research paper

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ON BANKS, COURTS AND INTERNATIONAL LAW

A CRITICAL ANALYSIS OF THE DRAFT INTERNATIONAL AGREEMENT ON THE FUNCTIONING OF THE SINGLE RESOLUTION FUND

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ABSTRACT

In December 2013 the ECOFIN Council has given its green light to the adoption of the second pillar of the so-called Banking Union: a Single Resolution Mechanism to wind down failing banks in the Euro-zone, and thus break the cycle between banks and sovereigns in the EU. Besides a regulation, to be adopted in co-decision procedure with the Parliament, the Council has however endorsed a plan to adopt an international agreement on the functioning of the Single Resolution Fund (SRF). The paper critically analyses the choice to resort to international law to establish the SRF. As the paper maintains, the use of an intergovernmental agreement in this case is not necessary from a legal point of view. In fact, the use of international law in this case rests on flawed legal argument, namely that EU regulations cannot impose financial obligations on the states. Moreover, as the paper explains, the use of international law generates bad policy outcomes. Resort to international law to establish the SRF opens the door for national courts' review of the agreement – a prospect which contrasts with the constitutional logic of leaving decision of economic questions in the political process. In light of these weaknesses, the paper concludes that the European Parliament should endeavor to block the intergovernmental avenue and bring back the regulation of the SRF within the framework of EU law.

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1. Introduction - 2. The draft Agreement on the functioning of the single resolution fund - 3. Wrong legal arguments: EU regulations and international agreements - 4. Worrisome policy implications: The specter of the courts - 5 Conclusion

1. *Introduction*

On 18 December 2013 the Council of the European Union (EU) has reached consensus on the second pillar of the European Banking Union: the Single Resolution Mechanism (SRM).[1] The SRM complements the Single Supervisory Mechanism (SSM),[2] and is expected to increase the stability of the EU banking sector by establishing a common procedure to wind up failing banks. The general approach agreed upon by the Economic and Financial Affairs (ECOFIN) Council in December – which was immediately endorsed by the European Council,[3] but still has to be approved by the European Parliament, a co-legislator in this field[4] – is based on two interwoven legal measures. One the one hand, the Council has given its green light on the draft text of an EU regulation establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a single resolution mechanism and a single bank resolution fund.[5] On the other hand, however, the Council – *rectius*: the representatives of the Eurozone member states congressed on the side of the ECOFIN Council – have decided to draft and sign a separate international agreement on the functioning of the single resolution fund (SRF).[6] This legal act – technically a treaty under international law – aims at defining the conditions according to which the member states participating to the SRM will (on a transitional basis) levy and transfer the financial resources necessary for the operation of the SRF.

The aim of this paper is to critically discuss the choice of resorting to a separate intergovernmental agreement to define the functioning of the SRF. During the last few years, the EU member states have increasingly made use of international treaties to respond to the Euro-crisis – witness the adoption of the Fiscal Compact treaty[7] to strengthen budgetary constraints, and of the European Stability Mechanism (ESM) treaty[8] to endow the Euro-zone of a permanent firewall against sovereign insolvency. The use of instrument outside the framework of EU law is

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[1] Council of the EU, Press release, 18 December 2013, Doc. 17983/13.
[2] Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, [2013] OJ L 287/63.
[3] European Council, Conclusions, 20 December 2013, EUCO 217/13, §29 (endorsing the compromise reached in the ECOFIN Council).
[4] See European Parliament Legislative Resolution on Resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Bank Resolution Fund, 6 February 2014, P7_TA-PROV (2014)0095 (advancing amendments to the draft agreed upon by the ECOFIN Council).
[5] Council of the EU, Proposal for a Regulation of the European Parliament and the Council establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a single resolution mechanism and a single bank resolution fund and amending Regulation (EU) No 1093/2010 of the European Parliament and the Council, 19 December 2013, Interinstitutional file 2013/0253 (COD).
[6] Agreement on the functioning of the single resolution fund, Working document #2, draft of 16 January 2014, available at: http://www.slideshare.net/lavoceinfo/agreement-on-the-functioning-of-the-srf-draft-wd2
[7] Treaty on the Stability, Coordination and Governance of the Economic and Monetary Union, available at: http://european-council.europa.eu/media/639235/st00tscg26_en12.pdf
[8] Treaty establishing the European Stability Mechanism, available at: http://www.european-council.europa.eu/media/582311/05-tesm2.en12.pdf

generally explained arguing that the EU lacks the legal powers to adopt specific legal measures under the current Treaties. As I shall make clear, nevertheless, the resort to an international agreement for the establishment of a SRF is not justified on legal basis arguments. Rather, it rests on a grave misunderstanding of the legal nature of EU regulations and their power to impose a specific conduct upon the member states. In particular, the use of an international agreement in the case of the SRF is premised on the view that an EU regulation cannot impose financial obligations upon the member states – a view which is at odds with the text, function and history of EU regulations since the beginning of the EU integration process.

