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THE NEW FINANCIAL STABILITY MECHANISMS AND THEIR (POOR) CONSISTENCY WITH EU LAW

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Abstract

This working paper examines the institutional reaction to the sovereign debt crisis in Europe. The response has so far consisted of three new financial mechanisms: the European Financial Stabilisation Mechanism, the European Financial Stability Facility, and the European Stability Mechanism. These have each a different legal basis and a specific regime. They display a varying degree of compatibility with EU law.

The institutional quick fix employed by Eurozone countries was essentially a resort to private law and traditional international law techniques. This constitutes a setback from the evolution of the EU, at the expense mainly of the European Parliament and the Court of Justice.

Keywords

European sovereign debt crisis; European Financial Stabilisation Mechanism; European Financial Stability Facility; European Stability Mechanism; no-bailout clause.

1. Introduction[*]

In response to the financial crisis, which has put under severe stress the capacity of several of its Member States to borrow on financial markets, the European Union and the Eurozone Members adopted a series of institutional measures. These constitute an inextricable mixture of European Union law, public international law as well as that of private and private international law. The measures consist essentially of the European Financial Stabilisation Mechanism, the European Financial Stability Facility, and – more recently – the European Stability Mechanism. Each of them has a different legal basis and a specific regime. And each of them has raised questions as regards to their relationship with EU law, in legal scholarship and even before courts[1].

This article aims at analysing each of them in order to bring to the forefront the complex legal nature of their bases, structures, and functioning. It further wishes to highlight several points that might cast doubt as to these mechanisms' conformity with EU law. The research question can thus be summarised as follows: To what extent are these entities consistent with EU law?

The structure of this article reflects these objectives. It briefly presents the essential traits of each of the new mechanisms in turn. It also focuses on the legal difficulties that may arise in the short as well as in the medium term. A crosscutting issue concerning Art. 125 TFEU is then examined. Finally, some tentative conclusions are drawn. The hypothesis is that the poor "readability" of the system currently in place is the result of the hasty decision-making made necessary in the face of the crisis. It also reveals the will of Member States to break free from the bulk of EU rules and resort to less constraining international and private law solutions.

Before starting to examine these measures, it must be recalled that the countries that were in need of assistance were Ireland, Portugal, and Greece. They have all adopted the Euro as their currency from 1999 (for the first two States) and 2001 (for Greece). Thus, Art. 143 TFEU (ex Art. 119 TEC) that provides for the possibility of granting mutual assistance, and specifically, the granting of limited credits by other Member States, subject to their agreement (Art. 143.2.(c)), could not be employed for them, since it is only available to Member States with a derogation (ie those which have not yet switched to the common currency).

2. The European Financial Stabilisation Mechanism

On 9 May 2010, the Finance Ministers at an extraordinary ECOFIN Council decided to create the European Financial Stabilisation Mechanism. Regulation 407/2010[2] mentions as its legal basis Art. 122(2) TFEU (ex Art. 100 TEC), which reads:

> "2. Where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control, the Council, on a proposal from the Commission, may grant, under certain conditions, Union financial assistance to the Member State concerned. The President of the Council shall inform the European Parliament of the decision taken".

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1 The reference is to the EU Tribunal - see Order of the General Court (Third Chamber) of 15 June 2011. *Thomas Ax v Council of the European Union*. Case T-259/10, not yet published; and to the German Federal Constitutional Court – see BVerfG, 2 BvR 987/10 vom 7.9.2011, Absatz-Nr. (1 - 142).

2 Council Regulation (EU) No 407/2010 of 11 May 2010 establishing a European financial stabilisation mechanism (OJ L 118, 12.5.2010, p.1).

Art. 122 does not specify the type of acts that can be adopted on its legal basis. As regards to Art. 100(1) TEC, the ECJ had affirmed that the Council had the freedom to choose the typology of acts[3]. Therefore, a binding instrument such as a regulation can be deemed legitimate and adequate to face these exceptional circumstances[4].

The second recital of Regulation 407/2010 states that "[s]uch difficulties may be caused by a serious deterioration in the international economic and financial environment", whilst the fourth underscores that "[t]he deepening of the financial crisis has led to a severe deterioration of the borrowing conditions of several Member States beyond what can be explained by economic fundamentals". Legal authors tend to agree: "the serious deterioration in the international economic and financial environment in the relevant period may be treated as an exceptional circumstance"[5]. This is an extremely important point to raise: arguably, only insofar as the borrowing capacities of Member States occurred under circumstances that did not reflect their economic situation, was a resort to Art. 122 TFEU legitimate. If interest rates matched the risk that investors could reasonably expect from the borrowing country, even if they reached high levels, the "exceptional occurrences beyond its control" would not have materialised. A "market failure" is the sole ground on which such a measure could be justified.

The assistance provided so far by the EFSM has been directed to Ireland and Portugal (up to €22.5 billion for Ireland and up to €26 billion for Portugal[6]), to be disbursed over three years. It thus appears to be consistent with Regulation 407/2010 and with Art. 122(2) TFEU. Should such assistance be provided to Greece, it would be rather dubious whether the legal basis would be respected. The condition specified in Art. 122(2) TFEU and repeated in Regulation 407/2010 is that the beneficiary Member State faces "exceptional occurrences beyond its control". In the Greek case, the borrowing difficulties of the State cannot be considered as fully provoked by external events. The lack of precision (to say the least) of official statistics concerning the budget had been acknowledged by the Commission: "the current set-up does not guarantee the independence, integrity and accountability of the national statistical authorities"[7], "the situation can only be corrected by decisive action of the Greek government […otherwise] the reliability of Greek deficit and debt data will remain in question"[8]. Such circumstances could reasonably explain the diffidence of financial markets. Consequently, a loan to Greece under the EFSM cannot be envisaged.

