Joined Cases M-80/16 and M-230/16

Woland v European Central Bank

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Woland v National Central Bank of Bezdomny

1. The Republic of Bezdomny is a small Eastern European Member State of the European Union. It joined the EU in 2004 and introduced only two years later the Euro as its currency. The introduction of the Euro in Bezdomny was considered an important political symbol as the young Republic was still part of the USSR until the fall of the Berlin wall and only left the USSR after heavy turmoil in the beginning of the 1990s. The Euro therefore represented the final step to breaking with the Soviet past and to entirely integrating in the West.

2. Shortly after the introduction of the free market economy in Bezdomny in the early 1990s, the government established the Bezdomnian General Bank for Modernisation and Thrift (Begemoth) as a public-law institution, for which the state of Bezdomny acts as guarantor. The tasks of the bank are defined in Article 1 of Law No 81/93, according to which it has, through its financing activities, to foster investments for the modernisation of Bezdomnian infrastructure, to provide low-cost financial support to small and medium-sized enterprises that are economically active in Bezdomny and to start-up businesses, as well as to provide low-interest loans for housing development and for families with children to acquire property. Article 2 of Law No 81/93 states that Begemoth has 'to conduct low-risk development businesses'. The Bank is governed by a management board, whose members are appointed by the government and which is led by a chairperson. The law does not prescribe any further requirements regarding the personal qualifications of the board members and of the chairperson. Traditionally, the position of the chairperson was given to a former high ranked politician from the party that was in power at the moment of the appointment.

3. On 1 February 2016, the government of Bezdomny appointed the long-standing minister of culture and education, Hector Woland, as chairman of the Begemoth management board. The governing party, which had been in power for the last twenty years, feared the loss of power in the upcoming elections on 1 March. It tried therefore to put own party members on important positions in public institutions in order to survive the expected years of opposition.

4. Woland, who has studied theology and philosophy and who has no previous experience in banking, received on 26 February 2016 a decision by the European Central Bank (ECB) that vetoed his appointment as chairman of Begemoth. According to the decision, the ECB Governing Council acting on behalf of the Single Supervisory Mechanism (SSM), decided that Woland did not meet the 'fit and proper requirements for the persons responsible for the management of credit institutions' as defined in substance by Directive 2013/36/EU. Begemoth

had been placed under the direct supervision of the SSM by a decision adopted by the ECB Governing Council on 1 September 2014 because Begemoth's assets exceed the threshold of 30 bn Euro foreseen by Article 6(4) of Regulation (EU) No 1024/2013. In 2014, Begemoth's assets were worth 42 bn Euro.

5. On 2 May 2016, Woland initiated an action for annulment of this decision against the ECB at the Administrative Court of Bezdomny. Although the ECB found it a bit peculiar that its decision was being challenged in a national court and not at the Court of Justice of the European Union (CJEU), acting in the spirit of loyal cooperation and with assistance of the national Central Bank of Bezdomny, it contested the action. The ECB claimed that only the CJEU has the competence under EU law to review the legality of acts of Union institutions.

6. Woland rejected this argument stating that the CJEU only has the competence to review a legal act if this act is based on Union law that directly applies to the addressee of the act. The ECB, however, relied on provisions of Directive 2013/36/EU, which was not transposed by the Republic of Bezdomny into national law and which cannot be directly applied to the disadvantage of individuals. Instead the ECB had to rely on the only applicable law relevant for the appointment of a chairperson of Begemoth, which is Bezdomnian national law. The interpretation of national law is, however, left to the national courts.

7. Whilst still objecting the competence of the Administrative Court of Bezdomny to review the legality of its decision, the ECB replied that in the particular context of the new rules on banking supervision and especially under Article 4(3) of Regulation (EU) No 1024/2013 it is entitled to rely on directives to the disadvantage of individuals even if they are not transposed into national law. Furthermore, a 'chairperson' in terms of Bezdomnian national law has to be understood in the way as it is specified by the relevant Union law. Even if the Administrative Court were to follow the ECB in its last argument, Woland countered, it would only be for the national court to come to such a conclusion. Since, however, the wording of the national law is clear and precise, Woland saw no legal ground neither in directly applicable Union law nor in national law for vetoing his appointment. Accordingly, the Administrative Court of Bezdomny should annul the ECB decision.

