BVerfG follows ECJ: ECB’s OMT Programme accepted

According to the German Federal Constitutional Court, the ECB’s OMT Programme did neither violate the German Constitution nor EU law.

Executive Summary

> As long as the criteria defined by the ECJ for the OMT Programme are followed, this EU government bonds acquisition programme of the ECB does not violate article 38 para. 1 sentence 1, article 20 paras. 1 and 2 in conjunction with article 79 para. 3 of the German Constitution (“GG”).

> Also, within these limits, there is no violation of EU laws, in particular not of the prohibition of monetary financing of the EU member states.

> The OMT Programme was not ultra vires, i.e. not obviously beyond the competences of the ECB.

> The future of European monetary policy measures, including quantitative easing measures, has legally become safer.

1. BverfG’s OMT judgement

On 21 June 2016, the German Federal Constitutional Court (Bundesverfassungsgericht – “BVerfG”) rejected a large number of complaints against certain monetary policy measures, the “Outright Monetary Transactions” Programme (“OMT Programme”), of the European System of Central Banks (“ESCB”), as announced by the European Central Bank (“ECB”) in 2012. The court explicitly held that, as long as the requirements set forth by the European Court of Justice (“ECJ”) are fulfilled, the German Central Bank (Deutsche Bundesbank) may well participate in the implementation of this OMT Programme. This judgement is particularly important because it (i) clarifies the primacy of the ECJ in interpreting the legal rules on the ESCB/ECB (i.e. in European monetary policy) and (ii) confirms the ECJ requirements which might in the future also apply in the legal assessment of other such monetary policy programmes under the ECB’s quantitative easing (“QE”) policy.

2. Background

On 6 September 2012, the ECB had announced a programme according to which the ESCB is entitled to acquire government bonds of European Union (“EU”) member states on the secondary markets (i.e. not directly from the issuing public authorities but indirectly via other market participants who have previously, either directly or indirectly, acquired such bonds on the primary market) provided that certain requirements are met – the OMT Programme.

This programme was not the first of its kind. Already in May 2010, the ECB had purchased government bonds by using the framework of a “Securities Markets Programme” (SMP) in order to fulfil its monetary policy functions. However, in the opinion of the ECB, the first programme was not sufficient. The ECB noticed that the interest rates of different Euro zone government bonds showed high volatilities and large differences, inter alia, due to the high risk surcharges required by the markets for bonds issued by certain member states of the European Monetary Union (“EMU”), allegedly necessary in order to counter the danger of a break-up of the Euro zone. According to the ECB, this situation led to disturbances of the ESCB’s monetary policy transmission mechanism, to a fragmentation of bank refinancing conditions and consequently to different lending costs in different parts of the Euro zone. Thus, these effects reduced...
the effectiveness and singleness of the monetary policy in the Euro zone. Against this background, the OMT Programme was announced.

One of the requirements of the OMT Programme was that only government bonds of such states may be acquired which have applied for financial assistance and which have agreed to comply with a macroeconomic adjustment programme of the European Financial Stability Facility ("EFSF") or the European Stability Mechanism ("ESM"). Whether a transaction should be started, continued or closed under the OMT Programme had to be decided on the basis of a thorough assessment by the ECB’s Governing Council. If the pursued OMT objectives had not been met or, in case of a non-compliance with the respective macroeconomic adjustment programme, the ECB’s Governing Council would have closed such transactions. Only government bonds with a maturity of one to three years could have been purchased. The overall portfolio of purchased securities from OMT deals as well as its market value had to be published weekly. However, the average duration and a detailed breakdown by country had to be published only on a monthly basis. In line with the respective bond terms and conditions, the Eurosystem (i.e., ECB and national central banks of the Euro zone) had to be treated equally, pari passu, with private or other bond creditors/bondholders.

Several constitutional complaints (Verfassungsbeschwerden) by groups of individuals (one case comprises more than 11,000 plaintiffs) were filed before the BVerfG as well as a court proceeding between state bodies (Organstreitverfahren) opened by the Left Party’s (DIE LINKE) parliamentary group (together the "plaintiffs") concerning the involvement of the German Central Bank (Deutsche Bundesbank) in the implementation of the OMT Programme and the alleged failure to act by Germany’s Federal Government (Bundesregierung) and Parliament (Bundestag).2

