



# The ECB's bond purchase programme in the crosshairs of the German Federal Constitutional Court

The Federal Constitutional Court's decision of 5 May 2020  
(2 BvR 859/15, 2 BvR 1651/15, 2 BvR 2006/15 and 2 BvR 980/16)

In an unprecedented ruling, the second senate of the German Federal Constitutional Court (Bundesverfassungsgericht, BVerfG, *the Court*) decided on 5 May 2020 with 7 votes against 1 that the lack of action of the German parliament (Bundestag) and the German government against the European Central Bank's (ECB) Public Sector Purchase Programme (PSPP) violated fundamental principles of the German constitution. The PSPP was launched in March 2015 and the central banks participating in the Eurosystem, including the German Central Bank (Deutsche Bundesbank), have since purchased more than €2tn in eligible government bonds (also known as 'quantitative easing').

The immediate consequence of the decision is that the German government and the German parliament are given a period of three months to cause the ECB's Governing Council to demonstrate, through a new decision, that the monetary policy goals pursued with the PSPP do not have disproportionate adverse economic and fiscal effects, and that a long-term exit strategy is developed for the German Central Bank's holding of government bonds. If these demands are not achieved, the German Central Bank would no longer be permitted to continue its participation in the PSPP.

The decision does not per se impact the ECB's Corporate Sector Purchase Programme (CSPP), as amended on 24 March 2020 to account for the exceptional economic and financial circumstances associated with the COVID-19 epidemic. The Court will decide and rule on this matter in separate proceedings, which are already pending as set out below.

From a legal point of view, what makes the decision stand out is the Court's departure from the established practice which considered decisions of the Court of Justice of the European Union (CJEU) on the application and interpretation of the law of the European Union (EU) as binding on Member State courts, even when it adopts a view which, according to the Court, is subject to considerable

doubt.<sup>1</sup> In its decision of 11 December 2018<sup>2</sup> the CJEU had concluded that the PSPP was within the realm of monetary policy and hence not *ultra vires*. The Court viewed the CJEU's judgment as conflicting with recognised principles and methods of legal arguments and reasoning, and hence as *objectively arbitrary* and as not binding in Germany. With this decision, the Court questions for the first time the CJEU's primary competence for the authentic interpretation of the European acquis.

## Procedural aspects of the decision

The Court dealt with four constitutional complaints (*Verfassungsbeschwerden*) against the ECB's PSPP,<sup>3</sup> its implementation in Germany and the omission on the part of the German government, the German parliament and the German Central Bank to take appropriate steps to ensure that the ECB, by means of purchasing government bonds under the PSPP, does not exceed its monetary policy mandate. Some constitutional complaints were also raised against the CJEU's decision of 11 December 2018. A constitutional complaint is a legal remedy available for the protection of constitutional rights. It derives from Article 93 (1) Nr. 4a of the German constitution, called the "Basic Law" (*Grundgesetz, GG*) and can be used by any person who alleges that his or her constitutional rights have been violated by an act of the German public administration or the German courts. The four constitutional complaints had

<sup>1</sup> BVerfG, decision of June 2016, 2 BvR 2728/13, 2 BvE 13/13, 2 BvR 2731/13, 2 BvR 2730/13, 2 BvR 2729/13.

<sup>2</sup> CJEU, Case 493/17, Weiss and Others.

<sup>3</sup> The Public Sector Purchase Programme (PSPP) is one of four sub-programmes established under the ECB's Expanded Asset Purchase Programme (EAPP). In its decision of 22 January 2015, the ECB's Governing Council decided to launch the PSPP. The PSPP was established through Decision (EU) 2015/774 of the European Central Bank of 4 March 2015 on a secondary markets public sector asset purchase programme (ECB/2015/10) (OJ L 121, 14.5.2015, p. 20), as amended by Decision (EU) 2015/2101 of 5 November 2015 (OJ L 303, 20.11.2015, p. 106), Decision (EU) 2015/2464 of 16 December 2015 (OJ L 344, 30.12.2015, p. 1), Decision (EU) 2016/702 of the European Central Bank of 18 April 2016 (OJ L 121, 24.11.5.2016, p. 24) and Decision (EU) 2017/100 of 11 January 2017 (OJ L 16, 20.1.2017, p. 51). The PSPP was recast by Decision (EU) 2020/188 of 3 February 2020 (OJ L 39, 12.2.2020, p. 12).



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been raised by a large number of complainants (more than 1,700), amongst them academics and entrepreneurs.

Initially the constitutional complaints also challenged the ECB's CSPP,<sup>4</sup> which might have impacted the ECB's support of non-financial companies suffering from the COVID-19 pandemic. However, with order of 14 January 2020 the Court decided to sever the proceedings for a separate decision.

The Court decided that the constitutional complaints were admissible and well-founded, but only to the extent that they challenge the German government's and the German parliament's omission to take appropriate steps to ensure that the ECB does not encroach upon the economic and fiscal policy competences of the Member States. The remaining parts of the constitutional complaints were held either inadmissible or unfounded.