8. After a first consultation of the written observations, the Administrative Court of Bezdomny takes the view that the authorities regarding European Union law are unclear, in particular with regard to its own competence to decide the case. On 30 May 2016 the Court rendered a decision to stay proceedings and to refer the following questions to the Court of Justice of the European Union under Article 267 TFEU:

   1. **Are Articles 274, 263 TFEU to be interpreted as precluding national courts to declare decisions of the ECB, acting on behalf of the SSM, void when the ECB applies (a) national law or (b) EU directives against individuals?**

2. **If the answer to the first question is negative, is Article 4(3) of Regulation (EU) No 1024/2013 to be interpreted as empowering the ECB to rely on Article 91 of Directive 2013/36/EU, which was not transposed into national law at the time of the adoption of the decision, in order to veto the appointment of an individual as chairperson of a management body of a credit institution?**

9. The order for reference was received by the Registrar of the Court, who assigned to the case the number M-80/16.

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10. After joining the European Union in 2004, the Bezdomnian parliament adopted laws to liberalise financial market regulations and to establish a preferential tax regime for the financial sector in order to attract financial service providers to establish themselves in the country. Being confronted with a borderless internal market, it appeared to the government at that time to be the easiest solution to gain competitiveness against the bigger industrial Member States by attracting financial services with little regulation and low taxation.

11. The policy choices were successful in the first years after their legal implementation. The country's GDP rose tremendously and reached growth rates of more than 10 % per year. The share of the Bezdomnian financial sector in the national GDP grew at the same time from 6 % in 2004 to 15 % in 2008. Many globally active corporations and major financial institutions established subsidiaries or even their European headquarters in Bezdomny.

12. The spectacular economic rise of the Bezdomnian 'tiger' came abruptly to an end when the American bank 'Lehman Brothers' filed for bankruptcy in September 2008. In the wake of this event, two major developments hit the Bezdomnian banks severely: An immediate need for liquidity as a consequence of failed risky investment strategies and a shortage of available liquidity due to a dried up interbank lending market. Liquidity was needed as the banks used financial products with a shorter maturity period than the one of the investments that were refinanced by them. The banks erred in the quality of the securities underlying these financial products that lost during their maturity period practically their entire value. After the expiry of the maturity of these financial products banks were hence in an immediate need for liquidity in order to meet their refinancing obligations. The concurrent demand for liquidity could, however, not be accommodated by private markets since not only Bezdomnian banks were active in trading with these financial products but also the vast majority of banks in Europe and in the world, which found themselves in the same need for liquidity as the Bezdomnian banks. Those banks that still had liquid assets used them for stabilising their own liquidity reserve instead of lending them to other banks. Moreover, after the bankruptcy of 'Lehman Brothers' loans to banks were considered too risky. To make things worse, the loss in value of the securities underlying the financial products required a downward correction of the balance sheets of the concerned banks, which put these banks' solvency at risk. In this situation

Bezdomnian based banks filed a request for financial support to the Bezdomnian government. Being a measure of last resort, refusing this request would have led to the bankruptcy of these banks.

13. After tough discussions and meetings on the weekend of 26 and 27 September 2008, the Bezdomnian government announced on Monday morning that it would back 'all deposits, covered bonds and senior debt' at Bezdomnian based banks with taxpayer funds and grant loans in order to meet the immediate liquidity needs of these banks. The significant share of banks in the country's GDP would not allow for an uncontrolled bankruptcy of the whole sector.

14. The consequences of this government decision were severe. Risks materialised and the Bezdomnian public budget had to bail out the banks. The annual government deficit rocketed to 32 % of GDP in 2010 and the government debt level grew to 110 % of GDP in 2010. The yields on Bezdomnian government bonds exceeded 7 %. Since it was impossible for the Bezdomnian government to refinance its budget on the private financial markets, it filed a request to the EU and the International Monetary Fund (IMF) for financial assistance. In March 2011, the newly built 'troika' consisting of the European Commission, the ECB and the IMF agreed with the Bezdomnian government on a two-year financial assistance programme, via the European Financial Stability Fund (EFSF) and the IMF, in return for structural policy reforms set out in a 'Memorandum of Understanding' (MoU). In April 2013, the European Stability Mechanism (ESM) took over the EFSF part of the financial assistance programme and the 'troika' agreed on a three-year prolongation of the financial assistance programme.