The EFSM essentially reproduces for the 27 EU Member States the basic mechanics of the existing Balance of Payments Regulation for non-Euro area Member States (which is based on Art. 143 TFEU)[9]. The procedure starts with the concerned Member State's evaluation of its financial needs in consultation with the Commission and the ECB. The country then has to present a draft economic and financial adjustment programme to the Commission and the Economic and Financial Committee.

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3 Judgment of the Court of 24 October 1973. *Balkan-Import-Export GmbH v Hauptzollamt Berlin-Packhof*. Case 5-73. P. 1091.

4 Viterbo, A.; Cisotta, R. *La crisi della Grecia, l'attacco speculativo all'euro e le risposte dell'Unione europea*, in Il Diritto dell'Unione Europea, 2010, n. 4, p. 980.

5 Seyad, S. M. *A legal analysis of the European Financial Stability Mechanism*. Journal of International Banking Law and Regulation, 2011, 26(9), p. 423.

6 European Union, *Investor Presentation*, 2 July 2012, p. 3. Available at

http://ec.europa.eu/economy_finance/eu_borrower/documents/eu_investor_presentation_en.pdf (last accessed on 18 July 2012).

7 Report by the Commission of 8 January 2010 on Greek government deficit and debt statistics (COM (2010)1 final, p. 4.

8 *Ibidem*, p. 5.

9 Council Regulation (EC) No 332/2002 of 18 February 2002 establishing a facility providing a mediumterm financial assistance for Member States' balances of payments (OJ L 53, 23.2.2002, p.1). Activated to date for Hungary, Latvia and Romania.

The Council, deciding on a qualified majority, can adopt a decision that has three facets. The first enumerates the details of the help to be offered: the amount, the average maturity, the pricing formula, the maximum number of instalments, the availability period of the Union financial assistance if it is a loan (Art. 3(3)a). If it takes the form of a credit line, it has to specify the fee for the availability of the credit line, the pricing formula applicable for the release of funds, and the availability period of the Union financial assistance (Art. 3(4)a).

Secondly, it must include the general economic policy conditions, determined by the Commission in liaison with the ECB, which are deemed necessary to re-establish sustainable borrowing conditions for the country. These reflect the "certain conditions" to which Art. 122(2) TFEU subordinates the grant of Union financial assistance.

Thirdly, the Council decision has to comprise "an approval of the adjustment programme prepared by the beneficiary Member State to meet the economic conditions attached to the Union financial assistance" (Arts. 3(3)c and 3(4)c). The assistance takes the form of a loan or of a credit line (which is an authorisation given to a Member State to draw funds up to a specified ceiling for a given period of time).

The Commission is the institution "empowered on behalf of the European Union to contract borrowings on the capital markets or with financial institutions" (Art. 2(1)). The Commission also has to conclude a Memorandum of Understanding with the beneficiary country. It will detail the general economic policy conditions established by the Council decision.

In comparison with Regulation 332/2002 on financial assistance for Member States' balances of payments, it is worth noting that Art. 7(1) of the latter does not find an equivalent in the EFSM Regulation. The provision states that "Where the Commission takes the view that the characteristics [of the successive instalments] desired by the Member State will lead to Community financing that runs counter to the technical constraints imposed by financial markets or is such as to tarnish the reputation of the Community as a borrower on those same markets, it has the right to withhold its agreement and propose an alternative solution". Arguably, such a rule can be implicit in the EFSM, since subsequent instalments must be negotiated between the concerned country and the Commission (Art. 6(2) of Regulation 407/2010). On the other hand, the lack of an analogous provision in the EFSM Regulation could be interpreted as requiring the Council's intervention in such cases. Thus, a shift of power from the Commission toward the Council, the most political and the least communitarian amongst the EU institutions, might have taken place. This is the first instance in a movement towards the intergovernmental approach, which can be discerned throughout the measures under scrutiny.

Continuing the comparison with Regulation 332/2002, it is a welcome novelty[10] that the EFSM Regulation included Art. 8(3): "…the European Court of Auditors shall have the right to carry out in the beneficiary Member State any financial controls or audits that it considers necessary in relation to the management of that assistance. The Commission, including the European Anti-Fraud office, shall in particular have the right to send its officials or duly authorised representatives to carry out in the beneficiary Member State any technical or financial controls or audits that it considers necessary in relation to that assistance". This provision can be read as a reaction to the misrepresentations by Greece of its economic situation. The article is particularly apt to ensure that the assistance is effectively used for the purposes agreed on. Moreover, it can strengthen the financial markets' confidence in the beneficiary Member State. Thus it could speed up the process leading to the conclusion of need for the emergency assistance.

To the same effect of expediting the end of the involvement of the EFSM, Art. 7 imposes the burden of the costs incurred by the EU on the concerned Member State. Such a provision underscores

[10] In 2009 Regulation 431/2009 was modified to the same effect. See Council Regulation (EC) No 431/2009 of 18 May 2009 amending Regulation (EC) No 332/2002 establishing a facility providing medium-term financial assistance for Member States' balances of payments, OJ L 128, 27.5.2009, pp. 1–2.

the principle of self-responsibility of the country, even in a context of economic solidarity amongst EU Member States.

Nevertheless, the role attributed to the European Parliament is remarkably limited. Art. 3(5) only provides for the transmission of the Memorandum of Understanding between the Commission and the beneficiary Member State to the assembly. This is however in line with what Art. 122(2) TFEU stipulates: "The President of the Council shall inform the European Parliament of the decision taken". Nonetheless, in consideration of the budgetary functions attributed to the European Parliament by Art. 14 TEU, a deeper involvement would have seemed more appropriate. As it has been affirmed, "One powerful arm of the budget authority [has been] left out"[11].

Concerning the follow up on the EFSM, in November 2010 the "Commission conclude[d] that the exceptional events and circumstances that justified the adoption of Regulation n°407/2010 establishing a European financial stabilization mechanism still exist and that the Mechanism should, therefore, be maintained"[12]. Art. 9(1) of Regulation 407/2010 affirms that the submission of a report by the Commission to the Economic and Financial Committee and to the Council every six months should take place "where appropriate". Since the report aims at verifying the effective subsistence of the exceptional circumstances and since the latter are the indispensable condition for the legitimacy of the assistance provision (under Art. 122(2) TFEU and under the Regulation itself), regular reporting would be more in line with the urgent and temporary nature of the EFSM, and ensure more transparency.

