of the market, and constitute, regardless of their rationality, the basis for the calculation of market prices. The attempt to identify and neutralise single alleged causes would constitute, according to the judges, an arbitrary interference into market activities. Finally, the Court declared, any distinction between rational and irrational causes would be meaningless, and in any case could not constitute a reason for ECB's intervention. See paragraph 98 of the Court's order.

[7] Decision of the Court (Plenary Session) of 27th November 2012, C-370/12, *Pringle* case, not yet published in the *Collection*. For an opinion on said decision see also E. GAMBARO, F. MAZZOCCHI, "*The rules of the European Union put on test by the government debts crisis: The Pringle case*", in *Diritto del Commercio Internazionale*, 2/2013, page 545; T. BEUKERS, B. DE WITTE, "*The Court of Justice approves the creation of the European Stability Mechanism. Pringle*", in *Common Market Law Review*, 2013, page 808; P.A. VAN MALLEGHEM, "*Pringle: A Paradigm Shift in the European Union's Monetary Constitution*", in *German Law Review*, 2013, page 162 and G. LO SCHIAVO, "*A judicial bail-out of the European Stability Mechanism: Comment on the Pringle Case*", Research Paper in Law, 9/2013, College of Europe.

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1.4. Rather than a definitive stance, the decision sounds more like a warning (yet another) to EU Institutions, as well as the ECB, to act exclusively within the limits of the mandate that Member States have conferred upon them. In light of this approach, it is clear that any "unconventional" measure aimed at overcoming the financial recession, yet also any future step along the path to European integration, will continue to be subjected to close examination in terms of constitutional legitimacy by German judges.

2. The Intervention of the ECB in Defence of Financial Market Stability

The ECB played a decisive role during national debt crisis and there is no doubt that the announcement of OMT interventions alone had a positive effect on the stability of financial markets. However, let us recall that the position adopted by the ECB provoked bitter conflict within the institution itself, notably pitting the *Bundesbank* (and the German monetary orthodoxy that it embodies) and the more flexible approach mainly supported by Governor Mario Draghi against each other. This contrast re-emerged with lively debate during the proceeding before the Court of Karlsruhe, where both the *Bundesbank* and the ECB intervened[8].

In August 2012, Mario Draghi announced that the ECB, within the scope of its mandate, was willing to save the Euro *using any means*.

It was in this context that, on 6th September 2012, the Governing Council of the ECB adopted the OMT decision, announcing the implementation of an "unconventional" purchase programme of government bonds on secondary markets, with the declared intent of "*protecting adequate monetary transmission and unified monetary policy*"[9].

The ECB's interventions as part of the OMT programme - which were certainly nothing new, having replaced, despite considerable changes, those adopted over the course of 2011 and 2012 as part of the "Security Market Programme" - were expressly *subjected* to the request by the struggling country for financial assistance from the ESM or *European Finanacial Stability Facility* ("EFSF")[10], and consequently to the subjecting of said country to the specific conditions of the relevant intervention programme.

[8] The *Memorandum* dated 21st December 2012 with which the *Bundesbank* joined the proceeding and harshly criticised the government bond-purchase programme adopted by the ECB is available online at: http://www.handelsblatt.com/downloads/8124832/1/stellungnahme- bundesbank handelsblatt-online.pdf . The ECB, in its turn, filed a *memorandum* on 16th January 2013. See http://www.handelsblatt.com/downloads/8135244/3/EZB%20Gutachten.

[9] The *Outright Monetary Transactions* programme was announced by Mario Draghi on 26th July 2012 at the *Global Investment Conference* in London. The text of his speech is contained in the following press release: http://www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html

[10] For a critical reconstruction of the origins of the aforesaid financial assistance mechanisms see A. SANTA MARIA, *op. cit.*, pages 332-335. See also E. GAMBARO, F. MAZZOCCHI, *op. cit.*, pages 545-548.

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The main characteristics of the bond purchase programme on the secondary market were outlined in a press release issued by the ECB, to which the decision of 6th September 2012 expressly refers[11].Namely::

- *conditionality*: purchases are subject to the condition that the Government of the country concerned requests the intervention from the ESM, as their financial assistance programmes are *strictly conditional*;
- *no maximum pre-defined limit* on the purchase of bonds;
- *absence* of the status of *privileged creditor* for the Eurosystem, which will be subject to the *same conditions* as private parties or *other creditors*;
- *Sterilisation* of the liquidity generated by the purchases.

3. The position adopted by the German Constitutional Court expressed in its Decision to refer the issue

3.1. The German Constitutional Court submitted *two* highly articulated preliminary references to the European Court of Justice.

The first is a reference for a preliminary ruling on *validity* as the Court is in doubt about the validity of the decision made by the ECB's Governing Council on 6th September 2012.

