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## Addressing the Debt Crisis in the European Union: The Validity of Mandatory Collective Action Clauses and Extended Maturities

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# Addressing the Debt Crisis in the European Union: The Validity of Mandatory Collective Action Clauses and Extended Maturities

Jason B. Gott\*

## Abstract

*The sovereign debt crisis in the European Union has put significant pressure on the fundamental divisions of power between the Union government and member states. One part of the recommended solution for the crisis calls for the imposition of mandatory collective action clauses and extended maturities for all sovereign bonds issued by member states, the first instances of Union-wide fiscal policy choices being forced upon member states. After an explanation of the relevant bond terms, this Comment evaluates the validity of the proposed mandates based on the current state of the framework of power in the EU and concludes that the mandates are valid under the EU implied powers doctrine. The Comment also explains why the acceptance or rejection of these bond-term mandates has the potential to lead to either the full integration or dissolution of the EU.*

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## I. INTRODUCTION

### A. The European Union

“We must now face the difficult task of moving towards a single economy, a single political entity. For the first time since the fall of the Roman Empire we have the opportunity to unite Europe.”<sup>1</sup> Debates about the nature of the European Union (EU or Community) project—is it economic, monetary, political?—have raged on and off since its creation in 1992. Some, like former EU Commission President Romano Prodi, quoted above, both see it as and want it to be political, a true integration of Europe into a super-state. Others passionately oppose that position, viewing the migration of sovereignty to the supra-national level as a dangerous trend.<sup>2</sup>

In 1993, a group of European countries continued the historic trend toward integration and became party to the Maastricht Treaty, the foundational document establishing the constitutional basis of the current EU.<sup>3</sup> The creation of the EU marked the next step for a European community looking to enhance cooperation and peace among the continent’s several nations.<sup>4</sup> But there was much debate and criticism over whether the Maastricht Treaty was a step forward or backward in that regard. Critics argued that it embodied a net loss of

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<sup>1</sup> Sharon Ellul Bonici, *The Gaban Syndrome*, *The Malta Independent* (May 20, 2000), online at [http://www.imperium-europa.org/media\\_clips/article.php?id=18](http://www.imperium-europa.org/media_clips/article.php?id=18) (visited Jan 12, 2011), quoting Romano Prodi, Speech Before European Parliament (Oct 13, 1999).

<sup>2</sup> See generally Robert Harmsen and Menno Spiering, *Eurocepticism: Party Politics, National Identity and European Integration*, 20 *Eur Stud: Am J Eur Culture, Hist & Polit* 1 (Rodopi 2005).

<sup>3</sup> Treaty on European Union (Maastricht Treaty) (1992), 31 *ILM* 247 (Feb 7, 1992).

<sup>4</sup> See Paul Craig and Grainne de Burca, *EU Law: Text, Cases, and Materials* 14 (Oxford 4th ed 2008).

unity and coherence among members, as it deconstructed the “cohesive legal unit” previously in place and left behind a system of “chaos and fragmentation” in the form of endless opt-outs and exceptions known as “variable geometry.”<sup>5</sup> Others felt that it was this very system of variable geometry that made the EU more integrative, more susceptible to greater and freer participation by members over time.<sup>6</sup> As this narrative suggests, the one point both sides agreed on was that the Maastricht Treaty provided for increased national sovereignty relative to previous continental regimes, regardless of whether the EU’s power was set at a desirable level.

Since 1993, the Treaty on European Union (TEU) as it emerged from Maastricht has been amended three times, with the most recent changes taking effect in 2009 after the adoption of the Treaty of Lisbon.<sup>7</sup> With each successive amendment, the EU formally grew in its authority by explicit additions to its powers and objectives.<sup>8</sup> On top of this formal growth, the EU’s real power expanded through increasingly loose judicial construction of the TEU and its powers framework.<sup>9</sup> The evolution of the TEU and the Treaty on the Functioning of the European Union (TFEU, and together with TEU, the Treaties) has also led to increased, though still limited, peremptory authority for the EU in fiscal and budgetary matters.<sup>10</sup> Yet the current status and the future objectives of the EU as a political union remain highly controversial.<sup>11</sup>

## B. The EU Sovereign Debt Crisis

In early 2010, worries began growing about the continued solvency of several European countries, with Greece being the foremost focus of concern.<sup>12</sup>

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<sup>5</sup> See, for example, Deirdre Curtin, *The Constitutional Structure of the Union: A Europe of Bits and Pieces*, 30 Common Mkt L Rev 17, 28, 67 (1993).

<sup>6</sup> Craig and de Burca, *EU Law* at 19 (cited in note 4).

<sup>7</sup> Treaty of Lisbon amending the Treaty on European Union and the Treaty Establishing the European Community, 2007 OJ (C 306) (Dec 17, 2007).

<sup>8</sup> Craig and de Burca, *EU Law* at 101 (cited in note 4).

<sup>9</sup> Id.

<sup>10</sup> Id at 753; The Treaty on the Functioning of the European Union, 2008 OJ (C 115/47) (Sept 5, 2008).

<sup>11</sup> See generally Harmsen and Spiering, 20 Eur Stud: A J of Eur Culture, Hist & Polit 1 (cited in note 2).

<sup>12</sup> See generally European Commission, *Public Finances in EMU 2010* (EU 2010), online at [http://ec.europa.eu/economy\\_finance/publications/european\\_economy/2010/pdf/ec-2010-4\\_en.pdf](http://ec.europa.eu/economy_finance/publications/european_economy/2010/pdf/ec-2010-4_en.pdf) (visited Feb 25, 2011); Patrick Allen, *Sovereign Debt Crisis Likely to Spread: Roubini* (CNBC Apr 21, 2010), online at [http://www.cnbc.com/id/36681836/Sovereign\\_Debt\\_Crisis\\_Likely\\_to\\_Spread\\_Roubini](http://www.cnbc.com/id/36681836/Sovereign_Debt_Crisis_Likely_to_Spread_Roubini) (visited Feb 25, 2011).

