

**A**lthough the European Union represents the most obvious forum for cooperation among European states, [EU members have continued to conclude international agreements between one another](#). While this may be rather unproblematic in areas that are only loosely related to EU law, some agreements are closely connected with the European legal order and even complementary to EU measures. An example is the Schengen Agreement: the very experiment of abolishing internal border controls and establishing common rules for the control at the external borders has its roots in an international agreement.

More recently, this method was followed to tackle the sovereign debt crisis. More precisely, neither the Fiscal Compact nor the Treaty establishing the European Stability Mechanism (ESM) are acts of the European Union, but rather international agreements concluded between (some of) the member states. Their main novelty, however, lays in [the attribution of certain tasks to EU institutions](#), most notably the Commission and the European Central Bank (ECB). To put it simply: EU Member States have concluded international agreements that lay outside of the EU legal order, but at the same time “borrow” some EU institutions, entrusting them with specific tasks that they will have to perform on the basis of the agreement.

## The legal ambiguities of the ESM

Let's look more closely at how this mechanism works in the context of the ESM. The latter is a vehicle established to provide financial assistance to euro area member states facing serious financial difficulties. Its loans are granted under strict conditionality. This means that member states applying for financial assistance from the ESM must enact reforms aimed to reduce public spending. Such commitments are taken in the form of a Memorandum of Understanding (MoU), an international agreement concluded between the ESM and the Member State in need of assistance. According to Article 13(2) of the ESM Treaty, the task to negotiate the MoU is entrusted to the European Commission. What is peculiar about this arrangement is that by doing so the Commission does not exercise a power attributed by the EU Treaties, but acts as an organ of the ESM.

Austerity reforms foreseen in MoUs have generated criticism and prompted judicial challenges, especially in the light of the EU Charter of Fundamental Rights. In [Pringle](#), the Court of Justice of the European Union (CJEU) held that the Charter did not apply to the member states in the establishment of the ESM. It did not decide, however, whether the Charter is binding upon EU institutions acting in the context of the ESM.

## Some clarity from the Court of Justice...

The recent judgment in the [Ledra Advertising](#) case has brought some [clarity](#) on this crucial issue. The case originates from the financial crisis that hit Cyprus in 2012 and forced it to request financial assistance from the ESM. In order to tackle the crisis, which took a heavy toll on the banking sector, the country had to recapitalize its largest bank and wind down another. According to commitments the State took in its MoU, the creditors of the banks concerned, including bondholders and depositors, had to bear a substantial part of the relevant costs. The applicants, who had thereby suffered a financial loss, brought legal actions before the EU Courts. In the first place, they challenged the legality of the MoU, which they deemed invalid for breach of the right to property enshrined in the Charter of Fundamental Rights. Second, they claimed compensation from the EU for the damages suffered.

*allowing Member States to borrow EU institutions is a dangerous practice for the integrity of the EU legal order*

The General Court, which [decided the case at first instance](#), ruled that since the MoU is not an act adopted by an EU institution, it could not be challenged by way of an annulment action. It also considered that the EU could not be held liable for the conduct of the Commission and the ECB in the context of the ESM, which only commits the ESM itself.

In reviewing the General Court's order, the CJEU took a partially, yet significantly different approach. It shared the General Court's view that the MoU did not constitute an EU measure and that therefore it had no jurisdiction to rule on its legality. This conclusion was in line with *Pringle* and consistent with the nature of the ESM as an international agreement at least formally separated from the EU legal order. The Court, however, was clearly aware that allowing Member States to borrow EU institutions is a dangerous practice for the integrity of the EU legal order. Indeed, if member states could do so and additionally free the institutions from the obligation to respect EU law, including fundamental rights, this would create a powerful incentive to resort to international agreements precisely in order to escape the constraints posed by the EU Treaties and the Charter.

In *Ledra*, the CJEU took care to clarify what it had stated in *Pringle*. Whereas member states are not bound by the Charter when they are not implementing EU law, the EU institutions cannot free themselves from the obligation to respect EU law, including the Charter, even when they act outside the EU legal order. In particular, with reference to the Commission, the Court pointed out that under Article 17 TEU it has the task to ensure the respect of EU law. This obligation also applies when the Commission acts in the context of the ESM. Thus, the CJEU held that the Commission must ensure that MoUs it negotiates with the Member States comply with EU law, including the Charter of Fundamental Rights. If it fails to perform this obligation, individual applicants, while unable to challenge the legality of MoUs, could engage the non-contractual liability of the Union and claim damages before the EU Courts.

## **...although with a flip side**

The damages action was therefore deemed admissible. Yet, moving on to the merits, the Court did not seriously engage in a proportionality review of the contested conduct. Instead, it restricted itself to identifying a legitimate ground that could justify a sacrifice of the right to property and easily found it in the objective of ensuring the stability of the euro area. Normally, however, this would only be the starting point of a proportionality test. After finding a legitimate objective capable of justifying the limitation of a fundamental right, the Court would proceed to assess whether the measure taken did in fact strike a fair balance between the interests at stake and did not too heavily affect the applicant's right. Although the CJEU is generally quite deferent towards EU institutions—and although there were many good reasons to argue that the measure adopted was in fact proportionate—the judgment really does little to substantiate the proportionality assessment.

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There are arguably two reasons for such a deferent approach. One is the nature of the claim: while any breach of a superior rule is sufficient to make an EU act invalid, only a “sufficiently

serious breach” may trigger the liability of the EU for damages caused by its institutions. This point, however, does not appear decisive, since in other liability cases the Court, while eventually rejecting the claim, [engaged in a more careful review of the EU action](#). This approach would also have been more consistent with Article 52(1) of the Charter, which provides that limitations to fundamental rights must be proportionate and in any case respect the essence of the right concerned. Another reason for the Court’s reluctance to engage in a closer scrutiny might be that it is divided as to how to deal with austerity measures, which carry huge political and constitutional implications. It may be that the Court was simply not ready to articulate a more precise test when dealing with similar issues.

In conclusion, in *Ledra* the CJEU has launched two powerful messages. On the one hand, it clarified that the Commission must comply with EU law, including fundamental rights, when negotiating MoUs for the ESM. On the other hand, however, it warned potential applicants that challenges to austerity measures are unlikely to succeed.

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