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EU Court of Justice finds OMT programme for purchase of government bonds not contrary to EU Treaties

In a judgment handed down on 16 June 2015, in the first ever preliminary reference made from Germany's Federal Constitutional Court (Bundesverfassungsgericht), in *Peter Gauweiler and Others v Deutscher Bundestag* (Case C-62/14), the Court of Justice of the European Union ("CJEU") has held that the outright monetary transactions ("OMT") programme announced by the ECB in September 2012 for the purchase of government bonds on secondary markets does not exceed the powers of the European Central Bank ("ECB") in relation to monetary policy and does not contravene the prohibition of monetary financing of Member States set out in the Treaty on the Functioning of the European Union ("TFEU").

Background

By a press release issued on 6 September 2012, the ECB announced that it had adopted certain decisions concerning a programme authorising the European System of Central Banks ("ESCB") to purchase on secondary markets government bonds of Member States of the Eurozone, provided that certain conditions were met. The aim of that programme, commonly referred to as the "OMT programme", was to deal with the disruption of the ESCB's monetary policy transmission mechanism caused by the particular situation of government bonds issued by certain Member States and to preserve the "singleness" of monetary policy.

In particular, the ECB had found that the interest rates on government bonds of the various Eurozone States were characterised, at that time, by high volatility and extreme spreads. In the ECB's view, those spreads were not accounted for solely by macroeconomic differences between the States concerned but were caused, in part, by the demand for excessive risk premia for the bonds issued by certain Member States, such premia being intended to guard against the risk of a break-up of the Eurozone. According to the ECB's analysis, that exceptional situation severely undermined the ESCB's monetary policy transmission mechanism in that it gave rise to a fragmentation of bank refinancing conditions and credit costs, which greatly limited the effects of the "impulses" transmitted by the ESCB to the economy in a significant part of the Eurozone. More than two years after that announcement was made, the programme has still not been activated. The ECB believes that simply making the announcement about the OMT programme was sufficient to achieve the effect sought.



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A number of constitutional actions were brought before the German Federal Constitutional Court concerning the participation of the Deutsche Bundesbank (German Central Bank) in the implementation of the OMT programme and the alleged failure of the Federal Government and the Bundestag (Lower House of the German Federal Parliament) to act with regard to that programme.

In dealing with these constitutional complaints, the Federal Constitutional Court asked the Court of Justice whether the EU Treaties permit the ESCB to adopt a programme such as the OMT programme. In particular, it had doubts as to whether the programme is within the powers of the ESCB, as defined by the EU Treaties, and was also uncertain about whether the programme is compatible with the prohibition of monetary financing of the Member States.

Commentators have looked at this case with a lot of interest because:

- (a) This was the first ever preliminary reference from the Federal Constitutional Court in more than 60 years of European integration.
- (b) The text of the reference had a rather unusual tone. The Federal Constitutional Court did not just ask questions but also suggested what the answer should be. In addition, the national court was suggesting that if it does not find the CJEU's answers satisfactory, it would follow its own views.
- (c) If, indeed, the views of the two courts were to collide, then a possible constitutional conflict might erupt.

CJEU judgment

The CJEU decided not to shy away from the substantive and sensitive questions posed by the Federal Constitutional Court, although a number of governments intervening (Ireland, Greece, Spain, France, Italy, Netherlands, Portugal and Finland), the European Parliament, the European Commission and the ECB were urging the CJEU to consider the reference inadmissible for various reasons, most

importantly because the OMT programme did not have to be activated and there were no specific measures adopted which directly affected the rights conferred by EU law on the applicants in the main proceedings.

Powers of the ESCB

The CJEU's conclusion was that the EU Treaties permit the ESCB to adopt a programme such as the OMT programme.

In reaching that conclusion, the CJEU started from the premise that the EU Treaties contain no precise definition of monetary policy but define both the objectives of monetary policy and the instruments which are available to the ESCB for the purpose of implementing that policy. Thus, under Articles 127(1) TFEU and 282(2) TFEU, the primary objective of the Union's monetary policy is to maintain price stability.

The Court then found that the OMT programme, in view of its objectives and the instruments provided for achieving them, falls within monetary policy and therefore within the powers of the ESCB. First, the OMT programme, in seeking to preserve the singleness of monetary policy, contributes to achieving the objectives of that policy, which under the EU Treaties must be "single". Secondly, in seeking to safeguard "an appropriate monetary policy transmission", that programme is likely both to preserve the singleness of monetary policy and to contribute to its primary objective, which is to maintain price stability.