Observers around the world understood the danger posed by a sovereign default in the EU, especially in the context of the protracted recession plaguing the global economy.<sup>13</sup> In addition to the actual financial damage from default, the devastating effects of contagion in other members of the closely integrated EU or countries outside of it had the potential to completely derail the world's economic recovery. And indeed, while the concerns over the Greek balance sheet widened yield spreads and deepened that country's difficulties, fear spread to other European countries with troublesome books, including Ireland, Portugal, and Spain.<sup>14</sup> As 2010 wore on, even France and Germany started to receive mention on the debt crisis watch list.<sup>15</sup>

Meanwhile, on May 2, 2010, Greece became the first EU member state to succumb to the financial pressures of overspending and insufficient revenues, as had been anticipated. Faced with record budget deficits, escalating borrowing costs, and potential default, the Greek government agreed to terms of a bailout package with EU members and the International Monetary Fund (IMF), drawing on the newly-improvised European Financial Stability Facility (EFSF).<sup>16</sup> But the bailout did not come without costs: as a condition of receiving the money (€110 billion), Greece agreed to enact an aggressive package of fiscal policies—designed to slash spending and increase government revenues—that have been generally coined “austerity measures.”<sup>17</sup> The measures have had some effect to date, but the final results are uncertain at best.<sup>18</sup>

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<sup>13</sup> See Brian Blackstone, Tom Lauricella, and Neil Shah, *Global Markets Shudder: Doubts About U.S. Economy and a Debt Crunch in Europe Jolt Hopes for a Recovery*, Wall St J (Feb 4, 2010), online at <http://online.wsj.com/article/SB10001424052748704041504575045743430262982.html> (visited Jan 12, 2011).

<sup>14</sup> Id.

<sup>15</sup> See, for example, Vincent Fernando, *Morgan Stanley: Europe's Sovereign Debt Crisis Could Next Hit France and Germany* (Businessinsider.com Sept 9, 2010), online at <http://www.businessinsider.com/morgan-stanley-europes-sovereign-debt-crisis-could-next-hit-france-and-germany-2010-9> (visited Jan 12, 2011) (relaying statements of Joachim Fels, co-head of the Global Economics Team and Chief Global Fixed Income Economist at Morgan Stanley).

<sup>16</sup> See *Eurozone approves massive Greece bail-out*, BBC News (May 2, 2010), online at <http://news.bbc.co.uk/2/hi/8656649.stm> (visited Apr 22, 2011). See also *About EFSF* (EFSF 2011), online at <http://www.efsf.europa.eu/about/index.htm> (visited Apr 30, 2011).

<sup>17</sup> See *Greece's austerity measures*, BBC News (May 5, 2010), online at <http://www.bbc.co.uk/news/10099143> (visited Jan 12, 2011).

<sup>18</sup> See Helena Smith, *Greece seeks longer to repay €110bn IMF bailout loan as austerity bites*, The Guardian (Dec 6, 2010), online at <http://www.guardian.co.uk/business/2010/dec/06/debt-crisis-greece> (visited Jan 12, 2011).

Additionally, in November 2010, Ireland faced the music and accepted a similar bailout package from the EU and IMF.<sup>19</sup> The total bailout for Ireland ran to the tune of €85 billion,<sup>20</sup> attenuating further the limited resources committed to the temporary EFSF.

The dwindling of resources available for rescue packages like those received by Greece and Ireland is one of the foremost reasons that EU and world leaders are so concerned about the risk of contagion and a spreading debt crisis.<sup>21</sup> With investors and regulators still keeping a fearful eye on Portugal, Spain, Italy, and France, the severity of the situation has only worsened.<sup>22</sup> If a country with an economy as large as Spain's or Italy's were to need rescuing, the remaining funds might not be enough to cover its deficit, let alone if multiple countries their size were to seek a bailout.<sup>23</sup> Haunted by this specter, EU leaders recognized the vital importance of establishing a program that could help to alleviate this debt crisis and prevent or head off future ones.<sup>24</sup>

### C. The European Stability Mechanism

On December 17, 2010, the European Council (EC) issued a decision establishing the foundation for a permanent tool for preventing future debt crises.<sup>25</sup> In that statement, the EC proposes creating the European Stability Mechanism (ESM), which is intended to be the primary weapon in combating

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<sup>19</sup> James G. Neuger and Simon Kennedy, *Ireland Gets \$113 Billion Bailout as EU Ministers Seek to Halt Debt Crisis*, Bloomberg News (Nov 29, 2010), online at <http://www.bloomberg.com/news/2010-11-28/ireland-wins-eu85-billion-aid-germany-drops-threat-on-bonds.html> (visited Jan 12, 2011).

<sup>20</sup> Id.

<sup>21</sup> EFSF has a current lending capacity of roughly €250 billion, to be raised eventually to €440 million. See *EU Leaders Agree EFSF to Have Higher Capacity by June*, CNBC (Mar 25, 2011), online at [http://mobile.cnbc.com/eur\\_news/42262542/1](http://mobile.cnbc.com/eur_news/42262542/1) (visited Apr 25, 2011). The bailout packages for Ireland, Greece, and Portugal have already totaled €270. See Jaoa Lima, Jim Silver, and Anabela Reis, *Portugal Set to Start Talks on \$107 Billion Bailout as Spain Threat Eases*, Bloomberg News (Apr 7, 2011) online at <http://www.bloomberg.com/news/2011-04-06/portugal-seeks-eu-bailout-after-yields-surge.html> (visited Apr 25, 2011); *Eurozone approves Greece bail-out* (cited in note 16); Neuger and Kennedy, *Ireland Gets Bailout* (cited in note 19).

<sup>22</sup> See note 21 and sources cited therein.

<sup>23</sup> See Gideon Rachman, *The euro crisis, Italy and its playful premier*, Financial Times (Apr 11, 2011) online at <http://www.ft.com/cms/s/0/2971a046-6474-11e0-a69a-00144feab49a.html#axzz1JtLGagPs> (visited Apr 18, 2011) (“A Spanish bail-out, if it were ever to happen, would be much bigger—although the EU could probably still manage. But Italy is too big to bail.”).

<sup>24</sup> See European Council, *Conclusions 16–17 December 2010*, EUCO 30/10, 1 (Dec 17, 2010) (“The temporary stability tools put in place earlier this year have proved their utility, but the crisis has demonstrated that there can be no complacency.”).

<sup>25</sup> Id.

debt crises in the EU beginning in June 2013, via amendment to the TFEU.<sup>26</sup> The EC also goes beyond this ex post, symptom-focused solution, stating that the system as a whole will require two important legal changes to the contracts governing the sovereign debt causing all these problems: inclusion of collective action clauses and extension of maturity terms.<sup>27</sup>

Set to replace the recently improvised EFSF and European Financial Stabilisation Mechanism in June 2013, ESM is essentially a pool of financial aid for troubled countries that may only be accessed by accession to stringent fiscal policies, often referred to generally as austerity measures.<sup>28</sup> ESM in that way formalizes on a permanent basis the practice pursued thus far by the EU and the IMF in lending to Greece and Ireland.<sup>29</sup> Clearly, one goal of ESM is to alleviate the immediate financial pressures of countries in distress while attempting to correct underlying budgetary problems. Although there is much to be discussed about ESM, its aims and structure are beyond the scope of this Comment.<sup>30</sup>

Instead, this Comment concerns itself with the subtler changes proposed by the EC: requiring member states to include collective action clauses in their bond issuances and to extend the maturity terms of future issuances. The legal nuances of these contract terms will be explained further in Section II, but a cursory initial understanding will suffice to permit an understanding of the controversy at hand.