## Legal basis and main arguments

The decision is based on Article 38(1) s.1 GG, which guarantees each citizen's right to vote in elections to the German parliament and the right to democratic self-determination. Article 38(1) s.1 GG is an emanation of the principle of democracy. According to the established case law of the Court, it can also be invoked by citizens where EU institutions (such as the ECB) are overstepping in a "manifest and structurally significant" manner the limits of the competences granted to them by the EU legal order, especially where this conflicts with the limits set by the fundamental principles of the German constitution enshrined in Article 1 GG (protection of human dignity) and Article 20 GG (protection of the principles of democracy, the rule of law, the social-welfare state and federalism), which cannot even be changed by the legislature acting with a supermajority in parliament.

The Court reiterates that, pursuant to Article 5 TFEU, the competences of EU institutions are governed (and limited) by the principle of conferral of enumerated powers (*Prinzip der begrenzten Einzelermächtigung*)<sup>5</sup> and the principle of proportionality (*Verhältnismäßigkeitsgrundsatz*)<sup>6</sup>. As

detailed by the Court, when delineating the competences of the EU and those of the Member States, the principle of proportionality and the overall assessment which it entails are of great importance. Disregarding this principle could (gradually) shift the division of competences in the EU and undermine the principle of conferral of enumerated powers. Such shift, which would not have been ratified by the German parliament as the elected representation of German citizens, would result in German citizens having no (not even indirect) influence on the exercise of public authority over them and, thereby, violate the principle of democracy protected by the German constitution.

According to the Court, the principle of proportionality would have required the ECB not only to define the monetary policy objectives pursued with the PSPP, but to also identify and assess the PSPP's impact on economic and fiscal policy for which, under the current EU legal order, the Member States, rather than the EU (or the ECB specifically), remain responsible. This required the ECB to weigh both sets of policies and to balance them against each other. Where a programme's monetary policy objective is pursued unconditionally and its effects on the economic policy are ignored, this, according to the Court's reasoning manifestly disregards the principle of proportionality.

The Court finds that the PSPP has a significant impact on the fiscal policy of Member States and furthermore affects the matters governed by Article 126 of the Treaty on the Functioning of the European Union (TFEU)<sup>7</sup>, i.e. the so-called 'Maastricht criteria'.

The Court also refers to the effects of the PSPP on the economies of Member States, notably on the banking sector, which is thus enabled to transfer large quantities of government bonds to the Eurosystem's balance sheets. The PSPP would therefore improve the economic situation of banks.

According to the Court, other significant economic policy effects included the risk of creating real estate and stock market bubbles, which impact virtually all citizens, who are either affected, among others, as shareholders, tenants, real estate owners, savers or insurance policy holders. The Court specifically mentions the risk of losses for private savings and the potential knock-on effects they may have on private pension schemes and the distributable income they generate. The Court also considers competition effects, because the PSPP may allow economically non-viable companies to stay in the market since they gain access to cheap credit.

<sup>4</sup> Decision (EU) 2016/948 of 1 June 2016 on the implementation of the corporate sector purchase programme (ECB/2016/16) (OJ L 157, 15.6.2016, p. 28), as amended by Decision (EU) 2017/103 of 11 January 2017 (OJ L 16, 20.1.2017, p. 57) and Decision (EU) 2020/441 of 24 March 2020 (ECB/2020/18) (OJ L 91, 25.3.2020, p. 5).

<sup>5</sup> Article 5(1) s. 1 of the Treaty of the European Union (TEU): 'The limits of Union competences are governed by the principle of conferral.' Articles 4(1) and 5(2) s. 2 TEU: '[In accordance with Article 5,] competences not conferred upon the Union in the Treaties remain with the Member States.'

<sup>6</sup> Article 5(2) TEU: 'Under the principle of conferral, the Union shall act only within the limits of the competences conferred upon it by the Member States in the Treaties to attain the objectives set out therein.' Article 5(4) TEU: 'Under the principle of proportionality, the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties. The institutions of the Union shall apply the principle of proportionality as laid down in the Protocol on the application of the principles of subsidiarity and proportionality.'

<sup>7</sup> Article 126(1) TFEU reads: 'Member States shall avoid excessive government deficits. The Commission shall monitor the development of the budgetary situation and of the stock of government debt in the Member States with a view to identifying gross errors. In particular it shall examine compliance with budgetary discipline...'



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The Court concludes that, in light of the considerable economic policy effects, ‘...it would have been incumbent upon the ECB to weigh these effects and balance them, based on proportionality considerations, against the expected positive contributions to achieving the monetary policy objective the ECB itself has set.’ Lacking the required balancing in the decision itself, the ECB’s decisions approving the PSPP violated the principle of conferral of enumerated powers and the principle of proportionality and hence exceeded the ECB’s monetary policy mandate.