Before rendering a judgement, the BVerfG requested on 14 January 2014 a preliminary ruling (Vorabentscheidung) by the ECJ.3 It asked the ECJ whether the ESCB is – under the EU Treaties and in particular articles 119, 123 para. 1 and 127 paras. 1 and 2 of the Treaty on the Functioning of the European Union ("TFEU") as well as articles 17 to 24 of the Protocol (no. 4) on the Statutes of the ESCB and ECB ("ESCB/ECB Protocol") – entitled to adopt a programme such as the OMT Programme and whether such programme is compatible with the prohibition of monetary financing of the member states. In particular, the BVerfG questioned the entitlement of the ECB to adopt such a programme due to the conditionality of the OMT Programme (i.e., its linking with the EFSF and ESM programmes as a condition), its selectivity (i.e., the purchase of government bonds of individual member states, as opposed to them all), its parallelism to, as well as its possibility to bypass the limitations and conditions of, the EFSF and ESM programmes. Regarding the prohibition of monetary financing of the member states, the BVerfG considered a violation due to its lack of limitation regarding the volume of government bonds of EU member states, its market price formation (i.e., lack of a minimum requirement on the time interval to be observed between the issue of bonds on the primary markets and their purchase on the secondary markets), its intervention of the market logic (i.e., possibility to hold the acquired government bonds until maturity), its risk of default (i.e., no specific requirement regarding the creditworthiness) as well as the equal treatment of ESCB, private and other bondholders.

In particular, the BVerfG stated that it tends to qualify the ECB’s decision as an act ultra vires, which would trigger duties of omission for the German Central Bank and obligations to act for the German Government. But according to its own case law (BVerfG, judgement dated 12 October 1993, Maastricht, 2 BVR 2159/92, BVerfGE 89, 155), the qualification of an act as ultra vires would have to be “obviously given” – but then the BVerfG went on and acknowledged that the OMT decision may not be objectionable if it would be restricted or interpreted by the ECJ in a certain manner. However, surprisingly the BVerfG never asked itself, if that is true, how could the OMT decision possibly qualify as being “obviously” ultra vires?
3. ECJ preliminary ruling

In the proceedings before the ECJ, it remained undisputed that the ECB’s announcement of the OMT Programme was sufficient in order to achieve the desired effects (i.e., restoring the monetary policy transmission mechanism and the singleness of monetary policy). In other words: The OMT Programme has never been implemented and no government bonds were purchased under this programme. However, the ECB has today an “Expanded Asset Purchase Programme” ("EAPP") in place, consisting of the third covered bond purchase programme (CBPP3), the asset-backed securities purchase programme (ABSPP), the public sector purchase programme (PSPP) and the corporate sector purchase programme (CSPP) which started in 2015 and securities purchases thereunder are currently planned to be carried out until March of 2017, as well as of targeted longer-term refinancing operations (TLTROs) announced in 2014 and on 10 of March 2016. These programmes serve the ECB’s current QE policy. A major difference between the OMT Programme and the QE programmes is that the latter are more clearly limited in their amounts. In any event, only the OMT Programme – and not the other EAPP/QE programmes – were the subject of the here discussed BVerfG and ECJ decisions.

According to the preliminary ruling of the ECJ dated 16 June 2015, the ECB was entitled to adopt a programme for the acquisition of government bonds of EU Member States and the adoption of the OMT Programme did not violate any European law, namely articles 119, 123 para. 1 and 127 paras. 1 and 2 of the TFEU and articles 17 to 24 of the ESCB/ECB Protocol.

In particular, the ECJ noted that ESCB and ECB may only act within the boundaries set forth by primary EU law and justifies this finding with the principle of conferral of powers (Grundsatz der begrenzten Einzelermächtigung) as defined in article 5 para. 2 of the Treaty on European Union ("TEU"). The ECJ continued: “In order to ensure that the principle of conferral is complied with, the acts of the ESCB are, on the conditions laid down by the Treaties, subject to review by the Court”.

The ECJ emphasised that the objectives of the relevant measures have to be considered as well as the measures to achieve these objectives. In its decision, the ECJ discussed both the objectives and means to achieve them in more detail as well as two of the specific BVerfG concerns, selectivity and conditionality:

- Objectives: The objectives set forth by the ECB for the OMT Programme, in particular the restoration of the monetary policy transmission mechanism and the singleness of monetary policy, serve, in the ECJ’s view, the aim primarily of stabilising price developments and are therefore of a monetary policy nature. This finding was not jeopardised by the fact that the programme was at the same time potentially suitable to contribute to the Euro zone’s stability, a policy target that belongs to economic policy, as a measure of monetary policy remains a measure of monetary policy even if it also has indirect economic policy effects.