Moreover, as I have argued elsewhere,[9] resort to international treaties is problematic because it allows national courts to get enmeshed in the adjudication of measures adopted to tackle the Euro-crisis. Because under domestic constitutional rules international treaties may be subject to a priori review in front of national constitutional or supreme courts, the choice to adopt an international agreement on the functioning of the SRF opens the way to future legal challenges before state courts on the constitutionality of the agreement. Yet, persuasive constitutional arguments related to expertise, voice and rights pleads in favor of having the political branches of government – rather than the courts – take decisions in the economic and financial domain. As such, the paper questions the opportunity in policy terms to establish the functioning of the SRF through an international agreement. Instead, it underlines in comparative terms the advantages that arise from the use of EU regulations, and explains why judicial review exclusively before the EU Court of Justice (ECJ) is preferable. Taking into account that the use of an international treaty is not necessary from a legal point of view – because an EU regulation is perfectly adequate in achieving the purpose of the draft international agreement – and given the policy problems that resort to international law poses – as per the unwarranted involvement of national courts in adjudicating measures enacted to tackle the root causes of the Euro-crisis – the paper makes the case against proceeding along the intergovernmental avenue in developing the second pillar of the Banking Union.

In light of this, the paper suggests that the European Parliament should make use of its co-legislative powers on the regulation for the establishment of the SRM to force national governments to abandon the draft international agreement and return the rules on the functioning of the SRF within the framework of EU law.[10] The SRM regulation is perfectly suitable to impose financial obligations on the member states to contribute to the SRF, and presents the advantage of centralizing all judicial review on its legality within the jurisdiction of the ECJ, rather than in the dispersed judicial fora of the 18 Eurozone member states. The construction of the new Banking Union – as a key component of the new Economic and Monetary Union (EMU)[11] – is

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[9] F. Fabbrini, 'The Euro-Crisis and the Courts: Judicial Review and the Political Process in Comparative Perspective', 32 *Berkeley Journal of International Law* 1 (2014).

[10] This view has also been advanced in a Letter from the Chair and members of the Economic and Monetary Affairs Committee of the European Parliament to the Council Presidency regarding the intergovernmental agreement currently negotiated within the framework of the SRM regulation, 15 January 2014, available at: http://www.europarl.europa.eu/document/activities/cont/201401/20140116ATT77594/20140116ATT77594EN.pdf

[11] On the prospects of reform of EMU see also F. Fabbrini, 'From Fiscal Constraints to Fiscal Capacity: the Future of EMU and its Challenges', in M. Adams, F. Fabbrini & P. Larouche, *The Constitutionalization of European Budgetary Constraints* (Hart, Oxford, 2014) 399.

leaning increasingly towards an intergovernmental direction. It lays on the European Parliament to halt this development before it is too late, bringing square and center, once again, the potentials of EU law. The paper is structured as follows. Section 2 briefly summarizes the content of the international agreement on the functioning of the SRF, in the draft version of January 2014 leaked to the public. Section 3 explains that the international agreement is premised on the legal argument that an EU regulation cannot impose obligations on the member states to transfer resources to the SRF and challenges this idea as inconsistent with EU law, history and practice. Section 4 then discusses the implications of the use of international law on the powers of national courts to review measures adopted at the EMU level and, in light of the rising trend of judicial involvement in economic and financial affairs, criticizes the choice to adopt an international treaty for the SRF. Section 5, finally, concludes and traces some policy-options for the future.

2. The draft Agreement on the functioning of the single resolution fund

The international agreement on the functioning of the SRF, in its draft version of January 2014,[12] is a text of 13 articles, structured in 4 titles. As explained in the Preamble, the agreement – which is signed by the 18 member states of the Eurozone and is open to the other EU member states willing to join – is connected to the SRM regulation and is part of the efforts pursued by the EU in the past years to adopt a number of legal acts "fundamental for the achievement of the internal market in the field of financial services and for guaranteeing the financial stability of the euro area and of the Union as a whole, as well as for the process towards deeper economic and monetary union." As stated in recital 14, "[t]he content of the present Agreement is limited to those specific elements concerning the Single Resolution Fund that are not regulated through [the SRM Regulation] and that, hence, remain within the competence of Member States. As such, this Agreement does not affect common rules laid down by the law of the Union nor does it alter their scope. It is rather designed as complementary to the Union legislation on banking resolution and as supportive and intrinsically linked to the achievement of Union policies, in particular the establishment of the internal market in the field of financial services."

The purpose and scope of the agreement is spelled out in Article 1, which affirms that "[b]y this Agreement, the Contracting Parties commit to, (i) transfer the contributions raised at national level in accordance with [SRM Regulation] to the Single Resolution Fund established by the latter (the Fund), (ii) allocate, during a transitional period starting at the date of application of this Agreement as determined under Article 9(2) and elapsing at the moment when the Fund reaches the target funding level fixed in Article 65 of the SRM Regulation but not later than 10 years after the date of application of this Agreement (the transitional period), the said contributions to different compartments corresponding to each Contracting Party. The use of the compartments shall be subject to a progressive mutualisation in a manner such that they will cease to exist at the end of the transitional period, thereby supporting the effective operations and functioning of the Fund." As clarified by Article 2 – which is modelled on an almost identical provision of the Fiscal Compact[13] – "[t]his Agreement shall be applied and interpreted by the Contracting Parties in

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[12] See supra n 6.
[13] See Fiscal Compact, Article 2.

conformity with the Treaties on which the European Union is founded and with European Union law" and "shall apply insofar as it is compatible with" them.