15. By the end of 2015, the Bezdomnian government faced troubles to refinance its deficit despite the financial assistance from the ESM and the IMF. In order to raise the needed amount of 11 bn Euro, the government decided to issue treasury bills (T-bills). The distinctive feature of T-bills is their short maturity period. The Bezdomnian T-bills had a maturity of six months and a yield of 3 %. Government officials informed the management of the leading Bezdomnian based banks in personal meetings that the government would highly appreciate it if the banks would purchase Bezdomnian T-bills. If the government could not place the T-bills, it would be forced to declare a sovereign default. By 31 December 2015, the Bezdomnian government successfully rolled over the total amount of the issued T-bills. At this moment, Bezdomnian based banks were holding in total 10 bn Euro of Bezdomnian T-bills.

16. Bezdomnian banks could use the government T-bills as collateral when borrowing liquidity from the ECB. The fact that Bezdomnian T-bills were rated BBB- by the rating agencies was of no importance since the ECB Governing Council decided to suspend the Eurosystem's minimum requirements for credit quality thresholds for marketable debt instruments issued by the government of the Republic of Bezdomny. This decision mentioned in its recitals that it was based on the assumption that Bezdomny would comply with the macroeconomic adjustment programme that it agreed with the ESM. Based on this ECB decision, Bezdomnian banks, which

could not satisfy their liquidity needs on the private interbank market anymore, retained still access to liquidity.

17. On 1 March 2016, national elections were held in Bezdomny. The radical left-wing party 'Social Justice Now!' with its charismatic leader Azazello won the elections. The party had promised during its election campaign to 'bring the dictatorship of austerity to an end'. Consequently, shortly after the elections, the new Bezdomnian government repealed laws on the increased VAT in the country and the cutting of wages for government officials – measures that were originally adopted by the Bezdomnian Parliament when implementing the MoU concluded with the ESM in 2013.

18. Several days later, the ECB Governing Council met in Frankfurt and discussed the recent developments in Bezdomny. The Governors came to the conclusion that the policy actions undertaken by the Bezdomnian government violate the MoU and that hence a successful conclusion of the next programme review appeared to be unlikely. The Governing Council therefore decided to repeal the waiver of the Eurosystem's minimum requirements for credit quality thresholds for marketable debt instruments issued by the government of the Republic of Bezdomny as from 15 March 2016. This waiver rendered Bezdomnian government T-bills ineligible as collateral for liquidity stemming directly from the ECB.

19. In the afternoon of the same day, the Supervisory Board of the Single Supervisory Mechanism (SSM) gathered in Frankfurt and discussed the situation. The non-eligibility of Bezdomnian debt instruments as collateral for liquidity prompted the supervisors to adopt a decision addressed to the Bezdomnian banks that were under the SSM's direct supervision to refrain from purchasing any Bezdomnian government debt instruments as from 15 March 2016. Furthermore, the ineligibility of these assets to be used as collateral would require a reassessment of the risk profile and of the solvency of banks holding them.

20. Under these circumstances, Bezdomnian banks were put into a difficult situation with regard to raising necessary liquidity: Private financial markets were closed since private financial market operators did not trust in the viability of the Bezdomnian banking market and did therefore not lend any money to Bezdomnian banks. Liquidity stemming from the ECB was shuttered as Bezdomnian banks did not have any eligible collateral at their disposal anymore. The only remaining liquidity channel was to request liquidity from the national central bank of Bezdomny. This so-called 'Emergency Liquidity Assistance' (ELA) is a national central bank instrument which differs from the ECB's instruments. In case of a default of the collateral for ELA, a national central bank remains exclusively responsible for the losses and cannot request the liability of the ECB or other national central banks of the Eurosystem. A national central bank may therefore also accept collateral which would not be eligible for liquidity from the ECB. Given the critical liquidity situation on the Bezdomnian national banking market, the national central bank of Bezdomny granted ELA for the Bezdomnian banks.

21. In the meantime, the newly elected Bezdomnian government entered into negotiations with the European Commission, the ECB, the Eurogroup, and the IMF on a third financial assistance programme, which should replace the second programme that was supposed to elapse at the end of April 2016. The negotiations were difficult as Prime Minister Azazello refused to sign any kind of agreement that, in his eyes, would lead to further social deterioration. On 30 April 2016 at 23.59 o'clock, the negotiations ended fruitlessly without any further prolongation of the second financial assistance programme or bridging financing.