The second is a reference on *interpretation* and is raised *in alternative* to the first[12]. This second is a sort of parachute- query raised by the German Court for fear that the Court of Justice may not deem the decision of 6th September 2012 as "adopted by EU Institutions" pursuant to Art. 267 of the TFEU and therefore not suitable to ground a preliminary reference on validity.

In fact, it is important to underline that the aforementioned decision only *announces* the intervention programme adopted by the ECB, outlining the fundamental details in a press release; however, within the scope of said programme, no bond-buying decision has been made so far. In other words, the decision – leaving aside its unquestionable positive influence on the market[13] - is in itself without any legal effect and has no influence on subjective legal situations.

3.2. The German Constitutional Court clarified that its powers of scrutiny *extend* to the examination of any possible *evident violation* by EU Institutions of the powers conferred

[11] http://www.ecb.europa.eu/press/pr/date/2012/html/pr120906_1.en.html

[12] On the merit, the substantive EU laws referred to are the same, except for referral to the OMT decision, replaced in the second question by the more generic notion of "act by the Eurosystem".

[13] On the Euro political crisis, the shortcomings of the system, with consequent room left to the (self-centred) monetary policy decision of States outside od the Eurozone and also on speculation, see . A. SANTA MARIA, *op.cit*. pages 325 and following.

on them under EU legislation, and the possible *vulnus* to the essential core of constitutional identity, which cannot be transferred.

Most notably, should the OMT be in violation of the ECB's monetary mandate or the ban on monetary financing of budgets pursuant to Art. 123 of the TFEU, this would constitute an "*ultra vires*" act, i.e. an act beyond the realm of competence transferred to the European Union by the German State . In the event of an *ultra vires* act, the Constitutional Court claims, the German authorities must *abstain* from adopting and implementing said act, and are even required to challenge said decision before the competent judicial authorities[14].

3.3. Firstly, the initiative adopted by the EBC – according to the opinion expressed by the German Court – would go beyond the limits of the mandate conferred upon it pursuant to Articles 119 (1), 127(1) and (2) of the TFEU, which is to adopt a monetary policy for the Union in line with the objectives pursued by the Treaty, including first and foremost *price stability*[15].

According to the Constitutional Court, the programme would not constitute an act of monetary policy, but an "independent act of economic policy" instead. In this regard, the German judges observed that the financial policy is a *prerogative reserved for Member States*, except for "special" powers of coordination and surveillance conferred on the European Union under Articles 121, 122 and 126 of the TFEU. The rules of the Treaty, the Karlsruhe Court underlines, attribute to the ECB (and Central Banks of the Eurosystem Member States) only the power to sustain *the general economic policies in the European Union* (Art.119(2) and Art. 127(1) and (2) of the TFEU) without granting them the authority to pursue any autonomous economic policies.

In the aforesaid context, the independence of the ECB and the Eurosystem, guaranteed by EU legislation[16], does not allow any actions outside the limits of the mandate conferred. According to the Constitutional judges the "economic policy act" status of the OMT programme would emerge from its main purpose, which is to neutralise the *spread* on the bonds of *selected* Member States in the Euro zone. If this were the case, it would

[14] The evaluation on the existence of an *ultra vires* act is conducted by the German Constitutional Court in accordance with the principles indicated by the same Court in its decision on the *Honeywell* case. According to said decision, the assessment must be carried out with a general spirit of favour with respect to the activity performed by the institutions of the European Union. This did not prevent the Court of Karlsruhe from repeatedly ruling that the competences attributed to the EU should be interpreted *restrictively*, notably for the purpose of protecting the principle of democratic legitimacy. In a situation of perennial balance between an attitude of "openness" and one of "closure" toward the EU legislation, what emerges *in substance* is that the *primauté* of the EU law, even though acknowledged in principle, is constantly subjected to the severe review of the German Constitutional Court.

[15] On the perplexities raised in connection with said objective, due to its vague content within the Treaty, see A. SANTA MARIA, *op. cit.*, pages 304-305. The fact that the supremacy of the principle of prices stability might one day be challenged was already foreseen by M. HERDEGEN, "*Price Stability and Budgetary Restraints in the European Monetary Union: the Law as Guardian of Economic Wisdom*", in *Common Market Law Review*, 1998, page 22.

[16] See Articles 130 and 282(3) of the TFEU, third and fourth section.

essentially be a *financial assistance measure* that, as such, does not *expressly* fall into the scope of monetary policy[17] and, consequently, the ECB would have unduly interfered in matters that remain the prerogative of Member States, which are solely responsible for the definition of the objectives of economic policies and the selection of the tools necessary to achieve them.

