

Client Alert

European Court of Justice says the European Stability Mechanism (ESM) is compatible with EU law

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In a judgment handed down today, in a preliminary reference from the Irish Supreme Court, in *Thomas Pringle v The Government of Ireland, Ireland and the Attorney General* (Case C-370/12), the Court of Justice of the European Union (“CJEU”) has held that the provisions of the Treaty on the European Union (“TEU”) and the Treaty on the Functioning of the European Union (“TFEU”) do not preclude the conclusion and ratification of the ESM Treaty.

Background

Thomas Pringle is a member of the Irish parliament and brought a constitutional challenge before the Irish Supreme Court, opposing the ratification of the Treaty Establishing the European Stability Mechanism (“ESM”).

ESM

The Treaty Establishing the ESM was originally signed by finance ministers of the 17 Eurozone countries on 11 July 2011. A modified version of the Treaty was signed in Brussels on 2 February 2012. The ESM Treaty entered into force on 27 September 2012 and the ESM was inaugurated on 8 October 2012 following ratification by all 17 Eurozone Member States. The ESM will function as a permanent firewall for the Eurozone, with a maximum lending capacity of €500 billion. It was intended to replace the existing European Financial Stability Facility (“EFSF”). ESM Member States can apply, subject to strict conditionality, for an ESM bailout if they are in financial difficulty or their financial sector is a stability threat in need of recapitalisation.

In March 2011, the European Council followed the simplified procedure and amended Article 136 of the Treaty on the Functioning of the European Union (“TFEU”), to avoid a protracted ratification process involving referenda in certain Member States. This procedure was introduced by the Lisbon Treaty in order to help facilitate changes to the policies and actions of the EU. This procedure applies only to the internal policies and actions of the EU and may not increase the competences conferred on the EU in the Treaties. European Council Decision 2011/199/EU (the “European Council Decision”) used the simplified Treaty revision procedure and allowed Eurozone Member States to establish a stability mechanism to be activated if absolutely necessary to safeguard the stability of the Eurozone as a whole.

Proceedings in the Irish courts

Thomas Pringle applied to the Irish High Court for an injunction to restrain the government from ratifying the ESM Treaty. He argued that the establishment of the ESM is a transfer of power from the national level to the EU and that, therefore, the European Council Decision to use a simplified revision procedure rather than

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allowing Member States a national referendum was a violation both of Irish and EU law. However, Mr Pringle was unsuccessful and the matter came before the Irish Supreme Court.

On 31 July 2012, the Supreme Court rejected Mr Pringle's constitutional challenge under Irish law and refused to grant the injunction sought.¹ However, the Supreme Court upheld the preliminary reference to the CJEU on three questions regarding EU law:

1. Is the EU Council Decision of 25 March 2011 to amend Article 136 of the TFEU on 1 January 2013, using a simplified revision procedure rather than allowing for national referenda, valid?
2. Is a Eurozone Member State entitled to ratify an international agreement like the ESM treaty, i.e. by choosing to use an international agreement rather than working within the framework of the EU, and does the European Council Decision infringe the EU's exclusive competence in the field of monetary union?
3. Given that the European Council Decision does not enter into force until next year, could Member States ratify the ESM before that entry into force or is the ratification by Member States subject to the entry into force of the Decision?

CJEU judgment

The CJEU decided to apply the accelerated procedure pursuant to Article 23a of the Statute of the Court of Justice and Article 104a of the Rules of Procedure of the Court of Justice because of "*the exceptional circumstances of the financial crisis surrounding the conclusion of the ESM Treaty*". So although the referral from the Irish Supreme Court was made on 31 July 2012, the CJEU managed to render its judgment in less than 4 months.

The case was heard before the full 27-judge Court, which is extraordinary. The Court held that the provisions of the TEU and the TFEU do not preclude the conclusion and ratification of the ESM Treaty.

Simplified Revision Procedure

By Decision 2011/199, the European Council used the possibility of amending the TFEU by a simplified procedure (that is, without convening a convention composed of representatives of the national Parliaments, of the Heads of State or Government of the Member States, of the European Parliament and of the Commission). This simplified procedure can be used if two conditions are satisfied: (i) it applies only to the internal policies and actions of the EU (in Part Three of the TFEU), and (ii) this procedure may not be used to increase the competences conferred on the EU in the Treaties.

The Court holds that the challenged amendment relates – both in form and content – to the internal policies and actions of the EU, and consequently the first of those conditions is satisfied. The second condition governing the use of the simplified revision procedure, namely that the amendment of the TFEU does not increase the competences conferred on the EU in the Treaties, is also satisfied.

Does the ESM Treaty infringe the EU's competence in the fields of monetary and economic policy?

The Court found that the TEU and TFEU do not prohibit the conclusion of an agreement such as the ESM Treaty between the Eurozone Member States.

Under the TFEU, the EU has exclusive competence for monetary policy. However, the Court held that the objective of this competence is to maintain price stability, and the purpose of the ESM is not to maintain price stability, but to meet financing requirements of ESM Members. Significantly, the Court held that the grant of financial assistance to a Member State does not fall within monetary policy. Crucial

¹ *Thomas Pringle v The Government of Ireland, Ireland and the Attorney General* [2012] IESC 47 (19 October 2012), <http://www.bailii.org/ie/cases/IESC/2012/S47.html#judge1>

in this assessment was that the ESM is not entitled either to set the key interest rates for the Eurozone or to issue euro currency. It found that the ESM policies may influence the inflation rate, but that this is an indirect consequence of the economic policy measures adopted.