In a general sense, collective actions clauses (CACs) provide a means by which the terms of a bond may be altered by the consent of some portion of the bondholders.<sup>31</sup> The specifics of the process vary between different bonds, but the seeming aim of the EC in requiring CACs is to ensure that all European bonds contain some mechanism that allows an issuer and bondholders to come together, work out private solutions to the issuer's financial crisis, and prevent a default. Such private solutions could perhaps obviate, coincide with, or even become a condition of gaining access to the ESM.

The second bond-related aspect of the EC's statement may be more recommendation than requirement, in that it declares that "Member States will

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<sup>26</sup> Id at 4.

<sup>27</sup> Id at 9.

<sup>28</sup> European Council, *Conclusions* at 8–9 (cited in note 24).

<sup>29</sup> See *Eurozone approves massive bail-out* (cited in note 16); Neuger and Kennedy, *Ireland* (cited in note 19).

<sup>30</sup> If for no other reason, "constitutional" discussion of ESM as proposed is moot in that the EC's recommendation entails amending the founding treaties to provide specifically for the power to set up ESM.

<sup>31</sup> Robert B. Ahdieh, *The Role of Groups in Norm Transformation: A Dramatic Sketch, in Three Parts*, 6 Chi J Intl L 231, 241–42 (2005).

strive to lengthen the maturities of their new bond emissions in the medium-term to avoid refinancing peaks.”<sup>32</sup> For the purposes of this Comment, though, the maturity term provision will be taken as a mandate. The goal of this provision is straightforward: to avoid the primary problem in any sovereign debt crisis—namely, the government not having the funds available to pay large chunks of principal coming due from multiple issuances at roughly the same time. Thus, if issuers provide for longer maturities in place of the shorter maturities that turn over quickly and possibly in bunches, they may avoid the disastrous bond overlapping that often leads to insolvency.

With this preliminary understanding of the EC statement, it is clear that these changes are Council-determined fiscal policy that will be required of all EU member states. Thus, the question arises: do EU bodies have the power to enact these recommendations as legislation binding on member states?

Complicating the picture is the TEU, which premises EU power on principles of conferral, subsidiarity, and proportionality.<sup>33</sup> Sorting out the interplay of those principles with respect to the EC’s decision on the ESM will be the primary objective of this Comment. After examining the foundational treaties of the EU, and considering potential arguments supporting and opposing this particular exercise of power, this Comment will posit that the actions taken by the EC with regard to European bond indentures should be considered a valid action in connection with establishing the ESM under the implied powers doctrine, as recognized by the EU judiciary.

## D. Consequences

The crisis and its resolution, as suggested by this introduction, may end up becoming a historical turning point for the EU.<sup>34</sup> Despite the seeming inconsequence of the bond term mandates, the fact is that these would be uniform fiscal laws imposed on member states by the EU bodies—an unprecedented step. Unlike in the US, where the passage of two-plus centuries has mostly settled the federalism debate, the EU is in a more infantile stage of its existence. In fact, the EU today could be better likened to the antebellum US,

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<sup>32</sup> European Council, *Conclusions* at 9 (cited in note 24).

<sup>33</sup> Consolidated Version of the Treaty on European Union, Art 5, 2010 OJ (C 83) 18 (“TEU”).

<sup>34</sup> See Michael Leonard, *EU Sovereign Debt Crisis: From Monetary to Fiscal Union* (Gerson Lehman Group June 15, 2010), online at <http://www.glggroup.com/News/EU-Sovereign-Debt-Crisis--From-Monetary-to-Fiscal-Union-48952.html> (visited Feb 25, 2011); Michael D. Bordo, *The Euro Needs a Fiscal Union: Some Lessons from History 4* (Shadow Open Market Committee Oct 12, 2010), online at <http://shadowfed.org/wp-content/uploads/2010/10/Bordo-Euro-Needs-A-Fiscal-Union.pdf> (visited Feb 25, 2011).



where the unknowns of dual sovereignty remained unresolved.<sup>35</sup> And like the antebellum States, the EU could be headed for a momentous occasion that will force a decision as to whether the members will either truly integrate or call off the project. Of course, events could unfold in any number of ways. But, as pertains to this Comment, there are two salient considerations: (1) the crisis itself and (2) the reaction to the ESM. Further, each of these factors potentially cuts two ways, both toward and away from integration.

First, the occurrence of the 2010 crisis and the bailout response implemented thus far have both inspired desire for greater EU oversight and influence and engendered resentment between the core and the periphery of the EU. For example, Angela Merkel, the Chancellor of Germany—a country that has historically stood in strident opposition to extensive integration—changed her tune in the midst of the crisis, indicating openness to EU-level economic governance.<sup>36</sup> In turn, the German people have turned up the volume of their dissension with regard to Germany's continued sponsorship of the lending facilities that have bailed out Greece and Ireland.<sup>37</sup> This dynamic in Germany will almost certainly persist into the future and may even serve as the crystallizing force in the debate over the ESM. In fact, the Germans may be the most likely party to challenge the bond term mandates, if anyone is to do it.

The general reaction to the ESM will likely resemble the reaction to the lending facilities already established in response to the crisis. In both the core and the periphery of the EU, there has been disapproval of the EFSF among the citizenry. People in the core, like the Germans, do not want their tax dollars spent on resolving other countries' problems.<sup>38</sup> People in the periphery, like the Greeks, resent the interference into their national autonomy that has accompanied bailout loans as well as the increased public focus on their finances.<sup>39</sup> That dissent among the citizens has already begun to be felt by

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<sup>35</sup> See Bordo, *Euro Needs Fiscal Union* at 2 (cited in note 34). See generally Ernest A. Young, *Protecting Member State Autonomy in the European Union: Some Cautionary Tales from American Federalism*, 77 NYU L Rev 1612 (2002).

<sup>36</sup> See Stephen Castle, *Merkel, In Reversal, Urges Rescue of Euro*, NY Times B1 (Feb 4, 2011).

<sup>37</sup> See Jens Bastian, *Euro Gets Cold Shoulder at Ballot Box of Outrage*, Bloomberg News (Feb 22, 2011), online at <http://www.businessweek.com/news/2011-02-22/euro-gets-cold-shoulder-at-ballot-box-of-outrage-jens-bastian.html> (visited Feb 24, 2011).

<sup>38</sup> See id. See also Andrew Ward, *Finland plays down Lisbon bail-out fears*, Financial Times (Apr 17, 2011) online at <http://www.ft.com/cms/s/0/aced63d4-68d6-11e0-9040-00144feab49a.html#axzz1JtLGagPs> (visited Apr 18, 2011) (describing the “public anger over the succession of taxpayer-funded rescue packages for crisis-hit eurozone countries”).