The core content of the intergovernmental agreement emerges from Title III, spanning from Article 3 to 7, which defines the conditions of the transfer of contributions to the SRF and the design of its compartments. The agreement demands to the contracting parties to raise contributions for the SRF (from the national banking sectors) and to allocate for a transitional period of 10 years these resources within separate national compartments within the SRF. Pursuant to Article 3, "[t]he Contracting Parties commit to reciprocally and irrevocably transfer to the Fund the contributions that they raise from the institutions authorised in each of their territories by virtue of [the SRM Regulation]". And pursuant to Article 7 the Contracting Parties "shall take the necessary measures in their national legal orders to ensure compliance with their obligation to transfer their contributions." As stated in Article 4, however, during a transitional period of 10 years, "contributions raised at national level shall be transferred to the Fund in a manner such that they are allocated to national compartments corresponding to each Contracting Party." The size of the compartments of each Contracting Party shall be equal to the totality of contributions payable by the institutions authorized in each of their territories pursuant to the SRM Regulation, to be further determined in their specific amounts by the Single Resolution Board established by the SRM Regulation.

Article 5 prescribes in detail the modalities for the use and merger of the compartments of the SRF in case money is needed to wind up a failing bank. This is based on the following rules. "a) In the first place, costs shall be borne by the compartments corresponding to the Contracting Parties where the institution or the group under resolution are established or authorised. [...] b) In the second place, if financial means available in the compartments of the Contracting Parties concerned referred to in point a) are not sufficient to comply with the mission of the Fund [...], recourse shall be had to the available financial means in the compartments of the Fund corresponding to all the Contracting Parties. [...] c) In the third place, if the financial means used in accordance with point b) are not sufficient to comply with the mission of the Fund [...], recourse shall be had to any further financial means in the compartments corresponding to the Contracting Parties concerned referred to in point a). [...] d) In the fourth place, if financial means referred to in point c) are not sufficient to cover the costs of a particular resolution action, the Contracting Parties referred to in letter a) shall transfer to the Fund the extraordinary ex post contributions from the institutions authorized in their respective territories." As stated by Article 5(2) however, "[t]he Contracting Parties whose compartments have been used in a specific resolution case shall ensure that, where appropriate, their respective national compartments are replenished by their respective national banking sectors within a reasonable time period."

The controversial issue of the mutualization of the various compartments is instead dealt with in Article 5(4) and Article 5A. While, according to the former, "[a]ll the compartments corresponding to the Contracting Parties shall be merged and shall cease to exist after the elapsing of the transitional period," the latter authorizes temporary transfer between compartments at the condition that "[i]n such a case, the Contracting Parties concerned shall subsequently transfer to the Fund, before the transitional period has elapsed, an amount equivalent to the one received by their compartments, plus the interest accrued, so that the

other compartments are refunded." On the basis of Article 6, in any case, the use of the SRF shall be contingent upon the continuous respect of the general principles and objectives established in the SRM regulation and "any Contracting Party may declare the suspension of its obligation to transfer the contributions under Article 3 of this Agreement, in case the Court of Justice of the European Union finds, pursuant to the relevant actions and procedures laid down in the Treaty on the Functioning of the European Union, that the Council, the Single Resolution Board or the national resolution authorities have, in the exercise of their powers under [SRM Regulation] breached any of the rules and obligations [...] in the course of a particular resolution action."

Title IV of the international agreement, finally, outlines the general provisions of the treaty. According to Article 8 – which tracks a similar provision of the ESM Treaty[14] – the agreement "shall be ratified by its signatories in accordance with their respective constitutional requirements" and will enter into force "on the date when instruments of ratification, approval or acceptance have been deposited by signatories participating in the Single Supervisory Mechanism and in the Single Resolution Mechanism whose respective national compartments represent no less than 80% of the sum of the compartments of all the signatories." Article 9 conditions the operation of the agreement to the entry into force of the SRM regulation. At the same time, while Article 9(4) excludes the operation of the agreement vis-à-vis states that have not joined the SSM, Article 10 clarifies that the treaty remains open to EU member states which do yet adopt the Euro as their currency. Finally, whereas Article 12 provides for a financial compensation to non-participating member states for the costs the SRF may trigger on the general EU budget, Article 11 devolves – just like the Fiscal Compact[15] – to the ECJ the competence to settle disputes arising on the interpretation of the agreement. And Article 13 proclaims that "[w]ithin ten years, at most, of the date of entry into force of this Agreement, on the basis of an assessment of the experience with its implementation [...], the necessary steps shall be taken, in accordance with the Treaty on the European Union and the Treaty on the Functioning of the European Union, with the aim of incorporating the substance of this Agreement into the legal framework of the European Union."

3. Wrong legal arguments: EU regulations and international agreements

In adopting an international treaty to define the rules on the functioning of the SRF the member states have sought to ground in international law – rather than in EU law – their obligation to levy the financial resources necessary for the SRF and to transfer them to the SRF. Whereas the EU regulation on the SRM creates the SRF and sets the procedures for its operation, it is the intergovernmental agreement that requires the member states to pay money into the SRF. This point has been underlined at multiple stages in the draft international agreement on the SRF (in the version of January 2014). Pursuant to recital 7 "[t]he obligation to transfer contributions raised at the national level towards the Single Resolution Fund will not derive from the law of the Union. Such obligation will be established by this Agreement that lays down the conditions upon which the parties, in accordance with their respective constitutional requirements, agree to reciprocally transfer the contributions that they raise at the national level to the Fund and to its

[14] See ESM Treaty, Article 48.