22. Few days before, on 26 April, the national central bank of Bezdomny informed the ECB of its intention to increase its ELA programme by 7 bn Euro on 2 May, anticipating the failure of political negotiations for a third financial assistance programme and the increased demand for liquidity by Bezdomnian banks. In the morning of 1 May, the ECB Governing Council assessed the economic situation in Bezdomny and the solvency of the Bezdomnian banks against the prospect of no further refinancing options for the Bezdomnian public budget. The forecast of a sovereign default and the subsequent write-off of Bezdomnian government debt instruments led the Governing Council to consider Bezdomnian banks not to be solvent anymore so that ELA provided by a national central bank of the Eurosystem would be illegal. It therefore adopted a decision addressed to the national central bank of Bezdomny to prohibit an increase in the country's ELA programme.

23. This decision of the ECB resulted into heavy turmoil on the Bezdomnian banking market. Immediately after the publication of the ECB Governing Council's decision, the Bezdomnian banks declared a bank holiday until the weekend of 7/8 May.

24. On 5 May, the Supervisory Board of the SSM met in order to discuss the situation of the Bezdomnian banks, including the situation of Begemoth and the Bank of Bezdomny (BoB), which is Bezdomny's largest bank. When assessing the situation of BoB, the Board came to the conclusion that it is 'failing or likely to fail'. This conclusion was based on a re-evaluation of BoB's assets that consisted to large parts of Bezdomnian government debt instruments. The likelihood of a sovereign default led the supervisors to the verdict that 'the assets of the Bank of Bezdomny will be, in the near future, less than its liabilities' and the lack of access to liquidity would soon result in a situation where BoB will be 'unable to pay its debts as they fall due'. The Governing Council of the ECB followed the assessment by the Supervisory Board and communicated it to the Single Resolution Board (SRB) for deciding on the resolution of BoB.

25. In the morning of 6 May, the SRB gathered and decided to place BoB under resolution. It adopted a resolution scheme, which included a bail-in of uninsured deposits in order to recapitalise the bank. The decision on the resolution scheme for BoB was communicated to the Council and the European Commission in the evening of 6 May. Both institutions remained silent, so the SRB sent the decision to its addressee, the national central bank of Bezdomny, which was acting as the Bezdomnian resolution authority, in order to implement it.

26. Before the opening hours of the Bezdomnian banks on 9 May, the national central bank of Bezdomny adopted and announced its decisions on the future of the Bezdomnian banks, including the decision to place BoB under resolution and to order a bail-in of uninsured deposits.

27. Besides all his trouble because of the pending ECB veto to his appointment as chairman of Begemoth, Hector Woland received on 10 May a letter from the national central bank of Bezdomny, acting as national resolution authority, dated 9 May 2016, announcing that his deposits at the Bank of Bezdomny, exceeding the value of 100.000 Euro, would be used to recapitalise BoB. Woland was furious after opening the letter: How could the national central bank dare to 'socialise' his deposits above 100.000 Euro after all that he contributed to the country and after all the taxes that he paid to Bezdomny? Unlike his wealthy investor friends, Woland had not established any letter box companies in Panama and thus was paying his taxes in his home country. If Bezdomny considers BoB so important as to recapitalise it, it should use taxpayer's money. Frustrated by the decision of the national central bank of Bezdomny, Woland consulted the international law firm Crayon, Paul & Schmitz to do something against this 'theft'.

28. Dr. Crayon advised Woland to initiate an action for damages against the national central bank of Bezdomny for the amounts on the deposits at BoB that were above 100.000 Euro. According to him, the national central bank implemented a decision that was legally void. The SRB had no competence to adopt a resolution scheme for BoB because the regulation on which this decision was based is violating EU law and is therefore void. Originally, Regulation (EU) No 806/2014 establishing the Single Resolution Mechanism (SRM) could not have been adopted on the basis of Article 114(1) TFEU. The powers transferred on the SRB exceed the limits set by this provision. Article 114(1) TFEU only allows for the approximation of national legal provisions and not for the transfer of executive powers. Even if Article 114(1) TFEU covers a transfer of executive powers upon a Union agency, sufficient control of the use of such executive powers by the European Commission and the Council cannot be effectively exercised considering the 24 hours period in which both have to decide under Article 18(7) of Regulation (EU) No 806/2014.

