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Short Study:

An intergovernmental treaty on the SRM violates European law and can be challenged in the court

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I. Background

On 10 July 2013 the European Commission presented a 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 (COM(2013) 520 final, hereinafter: SRM regulation). This proposal contains rules on the establishment of a single bank resolution fund (hereinafter: SRF, Chapter 2 of the SRM regulation proposal). According to this proposals credit institutions established in euro area Member States as well as in those that entered into a close cooperation with the ECB with regard to banking supervision under the SSM Regulation shall contribute to the SRF without any distinction as to the place of establishment of the respective credit institution. The use of the fund as a whole is clearly defined in Article 71 of the draft regulation.

In its meeting of 18 December 2013 the ECOFIN Council decided, in parallel to the to the SRM regulation, an "intergovernmental agreement" (hereinafter: IGA) on the SRF which provides for national compartments of the Fund to which the contributions that are raised by the participating Member States at national level are allocated. These national compartments shall merge progressively over a period of ten years into a single fund. The use of the fund is, as a first step, limited to the national compartments of the home and host Member State of the credit institution under resolution. If the means of this national compartment are exhausted the IGA shall provide for a complicated mechanism according to which, as a second step, a progressively increasing share of the other compartments may be used before, as a third step, *ex post* contributions may be raised at national level.

The proposal of the Commission and the envisaged IGA differ with regard to the (EU or national) authority to which the contributions are to be paid by the credit institutions and with regard to the use of the fund for credit institutions under resolution (the fund as a whole or national compartments of the fund).

II. Infringements of EU law by the IGA

The European Commission based its proposal entirely on Article 114 TFEU which provides for the ordinary legislative procedure. Legal scholars as well as the legal services of the European Commission and the Council consider that the legal base of Article 114 TFEU covers all subject matters of the proposal of the SRM regulation. The decision to outsource parts of the rules on the SRF from the SRM regulation into an IGA leads to a **conflict between Community method and Union method**.

On the one hand, there is the right of initiative of the European Commission, the co-decision rights of the European Parliament and the qualified majority voting among the representatives of the 28 Member States in the Council. On the other hand, there is a drafting by the representatives of the participating subset of Member States without any formal involvement of the European Commission, the European Parliament and the Council including the impossibility for the European Parliament to

amend the draft. The IGA has to be voted by unanimity of the future Contracting Parties and has to be ratified by all the Contracting Parties.

The proposed IGA therefore infringes the principle of sincere cooperation as enshrined in Article 4(3) TEU, the principle of institutional balance (Article 13 TEU), the principle of democracy (Article 10 TEU) and the rights of the Commission under Article 291(2) TFEU.

1. On the infringement of the principle of sincere cooperation (Article 4(3) TEU)

Pursuant to the principle of sincere cooperation, established in Article 4(3) TEU, Member States are required, inter alia, to refrain from any measure which could jeopardise the attainment of the Union's objectives and which could thwart the EU legal order. The system of checks and balances between the Member States, represented by the Council, and the EU, represented by the European Commission and the European Parliament, is at the constitutional core of the EU legal order. If, therefore, the adoption of a Union legal act is legally possible on the basis of a Union competence which refers, in particular, to the ordinary legislative procedure, such an act shall be adopted on the basis of this competence. If it were at Member States' discretion to choose between, on the one hand, the conclusion of an International Treaty, which is drafted by the Member States, negotiated by the Member States without any kind of formal involvement of the Commission and the European Parliament and , on the other hand, the adoption of a legal act, in accordance with the ordinary legislative procedure, where the proposal is exclusively drafted by the European Commission and where the European Parliament has the right to amend and to block any kind of provisionthe whole system of checks and balances would be rendered meaningless.

Member States are therefore under a legal obligation to sincerely respect the Union legislative procedures foreseen by a Union competence if the conditions for the use of this competence are fulfilled and the legislative procedure is initiated by a Commission proposal.

2. On the infringement of the principle of institutional balance and the principle of democracy

The European Court of Justice (ECJ), furthermore, consistently held that the Parliamentary participation rights in legislative procedures "provided for by the Treaty constitutes an essential formal requirement breach of which renders the measure concerned void. Effective participation of the Parliament in the legislative process of the Community, in accordance with the procedures laid down by the Treaty, represents an **essential factor in the institutional balance** intended by the Treaty. This function reflects the **fundamental democratic principle** that the people should take part in the exercise of power through the intermediary of a representative assembly" (ECJ, Case C-392/95, Parliament v Council [1997] ECR I-3212, paragraph 14; Case C-21/94 Parliament v Council [1995] ECR I-1827, paragraph 17).