As far as its legal basis is concerned, this first instrument appears to be by far the most "orthodox", EU law-compliant measure. It is grounded on an ordinary regulation based on Art. 122(2) TFEU. The difficulty lies in the exceptional circumstances evoked by this provision, which ought to require continuous monitoring of the financial context, and which would impede assistance to Greece. Furthermore, it is perhaps ironic that the resources with which it is endowed are the smallest when compared to the other mechanisms: €60 billion, which was the margin available in the EU budget[13].

3. The European Financial Stability Facility

The Representatives of the Governments of the Euro Area Member States, "wearing their intergovernmental hats"[14], but meeting within the Council of the European Union on 9 May 2010, adopted a decision which foresaw the EFSF[15]. It is a political statement in which, in addition to the EFSM, leaders "commit to provide assistance through a Special Purpose Vehicle that is guaranteed on a pro rata basis by participating Member States in a coordinated manner and that will expire after three years".

Others could interpret this decision as an international agreement in simplified form. The wording of the text, however, appears to suggest rather the political, soft-law at best, nature of this Act. At any rate, even if one sees it as an international agreement, the EFSF itself would not by consequence become an international organisation, and the following considerations would still be valid.

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[11] Louis, J.V. 'The No-Bailout Clause and Rescue Packages', *Common Market Law Review* (2010), p. 983.

[12] Communication from the Commission to the Council and the Economic and Financial Committee on the European Financial Stabilisation Mechanism, COM(2010) 713 final, 30.11.2010.

[13] Pursuant to Art. 2(2) of Regulation 407/2010.

[14] De Witte, B. 'The European Treaty Amendment for the Creation of a Financial Stability Mechanism', *SIEPS European Policy Analysis*, 2011:6.

[15] Decision of the Representatives of the Governments of the Euro Area Member States Meeting within the Council of the European Union, ECOFIN, Brussels, 9 May 2010. Note of the General Secretariat of the Council No. 9614/10, http://register.consilium.europa.eu/pdf/en/10/st09/st09614.en10.pdf (last accessed on 18 July 2012).

The EFSF was incorporated in Luxembourg under Luxembourgish law on 7 June 2010. It has been incorporated with Luxembourg as its sole shareholder "to expedite its creation"[16]. The EFSF is a limited liability company. It is a special purpose vehicle, which, according to the *Encyclopaedia of Quantitative Finance*, "is a legal entity created by a firm for a specific business objective, usually in the context of securitization. SPVs are often used to finance a project or issue securities without putting at risk the original holder of the securitized portfolio"[17].

The UNCITRAL definition highlights a complementary trait:

> "Special purpose entities (SPE, also known as a "special purpose vehicle" or "bankruptcy-remote entity") are created to fulfil narrow or temporary objectives, such as the acquisition and financing of specific assets, primarily to isolate financial risk or enhance tax efficiency. An SPE is typically a subsidiary owned almost entirely by the parent corporation; certain jurisdictions require that another investor own at least 3 per cent. Its asset and liability structure and legal status generally makes its obligations secure even if the parent becomes insolvent. The corporation establishing the SPE can accomplish its purpose without having to carry any of the associated assets or liabilities on its own balance sheet, thus they are "off-balance sheet""[18].

Thus, such an instrument allows for a certain degree of separation between the capital allocated to it and that of its shareholders, namely the Eurozone Member States. On the other hand, the experience with SPVs has not always been laudable, making it a "concept borrowed from sometimes very non-transparent market instruments"[19].

Besides and after the Articles of Incorporation, an Agreement was signed on 7 July 2010 between the EFSF and the sixteen[20] Eurozone Member States (the EFSF Framework Agreement). The question may be raised as to the nature of an agreement that has, as its contracting parties, on the one hand a group of sovereign states and on the other a private Luxembourg company (whose shareholders are the very same countries). Such an instrument could evoke that of "international contract", a highly debated concept in international law. To make a long story short, the Permanent Court of International Justice had ruled out the very possibility of such a contract:

> "Tout contrat qui n'est pas un contrat entre Etats en tant que sujets du droit international a son fondement dans une loi nationale"[21].

Towards the end of last century, however, international investment law seemed to be the perfect habitat for the growth of such a notion. In the words of René-Jean Dupuy:

> "L'évolution qui s'est produite par rapport à la vieille jurisprudence de la Cour permanente de justice international tient à ce que, alors que pour celle-ci, le contrat ne pouvait pas relever du droit international parce qu'il ne pouvait pas être assimilé à un traité entre Etats, dans la conception nouvelle, les traités ne sont pas les seuls accords régis par ce droit. Encore qu'ils ne se confondent pas avec les traités, les accords entre Etats et personnes privées peuvent néanmoins, sous certaines

16 See *European Financial Stability Facility,* société anonyme, Grand duché de Luxembourg, *Memorial* C, 8 June 2010, No 1189, p. 57026.

17 Polizu, C. ; Jiang, J. Special-Purpose Vehicle (SPV). Encyclopedia of Quantitative Finance, 2010.

18 UNCITRAL. Legislative Guide on Insolvency Law. Part three: Treatment of enterprise groups in insolvency, 21 July 2010. Footnote No. 5. See also Basel Committee on Banking Supervision, The Joint Forum Report on Special Purpose Entities, Bank for International Settlements, September 2009.

19 Louis, J.V. 'The No-Bailout Clause and Rescue Packages', *Common Market Law Review* (2010), Note 11.

20 After Estonia adopted the Euro on 1 January 2011, it entered into the Framework Agreement. The current contracting Eurozone Member States are thus seventeen.