[15] See Fiscal Compact, Article 8.

use." Moreover, Article 1 clarifies that by the agreement the Contracting Parties "commit to [...] transfer the contributions raised at the national level [...] to the Single Resolution Fund establish by the latter." And Article 7 of the agreement states that "Contracting Parties shall take the necessary measures in their national legal orders to ensure compliance with their obligation to transfer the contributions on a reciprocal basis in accordance with this Agreement."

For the avoidance of doubt, the member states as represented in the ECOFIN Council have made sure to include a reference to this point also in the draft SRM regulation. Pursuant to recital 11a of the SRM (as emerging from the draft of the December 2013 ECOFIN Council – which is still subject to negotiations with the European Parliament), it is now foreseen that the SRM regulation "establishes the modalities for the use of the Fund and the general criteria to determine the [...] contributions. [Nevertheless] Participating Member States remain competent to levy the contributions on the entities located in their respective territories [...] By means of an Agreement the participating Member States will assume the following obligations: to decide on the transfer of the contributions that they raise at the national level [...] and to allocate, during a transitional period, the said contributions to different compartments corresponding to each participating Member States. [...] However the obligation to transfer the contributions raised at the national level towards the fund will not derive from the law of the Union. Such obligation will be established by the [Intergovernmental Agreement]."

The decision to cut out from the SRM regulation and set through an international treaty the obligation of the member states to levy (from the banks) and transfer (to the SRF) the money for the functioning of the SRF has been forcefully advocated by Germany. Although the minutes of the ECOFIN Council are secret,[16] German Finance Minister Wolfgang Schäuble has repeatedly emphasized in public that the SRM could only stand on firm legal basis after a modification of the EU Treaties, and that, before the completion of such an amendment, a network of national funds could be put in place only through agreements between the member states.[17] Political arguments certainly play an important role behind the position of the German Government. Nevertheless, beyond politics, the position of the German Government also raises important legal questions. At first sight, it seemed that Germany was reluctant to endorse the establishment of a SRM out of concerns about the lack of a legal basis in the EU Treaties. Whereas Article 127(6) TFEU explicitly foresee the possibility of creating a SSM, centralized in the ECB,[18] no textual Treaty provision empowers the EU to create a SRM to wind up failing banks. For this reason, the German Finance Minister initially suggested caution and a two-steps approach which started with a resolution mechanism based on a network of national authorities as soon as the new SSM is operational.[19]

Nevertheless, by endorsing at the ECOFIN Council of December 2013 the Commission proposal for a regulation establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a single resolution mechanism and a single bank resolution fund – which is based on Article 114 TFEU, the harmonization clause of the

[16] See generally, D. Curtin, 'Challenging Executive Dominance in European Democracy', 77 *Modern Law Review* 1 (2014) 1.
[17] See in particular, W. Schäuble, 'Banking Union Must Be Built on Firm Foundations', Financial Times, 12 May 2013.
[18] See Council Regulation (EU) No 1024/2013.
[19] Schäuble, 'Banking Union Must Be Built on Firm Foundations'.

EU Treaties – Germany seems to have given up its opposition to the idea that the creation of a SRF as such fell outside the powers of the EU.[20] Article 64 of the draft regulation, after all, *creates* the SRF. As a result, it appears that the demand by the German Government to adopt an intergovernmental agreement imposing an obligation on the Contracting Parties to levy contributions for the SRF is not grounded on legal basis arguments anymore. Rather, the explanation for the German insistence on having an international treaty on the SRF seems to derive from a peculiar understanding on the nature of EU regulations and of their power to dictate conduct on the EU member states. As it appears from the debate, in particular, the German Finance Ministry has essentially opposed the establishment of the SRF simply through an EU regulation on the understanding that a secondary EU act *cannot* impose financial burdens on a member state. This debate echoes the discussion that took place – also at the academic level – at the time of the enactment of the Fiscal Compact whether an EU regulation could impose a constitutional amendment at the national level to incorporate a balanced budget obligation.[21] This debate has produced much confusion and it is time to cut it off once and for all.

Article 288 TFEU proclaims that "[t]o exercise the Union's competences, the institutions shall adopt regulations, directives, decisions, recommendations and opinions. A regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States." This provision – which has been part of the Treaties since the inception of the process of European integration[22] – introduces a clear and fundamental principle of the EU legal order: namely the capacity of EU institutions to develop laws that are directly binding within, and upon, the member states.[23] The addresses of EU regulations may be private parties – in which case, EU law pierces the veil of state sovereignty and affects directly individual and entities within the member states. Yet, the addresses of EU regulations may be *the member states themselves* – and the crucial point is that member states are here bound *because of EU law*, and without having the need to (or possibility of) adopting national measures to give effect to EU regulations.[24] This point is absolutely uncontroversial in the history of EU integration as evidenced by the most intrusive of all regulation adopted by the EU: the regulation on the multi-annual financial framework (MFF). This piece of legislation, which defines size of the budget of the EU, imposes on the member states pro quota an obligation to contribute to the budget of the EU.[25] As it is well known, the EU budget is mainly made of member states' contributions – and states contribute to the EU budget simply *because of* the EU regulation on the MFF.