3.4. Secondly, the German Court expresses its doubts as to the compatibility of the OMT programme with Art. 123(1) of the TFEU, which bans any monetary financing of Member State debt[18]. According to the Court, "*it seems clear that said ban cannot be circumvented by adopting functionally equivalent measures.*" The main aspects of the intervention – i.e. the purpose of neutralising the spread on interest rates, the selectivity of purchases, the parallelism of ECB activity with the assistance programmes adopted by the ESM and EFSF – all indicate that the OMT decision is aimed at circumventing the ban set forth by Art. 123(1) of the TFEU.

Said conclusion is also supported by a teleological interpretation of the Treaty, which the Court of Justice adopted in the *Pringle case* in order to construe the *bail-out* prohibition under Art. 125 of the TFEU, and which should also be used, according to the Karlsruhe judges, to interpret Art. 123(1) of the TFEU[19].

The circumstance whereby Art. 123 of the TFEU (also Art. 21 of the ECB Statute) prohibits any *direct* purchase of debt instruments and not the *purchase of debt instruments available on the market* would not be conclusive. On the other hand, again according to the German Constitutional Court, the risk of circumvention of the ban under Art. 123 of the TFEU was already evident when the EUM was established, if it is true that the (EC) Regulation No. 3603/93, when defining the scope of the bans contained in the (then) Articles 104 and 104 B, 1st paragraph, of the EC Treaty, provided that: "*Member States must take appropriate measures to ensure that the prohibitions referred to in Article 104 of the Treaty are applied effectively and fully; [...] in particular, purchases made on the secondary market must not be used to circumvent the objective of that Article;* "[20].

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[17] In this regard the Constitutional Court makes reference to the judgment of the Court of Justice in the *Pringle* case, cit., point 57.

[18] The law sets forth as follows: "*Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as "national central banks") in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments.*"

[19] See paragraph 86 of the order issued by the Constitutional Court.

[20] See the seventh whereas of the (EC) Regulations No. 3603/93.. For critical opinions on the compliance of ECB activity with Art. 123 of the TFEU, see M. RUFFERT, "*The European debt crisis and European Union Law*", in *Common Market Law Review*, 2011, page 1777: "*the basis for the ECB's security markets programme is rather weak* [...]. *The indirect purchase was only allowed to enable the ECB to undertake some open market operations in the fine-tuning of its monetary policy (art. 18 ECB Statute), but not to circumvent the ban on financial support to Member States*". In favour of the activity of the ECB, see F. CAPRIGLIONE,

Similarly, the fact that the ECB intends to purchase *short-term* bonds only (up to three years)[21] and, above all, the declared purpose of the intervention, i.e. an adjustment of the *monetary transmission mechanism*[22], would constitute elements that could justify changes to the preliminary assessment expressed by the German Court.

3.5. After over 60 paragraphs of *pars destruens*, the German Constitutional Judges offer, without great conviction, a lifeline to European judges, by providing, at paragraph 100, a possible interpretation of the ECB intervention in compliance with EU legislation. An interpretation that should not affect the conditionality of the financial assistance programmes adopted by EFSF and ESM, while ensuring that the intervention of the ECB is *exclusively* aimed at providing a *support measure for the general economic policies of the European Union*, in line with Art. 127(1) of the TFEU.

Compliance with Art. 123 of the TFEU could be guaranteed by setting forth: (i) the impossibility for the Eurosystem to accept reductions in the value of its bonds[23]; (ii) a ban on the purchase of unlimited governmental bonds, and (iii) a reduction, to the maximum possible extent, of interference in market price formation.

4. Final Considerations

The Court of Justice will have to face two preliminary references that are not without risks.

Market, Rules, Democracy, The UEM between Euro-scepticism and national identities, Turin, 2012, page 123, who however underlines that said mechanism [should be] "*i limited by the need to keep promised interventions within strictly defined limits in terms of quantities and time, and by the consent of EUM countries.*"

[21] In this regard the Court raises criticism in connection with two issues. Firstly, the "factual" limitation declared by the ECB, would not provide sufficient assurance as to the quantitative limits that, according to the Court, should be applied (paragraph 83 of the decision).Secondly, the fact that the title to the bonds is kept by the ECB until the relevant maturity date, thus causing an interference in the dynamics of the market, as said bonds are not subjected to the ordinary negotiation logic, might constitute an indirect form of financing, forbidden by Art. 123 of the TFEU. It is important to point out that the purchase would focus on short-term bonds, for being the most rapid to respond to monetary policy interventions,. Conversely, ECB's purchase of long-term bonds might result in a disincentive for crisis-hit countries to adopt virtuous budgetary policies. The distinction between long and short-term bonds in light of the prohibition of monetary financing is considered artificial and irrelevant by T. BUELL, "*The Magical Monetary Financing Line of Draghi*", *Wall Street Journal Post*, 23rd September 2012.