21 Cour Permanente de Justice internationale, « *Emprunts serbes et brésiliens* », France contre Brésil et France contre Yougoslavie, arrêts du 12 juillet 1929. Série A, n° 20, p. 41.

> conditions, relever d'une branche particulière et nouvelle du droit international : le droit international des contrats"[22].

Nevertheless, the law as it currently stands, does not seem to recognise such a category. National laws govern these contracts. The EFSF Framework Agreement thus has English legislation as its applicable law (Art. 16(1)). There is also a jurisdiction clause: Art. 16(2); this stipulates that the jurisdiction varies according to the parties. The Court of Justice has exclusive competence if the dispute concerns Eurozone Member States. Luxembourg courts have competence if the controversy is between one or several Member States and the EFSF.

For some, this has been a very innovative mixture of EU law and private financial law[23]. Other commentators opined nevertheless that it is reminiscent of intergovernmental cooperation, akin to the decisions of State representatives. These decisions were taken without respecting the Council's voting rules and their legal value depended on the Parties' will. This intergovernmental procedure surprises even more when one considers that after Lisbon, Eurozone Member countries can adopt measures to "strengthen the coordination and surveillance of their budgetary discipline" (Art. 136(1)a TFEU)[24]. The relationship between the EFSF and budgetary discipline is not clear: Art. 2(1)a of the Framework Agreement stipulates that the Commission negotiates with the Member State a Memorandum of Understanding on the loan, following the guidelines provided by a Council decision, taken on the basis of Art. 136 TFEU.

The situation becomes even further complicated by the choice of law contained in the Articles of Incorporation of the EFSF. Art. 24, commentating on the applicable law, stipulates that: "All matters not governed by these Articles shall be determined in accordance with the 1915 Law". The latter is the statute of Luxembourgish law "concernant les sociétés commerciales", last modified on 12 August 2011.

Thus, should a dispute concerning at once the EFSF Articles of Incorporation and the EFSF Framework Agreement arise, we would be faced with a practical example of *dépeçage*, that is "The principle of applying different national laws to different aspects of a case"[25]. In other words, a controversy may involve issues regulated by both texts (e.g. the governance by the Board of Directors, to which Art. 10 of both instruments refers). Thus, the section that pertains to the Articles of Incorporation would be governed by the 1915 Law, and, one should add, Luxembourgish Law in general, whilst the section concerning the Framework Agreement would be governed by English Law. In practice, however, it would be difficult to distinguish issues pertaining to the former and to the latter. What would then happen in a case of conflict? The answer will most probably rest with the court called upon to hear the case.

Despite being often termed "a temporary institution", the EFSF has actually been created with an "unlimited duration". This is expressly stipulated in Art. 4 of its Articles of Incorporation. Yet, the provision also establishes that the Facility will no longer grant loans or establish financing programmes after 30 June 2013[26]. It will be dissolved and liquidated on the earliest possible date (after 30 June 2013) on which there are no longer loans outstanding to a Euro-area Member State, and all Funding Instruments issued by EFSF and any reimbursement amounts due to Guarantors have been repaid in full. This leads one to conclude that the EFSF will be running at least until 24 February

[22] *Texaco Overseas Petroleum Co./California Asiatic Oil Co. contre The Government of the Libyan Arab Republic*. Sentence préliminaire, 27 novembre 1975, §32.

[23] Smits, R. 'L'Euro(pe) à l'épreuve', *Cahiers de droit européen* (2010), p. 12.

[24] Martucci, F. *Le défaut souverain en droit de l'Union européenne*. In Audit, Mathias (ed.). *Insolvabilité des Etats et dettes souveraines.* L.G.D.J. : Paris, 2011, p. 254.

[25] *Cheshire and North's Dictionary of Private International Law*, 12th ed., Butterworths: London, 1992, p. 56.

[26] Yet, the general meeting of shareholders (Euro-area Member States) may decide to extend such date with a decision taken in conformity with the quorum and unanimity requirements of Art. 17.8 of the Articles of Incorporation.

2042[27], since it will only close when all outstanding debt has been repaid. Moreover, Recital 2 of the Preamble to the Framework Agreement stipulates that loan maturities can be extended for up to 30 years. The temporary institution is not exactly so after all…[28]

As regards to the functioning of the EFSF, it is meant to assist only Eurozone countries. This represents the first difference with respect to the EFSM. Art. 3 of the Articles of Incorporation makes clear that it is intended for: "Member States of the European Union in financial difficulties whose currency is the Euro".

The EFSF is not a fund into which Member States transfer money to concerned countries. The financial means are raised on the open investment market, and Member States simply provide guarantees. The funding instruments issued by the EFSF (bonds, notes, commercial paper, debt securities or other financing arrangements) are backed by "irrevocable and unconditional guarantees" (Recital 4 of the Preamble of the Framework Agreement). These guarantees will amount to up to EUR 779,783.14 million, according to the second Recital.

As the Preamble of the Framework Agreement states, the original instruments available to the EFSF were solely loan facility agreements. After 21 July 2011, however, the possibility of enacting Financial Assistance Facility Agreements was added. This includes: "assistance by way of loan disbursements, precautionary facilities, facilities to finance the recapitalisation of financial institutions in a Euro-area Member State (through loans to the governments of such Member States including in nonprogrammer countries), facilities for the purchase of bonds in the secondary markets on the basis of an ECB analysis recognizing the existence of exceptional financial market circumstances and risks to financial stability or facilities for the purchase of bonds in the primary market". Thus a wide spectrum of financial instruments is available to the EFSF.

The main elements of the often "time-consuming" [29] procedure are as follows. The mechanism begins with a request for a Financial Assistance Facility Agreement by a Eurozone country in need. The Commission, in liaison with the ECB and the IMF, is then authorised to negotiate a Memorandum of Understanding ("MoU"), with conditions on budgetary discipline and economic policy. As already mentioned, the MoU "shall be consistent with a decision the Council may adopt under Article 136(1) TFEU" (Art. 2(1)). The Commission will sign it after its approval by the Eurogroup Working Group. During the negotiations and the signature, the Commission acts "on behalf of the Euro-area Member States".