<sup>39</sup> See *Greek unemployment hits new high, as protests continue against austerity measures*, Associated Press (Feb 10, 2011), online at <http://finance.yahoo.com/news/Greek-unemployment-at-new-apf-2437081264.html?x=0&.v=3> (visited Apr 23, 2011); Colm Heatley and Finbarr Flynn, *Angry Irish Set to Ditch Government in 'Historic' Election*, Business Week (Feb 25, 2011), online at

politicians.<sup>40</sup> Yet, political leaders have generally supported the EFSF, even in the core;<sup>41</sup> and of course, there are large segments of the European population that accept and support the EU's response to the debt crisis.

Because the ESM is intended to continue the same lending practices as the EFSF and to incorporate the additional bond term mandates at issue in this Comment, it seems sensible to conclude that this further interference will make the ESM less desirable to EU citizens than the EFSF, or equally desirable at best. The sentiment of politicians could also turn south, either as a result of popular backlash or as simple resistance to the political control being exerted by the EU. On the other hand, greater control and interdependence between member states may eventually be seen as a net positive for all involved, meaning affirmative support for the ESM.

Overall, though the end game is decidedly uncertain, the enactment of the ESM and its bond term provisions could tip off a chain of reactions leading to either true integration or dissolution of the EU. Accepting the bond term mandates as legitimate EU actions leaves members with little room to dissent to future fiscal policy-setting by the EU, whether it be in the form of general budgetary restrictions, taxation requirements, or prescribed funding for certain programs. The mandates could thus be the first step toward true fiscal union and eventually political integration. If, on the other hand, the mandates are challenged but upheld, such could be the impetus for a withdrawal by an unhappy member state. As the most likely candidates for opposition and withdrawal are in the core, this could destroy the EU. Of course, all this speculation comes with the caveat that if the bond term mandates were challenged successfully, this "either-or" hypothetical would be moot. But the possibility remains and should not be discounted, particularly in the context of setting bounds on EU power. In fact, the debate on the extent of EU power should probably be thought of as one and the same as the debate on integration.<sup>42</sup>

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<http://www.businessweek.com/news/2011-02-25/angry-irish-set-to-ditch-government-in-historic-election.html> (visited Feb 26, 2011).

<sup>40</sup> See Bastian, *Euro Gets Cold Shoulder* (cited in note 37); Ward, *Finland plays down Lisbon bail-out fears* (cited in note 38).

<sup>41</sup> See *Euro zone leaders ready to ensure adequate funds for EFSF*, Reuters (Dec 16, 2010), online at <http://www.reuters.com/article/2010/12/16/eu-summit-efsf-idUSLDE6BF28620101216> (visited Feb 25, 2011).

<sup>42</sup> See Franz C. Mayer, *Competences—Reloaded? The Vertical Division of Powers in the EU and the New European Constitution*, 3 *Intl J Const L* 493, 493 (2005).

## II. LEGAL BACKGROUND

### A. Collective Action Clauses

For basically the entire twentieth century, sovereign debt contracts almost uniformly contained unanimous action clauses (UACs), which provided a means by which bondholders could act as a group and vote to change the terms of a bond.<sup>43</sup> As implied, the vote required unanimous approval. But, between 2003 and 2004, the traditional practice of including UACs gave way to a “wholesale” shift to use of collective action clauses (CACs), which allows a subset of the bondholders, albeit a supermajority, to agree to term amendments in the bonds.<sup>44</sup> Importantly, that supermajority has the power to bind a resistant, dissenting minority to the new terms.<sup>45</sup> Typically, CACs not only prescribe the size of the majority needed for an amendment, but also set out other parameters, including quorum size, types of clauses eligible for amendment, and fairly specific procedural requirements such as those for notice of the bondholders’ meeting. Thus, CACs serve an important role in organizing a country’s creditors in a way similar to how bankruptcy law prevents a collective action problem for private debtors.<sup>46</sup>

For example, consider the CAC from Portugal’s 2010 €5 Billion Medium Term Note Programme.<sup>47</sup> The prescribed process for making changes to “Reserved Matters” requires the representation of 75 percent of the aggregate affected debt to be represented at the vote (or 25 percent on reconvening an adjourned meeting). “Reserved Matters” in turn is defined in the Terms and Conditions and basically covers any direct changes that could be made to reduce the amount owed to the bondholders, such as reducing the amount of principal owed, reducing the interest rate to be paid, or changing any fixed date of payment. For other matters (except for formal, minor, technical, or corrective changes that may be undertaken unilaterally by Portugal), the meeting requires only a 50 percent quorum, or a minimum of two representatives on reconvening after an adjournment.

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<sup>43</sup> See Ahdieh, 6 Chi J Intl L at 241–42 (cited in note 31).

<sup>44</sup> Id at 242. There are, accurately speaking, many types of mechanisms that are considered collective action clauses, but the supermajority restructuring mechanism is the most common.

<sup>45</sup> See Anna Gelpern and Mitu Gulati, *Public Symbol in Private Contract: A Case Study*, 85 Wash U L Rev 1627, 1639–42 (2006).

<sup>46</sup> Id.

<sup>47</sup> *Simplified Base Prospectus: The Republic of Portugal EUR 5,000,000,000 EURO Medium Term Note Programme* 37–39 (Feb 11, 2010) (on file with the author; also available through the Thomson ONE Banker electronic database). The collective action clause in the Portuguese Programme is Term 18, “Meetings of Noteholders; Modification and Waiver.”

If a quorum is present at a meeting, modifications must be approved by Extraordinary Resolution, a term that, according to the definitions in the Terms and Conditions, is defined in the Agency Agreements governing this note program. Unfortunately, copies of those agreements were not attainable. Because this bond program is governed by English law, determining the typical majority required for an extraordinary resolution under English law seemingly provides strong guidance on this uncertainty: that majority is three-quarters.<sup>48</sup> The requirement could also be two-thirds or other supermajority.