3. Starting point of standstill obligations of Member States

Yet, Article 2(2) TFEU states that, in the case of shared competences, Member States remain free to act as long as the Union did not legislate and adopt legally binding acts in that area. Member States shall, however, also refrain from any measures which may circumvent the legislative procedure under the "Community method". The important question is therefore from which moment on Member States are not free anymore to conclude an International agreement instead of adopting an EU legal act under the ordinary legislative procedure. This problem is not yet decided by the ECJ. The European

Court of Justice, however, decided already in cases of external action of the EU where the same conflict between concerted EU action on the one hand and Member States' freedom to conclude International Treaties on the other occurs. In a recent case the ECJ decided that, first, the "duty of genuine cooperation [Article 4(3) TEU] is of general application and does not depend either on whether the Community competence concerned is exclusive or on any right of the Member States to enter into obligations …". Second, "where it is apparent that the subject matter of an agreement or convention falls partly within the competence of the Community […], it is essential to ensure close cooperation between the Member States and the Community institutions, both in the process of negotiation and conclusion and in the fulfilment of the commitments entered into." Third, "the Court has held that Member States are subject to special duties of action and abstention in a situation in which the Commission has submitted to the Council proposals which, although they have not been adopted by the Council, represent the point of departure for concerted Community action" (ECJ, Case C-246/07, Commission v Sweden [2010] ECR I-3317, paragraphs 71 to 74).

Therefore standstill obligations of Member States with regard to an alternative conclusion of an international agreement start once the Commission presented the proposal for a legal act on the basis of a legal base which provides for the ordinary legislative procedure.

4. On the infringement of Article 291(2) TFEU

Article 291 TFEU deals with the implementation of EU law. It therefore concerns the question of raising the contributions for the SRF. As a matter of principle, Article 291(1) TFEU sets out the fundamental rule that implementation of EU law falls within the remit of Member States. When securing implementation of legally binding EU measures in a more uniform manner than would otherwise be possible, implementing powers can be conferred on the Commission, or under certain restrictive conditions, the Council (Article 291(2) TFEU). As a consequence implementing powers can be exercised at the EU level instead of the national level. Article 291 TFEU makes therefore clear that either implementation of EU law is made by every single Member States on its own or, if uniform implementation of EU law is required (as in the case of raising contributions for a uniform fund at EU level), it shall be made by Union bodies such as, in particular, the European Commission.

The establishment of a mechanism in the IGA that implements the SRF in a uniform manner but excludes Union bodies from doing so infringes on the distribution of implementing powers as foreseen by Article 291 TFEU.

III. On the possibilities for a Court action

1. Limited possibilities for the European Parliament to raise an action

The European Parliament has only limited possibilities to raise an action before the European Court of Justice. It may raise an action for annulment under Article 263 TFEU. The subject matter of such an action can only be Union acts. The IGA, however, is a Member States' act which can therefore not be challenged under Article 263 TFEU. Under Article 218(11) TFEU the European Parliament may request an opinion of the ECJ on the legality of International Agreements. This concerns, however, only Union agreements. The IGA at hand will be a Member States' agreement without any Union involvement so that the European Parliament cannot challenge the IGA under Article 218(11) TFEU.

Acts of Member States that violate EU law can only be challenged by the European Commission under Article 258 TFEU or by other Member States under Article 259 TFEU. The Commission's power to initi-

ate infringement proceedings against a Member State is, according to the wording of Article 258(2) TFEU (the Commission "may bring the matter before the Court of Justice"), a discretionary power.

2. Possibility for the European Parliament to oblige the European Commission to initiate infringement proceedings against Member States

Any discretionary power may turn in certain situations into an obligation to act (in German: *"Ermessenreduzierung auf Null"*). This applies as well to the discretionary power of the European Commission to raise an action under Article 258 TFEU. Such a turn of the discretionary power under Article 258 TFEU into a legal obligation may occur if there is a serious and evident breach of constitutional principles (cf. ECJ, Joined Cases C-402/05 P and C-415/05 P, Kadi [2008] ECR I-6351, paragraph 285) by Member States. The principle of democracy as enshrined in Article 10 TEU, the principle of institutional balance and the principle of sincere cooperation as well as the legislative procedures foreseen by the Treaties are part of those constitutional principles.

This reasoning is confirmed by a judgment of the General Court of 18 December 2009 (Joined Cases T-440/03, T-121/04, T-171/04, T-208/04, T-365/04 and T-484/04, Arizmendi [2009] ECR II-4883) in proceedings concerning the non-contractual liability of the European Commission with regard to the initiation of infringement proceedings against a Member State. It stated that "although, in the context of the powers which it derives from Article 226 EC [today's Article 258 TFEU], the Commission enjoys a discretion in deciding whether or not to initiate infringement proceedings and is not required to justify its decision (Case C-70/99 Commission v Portugal [2001] ECR I-4845, paragraph 17) and although it may address a reasoned opinion to the Member State concerned in the exercise of its powers, *it cannot be precluded that in very exceptional circumstances* a person may be able to demonstrate that such a reasoned opinion is vitiated with illegality constituting a *sufficiently serious breach of a rule of law* that is likely to cause damage to him" (paragraph 68). This judgment shows that the discretionary power of the Commission is bound by EU law and that a serious breach of EU law by the (non-)exercise of this discretionary power may give rise to claim damages. Damages may only be claimed if the Commission was in a position to only use its discretionary power in one particular way which corresponds to a legal obligation.

Therefore the discretionary power of the Commission to initiate infringement proceedings against Member States under Article 258 TFEU turns into a legal obligation to initiate such proceedings if Member States violate in an evident and serious manner constitutional principles of the EU Treaties. Avoiding the ordinary legislative procedure by enacting on the basis of international agreements or undermining the Commission's position in Article 291(2) TFEU when uniform implementation of EU legal acts is needed constitutes such an evident and serious violation of EU constitutional principles.