Once the Memorandum is in place, a Financial Assistance Facility Agreement must be negotiated. Here again, powers are shared between different entities. First, the Commission drafts the main terms of the Agreement. Second, the Eurogroup Working Group adopts a decision. Third, together with the latter, the EFSF shall "negotiate the detailed, technical terms of the Financial Assistance Facility Agreements" (Art. 2(1)(a)).

The first question that arises concerns the legitimacy of commissioning an array of functions to institutions and organs of the European Union. The most difficult issue relates to the Commission. A decision of the representatives of the governments of the 27 EU Member States, adopted in the context of the (Ecofin) Council on 9 May 2010, stipulates that "The 27 Member States agree that the Commission will be allowed to be tasked by the Euro area Member States in th[e] context [of the

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[27] €29.7 billion issue with a thirty-year long maturity, launch date: various dates (in conjunction with the Private Sector Involvement in Greece), maturity: 24/02/2042.

[28] Such a statement must however be nuanced. As will be explained *infra*, the European Stability Mechanism is supposed to succeed to the EFSF, taking its rights and obligations. Yet, since the ESM treaty is not yet in force, such a succession cannot be taken for granted.

[29] Deubner, C. *Facing the Test of Global Financial and Economic Crisis: Will the EU Rise to the Challenge and Deepen Integration?* Research project 2009 of the Foundation for European Progressive Studies. Brussels, January 2011, p. 76.

EFSF to come]"[30]. Such a decision can be read in two ways: as an agreement in simplified form or as an amendment to the EU treaties[31].

If it is regarded as an agreement in simplified form, it is hard to see how it could extend the competences attributed to the Commission, a EU institution. If it is to be seen as a revision of the EU treaties, such an amendment would probably not be recognised by the Court of Justice, since "According to settled case-law, a mere practice cannot override the provisions of the Treaty"[32]. Either way, the conferral of such a role to the Commission in the procedures of the EFSF does not appear to rest on firm ground.

The second issue concerns the jurisdiction attributed to the Court of Justice. Art. 16(2) of the EFSF Framework Agreement stipulates that "the Euro-area Member States agree that to the extent [the dispute] constitutes a dispute between them only, it shall be submitted to the exclusive jurisdiction of the Court of Justice of the European Union". On this matter, Art. 273 TFEU seems to offer a basis for such a clause: "The Court of Justice shall have jurisdiction in any dispute between Member States which relates to the subject matter of the Treaties if the dispute is submitted to it under a special agreement between the parties". Nevertheless, in the present case the submission is made within a private law agreement, governed by English law, whose contracting parties are not only EU Members, but also a limited liability company. Although the "special agreement", mentioned by Art. 273 TFEU, should have reasonably been a fully-fledged treaty between Member States governed by public international law.

In sum, the picture of the EFSF that emerges from this brief overview is rather puzzling. On the one hand, private law elements seem predominant. The legal basis comprises both the Articles of Incorporation under Luxembourgish law and the Framework Agreement between States acting *jure gestionis,* and the Facility itself, governed by English law. On the other hand, EU institutions and committees are involved. The Commission as well as the Eurogroup Working Group are tasked with important functions under the EFSF texts. The Court of Justice is moreover competent in case of a dispute between Eurozone countries.

Thus, the EFSF has a hybrid nature. Its future work will probably tell whether it is a clumsy step towards further European integration or a first move to private undertakings in a purely international context. Contrary to the EFSM, in this case the mechanism that raises the most legal doubts as to its nature and relationship with EU law is the one endowed with extreme levels of resources.

4. The European Stability Mechanism

The European Stability Mechanism is an international financial institution based on an international agreement between the seventeen Eurozone Member States. The nature of the instrument is fairly clear: a treaty governed by public international law, entered into by sovereign States. Therefore, it is not the product of the collective will of the Council, not even in the form of the Representatives of the Governments of the Euro Area Member States meeting within the Council of the European Union (contrary to the decision on the EFSF of 9 May 2010). This is confirmed by the Conclusions of the European Council of 24 and 25 March 2011: "The ESM will be established by a treaty among the

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[30] See Note of the General Secretariat of the Council No. 9614/10, available at http://register.consilium.europa.eu/pdf/en/10/st09/st09614.en10.pdf (last accessed on 18 July 2012).

[31] Viterbo, A.; Cisotta, R. 'La crisi della Grecia, l'attacco speculativo all'euro e le risposte dell'Unione europea'. *Il Diritto dell'Unione Europea* (2010), p. 986.

[32] Judgment of the Court of First Instance of 17 September 2007, *French Republic v Commission of the European Communities*, T-240/04, II-04035, paragraph 45.

Euro-area Member States as an intergovernmental organisation under public international law"[33]. Furthermore, it is stipulated in Art. 32(2) of the ESM treaty that it has full legal personality.

The ESM treaty is in the process of ratification by its future member countries, pursuant to their respective constitutional requirements[34]. According to Art. 48, the Treaty "shall enter into force on the date when instruments of ratification, approval or acceptance have been deposited by signatories whose initial subscriptions represent no less than 90% of the total subscriptions [of the authorized capital stock]."

The purpose of the ESM is stated at Art. 3: "to mobilise funding and provide stability support under strict conditionality […] to the benefit of ESM Members which are experiencing […] severe financing problems, if indispensable to safeguard the financial stability of the Euro area as a whole and of its Member States". The ESM stands in continuity with respect to the examined mechanisms. The first Recital of the Preamble states, "This European Stability Mechanism ("ESM") will assume the tasks currently fulfilled by the European Financial Stability Facility ("EFSF") and the European Financial Stabilisation Mechanism ("EFSM") in providing, where needed, financial assistance to Euro area Member States".