From a policy perspective, the salient considerations here are the pricing effect that CACs have on sovereign bonds and the restructuring flexibility they create. CACs create two contravening effects on the level of security, and therefore the price, of bonds containing them. On one hand, creating the opportunity for private workouts opens the possibility that default may be avoided in a crisis situation, leading eventually to full or greater repayment. Thus, in this sense, CACs should increase the security and the price of bonds. But, on the other hand, the fact that CACs allow a portion of bondholders to make changes that affect all bondholders means that each bondholder faces the risk that his bond will become less valuable in the future. That risk is very concerning for bondholders, because it is the one way (other than default) in which their earnings may be reduced without their consent. It is difficult to assess which of these two effects is the more potent, and in theory, it seems plausible that opposite net impacts are possible given different issuers. In particular, and as this narrative suggests, more credit-worthy, stable issuers would likely see a reduction in borrowing costs from CACs, while borrowing for higher-risk issuers would become more expensive with their inclusion.<sup>49</sup> Regardless of the pricing effects of CACs, the Council apparently desires the flexibility they present for finding private solutions outside of resorting (or in addition) to the ESM.<sup>50</sup>

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<sup>48</sup> In the absence of copies of the agreement, other English law sources provide guidance on likely terms for determining majority requirement. See Stewart Rapalje and Robert L. Lawrence, *A Dictionary of American and English Law* 1116 (Lawbook Exchange 2002).

<sup>49</sup> For a full discussion on these theories of the pricing effects of collective action clauses, see Barry Eichengreen and Ashoka Mody, *Would Collective Action Clauses Raise Borrowing Costs?* (Cal Dept of Econ 1999), online at <http://www.econ.berkeley.edu/~eichengr/research/governinglaw6.pdf> (visited Jan 30, 2011).

<sup>50</sup> See European Council, *Conclusions* at 9 (cited in note 24).

## B. Maturity Terms

Perhaps the most fundamental and important term in a sovereign bond, the maturity term, is “the date when a debt falls due.”<sup>51</sup> The maturity term, in other words, usually sets the date on which the principal originally paid for the bond will (hopefully) be repaid to the bondholder. In the context of the current EU debt crisis, maturity terms, and more particularly the peaking of maturity dates on multiple bonds, are the most problematic component of European sovereign bonds. In fact, Greece not only encountered this peaking problem with its bond issuances, but also faced the prospect of dealing with it again with the maturity terms on the bailout loans it received from the EU and IMF.<sup>52</sup> Accordingly, European finance ministers sought a plan to extend and spread out the maturity dates on those loans to avoid a potentially problematic repayment hump.<sup>53</sup>

There are two distinct policy concerns that drive the choice of a maturity term. The first derives from the peaking concern described above. When issuing a new bond, a country will (or should) consider what other outstanding bonds it has issued in the past and when those bonds will come due. To avoid the problematic overlap that Greece faces, the maturity dates should be spread out to make them manageable given the issuer’s ability to repay or obtain refinancing.

Second, maturity terms are a pivotal factor in determining the yield investors will demand from the issuer in order to purchase the bond, which in turn determines the cost of financing for the issuer. Bonds with long maturity terms are necessarily riskier than those with shorter terms. One reason is that there is a greater risk of some event—internal or external—rendering the issuer unable to repay when there is more time in which that event could occur. More risk means a higher premium, making longer maturity terms more expensive to the issuer and less sustainable.<sup>54</sup> But issuing short-term bonds increases the risk of peaking, meaning these two concerns must be weighed against one another in setting a maturity date.

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<sup>51</sup> Bryan A. Garner, ed, *Black’s Law Dictionary* 423 (West 8th ed 2004 ).

<sup>52</sup> See Natalie Weeks and Maria Petrakis, *Greece Says No Debt Restructuring Amid ‘Complicated’ EU Talks*, Bloomberg News (Jan 19, 2011), online at <http://www.bloomberg.com/news/2011-01-19/greece-says-no-debt-restructuring-amid-complicated-eu-talks.html> (visited Jan 21, 2011).

<sup>53</sup> See id.

<sup>54</sup> Laura Alfaro and Fabio Kanczuk, *Sovereign Debt: Indexation and Maturity* 20 (Inter-American Development Bank 2006), online at <http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=845647> (visited Jan 23, 2011).

## C. Framework of Power in the EU

The basic tenet of power at the EU-level is that the EU's authority is limited to the areas in which it has been given power. Accordingly, the powers, or competences,<sup>55</sup> of the EU-level entities are governed by three basic principles as set out in Article 5 of the TEU: conferral, subsidiarity, and proportionality.<sup>56</sup> Though at first glance this framework may seem to compose a small grant of authority, the reality is that over time the EU's powers have expanded both by additional inclusions of competences in the Treaties and by looser construction of the treaties by the European Court of Justice (ECJ; the Court).<sup>57</sup>

### 1. The principle of conferral.

The realms of power for the EU seem to be expressly limited to those delegated to it by the TEU and TFEU. Article 5, Section 2 of TEU reads:

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. Competences not conferred upon the Union in the Treaties remain with the Member States.<sup>58</sup>

The TFEU specifically sets out three lists of EU powers, one of exclusive, one of shared, and one of supplementary areas of authority.<sup>59</sup> Interpreting only from the text itself, it seems there are three potential ways of defining the scope of "conferred" EU competences based on those explicit grants.

The first definition focuses on the clause "within the limits of the competences conferred upon it by the Member States in the Treaties." This clause seems to limit EU actions strictly to those that can be legitimately characterized as exercises of competences explicitly set out in the TEU or TFEU. Thus, one interpretation is that EU entities may only act when they can point to a clause somewhere in the treaties justifying their action.

The second plausible way of interpreting this section draws from the clause "to attain the objectives set out therein." If one posits that the "competences conferred" must include any that are necessary to "attain the objectives," one can shift the focus to the latter descriptor and broaden the scope of power from the first interpretation. This interpretation adds breadth because the objectives

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<sup>55</sup> Though the two terms are not truly interchangeable, I will take them to be synonymous for the purposes of this paper.

<sup>56</sup> TEU, Art 5.

<sup>57</sup> See Craig and de Burca, *EU Law* at 101 (cited in note 4).

<sup>58</sup> TEU, Art 5 § 2

<sup>59</sup> Consolidated Version of the Treaty on the Functioning of the European Union, Arts 3, 4, 6, 2010 OJ (C 83) 51–53 ("TFEU").

set out in the Treaties are more broadly worded and therefore would encompass greater authority than the more specific grants of competence.

Third, the conditions could be read to operate in combination—that is, in order to exercise a power legitimately, the EU must first be able to point to an explicit grant justifying that exercise, and then also demonstrate how it attains an explicit objective in the Treaties. At first, this version of the inquiry might seem redundant. But, one could conceive of an act that falls within a realm of competence as granted explicitly but does not advance any objective. For example, a labor market regulation that would otherwise be authorized by the TEU might actually disrupt the market, rather than enhance coordination, which would subvert TEU's objectives. And vice versa, many potential actions by the EU could further an objective of the Treaties, despite having no explicit authorization under any competence.

In applying the conferral principle, the ECJ has construed the Treaties much more broadly than any of these interpretations would suggest. Two of the most significant avenues to this expansion have been usage of an implied powers doctrine and broad reading of Article 352 of the TFEU. As applied, these two legal paths lead to wide EU competence for determining member policy. Yet, the implied powers doctrine and usage of Article 352 have been restrained in their capacity for expanding EU competence. Thus, fully assessing the EC's ESM under the principle of conferral requires understanding this framework.

