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Impact of this judgment on the proposal of the SRM regulation

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Assessment of the Judgment of the European Court of Justice in Case C-270/12, United Kingdom v Council and European Parliament

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A. The judgment of the European Court of Justice

“The powers available to ESMA under Article 28 of Regulation No 236/2012 are precisely delineated and amenable to judicial review in the light of the objectives established by the delegating authority. Accordingly, those powers comply with the requirements laid down in Meroni v High Authority (para 53).

The institutional framework established by the FEU Treaty, in particular the first paragraph of Article 263 TFEU and Article 277 TFEU, expressly permits Union bodies, offices and agencies to adopt acts of general application (para 65).

Article 28 of Regulation No 236/2012, read in conjunction with the other regulatory instruments adopted in that field identified above, cannot be regarded as undermining the rules governing the delegation of powers laid down in Articles 290 TFEU and 291 TFEU (para 86).

The harmonisation of the rules governing such transactions [short selling and credit default swaps] is intended to prevent the creation of obstacles to the proper functioning of the internal market and the continuing application of divergent measures by Member States (para 114). ... It is apparent from all the foregoing considerations that Article 28 of Regulation No 236/2012 satisfies all the requirements laid down in Article 114 TFEU. The latter provision therefore constitutes an appropriate legal basis for the adoption of Article 28 (para 117).”

B. Issue of the case

The United Kingdom seeks the annulment of Article 28 of Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps (OJ 2012 L 86, p. 1). In short, this article confers to the European Securities and Markets Authority (ESMA) powers to intervene, and by way of legally binding acts, in Member State financial markets in the event of a “threat to the orderly functioning and integrity of financial markets or to the stability of the whole or part of the financial system in the Union”. These circumstances are further defined in Article 24(3) of Commission Delegated Regulation (EU) No 918/2012 (OJ 2012 L 274 p. 1). The action which ESMA is empowered to take under Article 28(1) of Regulation No 236/2012 includes the imposition on natural and legal persons of notification and disclosure requirements, and a prohibition on the entry into certain transactions or subjecting such transactions to conditions with respect to short selling.

The United Kingdom challenged the legality of Article 28 based on four grounds of annulment:

1. The authority vested in ESMA under Article 28 of Regulation No 236/2012 breached the limits set by the Court in the *Meroni* judgment for delegation of powers by the institutions (Case 9/56 *Meroni v High Authority* [1957 and 1958] ECR 133);

2. Article 28 seeks to empower ESMA to pass measures of general application which have the force of law, contrary to the Court's ruling in *Romano* (Case 98/80 *Romano* [1981] ECR 1241);
3. Article 28 purports to confer power on ESMA to adopt non-legislative acts of general application in breach of Articles 290 and 291 TFEU;
4. Article 114 TFEU is an incorrect legal basis for the adoption of individual decisions that are binding on third parties in the event of insufficient or inadequate action by relevant competent authorities of the Member States.

C. Main findings of the judgment of the European Court of Justice

The main findings of the judgment of the European Court of Justice can be split into two: First, the Union legislature may, in an area which requires the deployment of specific technical and professional expertise, confer discretionary implementing powers upon a Union agency if these powers are clearly defined and limited by various conditions and criteria (I.). Second, Article 114 TFEU serves as a legal base for the establishment of a mechanism which would enable measures to be adopted throughout the EU which may take the form, where necessary, of decisions directed at certain participants in financial markets (II.).

I. Conferral of discretionary powers upon Union agencies

The ECJ interprets the so-called *Meroni* and *Romano* case law in the light of, first, the particular factual circumstances of the original cases, and of, second, the changes introduced by the Lisbon Treaty.