The ESM will thus be the successor to two programmes that have very different legal profiles. The EFSF is a private company, whereas the EFSM is an EU instrument based on a Regulation. Art. 40(2) provides for the possibility of a succession of the ESM to the EFSF by the acquisition of rights and assumption of obligations, in particular with respect to existing EFSF loan facilities. Such a transition from a *société anonyme* to an international financial body will necessitate careful legal preparation, and the provision requires the Board of Governors to oversee it. The transfer of competences from the EFSM to the ESM can be read as a move from EU-run mechanisms to a purely international law structure.

At the same time, the establishment of the ESM is made possible thanks to an amendment of the TFEU. Decision 2011/199/EU[35] of the Council added a third paragraph to Art. 136 TFEU, which envisages the creation of such a mechanism by Euro area countries. There is thus a progress from the emergency nature of the legal basis of the EFSM (Art. 122(2) TFEU) to the permanent nature of the ESM. Recital 4 of the Preamble of Decision 2011/199/EU makes it clear: "as this mechanism is designed to safeguard the financial stability of the Euro area as whole, Article 122(2) of the TFEU will no longer be needed for such purposes".

The modification of the legal basis, which this decision renders possible, has the consequence of changing the nature of the intervention. Whilst Art. 122(2) TFEU allows the EFSM to react in case of "natural disasters or exceptional occurrences beyond [the country's] control", Art. 136 requires that the assistance be granted when it is "indispensable to safeguard the stability of the Euro area as a whole". Thus, the initial response to exceptional circumstances becomes a preventive, permanent mechanism, which aims to eliminate the very possibility of such conditions. In other words, the scope of the new mechanism is strengthened, and is permitted to act at an early stage, before a full-blown crisis occurs.

There is an evident link between the ESM treaty and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (often referred to as the "Fiscal compact"). Recital

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[33] Conclusions of the European Council of 24 and 25 March 2011, Annex II, Term Sheet on the ESM, p. 22. Available at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/120296.pdf (last accessed on 18 July 2012).

[34] To monitor the ratification process, see http://www.consilium.europa.eu/policies/agreements/search-the-agreements-database?command=details&lang=en&aid=2012002&doclang=EN (last accessed on 18 July 2012).

[35] Decision 2011/199/EU amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro. OJ L 91, 6.4.2011, p. 1. Art. 2 indicates that the amendment shall enter into force on 1 January 2013, provided that all the national approval procedures have successfully been accomplished by that time.

5 of the Preamble subordinates the granting of financial assistance under the ESM to the beneficiary country's ratification of and compliance with the requirements of the TSCG. Like the ESM, the TSCG is an international public agreement between Eurozone members. The simultaneous development of a financial firewall and an economic governance branch raises the doubts as to the creation of a parallel, interrelated system outside the realm of EU law. Had these undertakings been adopted entirely within the EU ambit, the Union would have provided a coherent framework to coordinate these complementary arms.

Recital 7 of the Preamble touches upon the relationship between the ESM treaty and the Euro area. It stipulates "All Euro area Member States will become ESM Members. As a consequence of joining the Euro area, a Member State of the European Union should become an ESM Member with full rights and obligations, in line with those of the Contracting Parties". It is an obligation that suggests a chronological precedence of the membership in the Eurozone before adhering to the ESM treaty. Art 2(1) confirms this. Yet, such an obligation would be rather difficult to enforce once the country has already been admitted to the Eurozone. What appears more realistic from a practical point of view is that it will be dealt with during the negotiations on the accession to the Euro area of a new country. The latter will be required to commit to ratify the ESM treaty as a condition to adopt the Euro, albeit the ESM stands outside of the EU legal order.

Even though the ESM is not a part of the EU legal environment (it is a "créature non communautaire"[36]), it will be tightly linked to the Union as far as the granting of financial assistance is concerned. The Eurogroup, for instance, must inform the Council when a country requests its aid. Moreover, the Commission, in liaison with the ECB, will assess the level of public debt that the concerned Member State can bear. Furthermore, the Commission will sign the Memorandum of Understanding with the beneficiary country, and shall do so "on behalf of the ESM" (Art. 13(4)).

Therefore, in a manner analogous to the EFSF, the question of the involvement of EU institutions in the ESM arises. An authorisation of the representatives of the Governments of the Member States of the European Union was given on 20 June 2011 to the contracting parties of the ESM treaty. It allowed them to "request the European Commission and the European Central Bank ("ECB") to perform the tasks provided for in th[e] Treaty" (Recital 10). Such a basis does not seem to suffice. Repeating the reasoning developed *supra*[37], the decision can be read as an international treaty in simplified form or as an amendment of the EU treaties. Either way, the authorisation does not seem capable of enlarging the competences of EU institutions. Neither the Commission nor the ECB, as far as it has been possible to investigate, has adopted formal decisions to accept the functions entrusted to it by the ESM treaty. Thus, they have not given their consent to such an attribution in an agreement with the new entity. Relationships will develop on the basis of a mere practice.

As regards the procedures set out in the ESM treaty in order to obtain financial assistance, they essentially resemble those of the EFSF. It is, however, worth noting that Art 13(1)(a) adds a further condition before deciding whether to grant a financial assistance facility. The Commission, together with the ECB, will need "to assess the existence of a risk to the financial stability of the Euro area as a whole or of its Member States". The paradoxical flavour of the situation emerges if one recalls that the monetary union is an objective of the EU treaties, expressed in Art. 3(4) TEU ("The Union shall establish an economic and monetary union whose currency is the Euro"). And yet, when a menace to such a union materialises, an entity external to the EU legal order is to react. If effective (perhaps) from an economic point of view, the legal enterprise is certainly not satisfactory.

Such an impression persists even though Art. 13(3) envisages a requirement of conformity between the Memorandum of Understanding and EU law. The provision stipulates "The MoU shall be fully

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[36] Martucci, F. *Le défaut souverain en droit de l'Union européenne*. In Audit, Mathias (ed.). Insolvabilité des Etats et dettes souveraines. L.G.D.J. : Paris, 2011, p. 269.