[20] The legality of the legal basis of the proposal for the SRM has been endorsed also by the Legal Service of the Council. See the Opinion of the Legal Service of the Council of the EU, 7 October 2013, Doc. 14547/13.
[21] See further F. Fabbrini, 'The Fiscal Compact, The "Golden Rule" and the Paradox of European Federalism', 36 *Boston College International and Comparative Law Review* 1 (2013) 1.
[22] See already Article 189 Treaty establishing the European Economic Community (1957).
[23] See for all P. Craig & G. de Burca, *EU Law: Texts, Cases and Materials* (5th edition, Oxford University Press, Oxford, 2011), 105 (explaining that regulations are directly applicable because they "are part of the national legal systems, without the need for transformation or adoption by separate national legal measures").
[24] Ibid. (stating that the "Member States may […] need to modify their law in order to comply with a regulation, or they may need to pass consequential legal measures in order to give full effect to what is demanded by the regulation. This does not alter the fact that the regulation itself has legal effect in the Member States independently of any national law").
[25] See on the MFF, F. Bassanini & M.T. Salvemini, *Il finanziamento dell'Europa. Il bilancio dell'Unione e i beni pubblici europei* (Passigli, Firenze, 2010).

In a variety of fields the EU has adopted EU regulations that affect the EU member states and impose on them obligation to act in a pre-defined manner. Just in the context of the latest reforms of the EMU, EU regulations demand that member states establish independent fiscal councils to control the quality of the economic forecasts of national governments,[26] that they submit their draft budget bills to the European Commission for prior assessment of their compliance with the reinforced Stability and Growth Pact,[27] and that they renounce national supervision of transnational credit institutions to the benefit of the ECB.[28] Unsurprisingly, this has not surprised anyone. Whether one likes this state of affairs or not, it has always been a feature of the EU legal order that the EU institutions have the power to commandeer the member states and demand of them to carry out tasks mandated by the EU.[29] Of course, member states have retained the power under international law to adopt agreements outside the framework of the EU legal order.[30] In some cases the exercise of this power may even arguably be necessary, to address issues which fall outside the scope of EU law. But it can never be argued that the use of international law is justified because EU law lacks the power to impose obligations on the member states. As the Treaties make clear, EU regulations pursue precisely the function of providing the EU institutions with the legal instrument to impose obligations upon the member states.

In light of the above, the argument that the adoption of a separate international agreement is necessary to require the member states to contribute to the SRF is legally flawed. One can *politically* oppose the idea that (for a transitional period of 10 years) the member states will be asked to contribute to the SRF (pro quota of the size of their banking sector). But no one can *legally* argue that the EU institutions lack de jure the power to impose on the member states the obligation to contribute to the SRF (given that the EU has the competence to establish the SRF). EU regulations exist – and have always existed – precisely to impose obligations directly *qua EU regulations*. And to deny that EU regulations can perform this task – as the position of the German Finance Minister seems to suggest – would be to overturn 50 years of European integration and undermine the most effective instrument of governance that exists in the armory of EU law. The first conclusion that has to be reached on the draft agreement on the functioning of the SRF, therefore, is that this international agreement is not necessary. The goal of the treaty can perfectly well be achieved within the framework of EU law. In fact, they can be achieved through the SRM regulation which the Council endorsed and which is under negotiation with the European Parliament. From a legal point of view, nothing in EU law prevents an EU regulation

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[26] See Regulation (EU) 473/2013 of 21 May 2013 of the European Parliament and the Council on monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficits in euro-area Member States, [2013] OJ L 140, Article 5.

[27] See Regulation (EU) 473/2013, Article 6.

[28] See Council Regulation (EU) No 1024/2013.

[29] See D. Halberstam, 'Comparative Federalism and the Issue of Commandeering', in K. Nicolaidis & R. Howse, *The Federal Vision. Legitimacy and Level of Governance in the US and the EU* (Oxford University Press, Oxford, 2001) (explaining how in the EU the supranational authority are empowered to commandeer the member states and customarily relay on them to carry out their task, whereas in the US commandeering is constitutionally prohibited but the federal government is endowed with the instrument – notably a large public administration – to exercise directly a number of tasks).

[30] See Bruno de Witte, *International Treaties on the Euro and the EU Legal Order* (2012) (unpublished manuscript on file with author) (underlying how resort to international treaties adopted outside the EU legal order proper has a long pedigree in the history of EU integration).

from establishing the ways and means through which the member states of the Eurozone have to contribute to the SRF which is needed for the proper functioning of the EMU.

4. *Worrisome policy implications: The specter of the courts*

As much as the justification for the use of an international agreement to set up the obligation for the member states to contribute to the SRF rests on a flawed legal argument, resort to an international agreement to create the SRF is liable to create future policy problems – problems that would be largely avoided if the SRF were to be set up normally through an EU regulation. These problems are linked to the ability of courts at the domestic level to review and, possibly, to suspend or strike down, international treaties ratified by the member states. As I have explained in detail elsewhere,[31] during the last three years courts in the EU have acquire an unprecedented influence in the field of economic and financial affairs. Many of the measures adopted to respond to the Euro-crisis – such as the Fiscal Compact, the ESM Treaty but also the implementing measures of memoranda of understandings agreed upon by states in financial distress and the troika of international lenders – have fall under the scrutiny of courts, at the national and the supranational level.[32] Courts have, by and large, validated the reforms of EMU. Nevertheless, over-time courts have also expressed their discomfort for specific aspects of the new EMU, especially those on financial stabilization and economic adjustment – and in some recent cases have even introduced important conditions on the validity of the measures under review or struck them down tout court.[33]