- Measures: The ECJ stated that, in accordance with article 18 para.1 of the ESCB/ECB Protocol, the measures of the OMT Programme, i.e., the purchase of Euro-denominated government bonds on secondary markets by means of so-called outright monetary transactions (i.e., legally full title transfer) in the form of purchases/sales, were and are admissible...
No violation of the German Constitution due to the OMT Programme

Instruments of the ECB and the national central banks in order to achieve the objectives of the ESCB.

- Selectivity: The fact that the OMT Programme was selective in the sense that its purchases of government bonds related to those bonds of certain member states only, was not seen as contradictory to its classification as an instrument of monetary policy since the main objective of this programme is the very clearance of such interferences with the transmission mechanism of monetary policy which were caused by the situation of the government bonds of specific member states. Moreover, no TFEU provisions exist which instruct the ESCB to intervene only by measures affecting any and all EMU members.

- Conditionality: The ECJ’s analysis was not changed by the fact that the execution of the OMT Programme depended on full compliance with applicable macroeconomic adjustment programmes by EFSF or ESM. This was meant to ensure that the monetary policy does not offer any financing options to such member states whose bonds are purchased which would enable them to deviate from such adjustment programmes. Irrespective of the main objective of price stability, indirect economic effects are in the ECJ’s view covered by the ESCBs’ secondary objective to support European economic policy in general.

Moreover, the ECJ also held that the OMT Programme did not infringe the principle of proportionality under articles 119 para. 2 and 127 para. 1 of the TFEU in conjunction with article 5 para. 4 of the TEU. Since complex forecasts and technical decisions are essential in order to implement and execute a programme such as the OMT Programme, it is, in the ECJ’s view, necessary to give ECB/ESCB “full discretion”. The argument raised by the BVerfG, that objections were made against the reasons provided by the ECB, was not seen as sufficient to jeopardise the ESCB’s assessment decision, as monetary policy issues are usually controversial and in view of its full discretion nothing more could be demanded from the ESCB “than to use its economic expertise and the technical features available ... to conduct the analysis with the utmost rigour and care”. Under the economic circumstances described by the ESCB, it could lawfully be concluded that the OMT Programme contributed to the achievement of the ESCB’s objectives, namely to the maintenance of price stability.

Furthermore, the OMT Programme did not obviously go beyond what is necessary in order to achieve its objectives. The ECB’s press release on the OMT Programme explicitly explained that the purchase of government bonds should only be permitted to the extent necessary to achieve the programme objectives and, as soon as these objectives are achieved, the purchases should be stopped. Even two years after its announcement the OMT Programme had not been implemented in practice, particularly because the Governing Council of the ECB had not considered such implementation as justified due to the Euro zone’s current economic situation. By means of the strict ties of the programme to its objectives, the OMT programme’s potential scale was seen as limited in several respects:

(i) solely government bonds of countries participating in macroeconomic adjustment programmes were allowed to be purchased,

(ii) a purchase had to be covered by the programmes’ objectives and

(iii) solely government bonds with a term of less than 3 years should have been purchased but may have been sold at any time.

For the reasons mentioned above, the OMT Programme was regarded by the ECJ as having a limited volume although no quantitative limitation had been defined (the latter in order for its effectiveness not to be weakened).

Finally, the ECJ also stated that the prohibition of monetary public financing under article 123 of the TFEU was not violated by the OMT Programme since the purchases made under the programme would not have had the same effect as direct (i.e., primary market) purchases of government bonds which is the subject of that provision. In this context, the ECJ further stated that article 123 of the TFEU does not prohibit ECB and ESCB to purchase government bonds already issued from its current creditors/bondholders (hence in the secondary markets). However, in the ECJ’s view, such purchases shall, in practice, not have the
same effect as the direct purchase of government bonds.

However, according to the ECJ, purchases on the secondary market could only have the "same effect" as purchases on the primary market if the economic participants who purchase government bonds on the primary market «would have the certainty that the ESCB will purchase such bonds within a certain period of time and under certain circumstances which enables them to actually act as intermediary of the ESCB» for the purchase of government bonds. However, this was not the case with the OMT Programme. On the one hand, the ECB Governing Council was responsible to initially decide on the extent, beginning, continuation and suspension of intervention under the programme. Furthermore, according to the ECJ, the ECB had clarified "before the Court" that a minimum time between the issuance on the primary markets and the purchase on the secondary markets is to be observed and that no prior announcements of purchases or of their volume will be made. As the BVerfG had already stated, and as the Advocate General agreed, purchases of government bonds on secondary markets "may have a certain influence on the functioning of the primary markets". But the Advocate General then concluded that such influence is an inherent effect of all permitted secondary market purchases. This view has been shared by the ECJ which held that monetary policy always influences interest rates and refinancing conditions and therefore has compulsory consequences in regard of the financing conditions of national budgets.