[37] See chapter 3 above.

consistent with the measures of economic policy coordination provided for in the TFEU, in particular with any act of European Union law, including any opinion, warning, recommendation or decision addressed to the ESM Member concerned". Undoubtedly, such a condition is welcome, since it increases the compatibility of the ESM's action with Union law. Nevertheless, the clause only applies to the Memorandum of Understanding, and not to the whole of the ESM.

Furthermore, Art. 30(5) establishes that the annual report of the ESM be made accessible to the European Court of Auditors. Such a transparency requirement represents a positive feature. It does not however allow the European Court of Auditors to exercise its full mandate as set out in the EU treaties.

The fact that the ESM operates outside of the EU legal system may result in difficulties for the management of the ESM itself. For instance, when a country does not provide its payment subsequent to a capital call, Art. 25(2) stipulates that "[t]he Board of Governors shall decide an appropriate course of action for ensuring that the ESM Member concerned settles its debt to the ESM within a reasonable period of time". Legal proceedings against any possible failure to fulfil obligations under EU law are clearly not be available here, since the ESM lies outside of the EU legal order. Traditional issues of international law concerning State responsibility would thus arise.

The EU court has a limited scope of intervention as regards the ESM. Recital 16 states that "Disputes concerning the interpretation and application of this Treaty arising between the Contracting Parties or between the Contracting Parties and the ESM should be submitted to the jurisdiction of the Court of Justice of the European Union, in accordance with Article 273 of the Treaty on the Functioning of the European Union ("TFEU")". Unlike the EFSF Framework Agreement, the ESM treaty clearly includes a mention of the relevant TFEU provision. Furthermore, since it is a fully-fledged agreement among sovereign States, it seems to fulfil the requirements of Art. 273 TFEU.

The possibility to bring an action before the Court of Justice is however limited by Art. 37(3) of the ESM treaty. In case of a dispute among Member States, or between a Member State and the ESM on the interpretation and application of the ESM treaty, a decision of the Board of Governors is first to be requested. Only if a country contests it, can the Court of Justice hear the matter. Moreover, the Court will not assess the conformity of ESM's conduct or of its treaty with EU law, which is a further confirmation of its autonomy from such legal order.

The cooperation envisaged between EU and ESM institutions and the IMF on the conditionality imposed on beneficiary countries also needs careful consideration. A difficulty is that the EU is not a member of the IMF, which impairs the establishment of clearly defined, formal relationships. The practice followed to date is rather pragmatic: the drafting of the conditions as well as the assessment of their implementation is carried out by personnel of both the EU and the IMF, on joint missions.

The ESM treaty calls for the involvement of the IMF, since it affirms that "[a] Euro area Member State requesting financial assistance from the ESM is expected to address, wherever possible, a similar request to the IMF"[38]. Although it is not construed as a formal obligation, this "expectation" might result in practice with the participation of the IMF in all of the programmes adopted by the ESM. Art. 38 entitles the ESM to cooperate with the IMF and other international organisations, without providing further details. Thus, it seems desirable that the links between the two institutions be the object of a formal agreement in order to ensure higher legal certainty as to the respective fields of action and competences.

In sum, the European Stability Mechanism constitutes an international financial institution that has a wide array of instruments available to preserve the stability of the Euro area. The unfortunate characteristic is that it lies completely outside of the boundaries of the EU regime. Nevertheless, several EU institutions are required to perform activities on its behalf. The opaque bases on which

[38] Recital 8 of the Preamble.

such conferrals are grounded cast a dim light on the entire Mechanism. One cannot but agree with the opinion provided by the ECB in this regard:

> "A key element of the draft decision [to add a third paragraph to Art. 136 TFEU] is that it provides for an intergovernmental mechanism instead of a Union mechanism. The ECB supports recourse to the Union method and would welcome that, with the benefit of the experience gained, the ESM would become a Union mechanism at an appropriate point in time"[39].

5. The overarching issue of Art. 125 TFEU

There is an issue that permeates the debate concerning all of the institutional arrangements so far analysed. It regards Art. 125 TFEU (ex Art. 103 TEC), whose first paragraph stipulates: "The Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project".

This is the well-known "no bailout" clause. It maintains that the Union as well as its Member States do not assume liabilities or commitments in lieu of governments or public entities of fellow Members. Its importance cannot be neglected. It strengthens the principle of self-responsibility of each country with respect to its public debt. The provision relies on the market to establish the conditions under which EU countries will be allowed to borrow. Financial markets are thus supposed to impose discipline on Member States.

Broadly speaking two interpretations of Art. 125 TFEU are possible. Firstly it might be read as an absolute prohibition[40]. The EU and its countries are prevented from committing to be *ex ante* liable for, or assume *ex post,* the commitments of other Members. Otherwise, such behaviour would distort the ordinary activities of financial markets. Lenders would have an incentive to allow for lower interest rates, because they know other countries (or the EU) are also liable. This is closely related to the issue of 'moral hazard'. If a State knows that in any case other members of the monetary union will be liable for its debts, it might increase its expenditures without any restraint.

According to the second interpretation of Art. 125 TFEU, however, this provision simply excludes the existence of an obligation for the EU and its Members to be liable for other Members' debts[41]. They are under no obligation to do so. Instead they might spontaneously decide to act. This approach appears more balanced. The exclusion of an obligation to bailout member countries, however, should be accorded the role of a guideline.

In other words, the fact that neither the EU nor its Member States are required to be liable for other countries' debt is an indication of the important role financial markets are called upon to perform. As a rule, EU countries will have to borrow at the conditions private investors judge appropriate, taking into account the Member's economic and financial situation, without having the guarantee of a legal

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[39] Opinion of the European Central Bank of 17 March 2011 on a draft European Council Decision amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro (CON/2011/24), paragraph 8.