The implied powers doctrine has long existed in ECJ jurisprudence. Even its wide formulation—which holds that the existence of a conferred objective or function implies the existence of any power reasonably necessary to attain it—has generally been accepted as legitimate by the Court.<sup>60</sup> Certainly the Court has explicitly endorsed a more narrow construction of the doctrine. In *Germany v Commission*, the Court affirmed the European Commission's competence to require member states to participate in consultations and submit essential information to the Commission to that end.<sup>61</sup> The Court laid down a basic statement of the narrow construction as accepted law: where the Treaties confer competence on the EU to carry out some specific task, that conferral implies “necessarily and per se the powers which are *indispensable to carry out that task*.”<sup>62</sup>

But the Court has also indicated willingness to apply the implied powers doctrine more broadly. In 2005, the ECJ affirmed the EU Council's enactment of certain criminal provisions—which, considered separately, is almost certainly beyond the EU's power—as valid because the provisions furthered the

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<sup>60</sup> Craig and de Burca, *EU Law* at 90 (cited in note 4).

<sup>61</sup> Cases 281, 283–285, 287/85, 1987 ECR 3203 (1987).

<sup>62</sup> *Id.* at ¶ 28 (emphasis added).

objectives of an environmental law that *was* within the Council's power.<sup>63</sup> Rather than the somewhat restrictive "indispensable to carry out that task" language from *Germany v Commission*, the Court's more recent ruling authorizes the Council to "[take] measures . . . which it considers necessary in order to ensure that the rules which it lays down . . . are fully effective."<sup>64</sup> Here, it is only required that the Council consider its action necessary to making other valid actions effective, as opposed to the action being objectively indispensable to the very execution of a conferred competence. This is certainly a more expansive understanding of implied powers than that displayed in *Germany v Commission*.

Yet the implied powers doctrine is not without its limits. Obviously, the EU must be able to tie its actions to a legitimate reading of the Treaties conferring some power to it. In that sense, then, the scope of the implied powers doctrine is delimited by the legitimate reading of the Treaties. Accordingly, the ECJ struck down a tobacco advertising and marketing harmonization measure passed in accordance with the provision now located in Article 95 permitting the adoption of harmonization measures for improving the function of the internal the EU market.<sup>65</sup> The Court explicitly stated that reading a power to *regulate* into Article 95 (then Article 100a) goes too far and constitutes a violation of "the principle embodied in Article [5] . . . that the powers of the Community are limited to those specifically conferred upon it."<sup>66</sup> Thus, there are instances where EU attempts to legislate substantively are not supported by implying powers into provisions of the Treaties that otherwise may seem to be on point.

Another potentially broad path to justifying EU action comes in the form of Article 352 of TFEU. This catch-all article gives the EU power to "adopt the appropriate measures" when "action by the Union should prove necessary . . . to attain one of the objectives set out in the Treaties" after abiding by the prescribed procedure.<sup>67</sup> As one commentator put it, if the Community's institutions align in their reading of Article 352, "it would become virtually impossible to find an activity which could not be brought within the objectives of the Treaty."<sup>68</sup> Thus, it seems that Article 352 justifies almost any EU action as long as it furthers an explicit objective—not an explicitly conferred power.

Article 352, however, also has its limits. When the EU acceded to the European Human Rights Convention in 1996, an opinion was issued that

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<sup>63</sup> *Commission v Council*, Case C-176/03, 2005 ECR I-7879 (2005).

<sup>64</sup> *Id.* at ¶ 48.

<sup>65</sup> *Germany v European Parliament and Council*, Case C-376/98, 2000 ECR I-8419 (2000).

<sup>66</sup> *Id.* at ¶ 83.

<sup>67</sup> TFEU, Art 352.

<sup>68</sup> J.H.H. Weiler, *The Transformation of Europe*, 100 Yale L J 2403, 2445–46 (1991) (quotation omitted).



included a comment regarding Article 352 (then Article 308).<sup>69</sup> According to that opinion, 352 may not be used to widen the scope of EU powers beyond the framework created by the EU Treaties taken as a whole nor to create the foundation for the adoption of provisions that would, in substance, amend the Treaties without following the necessary amendment procedures.<sup>70</sup> Further, the procedure for invoking Article 352 is also an obstacle.<sup>71</sup> If a measure is adopted that does not explicitly refer to Article 352 and provide its own justification with regard to its necessity, it will not be enforced.<sup>72</sup>

Thus, under the principle of conferral, an exercise of EU competence is valid only if explicitly authorized in the Treaties, including under Article 352, or if justifiable under the implied powers doctrine.

## 2. The principle of subsidiarity.

Where the Treaties have not explicitly granted exclusive competence, but do allow for shared competence, EU actions must comply with the principle of subsidiarity. The principle of subsidiarity found in Article 5 grants non-exclusive authority “only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States . . . but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level.”<sup>73</sup> The functional application of this principle is governed by the Protocol on the Application of the Principles of Subsidiarity and Proportionality (Second Protocol), which is premised on the “wish [of] ensur[ing] that decisions are taken as closely as possible to the citizens of the Union.”<sup>74</sup> The Second Protocol imposes specific procedural requirements on any exercise of the principle of subsidiarity, including wide consultations,<sup>75</sup> statements of justification and compliance,<sup>76</sup> and a deliberate, although non-binding, national approval process.<sup>77</sup> Thus, this principle of EU power is, at least on its face, a restriction on the exercise of non-exclusive competence.

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<sup>69</sup> *Opinion 2/94, Accession of the Community to the European Human Rights Convention* (1996) ECR I-1759, discussed in Craig and de Burca, *EU Law* at 93–94 (cited in note 4).

<sup>70</sup> *Id.*

<sup>71</sup> See Ingolf Pernice, *The Treaty of Lisbon: Multilevel Constitutionalism in Action*, 15 *Colum J Eur L* 349, 395–96 (2009).

<sup>72</sup> See, for example, *Tariff Preferences Case, Commission v Council*, Case 45/86, 1987 ECR 1493 (1987).

<sup>73</sup> TEU, Art 5.

<sup>74</sup> Protocol (No 2) on the Application of the Principles of Subsidiarity and Proportionality, preamble, 2010 OJ (C 83) 206 (“Second Protocol”).

<sup>75</sup> Second Protocol, Art 2.

<sup>76</sup> Second Protocol, Art 5.

<sup>77</sup> Second Protocol, Art 7.