In particular, a prominent player in the oversight of latest EMU reforms has been the Federal Constitutional Court of Germany.[34] To begin with, on 7 September 2011, the Constitutional Court delivered a judgment on the compatibility with the German Basic Law of the first rescue package adopted to aid Greece.[35] The Court declared the case admissible but rejected the constitutional complaints, holding that the two pieces of legislation under review did not violate the Parliament's budgetary autonomy.[36] The Court however affirmed that any large amount of financial aid had to be approved by Parliament as the locus of democratic legitimacy, and thus required an interpretation of the legislation as imposing prior involvement of the Parliament on every decision by the German Government to accord financial guarantees.[37] Subsequently, the

[31] F. Fabbrini, 'The Euro-Crisis and the Courts', p. 50.
[32] See e.g. Supreme Court of Estonia, Judgment of 12 July 2012, case 3-4-1-6-12 (upholding the constitutionality of the ESM Treaty); Constitutional Council of France, decision No. 2012-653DC, judgment of 9 August 2012 (upholding the constitutionality of the Fiscal Compact); ECJ, Case C-370/12, *Pringle v. Gov't of Ireland*, judgment of 27 November 2012, nyr (declaring the ESM Treaty compatible with EU law).
[33] See e.g. Constitutional Tribunal of Portugal, Acórdão N° 187/2013, judgment of 5 April 2013 (striking down several provisions of the budget law agreed upon by the Portuguese government and the troika of international lenders as in violation of the Portuguese Constitution).
[34] See F. Lamaître, 'L'Europe à l'épreuve des tribunaux', Le Monde, 2 October 2012.
[35] Constitutional Court of Germany [BVerfG], Case No. 2 BvR 987/10, judgment of 7 September 2011 (upholding the EFSF and the Euro-rescue package).
[36] Ibid., §94 and §119.
[37] The decision opened a stream of litigation before the Constitutional Court on the precise role of the Parliament vis-à-vis the Government on issues related to the responses to the Euro-crisis. See BVerfG, Case No. 2 BvE 8/11, 28 Feb. 2012 (holding that legislation allowing a special 9-member committee of the *Bundestag* to authorize, in cases of emergency, the government to act in the management of the EFSF violated the right of the Parliament, as a whole, to be involved in decisions relating to the EFSF); BVerfG, Case No. 2 BvE 4/11, 19 June

Constitutional Court was asked to review the constitutionality of the Fiscal Compact, the law ratifying the amendment to Article 136(3) TFEU and the ESM Treaty. In its preliminary judgment of 12 September 2012, the Court rejected the request for temporary injunction, holding that the measures were compatible with the German Basic Law.[38] In the case of the ESM Treaty, however, the Court explicitly required the German government to accompany its ratification with two declarations under international law clarifying that nothing in that Treaty could be interpreted as increasing the share of Germany to the ESM capital without the *Bundestag* approval or as depriving the *Bundestag* of the right to obtain all information about the internal functioning of the ESM.[39] In its decision, therefore, the Court professed to strengthen the role of the German Parliament, but effectively empowered itself to review any decision by the German Parliament whose effect may be to reduce the *Bundestag*'s overall budget responsibility.[40] Finally, on 7 February 2014 the Constitutional Court ruled that it would deliver a final judgment on the merits of the ESM case in March 2014, and simultaneously raised a preliminary reference in front of the ECJ in another case dealing with the legality of the Outright Monetary Transaction policy of the ECB.[41] While the reference to the ECJ – the first in the history of the German Constitutional Court – marked headlines, the nature of the reference (framed as an indictment of the ECB), and the legal basis on which the German Constitutional Court came to adjudicate the case revealed how much the Court has overstepped its boundaries and colonized with its case-law the field of EU economic governance – as openly acknowledged in two forceful opinions dissenting from the majority ruling.[42]

As I have argued, the main explanation for the rise of judicial review in the economic and financial affairs – in Germany, but also elsewhere – lays in the overall strategy pursued by the EU member states in responding to the Euro-crisis.[43] While a number of reforms to the architecture of EMU have been carried out in the framework of EU law, to a large extent the member states have decided to act outside the EU legal order, tightening budgetary constraints, establishing new mechanisms of financial stability and setting up a framework for economic adjustment for countries in fiscal troubles *through international agreements*. This strategy is the direct result of an intergovernmental model for the management of the Euro-crisis, which has stressed the centrality of national governments in the European Council, and their freedom to act through agreements outside EU law, rather than the centrality of the EU institutional machinery and the

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2012 (holding that the Government had violated the right of the Parliament to be fully and comprehensively informed about the negotiation undertaken at the EU level for the adoption of the Euro-plus Pact and of the ESM Treaty). See S. Schmidt, 'A Sense of *Déjà Vu*? The FCC's Preliminary European Stability Mechanism Verdict', 14 *German Law Journal* 1 (2013) 10-11.

[38] BVerfG, Case No. 2 BvR 1390/12 et al., judgment of 12 September 2012.

[39] Ibid., §209.

[40] See K. Schneider, 'Yes, But…One More Thing: Karlsruhe's Ruling on the European Stability Mechanism, 14 *German Law Journal* 1 (2013) 54.

[41] See BVerfG, Case No. 2 BvR 1390/12, 2 BvR 1421/12, 2 BvR 1438/12, 2 BvR 1439/12, 2 BvR 1440/12, 2 BvR 1824/12 and 2 BvE 6/12, order of 7 February 2014.