1. The *Meroni* doctrine

The ECJ prevented in his *Meroni* judgment, decided in 1958, that executive powers were conferred into a politically and legally uncontrolled space. The "High Authority" (today's European Commission) delegated certain powers upon external bodies. There was no control over the exercise of these powers by the High Authority and the ECJ had no jurisdiction for acts taken by external bodies. The ECJ stated in this judgment the following:

"The consequences resulting from a delegation of powers are very different depending on whether it involves clearly defined executive powers the exercise of which can, therefore, be subject to strict review in the light of objective criteria determined by the delegating authority, or whether it involves a discretionary power, implying a wide margin of discretion which may, according to the use which is made of it, make possible the execution of actual economic policy. A delegation of the first kind cannot appreciably alter the consequences involved in the exercise of the powers concerned, whereas a delegation of the second kind, since it replaces the choices of the delegator by the choices of the delegate, brings about an actual transfer of responsibility."

It was concluded from this case law that there can be no conferral of discretionary powers on Union agencies. This finding seemed to be repeated by the Court in the *Romano* judgment and extended it to "acts having the force of law".

2. ECJ upholds the *Meroni* doctrine but places it in the context of the Lisbon Treaty

In a first step, the ECJ pointed out the differences in facts between the *Meroni* judgment and the case at hand by referring to the fact "that the bodies in question in *Meroni v High Authority* were entities governed by private law, whereas ESMA is a European Union entity, created by the EU legislature" (para 43) and that "unlike the case of the powers delegated to the bodies concerned in *Meroni v High Authority*,

the exercise of the powers under Article 28 of Regulation No 236/2012 is circumscribed by various conditions and criteria which limit ESMA's discretion" (para 45).

In a second step, the ECJ recalls that the institutional framework established by the Lisbon Treaty differs from the one established by the EEC Treaty. Article 263(1) TFEU on the review of "the legality of acts of bodies, offices or agencies of the Union intended to produce legal effects vis-à-vis third parties" and Article 277 TFEU referring to acts "of general application adopted by an institution, body, office or agency of the Union" presumes the competence of Union agencies to adopt such measures. The Lisbon Treaty therefore "overruled" the *Romano* judgment.

Against this background the ECJ updated the *Meroni* doctrine as follows:

1. There can be a conferral of discretionary powers upon Union bodies other than the European Commission if
 - a) this body is "is a European Union entity, created by the EU legislature" (para 43) and
 - b) the exercise of the delegated powers "is circumscribed by various conditions and criteria which limit [the] discretion" (para 45)
2. These powers may concern individual decisions as well as acts of general application

3. Application of the updated *Meroni* doctrine to Article 28 of Regulation No 236/2012

The application of this updated *Meroni* doctrine lead the ECJ to the consequent conclusion that Article 28 of Regulation (EU) No 236/2012 does not violate this doctrine. The conditions set out for a decision by ESMA on the basis of this Article are:

■ Substantive conditions

- There has to be a threat to the orderly functioning and integrity of financial markets or to the stability of the whole or part of the financial system in the Union and there are cross-border implications.
- No competent national authority has taken measures to address the threat or one or more of those authorities have taken measures which have proven not to address the threat adequately.
- The measure taken by ESMA must significantly address the threat or must significantly improve the ability of the competent national authorities to monitor the threat.
- The measure shall not create a risk of regulatory arbitrage.
- The measure shall not have a detrimental effect on the efficiency of financial markets.

■ Procedural conditions

- ESMA has to consult ESRB and, if necessary, other relevant bodies;
- ESMA has to notify the competent national authorities concerned;
- ESMA is also required to review the measure at appropriate intervals, at least every 3 months.

These conditions and criteria clearly define the scope of the exercise of the discretionary implementing powers that are conferred upon ESMA. Furthermore, the European Commission may specify criteria and factors to be taken into account by the competent authorities and by ESMA in determining in which cases there are threats by means of delegated acts. This altogether appears sufficient for the ECJ to legally control the exercise of the discretionary powers.

4. Conferral of powers upon a Union body other than the European Commission

Finally, the ECJ found that the powers conferred by Article 28 of Regulation (EU) No 236/2012 were not in breach with Articles 290 and 291 TFEU. These Articles provide for a conferral of delegated and implementing powers upon the European Commission. If those Articles were to be interpreted in such a way

that only the Commission may be an addressee of such a conferral, no delegated or implementing powers may be conferred upon Union agencies such as ESMA.