One could argue for at least two different applications of this principle. First, the criteria for valid EU legislation could be applied conjunctively: aggregate action by member states would be insufficient to achieve the objectives of the proposed action *and* EU action will achieve those objectives better. A second, less restrictive approach would simply incorporate the consideration of whether the EU action would be more effective to accomplish the action's objective, given the action's scale and effects, into the assessment of whether the member states cannot sufficiently achieve that objective. Given the "by reason of" connector in the clause, it seems the second version is more appropriate. Further, the Commission has explained that the principle of subsidiarity is really a test of comparative efficiency, which seems to confirm this interpretation.<sup>78</sup>

But it must be understood that the comparative test has usually been weighted heavily in favor of the Community. After all, the EU's reason for existing is to promote harmonization, a goal that inherently lends itself to accomplishment at a higher level of government. Necessarily, then, the pursuit of that goal "often [demands] Community action to ensure the uniformity of a general approach which is of central importance to the realization of a common market."<sup>79</sup>

The approach of the ECJ in applying the principle of subsidiarity has generally reflected the logic above and resulted in only very loose enforcement of procedural and substantive requirements for satisfying the principle.<sup>80</sup> For example, the Court affirmed a Council directive harmonizing labor law in the Union regarding working time.<sup>81</sup> As summarized by a commentator, "[o]nce the Council had found it necessary to improve the existing level of protection and to harmonize the law in this area . . . achievement of that objective necessarily presupposed Community-wide action."<sup>82</sup> Thus, in general, it is unlikely that the principle of subsidiarity would be utilized to strike down an EU action, particularly where the action is one aimed at harmonization or standardization.<sup>83</sup>

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<sup>78</sup> See Craig and de Burca, *EU Law* at 101 (cited in note 4), discussing *Commission Communication to the Council and the European Parliament*, Bull EC 10-1992, 116.

<sup>79</sup> *Id.* at 104.

<sup>80</sup> See *id.* ("The indications are that the ECJ will not lightly overturn Community action on the ground that it does not comply with Article 5").

<sup>81</sup> *United Kingdom v Council* ("Working Time Directive Case"), Case C-84/94, 1996 ECR I-5755 (1996).

<sup>82</sup> Craig and de Burca, *EU Law* at 105 (cited in note 4) (discussing *UK v Council*, 1996 ECR I-5755).

<sup>83</sup> *Id.*

### 3. The principle of proportionality.

The final principle governing the exercise of EU power is the principle of proportionality. Article 5 explains that “the content and form of Union action shall not exceed what is necessary to achieve the objectives of the Treaties.”<sup>84</sup> The ECJ has restated this principle as “requir[ing] that measures implemented through Community law provisions be appropriate for attaining the legitimate objectives pursued by the legislation at issue and . . . not go beyond what is necessary to achieve them.”<sup>85</sup> As with subsidiarity, this principle activates when the EU is exercising a non-exclusive competence and combines with subsidiarity to set a bound to its authority in that instance.

As set out recently by the ECJ, the application of the principle of proportionality will invalidate a Community action “only if the measure is manifestly inappropriate having regard to the objective which the competent institution is seeking to pursue.”<sup>86</sup> Thus, the EU bodies are permitted wide discretion in making their political, economic, and social policy choices, provided that the decisions are based on objective criteria.<sup>87</sup>

For example, in 2002 the EU enacted ceilings for wholesale and retail roaming charges for cell phone users and a requirement to inform the users of those charges, with the objective of “ensuring that users of . . . public mobile telephone networks when travelling within the Community do not pay excessive prices for Community-wide roaming services when making calls and receiving voice calls.”<sup>88</sup> Phone service providers challenged the act before the ECJ, arguing that the act’s objective necessitated only the wholesale charge ceiling and that room should have been left for market forces to govern retail charges without the information requirement.<sup>89</sup> In its opinion, the court noted that the EU legislation had been premised on the concern that changes to the wholesale market *might* not have ensured the desired effect on the retail market.<sup>90</sup> In light of its wide discretion in making that assessment, the ECJ concluded that the concern was sufficient to find that the EU had not exceeded its competence under the principle of proportionality.<sup>91</sup>

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<sup>84</sup> TEU, Art 5.

<sup>85</sup> *Preliminary Ruling in The Queen, on the application of Vodafone, Ltd. v Secretary of State for Business, Enterprise and Regulatory Reform*, Case C-58/08, 2010 ECR I-00000, ¶ 51 (June 8, 2010).

<sup>86</sup> *Id.* at ¶ 52.

<sup>87</sup> *Id.* at ¶¶ 52–53.

<sup>88</sup> Council Regulation 2002/21/EC, 2007 OJ (L 171) 36.

<sup>89</sup> *Application of Vodafone*, Case C-58/08, 2010 ECJ at ¶¶ 54–61.

<sup>90</sup> *Id.* at ¶¶ 62–67.

<sup>91</sup> *Id.* at ¶ 70.

Thus, it is unlikely that an action justified under the principle of conferral and passing muster under the principle of subsidiarity would be nullified by the principle of proportionality. If the scope of a measure can be legitimately (that is, not by pretext) tied to advancing its objective, the ECJ would almost certainly not void it.

### III. LEGAL ARGUMENTS

Based on the legal framework set out in Section II, any legal argument seeking to justify Community-level legislation would likely come in one of the following forms. First, it may be neatly characterized within an explicit conferral of exclusive power, in which case the inquiry would end. Second, the act may be justified by Article 352 of the TFEU. Third, the legislation may be authorized by an explicit grant of shared power. If so, the motivation and the scope of the act must also comport with the principles of subsidiarity and proportionality. Fourth, an act by the EU could be defended as an act of implied power. Thus, the question to be confronted in this section is whether the bond-related provisions of the EC's ESM decision can be justified by one of these three arguments.

#### A. Explicit Conferral of Exclusive Power

The exclusive competences of the EU are set out in Article 3 of TFEU. These are comprised of power in the areas of customs union, establishing the competition rules necessary for the functioning of the internal market, setting monetary policy for the Member States whose currency is the euro, and making common commercial policy.<sup>92</sup> Importantly, there are also two other provisions dealing specifically with budgetary matters—Articles 126 and 136. Article 126 grants the EU Council the power to intervene when a member state is running an excessive budget deficit.<sup>93</sup> Article 136 makes the EU Council responsible for “strengthen[ing] the coordination and surveillance of [the member states’] budgetary discipline.”<sup>94</sup> But, after consideration, any argument attempting to justify the EC decision based on any of these explicit conferrals of exclusive power falls short.

Of the brief list of exclusive powers set out in Article 3, none appropriately encompasses an area that could reasonably be considered to include determining specific sovereign bond provisions. Sovereign bonds are not correlated in any

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<sup>92</sup> TFEU, Art 3.

<sup>93</sup> TFEU, Art 126. The authority of the EU in this circumstance is set out in §§ 7–11, and “excessive budget deficit” is defined in § 2.