[22] The transmission mechanism is the process through which monetary policy decision influence the economy in general and prices more specifically. The central bank intervenes on some monetary instruments, most notably official interest rates and the monetary base, which can affect final objectives through various transmission "channels". The matter, though a complex one, seems not to have been duly examined by the German Court.

[23] At the time being, indeed, the Eurosystem does not benefit from the *status* of privileged creditor.

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There is no doubt that if the ESM intervention concerns the economic policy of Member States, as acknowledged by the Court of Justice in the *Pringle* case, the fact of subjecting the ECB's activity to the intervention of the ESM is indicative of the (unavoidable?) overlapping of economic and monetary policy, and makes the task of defining the boundaries between the respective areas of intervention very difficult for the Court of Justice.

Upon further consideration, said difficulty reflects the aporie innate to the institutional model adopted by the Maastricht Treaty, i.e. the creation of a monetary union which is stripped of any political authority, and whose administration is exclusively attributed to a technical body[24].

The Court of Justice will struggle to find support, in order to reach an interpretation of the OMT programme that is compliant with Art. 123(1) of the TFEU, in its own decision on the ESM intervention in connection with the *Pringle* case. In said instance, the EU Judges defined the object and the scope of monetary policy on the basis of the principle of exclusion (i.e. "what monetary policy *is not*") and made a clear distinction between the *bail-out* prohibitions under Art. 125 of the TFEU – i.e. the main objective of interpretation in that case – and the ban set forth by Art. 123 of the TFEU. In this regard, suffice it to say that the Court, in addition to indicating that the ban under Art. 123 of the TFEU *specifically* concerns the ECB and Central Banks[25], declared that it "is *to be intended in stricter terms*" being *"aimed at prohibiting any financial assistance in favour of any Member State*."[26]

On the other hand, although the *conditionality* of interventions is a key element that constitutes a prerequisite not only for ESM action, but *also* for any ECB activity within the OMT programme, it could be argued that the "constitutionalisation" of the "strict conditionality" requirement set out by the Court of Justice in the *Pringle* case may protect the ECB's intervention from the major risk indicated by the German Court, i.e. the fact that it operates without restrictions, with the power to make unlimited purchases on the market in favour of one or the other Member State. After all, it is important to consider that the depositaries of the ESM (which is an inter-governmental mechanism and not a UE one) are the individual Member States: including the ECB within the scope of the ESM intervention is an indirect way of *preventing* the ECB from pursuing *its own* economic policy.

More generally, faced with the extraordinary tests that the monetary Union has faced and the serious economic and financial unbalance existing between Member States, it is important to reflect on the role played by the *solidarity principle* among the peoples of the European Union, which is a cornerstone of the European construction and referred to from

[24] On these topics see extensively A. SANTA MARIA, *op. cit.*, and notably pages 312-317 and 345-346.

[25] Point 125 of the *Pringle* decision.

[26] *Ibidem*, point 132.

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the preamble to the European Union Treaty[27]. Support for ECB action, upon further analysis, is not a disinterested act, as it is now clear that the *economic co-dependence* between States that are members of an integrated monetary union is such that "the effects of a possible *default* of a Member State would be felt in an utterly unpredictable and uncontrollable way also by the others[28]."

For the purposes of finding a reply to the issues raised by the Court, it seems essential to understand whether the action carried out by the ECB can be included among the goals of *providing support to the general economic policies in the Union*, a goal that, although subordinated to price stability, is expressly encompassed in the mandate of the ECB. Which criteria should be adopted for the identification of the "*general economic policies in the Union'*" is not entirely clear, given that, *inter alia*, said expression is only mentioned in the rules relating to the Eurosystem, and that the EU, as known, is competent only in connection with the "*coordination of Member States' economic policies*".

It is, in any case, a wording that leaves room for interpretation by the Court of Justice, which, once again, will be entrusted with the unpleasant task of filling the gaps in the economic and monetary union, and replacing the vacuum in legislation, ahead of that in politics, that characterises the current EU scenario[29].

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[27] In said preamble it is specified that the contracting parties seek, in connection with the European Union, "*to deepen the solidarity between their peoples*" See also Art. 3, 3rd paragraph, 3rd subsection of the TUE, pursuant to which the Union promotes "*economic, social and territorial cohesion, and solidarity among Member States*". As to the relevance of said principle also from an economic point of view, see points 142 and 143 of the view delivered submitted by AG Kokott on 26th October 2012 in the *Pringle* case, not yet published. In this regard, cf. also A. SANTA MARIA, *op. cit.*, pages 277-278 and 353-355.

[28] See, in this regard, the considerations of L. BINI SMAGHI, former member of the ECB, in "*The Group of Thirty*", 63rd Plenary Session, Session I: The Crisis of the Eurosystem, Rabat, 28th May 2010.

[29] On these issues see also A. SANTA MARIA, *op. cit.*, pages 328-329.