According to the ECJ, “the treaties do not contain any provision to the effect that powers may be conferred on a Union body, office or agency, a number of provisions in the FEU Treaty none the less presuppose that such a possibility exists” (para 79). It refers to the above mentioned Articles 263, 265 and 277 TFEU and to the fact that with the entry into force of the Lisbon Treaty, acts taken by Union agencies can be reviewed by the European courts.

At that point AG Jääskinen seemed to propose to apply Article 291 TFEU by analogy to Union agencies (para 86 of the Opinion of AG Jääskinen). Fundamental constitutional principles do not prevent the legislator from conferring implementing powers on agencies “as a midway solution between vesting implementing authority in either the Commission or the Council, on the one hand, or leaving it to the Member States, on the other” since “implementing powers do not extend to amending or supplementing legislative acts with new elements”.

The ECJ makes clear in its judgment that “that conferral of powers does not correspond to any of the situations defined in Articles 290 TFEU and 291 TFEU” (para 83). The ESMA regulation supplemented by Regulation (EU) No 236/2012 on short selling and certain aspects of credit default swaps form

*“part of a series of rules designed to endow the competent **national authorities and ESMA** with **powers of intervention** to cope with adverse developments which threaten financial stability within the Union and market confidence. To that end, those authorities must be in a position to impose temporary restrictions on the short selling of certain stocks, credit default swaps or other transactions in order to prevent an uncontrolled fall in the price of those instruments. Those bodies have a high degree of professional expertise and work closely together in the pursuit of the objective of financial stability within the Union” (para 85).*

By stating so the ECJ takes a clear position on the distribution of implementing powers between the EU level and Member States. If **Union bodies** (such as the Commission or Union agencies) are **vested with own implementing competences** in clearly defined cases, such a situation is **not covered by Article 291 TFEU**. This Article only covers situations in which the EU level may interfere in Member States’ own general competence to implement legal acts. In such a situation Union bodies would not act on the basis of own implementing competences but on the basis of Article 291(2) TFEU in order to streamline Member State’ own implementing competences.

With regard to financial market regulation, there is an **integrated network administration** composed of national authorities and, in the case at hand, ESMA vested with own exceptional implementing powers. Such a situation is to be distinguished from the situation covered by Article 291 TFEU. The ECJ makes clear that Article 291 TFEU does not prevent the Union legislator from creating such a network as long as this is **covered by a legal base in the Treaties** (such as Article 114 TFEU). The limits for the conferral of necessary implementing powers follow therefore the limits set for the use of legal bases: The principles of subsidiarity and of proportionality as enshrined in Article 5 TEU. The **necessity** for the establishment of such a network in which there is a Union body vested with own implementing powers is given in the eyes of the Court in cases that require the deployment of **specific technical and professional expertise**.

II. Article 114 TFEU as legal basis for Article 28 of Regulation No 236/2012

Whilst AG Jääskinen concluded in his opinion that Article 114 TFEU could not serve as a legal base for Article 28 of Regulation (EU) No 236/2012, the European Court of Justice considers Article 114 TFEU to be the appropriate legal base.

1. Reasoning of AG Jääskinen

AG Jääskinen refers in his opinion to the Court's judgment in Case C-217/04 *United Kingdom v Parliament and Council (ENISA)* where the ECJ stated that Article 114 TFEU may serve as a legal basis for the establishment of a Community body responsible for contributing to the implementation of a process of harmonisation "in situations where, in order to facilitate the uniform implementation and application of acts based on [Article 114 TFEU], the adoption of non-binding supporting and framework measures seems appropriate."