The EU also has competence for the coordination of economic policy. The Court found that the ESM does not encroach upon this EU competence as the ESM does not coordinate the economic policy of all Member States. Rather, it is a financing mechanism between certain Member States. The fact that the financial assistance provided to an ESM Member State is subject to strict conditionality and is linked to a macroeconomic adjustment programme does not constitute an instrument for the coordination of the economic policies of the Member States and does not frustrate the EU measures adopted pursuant to Article 126 TFEU. On the contrary, according to the Court, the ESM was drafted precisely so as to ensure that any financial assistance granted by the ESM will be consistent with such coordination measures taken by the EU and the “no bail-out” clause of Article 125 TFEU. Besides, the ESM Treaty itself makes clear that ESM conditionality must be consistent with any recommendation which the Council might issue under Article 126(7) and (8) TFEU. Finally, the competence of the Council to grant EU financial assistance to a Member State which is in difficulties or is seriously threatened with severe difficulties does not prevent Member States from establishing a stability mechanism.

Article 123 TFEU prohibits the ECB and the central banks from granting credit facilities to public authorities of the EU and of Member States and from purchasing debt directly. The Court held that the ESM is not subject to that prohibition. The Treaty prohibition is addressed specifically to the ECB and the central banks of the Member States. This prohibition does not prevent one Member State or a group of Member States from granting financial assistance to another Member State, directly or through the ESM.

Similarly, the “no bail-out” clause (Article 125 TFEU), which provides that neither the EU nor a Member State are to be liable for the commitments of another Member State, does not prohibit the granting of financial assistance by one or more Member States to a Member State. Under the ESM Treaty, the ESM itself and the participating Member States are not “liable” for the commitments of a Member State which receives stability support and therefore the ESM is not subject to the bail-out prohibition. The Court here uses a number of arguments to support its conclusion that the ESM does not infringe the “no bail-out clause”:

- (a) if that clause meant that any financial assistance to one or more Member States is prohibited, Article 122 TFEU which allows for the Union to provide ad hoc financial assistance to a Member State should have stated that it is a derogation from that clause;
- (b) Article 123 TFEU, which prohibits the ECB and the central banks of the Member States from granting “overdraft facilities or any other type of credit facility”, employs wording which is stricter than that used in the “no bail-out clause” in Article 125 TFEU, so this difference in the wording must mean that this clause is not intended to prohibit any financial assistance to a Member State;
- (c) a teleological interpretation of Article 125 TFEU leads to the conclusion that the aim of the “no bail-out clause” is to ensure that the Member States follow a sound budgetary policy; that does not prohibit the granting of financial assistance by one or more Member States to a Member State which remains responsible for its commitments to its creditors, provided that the conditions attached to such assistance are such as to prompt that Member State to implement a sound budgetary policy, which is actually the case with the ESM Treaty; besides, stability support may be granted to ESM Members which are experiencing or are threatened by severe financing problems only when such support is indispensable to safeguard the financial stability of the Eurozone as a whole and of its Member States, and the grant of that support is subject to strict conditionality;
- (d) then, the ESM’s instruments for stability support demonstrate that the ESM will not act as guarantor of the debts of the recipient Member State, which remains responsible to its creditors for its financial commitments; indeed, as

the Court notes, the assistance amounts here to the creation of new debt, owed to the ESM by the recipient Member State.

The Court, finally, rejected the arguments raised that the use of EU institutions, such as the Commission, the ECB and the Court of Justice, by the ESM Treaty was incompatible with EU law. The Treaty texts allowed for such a role for the institutions. With reference to the role of the Commission, the Court stated that its duties and powers under Article 17(1) TEU to “promote the general interest of the Union” and to “oversee the application of Union law” were in fact well served, since the objective of the ESM Treaty is to ensure the financial stability of the Eurozone as a whole and, by its involvement in the ESM Treaty, the Commission promotes the general interest of the Union.

The conclusion and ratification of the ESM before the entry into force of Decision 2011/199

As Decision 2011/199 does not confer any new powers on the Member States, but confirms the existence of powers already possessed by the Member States (to conclude the ESM Treaty), the right of a Member State to conclude and ratify the ESM Treaty is not subject to the entry into force of Decision 2011/199. In other words, the amendment of the TFEU brought by the above Decision merely confirmed what the Member States are perfectly entitled to do.

Implications of the judgment

The court's conclusion was pragmatic, ensuring the ability of the Eurozone members to react quickly and effectively to the current sovereign debt crisis. The Court also dispelled the doubts about the compatibility of financial assistance mechanisms with the “no bail-out clause”. It is significant here that the Court did not restrict its conclusions to the ESM itself, but rather used a general expression referring to “*the grant of financial assistance by one Member State or by a group of Member States to another Member State*”. This means that the Court's conclusions are also valid for both the bilateral assistance scheme that was initially used in the Greek case and the subsequent use of the EFSF. At the same time, the Court seems to be giving more leeway to the Member States in this respect than it does to the ECB. All in all, in keeping with tradition, the Court's judgment is permeated by a mixture of literal and teleological interpretation. If the Treaties do not specifically prohibit a certain action, then it is lawful, as long as it is in accordance with their broader teleology, which is expressed here by the need to safeguard the financial stability of the Eurozone as a whole and of its Member States.

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