[42] See Ibid. Separate Opinion of Justice Lübbe-Wolff (arguing that the Court "exceed[ed its] judicial competence" and should have rejected the case as inadmissible) and Separate Opinion of Justice Gerhardt (holding that "[t]he citizens can influence the way and objectives of the political process through petitions, the political parties and Members of Parliament" and emphasizing how the fact that none of the German institutions had responded to the OMT policy of the ECB "does not indicate a democratic deficit, but is an expression of its majority decision for a certain policy when handling the sovereign debt crisis in the euro currency area").

[43] F. Fabbrini, 'The Euro-Crisis and the Courts', p. 60

potentials of EU law to address the crisis.[44] Yet, responding to the Euro-crisis through an intergovernmental approach has come with a high price in terms of judicialization.[45] In most state jurisdictions, supreme or constitutional courts are empowered to review *a priori* international treaties. As such, the use of intergovernmental agreements to reform the EMU has empowered courts to intervene in economic affairs to an unprecedented degree.

It is my opinion that this rising trend of judicial involvement ought to be assessed with some skepticism. There are indeed strong *constitutional* arguments that plead in favor of letting the political branches, rather than the courts, take fundamental decisions in the fiscal arena. As Daniel Halberstam has explained, in separation-of-powers systems three main considerations should guide the allocation of competences among alternative institutions: expertise, voice and rights.[46] The first consideration asks which actor has the better claim of knowledge or instrumental capacity to take a decision in a given field. The second asks which actor has the better claim of representing the relevant political will. And the third asks which actor is better placed to protect rights. In the fiscal domain, the first and second considerations (expertise and voice) strongly plead in favor of letting the political branches, rather than the courts, take decisions. At the same time, the third consideration (rights) does not play a fundamental role in the economic domain so as to change the balance of institutional capacities in favor of greater judicial involvement.[47] For this reason I have argued that future reforms of EMU ought to be accomplished within the framework of EU law: this framework is not only more legitimate in democratic terms (because of the involvement of the Parliament on par with the member states in the Council), but also more secure in judicial terms (because of the more limited space for judicial overreach).

It is indeed a core principle of EU law that national courts cannot review the legality of EU legislation:[48] national courts can refer a preliminary question to the ECJ, but only the ECJ can declare an EU act void.[49] As a result, contrary to the Fiscal Compact and the ESM Treaty, the reforms of the EMU architecture adopted through EU regulations and directives – for instance the so-called "Six-Pack", the "Two Pack", or the European Financial Stability Mechanism (EFSM)[50] – have all escaped review at the national level, while remaining the potential object for control by the ECJ. Although none of this measure was eventually referred to the ECJ, the fact that the ECJ has a role in reviewing the EU legal measures adopted in response to the Euro-crisis is consistent with the idea of the rule of law in the EU. As such, the adoption of reform to the architecture of EMU via EU legislation would not provide a waterproof shield against the possibility of judicial oversight and invalidation of legal measures adopted in response to the Euro-crisis. Nevertheless,

[44] See also S. Fabbrini, 'Intergovernmentalism and Its Outcomes: The Implications of the Euro Crisis on the European Union', *Comparative Political Studies* 1 (2013) 2.
[45] See M. Shapiro & A. Stone Sweet, *On Law, Politics and Judicialization* (Oxford University Press, Oxford, 2002), p. 71 (defining judicialization as the process of mutation of the role of the judicial power with its growing capacity to shape strategic behavior of political actors).
[46] D. Halberstam, 'Constitutional Heterarchy: the Centrality of Conflict in the European Union and the United States', in J. Dunoff & J. Trachtman, *Ruling the World* (Cambridge University Press, Cambridge, 2009), 326, 337.
[47] See further F. Fabbrini. 'The Euro-Crisis and the Courts'.
[48] See e.g. P. Craig & G. De Burca, *EU Law*, p. 453 (stating that "national courts cannot themselves find that an EU norm is invalid").
[49] Case 314/85, *Foto-Frost*, ECR [1987] 4199 (holding that only the ECJ can quash EU legislation).
[50] Council Regulation (EU) No. 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism, [2010] OJ L 118/1.

there are two distinct advantages in having exclusively the ECJ review, and at worse annul, measures adopted to tackle the Euro-crisis. To begin with, a positive feature of the centralization of review in the ECJ is that the validity of a legal measure will be conditional on the approval of *one court only*. On the contrary, the decentralization of review multiplies the potential authorities empowered to invalidate a legal measure, giving to the latter a higher degree of instability – as confirmed by the worries and uncertainties with which policy-makers and financial markets have awaited the decisions of several national courts on the ESM Treaty.[51]

Moreover, the centralization of review in the ECJ which result from the use of EU legislation is preferable because the ECJ is an *EU institution*, and can therefore better appreciate the legality of a measure adopted at the supranational level from an EU perspective. National courts, on the contrary, adjudicate international treaties purely on the basis of domestic benchmarks, and in light of national doctrines and jurisprudences. For structural reasons national courts are not designed – nor expected – to take into account the broader European legal perspective.[52] Yet, this is liable to obliterate the European dimension of the legal measures under review. As was explained in Section 2, the draft international agreement on the functioning of the SRF is inherently connected to EU law, it complements it, and develops upon it. As such, it is necessary that EU legal arguments and counter-arguments be taken into account when judging upon it: the treaty cannot be examined as a self-standing legislative act. Given this state of affairs, the ECJ is certainly better placed to exercise judicial review. Since the member states have decided to act in concert at the European level, it should be a European institution that reviews their action on the basis of European standards. This seems to be nothing more than a fair application of the principle of subsidiarity:[53] if for reasons of scale or effect powers are exercised at the European level, judicial review of these powers ought to be activated, if at all, at the European level too.