With regard to the prohibition of monetary financing set out in Article 123(1) TFEU,<sup>8</sup> the Court, despite raising various doubts, ultimately follows the CJEU’s judgment that, due to the PSPP’s purchase limits specified in Article 5(1) and (2) of Decision (EU) 2015/774,<sup>9</sup> which ensure that central banks participating in the Eurosystem, on consolidated basis, cannot purchase more than 33 per cent of a particular issue of government bonds (ISIN) or more than 33 per cent of the outstanding securities of the central government of a Member State, the PSPP cannot be viewed as a violation or circumvention of the prohibition of monetary financing.

## Decision

The Court grants a transitional period of no more than three months allowing the German government and the German parliament for the necessary interaction with the ECB.

The purpose of this is to cause the ECB’s Governing Council to take a new decision that demonstrates in a comprehensible and substantiated manner that the monetary policy objectives pursued by the Eurosystem are not disproportionate to the economic and fiscal policy effects resulting from the PSPP.

After the three months transitional period, if no such new decision has been made, the German Central Bank will no longer be permitted to participate in the PSPP to the effect that all government bonds already purchased under the PSPP and held by the German Central Bank would have to be sold, based on a – possibly long-term – strategy coordinated with the ECB.

## Consequences and outlook

The Court’s decision has no immediate consequences for the PSPP, at least not for the next three months. However, significant uncertainty about a possible drop-out of the German Central Bank from the PSPP might in itself have

noticeable effects on the capital markets.<sup>10</sup> Not the least for this reason, the ECB reacted promptly by confirming their commitment to their mandate and monetary policy actions.<sup>11</sup>

At this stage, it is unclear whether and how the German government and German parliament will use the three months transitional period to interact with the ECB. One can also question whether this type of interaction would not cross the line of the ECB’s independence. A way out might be interaction through the German Central Bank as member of the Eurosystem.

There is also no indication yet whether the ECB’s Governing Council will be willing to adopt a new decision discussing the balancing of its monetary policy objectives with the substantive economic policy effects described by the Court. The ECB’s Governing Council may follow the view of the CJEU, which discussed the reasoning provided by the ECB in its decisions and the proportionality of the PSPP without major complaints.<sup>12</sup>

Even if the three-months period expired without an appropriate response of the ECB’s Governing Council, the sole consequence would be that the German Central Bank, going forward, would no longer be permitted to participate in the PSPP. This prohibition would not have retroactive effects, i.e. any purchase of government bonds effected by the German Central Bank in the past would not be invalidated.

Further, as set out by the Court, any sale of government bonds by the German Central Bank should be carried out in accordance with a strategy coordinated with the ECB, i.e. it should not imperil the intentions pursued with the Eurosystem’s monetary policy. We therefore do not expect a ‘fire sale’ and associated negative knock-on effects on the pricing of government bonds.

If the ECB’s Governing Council decided to address the Court’s concern within the three months transitional period, there is no mechanism that would ensure that the Court would automatically review and opine on the ECB’s revised decision. Any remaining deficiency in reasoning or balancing would require additional actions of the German government or the German parliament or a new constitutional complaint raised with Court.

Finally, it is unclear whether the ECB’s new temporary Pandemic Emergency Purchase Programme (**PEPP**) of

<sup>8</sup> Article 123(1) TFEU reads: ‘Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as ‘national central banks’) in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments.’

<sup>9</sup> The purchase limits are now defined in Article 5(1) and (2) of Decision (EU) 2020/188.

<sup>10</sup> According to the internal briefing of the unit PE2 of the German parliament’s subdivision of Europe (PE) of 6 May 2020, the capital markets have so far been largely unimpressed.

<sup>11</sup> See ECB’s press release ‘ECB takes note of German Federal Constitutional Court ruling and remains fully committed to its mandate’ of 5 May 2020; copy available at: <https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200505~00a09107a9.en.html>

<sup>12</sup> See ECB’s press release: ‘The Court of Justice of the European Union ruled in December 2018 that the ECB is acting within its price stability mandate.’



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24 March 2020<sup>13</sup> would withstand a review by the Court, given the relaxed safeguards for this programme. The ECB's decision on the PEPP explicitly waives the application of the consolidation requirement for the 33 per cent per ISIN and of the outstanding securities of an issuer, which significantly increased the ability of central banks to purchase government bonds. The ECB's decision also broadened the scope of eligible government bonds by freezing or suspending (for Greece) the otherwise applicable minimum rating requirements. However, it is also possible that the Court would apply less stringent standards to such an emergency programme, given that it is a temporary measure implemented in times of acute crisis, provided it is terminated when the ECB's monetary policy operations are again able to influence price stability and interest rates notwithstanding the market dislocations created by the COVID-19 pandemic.

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<sup>13</sup> Decision (EU) 2020/440 of the European Central Bank of 24 March on a temporary pandemic emergency purchase programme (ECB/2020/17) (OJ L 91, 25.3.2020, p. 1).

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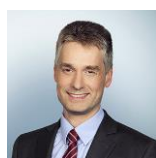


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