According to the ECJ, the OMT Programme did not discourage EU Member States from pursuing a sound budgetary policy. Due to the conditions of the OMT Programme mentioned above, the Eurozone member states did not have the certainty that their government bonds will be purchased under this programme. Moreover, in this context the ECJ also discussed three further specific BVerfG concerns:

- The ECB formally expressed that in the proceedings before it, the ECB had made clear that under the OMT Programme the ESCB intended to observe a minimum period of time between the issuance of the respective government bonds on the primary markets and their purchase on the secondary market.

- The ECB faced a considerable risk of loss due to the fact that solely government bonds from EU member states which comply with the rules of a structural adjustment programme should have been purchased. However, in the ECJ’s perspective, the programme’s conditions lowered such risk since the said requirement also meant that no government bonds of such countries could have been purchased which would not receive any further financings in the markets due to their devastated financial situation. Also the conditions of the programme would have a loss-reducing effect. Moreover, a central bank such as the ECB was obliged to decide on open market operations even if they "bear an inevitable risk of loss". In particular, this is the reason why the ESCB/ECB Protocol provides for a rule of loss distribution.

- Finally, the ECB’s waiver of a privileged creditor position means in the ECJ’s view that it only bears such risk which "is inherent to any bond purchase on the secondary markets". The ECB would not be required to have a privileged creditor status.

4. Final judgement by the BVerfG

There had been speculations in the German media that, despite the ECJ’s clear judgement, the BVerfG might prohibit the German Central Bank from any direct or indirect participation in the implementation of decisions such as the OMT decision, and even request from the Government to re-negotiate the EU Treaties which would have triggered a constitutional crisis. However, the BVerfG was wise enough, despite such public pressure, to do what it was under law obliged to do, i.e. to apply the ECJ’s binding decision.
In summary, the BVerfG held that

(i) the transfer of sovereignty to the EU level must occur only in the form set forth in article 23 para. 1 sentences 2 and 3 and article 79 para. 2 of the GG;

(ii) EU measures which qualify as *ultra vires* violate article 23 para. 1 sentence 2 of the GG and thus the principle of peoples’ sovereignty under article 29 para. 2 sentence 1 of the GG, and therefore exists the legal instrument of *ultra vires* supervision;

(iii) German constitutional bodies are obliged to counter *ultra vires* acts; and

(iv) the German Central Bank may participate in the future implementation of the OMT programme, provided the requirements set forth by the ECJ are fulfilled, i.e. if

- the volume of purchases is in advance limited,
- there is an in advance fixed minimum period between the issue of the debentures and their purchase by the ESCB,
- only debentures of such member states may be purchased which have access to the bond market for their financing,
- debentures purchased may only exceptionally be held until maturity, and
- purchases are limited or will be stopped and acquired debentures sold in the market if a continuation of the intervention is not necessary.

However, in its reasoning the BVerfG also criticised the ECJ decision, as it did not question the allegations of the ECB regarding its intention for establishing the OMT Programme and regarding the overlap between the monetary policy and the economic policy. However, the BVerfG accepted that there were no manifest errors of assessment by the ECB in adopting the OMT Programme. Furthermore, the BVerfG also accepted the ECJ’s criteria for acceptance of programmes such as the OMT Programme as sufficient to avoid a violation of EU law, especially the prohibition of monetary financing of member states. Therefore, the German Central Bank may also acquire government bonds of EU member states, and there is no obligation of the Federal Government or the German Parliament to take actions against the OMT Programme. However, the Federal Government and the German Parliament do have the obligation to permanently review an implementation of such programme in order to avoid a possible specific risk for the federal budget.

5. And now?

With the BVerfG’s judgement of 21 June 2016 a perennial court proceeding ended. This judgement might be seen as a compromise between the different opinions of the BVerfG and the ECJ. However, the BVerfG has highlighted that it is in general EU-friendly and that it accepts the interpretation of the ECJ that the ECB’s OMT decision did not show a manifest error of assessment and was not *ultra vires*.

This judgement might also have an impact on other pending or future legal proceedings, for example the legal action before the BVerfG regarding the EAPP, which is, *inter alia*, also based on the assumption that this programme is violating the prohibition of monetary financing of member states. After the judgement of the BVerfG regarding the OMT Programme, the chances of success against other programmes of the ECB are not promising. We will keep you updated!

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