The fact that the OMT programme might also be capable of contributing to the stability of the Eurozone, which is a matter of economic policy, did not call that assessment into question. According to the CJEU a monetary policy measure cannot be treated as equivalent to an economic policy measure merely because it may have indirect effects on the stability of the Eurozone. Besides, the implementation of such a programme would entail outright monetary transactions on secondary sovereign debt markets and Article 18.1 of the Protocol on the ESCB and the ECB allows the ECB and the national central banks to operate in the financial markets by buying and selling outright marketable instruments in euro.

Then, as regards the fact that implementation of the programme is conditional upon full compliance by the Member States concerned with a European Financial Stability Facility (EFSF) or European Stability Mechanism (ESM) macroeconomic adjustment programme, it is possible that that feature of the OMT programme may have indirect effects so far as the realisation of certain economic policy objectives is concerned. However, according to the CJEU, such indirect effects do not mean that such a programme must be regarded as an economic policy measure.

The Court also stated that the OMT programme does not infringe the principle of proportionality, since, in economic conditions such as those described by the ECB on 6 September 2012, the ESCB could reasonably take the view that the OMT programme was appropriate for the purpose of contributing to the ESCB's objectives and, therefore, to the maintenance of price stability. In addition, the OMT programme does not go manifestly beyond what is necessary to achieve the objectives it pursues.

Compatibility with the prohibition of monetary financing of the Member States

At this point, the CJEU rejected the view that the OMT programme may be incompatible with Article 123(1) TFEU, which prohibits the ECB and the central banks of the Member States from granting overdraft facilities or any other type of credit facility to Member States and from purchasing directly from them their debt instruments. According to the Court, although the EU Treaties prohibit all financial assistance from the ESCB to a Member State, they do not preclude, generally, the possibility of the ESCB purchasing from the creditors of such a State bonds previously issued by that State.

However, the purchase of government bonds on secondary markets must not have an effect equivalent to that of a direct purchase of such bonds on the primary market. Furthermore, such purchases may not be used to circumvent that rule. At this point, the CJEU followed the approach espoused by Advocate General Cruz Villalón in his Opinion of 14 January 2015 and held that when the ECB purchases

government bonds on secondary markets, sufficient safeguards must be built into its intervention to ensure that the latter does not fall foul of the prohibition of monetary financing in Article 123(1) TFEU.

The ESCB's intervention could, in practice, have an effect equivalent to that of a direct purchase of government bonds if the potential purchasers of such bonds on the primary market knew for certain that the ESCB was going to purchase those bonds within a certain period and under conditions allowing those market operators to act, de facto, as intermediaries for the ESCB for the direct purchase of those bonds. However, in the case at hand, the Governing Council is to be responsible for deciding on the scope, the start, the continuation and the suspension of the intervention envisaged by the OMT programme on the secondary market. The CJEU also took note of the ECB's explanation that the ESCB intends to ensure that a minimum period is observed between the issue of a security on the primary market and its purchase on the secondary market and also to refrain from making any prior announcement concerning either its decision to carry out such purchases or the volume of purchases envisaged.

The CJEU then accepted that, despite those safeguards, the ESCB's intervention may still have some influence on the functioning of the primary and secondary sovereign debt markets. However, according to the Court, that fact is not decisive since such influence constitutes an inherent effect in purchases on the secondary market which are authorised by the TFEU. Finally, in the Court's view, the features of the OMT programme also ensure that the programme cannot be considered to be of such a kind as to lessen the Member States' impetus to follow a sound budgetary policy and thus to circumvent the objective pursued by the prohibition of monetary financing of the Member States.

Implications of the judgment

The general implications of the judgment are no doubt of utmost importance. The CJEU gives a sufficient degree of comfort and discretion to the ECB to continue playing

its pro-active role in the handling of the Eurozone crisis. At the same time, the CJEU strikes a careful balance with the maintenance of a coherent constitutional structure for the EU.

The Federal Constitutional Court will now have to decide under German constitutional law whether the OMT programme is to be qualified as “ultra-vires” or whether it violates the German constitution. It is not certain if the German court will concur and follow the CJEU’s reasoning, bearing in mind that not all restrictions deemed necessary by it with regard to the OMT programme have been adopted by the CJEU. Although German constitutional lawyers and legal scholars predict that the Federal Constitutional Court has no other option but to accept the CJEU’s judgment, a conflict of jurisdiction and of legal orders cannot be totally excluded. Such a scenario would lead to the question as to the legal consequences for the Deutsche Bundesbank. At the same time, the question arises as to what a conflicting ruling of the Constitutional Court would mean for the independence of the ECB.

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