In light of the above, it appears that the choice to define the functioning of the SRF through an international agreement has to be criticized for opening up new opportunities for national courts' interference in the economic and financial affairs. No doubt, the German Constitutional Court will be eager to state its view on the SRF. In fact, arguably the German Government has demanded that the SRF be established through an intergovernmental agreement to accommodate prior dicta of the German Constitutional Court that financial obligations from Germany must be approved by the Bundestag – and subject to review by the Constitutional Court. Yet, if it is understandable that the German national government feels compelled by its own Constitutional Court, there is no reason why the EU institutions and the other member states shall agree to an international treaty because of Karlsruhe's request. For the reasons explained in the previous paragraph, EU regulations provide a perfectly legitimate and adequate legal instrument to establish a SRF by imposing financial obligations on the member states. And for the reasons discussed in this paragraph, the rise of a pervasive judicial oversight of economic and financial

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[51] See e.g. *European Economics Strategy: Concerns about the German Constitutional Court*, Morgan Stanley report, 30 August, 2012 (emphasizing major financial risks if the German Constitutional Court strikes down the ESM Treaty).

[52] See also I. Pernice, 'Domestic Courts, Constitutional Constraints and European Democracy: What Solution for the Crisis?', in M. Adams, F. Fabbrini & P. Larouche, *The Constitutionalization of European Budgetary Constraints* (Hart, Oxford, 2014) 297.

[53] On the principle of subsidiarity in EU law see F. Fabbrini, 'The Principle of Subsidiarity', in R. Schütze & T. Tridimas, *The Oxford Principles of EU Law* (Oxford University Press, Oxford, 2014).

measures does not withstand constitutional arguments related to expertise, voice and rights. All in all, therefore, the establishment of the SRF should be brought back within the SRM regulation – a measure which would only be subject to judicial review before the ECJ.

5. Conclusion

The new EU Banking Union relies on the SSM, the SRM and the Single Deposit Guarantee Scheme. As the European Council has stated, "the SRM will represent a crucial step towards the completion of the Banking Union."[54] At the same time, it is crucial that the Banking Union is built soundly. On December 2013 the ECOFIN Council reached agreement on a package of measures to establish the SRM. This includes an EU regulation, to be adopted together with the European Parliament. But it also includes an international agreement, by which the governments of the Eurozone member states commit to contribute to the funding of the SRF outside the framework of EU law. As this paper has argued, the use of an intergovernmental agreement – a treaty under international law – is not justified in legal terms and is liable to create problems in policy terms. From a strictly legal point of view – and contrary to the opinion seemingly advanced by the German Finance Minister – there is nothing in EU law that prevents the EU from imposing financial obligations on the member states through an EU regulation. Since the incipit of EU integration, regulations have served the purpose of mandating specific action on the member states, notably imposing upon them a duty to contribute to the EU budget. The SRF is no different. As a result, the establishment of the SRF can be normally accomplished within the text of the SRM regulation currently under negotiation with the European Parliament.

Furthermore, as this paper has emphasized, establishing the SRF through an international agreement creates the potential for a plurality of national supreme and constitutional courts to review the legality of the SRF based on national principles. As constitutional arguments related to expertise, voice and rights pleads in favor of letting the political process – rather than the courts – take decisions in the economic and financial domain, the choice to adopt a legal measure that widens the space for judicial overreach is regrettable. From this point of view, on the contrary, establishing the SRF within the SRM regulation would be preferable. EU regulations are only subject to review, possibly upon referral by national courts, in front of the ECJ. While the review by the ECJ ensures that all legal measures adopted by the EU comply with the principle of legality, the centralization of review, and the attribution of review to an institution that operates at the supranational level, are to be preferred to the devolution of oversight to scattered national judges which are bound to scrutinize the legality of the SRF purely on national legal grounds. Also from a policy perspective, therefore, it is advisable that the SRF be brought back within the SRM regulation. Not only is EU legislation more legitimate in democratic terms, because of the involvement of the European Parliament besides the member states in the Council, but is also more secure in judicial terms, because of its subjection only to the oversight of the ECJ.

Given the legal and policy weaknesses of the draft international agreement on the functioning of the SRF, the Parliament should take advantage of its position as co-legislator in the adoption of the SRM regulation to force the member states of the Eurozone to abandon the

[54] European Council, Conclusions, 20 December 2013, EUCO 217/13, §29.

intergovernmental strategy and bring back the international agreement on the SRF within the framework of EU law. The regulation on the SRM offers the perfect context in which the SRF can be regulated, and the states' contributions required. The Parliament should state that there is no need – from a legal point of view – of an international agreement to create a SRF and mandate states to pay up the fund. An EU regulation will do. In fact, an international agreement will be bad for the further opportunities it will create for courts – in Germany and elsewhere – to rule on how best to address the Euro-crisis. The stability of the EU banking sector is too important to be left under the threat of judicial invalidations from state courts scattered throughout the EU. The voice of the European Parliament, as advised by the Committee of Economic and Financial Affairs,[55] is thus crucial at this point to make sure that a SRM, inclusive of a SRF, is adopted by the EU in the manner which is fitting and adequate to meet the challenges posed by the Euro-crisis and increased interdependence within the Eurozone.

[55] See supra note 10.

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