[40] For instance: Ruffert, M. *The European Debt Crisis and European Union Law*. Common Market Law Review, No. 48, 2011, p. 1785 *et seq.*

[41] Martucci, F. *Le défaut souverain en droit de l'Union européenne*. In Audit, Mathias (ed.). Insolvabilité des Etats et dettes souveraines. L.G.D.J. : Paris, 2011, p. 256.

duty of subrogation of other sovereigns. Thus, the market is to be allowed to play its role to the largest extent possible.

Under this approach the possibility of intervention opened by Art. 122(2) TFEU does not actually constitute an exception to Art. 125 TFEU[42]. It would rather indicate that "natural disasters or exceptional occurrences beyond [a country's] control" are an undoubtedly legitimate reason for the Union's (and, *a fortiori*, also Member States') assistance. It suggests the extreme circumstances under which a financial intervention is fully justified, and, perhaps, necessary (if the objective of promoting solidarity among Member States of Art. 3(3) TEU is taken into account). Thus, the EFSM represents a rightful instance of such an involvement.

Between the exceptional occurrences beyond a State's control and the ordinary, well-functioning situations of borrowing on the markets, EU law would arguably leave the field free for potential interventions. When the circumstances do not attain the level of Art. 122(2) TFEU, the EU and its Members have the political margin of manoeuvre to decide whether to act to aid a country in need. The evaluation of the negative consequences for the stability of the monetary union might then push States to intervene even when difficult borrowing conditions result from actions under the concerned country's control. Proportionality must be taken as a guiding principle when acting on such occasions[43]. The Union has to take into account the principle of self-responsibility of each country in its budgetary sustainability and not go beyond what it is necessary to re-establish appropriate financial conditions.

Such a position seems to be corroborated by the reasoning behind new Art. 136(3) TFEU. Thus, the amendment would not introduce a derogation from the absolute prohibition of Art. 125 TFEU. Rather, it would render explicit a possibility that was already present in the logic of the treaties. In this view, the creation of the EFSF and the ESM as entities lying outside the EU legal order appears to be provoked by the fear of a misinterpreted prohibition.

If one were to adhere to the first interpretation of Art. 125 TFEU, the EFSM would still be compatible with EU law. This is because it is grounded on Art. 122(2) TFEU; this is seen as an exception to the prohibition of Art. 125 TFEU. As regards the EFSF and the ESM, their establishment outside of the EU legal framework may be a reason for asserting their legality. One might apply, *mutatis mutandis*, the approach adopted by the International Court of Justice on its Advisory Opinion on Kosovo, when it affirmed that since the declaration of independence was not intended to take effect within the legal order of the Constitutional Framework, it did not violate such a Framework[44]. Nevertheless, apart from the criticisms expressed with respect to this approach of the ICJ[45], the principle would seem particular to the case of a declaration of independence in the context of the creation of a new State and not applicable by analogy elsewhere.

The most appropriate assessment of such a conduct would arguably be that Eurozone Members have breached Art. 125 TFEU through the establishment of these non-EU mechanisms. The rule is stated in Art. 61 of the Draft articles on the responsibility of international organizations[46]: "A State member of an international organization incurs international responsibility if, by taking advantage of

[42] *Contra*, Ruffert, M. *The European Debt Crisis and European Union Law*. Common Market Law Review, No. 48, 2011, p. 1787.

[43] Louis, J.V. 'The No-Bailout Clause and Rescue Packages', *Common Market Law Review* (2010), p. 983.

[44] *Accordance with International Law of the Unilateral Declaration of Independence with respect to Kosovo*, Advisory Opinion, I.C.J., p. 13, paras. 120-121.

[45] See, *ex pluribus*, Burri, T. *The Kosovo Opinion and Secession: The Sounds of Silence and Missing Links*. German LawJournal, Vol. 11, No. 08, 2010, pp. 881-890.

[46] Adopted by the International Law Commission at its sixty-third session, in 2011, and submitted to the General Assembly as a part of the Commission's report covering the work of that session (A/66/10). *Yearbook of the International Law Commission, 2011 (forthcoming)*, vol. II, Part Two.

the fact that the organization has competence in relation to the subject-matter of one of the State's international obligations, it circumvents that obligation by causing the organization to commit an act that, if committed by the State, would have constituted a breach of the obligation". The fact that a State utilises the "veil" of an international organisation to breach one of its obligations does not eliminate its international responsibility. Since Art. 125 TFEU contains (under the first interpretation) a prohibition binding EU Members, the attribution of those competences to the ESM as an international organisation (and, *a fortiori*, to the EFSF as a private company), would in any case constitute a violation of EU law by the Eurozone countries.

6. Conclusions

From this brief analysis of the institutional arrangements undertaken by the European Union and its Members to react to the debt crisis, a heterogeneous picture emerges. As regards the consistency with EU law, the EFSM gets the best grade. Solidly grounded on a Regulation 407/2010, it possesses an entirely communitarian structure, the main drawbacks of which consist of the insufficient review by the European Parliament and the need for more regular reporting by the Commission on the persistence of the exceptional circumstances.

The EFSF and the ESM, however, have been established outside of the Union's boundaries. The incorporation of a special purpose vehicle rests on an incoherent basis of private contracts and Members' collective statements. Furthermore, the creation of the ESM, in parallel with the TSCG, appears to be a continuation of the Union by other means. Both the EFSF and the ESM benefit from the services of prominent EU institutions, such as the Commission and the ECB, whilst their respective relationships do not find a sufficient legal basis. Furthermore, the menace of non-conformity with the no bailout clause of Art. 125 TFEU (if so construed) adds to the opaque character of the enterprise.

Conclusively, the impression is that the need for an urgent reaction incited Eurozone countries to find quick solutions, irrespective of their consistency with the EU legal framework. This meant a resort to private law and traditional international law techniques. The outcomes currently in force, and those that may come in the near future, represent a setback from the evolution of the Union, essentially at the expense of the European Parliament and the Court of Justice. The question is thus whether this "state of emergency" will sooner or later be reintegrated within the EU, so that the latter's democratic guarantees may then fully apply.

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