29. Crayon referred to the course of events that led to the bail-on. If the ELA programme of the national central bank of Bezdomny had been increased, BoB would still be liquid and no resolution of the bank would have been necessary. The national central bank had to increase its ELA since the closing of the Bezdomnian banks as a consequence of no further access to liquidity was obstructing the smooth operation of payment systems and threatening financial stability. It is therefore liable for the losses occurred due to the lack of liquidity on the Bezdomnian banking market. Furthermore, the national central bank was under no obligation to withdraw its intention to increase ELA. The decision of the Governing Council of the ECB to freeze the ELA programme of the Bezdomnian national central bank violated EU law and was thus void. Stalling ELA was not covered by the ECB's mandate. The decision ultimately only aimed at forcing the government of Bezdomny to sign the MoU for the third financial assistance programme. Furthermore, the decision was based on the wrong assumption that Bezdomnian

banks were insolvent. The opposite was true, as can be drawn from the timing of the SSM's action. Moreover, also the ECB has to safeguard the financial stability of the Euro area, which required an increase in ELA. In view of the liquidity crisis on the Bezdomnian banking market the national central bank of Bezdomny should therefore have ignored the ECB decision.

30. On 2 August 2016, Woland initiated an action for damages at the District Court of Margarita, the capital of Bezdomny. In its reply, the national central bank of Bezdomny argued that Woland's claim is unfounded because both the SRB decision and the ECB decision on ELA are final and effective. The national central bank of Bezdomny was under a legal obligation to implement the SRB and the ECB decisions without any margin of discretion and without any right to deviate or to ignore these decisions. Woland should therefore have challenged both at the CJEU within the two month period for raising an action for annulment.

31. If the District Court considers to judge on the substance of the claim, the national central bank took the view that there was a legal base for the decisions on the resolution of BoB. The Union legislator is allowed to transfer executive powers on Union agencies under Article 114(1) TFEU if it is necessary to achieve an effective functioning of the internal market. This also covers a bail-in of uninsured deposits as such bail-in only reflects market behaviour. Depositors of a bank originally accepted favourable conditions offered by a bank and hence they have to bear the risks that are inherent to free market developments such as the bankruptcy of the deposit-holding bank. Taxpayers' money is not supposed to compensate for the economic risks accepted by depositors.

32. Regarding the ELA programme of the national central bank of Bezdomny, the ECB when deciding to freeze the programme did not only act within its mandate, it was even obliged to decide so as Bezdomnian banks were not solvent anymore. Furthermore, ELA paid to Bezdomnian banks in return for Bezdomnian T-bills effectively amounts to monetary financing, which is prohibited under the Treaties. In the oral hearing the counsel for the national central bank declared that these arguments do not contradict the national central bank's previous request to increase ELA. This is because in the Eurosystem, after the Governing Council of the ECB has taken a decision, the decision is binding for the national central bank.

33. After having heard the submissions from Woland and the national central bank of Bezdomny, the District Court of Margarita came to the conclusion that the authorities regarding European Union law are unclear. It decided therefore on 18 August 2016 to stay proceedings and to refer the following questions to the Court of Justice of the European Union under Article 267 TFEU:

    1. **Is the decision of the Single Resolution Board (SRB) of 6 May 2016 on the resolution scheme in relation to the Bank of Bezdomny instructing the national resolution authority to implement a bail-in of uninsured deposits valid, having regard the limits of the legal base for adopting Regulation (EU) No 806/2014? Is the Union legislator, in this context, entitled to transfer on the basis of Article 114(1) TFEU executive powers, such as the one to adopt a resolution scheme, on a Union agency?**

2. **Is the decision of the ECB of 2 May 2016 to prevent the National Central Bank of Bezdomny to increase its 'Emergency Liquidity Assistance' programme valid, having regard Article 14.4 of the ESCB/ECB Statute and the policy mandate of the ESCB in Article 127 TFEU?**

34. The order for reference was received by the Registrar of the Court, who has assigned to it the case number M-230/16.

35. By order of 1 September, the President of the Court of Justice ordered on the basis of Article 54 of the Rules of Procedure that Cases M-80/16 and M-230/16 be joined for purposes of written and oral procedure. In accordance with Article 23 of the Statute of the Court of Justice, the Registrar has notified Hector Woland (as the applicant) and the European Central Bank and the National Central Bank of Bezdomny (as the defendants) and has invited them to submit written observations to the Court. The parties are requested to lodge their observations by 30 November 2016.

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