In the eyes of AG Jääskinen Article 28 of Regulation 236/2012 goes beyond internal market harmonisation. This is, however, not because the decisions taken on the basis of Article 28 are legally binding:

"While [taking legally binding measure] is not objectionable in and of itself, it is difficult to envisage how the exercise of a power under Article 28 of Regulation No 236/2012 could contribute to harmonisation of the kind described by the Court in ENISA. Rather its function is to lift implementation powers contained in Article 18, 20 and 22 of Regulation No 236/2012 from the national level to the EU level when there is disagreement between ESMA and the competent national authority or between national authorities." (para 50 of the Opinion)

The AG understands Article 28 as a provision whose purpose is the division of competences between Member States and the EU. For him

"the outcome of the activation of ESMA's powers under Article 28 of Regulation No 236/2012 is not harmonisation, or the adoption of uniform practice at the level of the Member States, but the replacement of national decision making under Articles 18, 20 and 22 of Regulation No 236/2012 with EU level decision making." (para 52 of the Opinion)

Instead of Article 114 TFEU AG Jääskinen considers Article 352 TFEU to be an appropriate legal base for Article 28 of Regulation No 236/2012 (para 54 of the Opinion). He recognises "clearly a need for action at the EU level since, in an integrated market of financial instrument, inaction or inadequate action by a competent national authority in relation to short selling may have significant cross-border effects." But the fact that "the functioning of the common market is 'affected' by short selling is insufficient to support Article 114 TFEU as the legal basis of Article 28 of Regulation No 236/2012" (para 56 of the Opinion). It is, however, necessary for him "to attain one of the objectives set out in the treaties" which is the functioning of the internal market (para 55 of the Opinion).

2. Reasoning of the European Court of Justice

The ECJ examines Article 114 TFEU in a two-step approach: First, Article 28 of Regulation (EU) No 263/2012 must be a measure for the approximation of the provisions laid down by law, regulation or administrative action in the Member States and, second, has as its object the establishment and functioning of the internal market.

With regard to the approximation criterion the ECJ refers to the **discretion of the Union legislature as regards the most appropriate method of harmonisation** depending on the general context and the specific circumstances of the matter to be harmonised, for achieving the desired result, especially in **fields with complex technical features** (para 102). It emphasizes the "highly technical and specialist analyses to be made and developments in a specific field" with regard to the broad margin of appreciation for the EU legislature. On this basis the Court concludes that

*"the **EU legislature**, in its choice of method of harmonisation and, taking account of the discretion it enjoys with regard to the measures provided for under Article 114 TFEU, **may delegate to a Union body, office or agency powers for the implementation of the harmonisation sought.** That is the*

*case in particular where the measures to be adopted are **dependent on specific professional and technical expertise** and the ability of such a body to respond swiftly and appropriately” (para 105).*

In the following the ECJ makes clear that the aim of the orderly functioning and integrity of the financial markets or the stability of the financial system in the EU includes the establishment of an appropriate mechanism which would enable measures to be adopted throughout the EU which **may take the form**, where necessary, **of decisions directed at certain participants** in those markets. It understands this mechanism as a necessary facilitation of the proper functioning of the internal market: A uniform decision-making at Union level intends to “to prevent the creation of obstacles to the proper functioning of the internal market and the continuing application of divergent measures by Member States by ensuring greater coordination and consistency between Member States where measures have to be taken in exceptional circumstances (para 115).

3. Short assessment

The European Court of Justice corrected in its judgment the misleading opinion of AG Jääskinen with regard to the scope of Article 114 TFEU. Whilst the AG ignored that Article 28 of Regulation (EU) No 236/2012 seeks to implement legal standards that are fixed by Regulation No 236/2012, the ECJ examined Article 114 TFEU against its background as a harmonisation competence. As in the ENISA judgment, the question was not whether certain administrative provisions (such as the establishment of an agency in ENISA or the conferral of implementing powers in Article 28 of Regulation No 236/2012) are “approximation” in itself. The Court clearly stated for these kinds of rules that they have “to **facilitate the uniform implementation and application**” of legal acts that were adopted on the basis of Article 114 TFEU. Therefore the ECJ examined whether Article 28 of Regulation No 236/2012 facilitates the uniform implementation of rules on short selling and credit default swaps that were harmonised and found it to be the case in the exceptional situations that this Article defined.

D. Conclusions

The judgment of the ECJ is to be welcomed. Other than its AG the ECJ distinguished between whether a conferral of discretionary implementing powers upon the EU level as such is legally possible under the Treaties, on the one hand, and whether these powers were necessary for the achievement of the objectives of the establishment and functioning of the internal market, on the other. Finally, the ECJ made clear that the *Meroni* doctrine is to be updated. It includes now the conferral of discretionary powers upon Union agencies as long as the conditions for their use are clearly defined by the Union legislature.

Even though the facts of the case may appear to limit the scope of this judgment to last resort decisions the reasoning of this judgment does not. It is not required that the conferred powers are last resort. The main requirement is a clear and precise definition of these powers.

E. Impact of this judgment on the proposal of a regulation establishing a Single Resolution Mechanism: Implementing rights including discretionary powers may be conferred upon EU level but have to be clear and precise

This judgment is of high importance for the current legislative procedure on the proposal of a regulation establishing a Single Resolution Mechanism (SRM). It was disputed that either a new resolution Union agency or the Commission may have the necessary executive powers for banking resolution under Article 114 TFEU. One of the main arguments was the *Meroni* case law and its exclusion of the conferral of discretionary implementing powers upon Union bodies (cf. *Schäuble*, in: Financial Times of 12 May 2013: “The EU does not have coercive means to enforce decisions.”).

I. Article 114 TFEU as appropriate legal base for safeguarding financial stability

It is now clear that measures which are needed for the orderly functioning and integrity of the financial markets or the stability of the financial system in the EU serve the functioning of the internal market under Article 114 TFEU, in particular where the consistency between Member States is of importance and the continuing application of divergent measures by Member States may create obstacles to the internal market.

II. Article 114 TFEU does not only include the establishment of Union agencies but also the conferral of necessary discretionary implementing powers

Furthermore, in “fields with complex technical features” and “highly technical and specialist analyses to be made” Article 114 TFEU does not only serve as a legal basis for establishing Union agencies (cf. Case C-217/04 *United Kingdom v Parliament and Council (ENISA)*) but also for conferring the necessary implementing powers upon those agencies even though these powers may be discretionary.

These conditions are met by the very technical and specialist nature of banking resolution. The decision of the European Court of Justice paves the way for the conferral of implementing powers including discretionary powers upon the EU level with regard to banking resolution. It furthermore clarified that the conferral of these powers takes place outside of the scope Article 291 TFEU which means that there is **no legal obligation to include mechanisms for the control of Union agencies by Member States** (as required by Article 291(3) TFEU).

III. Conferral of implementing powers has to comply with the updated *Meroni* doctrine: Clear and precise implementing powers and effective control of the use of these powers by the European Parliament and the Council

Implementing powers in banking resolution have therefore to be in line with the conditions set by the updated *Meroni* doctrine. These means, with regard to the judgment of the Court at hand, that the conferred powers have to be clearly defined with respect to substantive and procedural requirements. This is supplemented by the further requirements set by the *Meroni* doctrine which were not treated by the judgment since they were not relevant for the case at hand.

According to the updated *Meroni* doctrine any conferral of powers must be (1) clearly defined by the empowering act and the exercise of the powers must be (2) effectively controlled by the delegating authority (political control) and (3) subject to a legal review (legal control). Finally, as the purpose of “*Meroni*” is the protection of the institutional balance, (4) political responsibility cannot be conferred upon executive bodies.

Nowadays, legal protection is guaranteed as the action for annulment before the ECJ was extended to “acts of bodies, offices or agencies of the Union” with the entry into force of the Lisbon Treaty (Article 263(1) TFEU). Therefore the main legal requirements for the establishment of a SRM vested with discretionary implementing powers are in addition to the clear and precise definition of these powers to provide for effective control and supervision mechanisms of the politically responsible Union institutions: The European Parliament and the Council.