<sup>94</sup> TFEU, Art 136.

plausible way to customs union, commercial policy, or internal competition rules. The argument from the monetary policy power is more interesting, though. The relationship between monetary policy and economic policy is an “intimate” one, but there are “political difficulties for the [EU] in extending control over national economic policy . . . lest it be accused of excessive centralization of economic decision-making.”<sup>95</sup> Articles 126 and 136 crystallize the conundrum with particular regard to budgetary practices; however, the Article 3 monetary power does not on its face appear to clearly grant the EU competence to set the collective action clause and maturity term policies recommended by the EC.

Article 126 at first seems to come closer to the mark. After all, it activates a set of EU powers in the specific instance of member states running excessive—that is, dangerous—budget deficits.<sup>96</sup> But beyond the power to make recommendations to the member state, Article 126 only provides for the power of four enforcement mechanisms: requiring additional disclosures prior to bond issuances; recommending that the European Investment Bank reconsider lending to the member; requiring a deposit of sufficient collateral from the member; and imposing fines.<sup>97</sup> Thus, although the EU could recommend the proposed term changes to bonds, it does not appear to have the power to require them. Further, the target of action under Article 126 is clearly restricted to members who are actually running, or are at risk of running, excessive budget deficits.<sup>98</sup> Therefore, imposing the EC bond requirements on all member states cannot be supported by Article 126.

Unlike Article 126, Article 136 explicitly applies to all member states whose currency is the euro and seems to provide for a broader power to monitor budgetary matters of the member states.<sup>99</sup> Specifically, the TFEU requires the EU Council “to strengthen the coordination and surveillance of their budgetary discipline.”<sup>100</sup> It seems sensible to stipulate that setting a standard for bond terms strengthens coordination and surveillance of those bond terms—but do bond terms relate to “budgetary discipline”?

Sovereign bond issuances certainly play a key role in financing national budgets (or deficits, more particularly). An argument supporting the EC decision would have to stress that point. Thus, one could legitimately argue that because the cost of financing is tied to the terms as described in Section II, the

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<sup>95</sup> Craig and de Burca, *EU Law* at 741 (cited in note 4).

<sup>96</sup> See generally TFEU, Art 126.

<sup>97</sup> TFEU, Art 126, § 11.

<sup>98</sup> TFEU, Art 126, § 7.

<sup>99</sup> TFEU, Art 136 § 1.

<sup>100</sup> TFEU, Art 136 §1, cl (a).

“coordination and surveillance” of those terms is correlated to the manageability of national debts and budgets, particularly maturity terms. But, there are at least three counterarguments.

First, the link between collective action clauses, maturity terms, and budget management might be too attenuated. The pricing effects of those terms, although real, could be counteracted or aggravated by other bond terms, and a major factor in the cost of financing is overall macroeconomic health and other risk factors, independent of the bond terms.<sup>101</sup> Second, “budgetary discipline” could be interpreted more restrictively to pertain to spending and taxing, rather than to include debt financing. These two arguments could also be tied together—because debt financing does not really pertain to budgetary discipline, properly conceived of, the attenuated link between the clauses and the cost of financing becomes even less convincing as a basis for supporting the EC decision. Third, given that the economic and fiscal situations of the EU countries are so varied, many member states will be negatively affected by the restricted flexibility available to them in their bond offerings. The impact, in theory, could be significant enough to impair a country’s ability to manage its budget, contravening the intent of Article 136. In total, and considered in conjunction, the counterarguments appear stronger, even when reading the Article 3 monetary power in combination with Article 136.

## B. Article 352

Article 352 authorizes the EU to take appropriate action when “action by the Union should prove necessary . . . to attain one of the objectives set out in the Treaties.”<sup>102</sup> By attachment to an explicit objective of the Treaties—not an explicit competence—an act of the EU could be justified as within its explicitly conferred power. Among the many objectives stated in the Treaties are achieving “the strengthening and the convergence of their economies,”<sup>103</sup> pursuing “the stability of the financial system,”<sup>104</sup> and complying with the guiding principle of “sound public finances.”<sup>105</sup> But, even if amenable to an

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<sup>101</sup> See Kerstin Bernoth, Jürgen von Hagen, and Ludger Schuknecht, *Sovereign Risk Premia in the European Government Bond Market* \*5–6 (European Central Bank Working Paper Series, 2004), online at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=533129](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=533129) (visited Feb 25, 2011). See also Gianluigi Ferrucci, *Empirical Determinants of Emerging Market Economies’ Sovereign Bond Spreads* \*7 (Bank of England Working Paper 2003), online at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=597422](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=597422) (visited Feb 25, 2011).

<sup>102</sup> TFEU, Art 352.

<sup>103</sup> TEU, preamble.

<sup>104</sup> TFEU, Art 127 § 5.

<sup>105</sup> TFEU, Art 119 § 3.

explicit objective, an EU action pursuant to Article 352 may not enlarge the scope of EU power beyond the general framework of the Treaties or amount to an amendment thereof.<sup>106</sup>

On initial consideration, the bond-term requirements seem to fit perfectly within the overlap of the objectives stated above. The problems with sovereign debt stocks have shaken financial systems across the EU (and around the world) and weakened Europe's economies and ability to compete.<sup>107</sup> Further, one could plausibly argue that an implicit objective underlying all other objectives is the continued viability of the Union, which is legitimately threatened by serious debt crises, according to EU president Herman von Rompuy.<sup>108</sup> Thus, addressing these problems in the way the EC decision proposes is in clear pursuit of these various objectives.

Nonetheless, it may be countered that the fact that the bond requirements could not be sufficiently tied to any explicit conferral of power severely weakens the argument from Article 352. As has been noted by commentators, reading Article 352 as argued above all but eliminates the inherent limitations created by the principle of conferral.<sup>109</sup> Further, on a lower level of analysis, the objectives recited above as justifying bond term requirements could arguably be read in contrasting ways. Pursuing financial stability is an objective set out for the European System of Central Banks and arguably, therefore, is restricted to its banking practices, not Community legislation.<sup>110</sup> And the requirements may actually undermine "sound public finances" in some countries that may derive greater benefit from different terms.<sup>111</sup>

Overall, an argument from Article 352 may be too shaky to be relied upon exclusively as a justification, given the limitation that Article 352 should not be read to expand on the framework of power as otherwise set out in the Treaties. But, the conceptual overlap of the objectives mentioned above does seem to lend itself to encompassing some power to prescribe certain fiscal policy choices when the stability of the EU financial system is threatened. This argument, then,

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<sup>106</sup> Craig and de Burca, *EU Law* at 93–94 (cited in note 4), discussing *Opinion 2/94, Accession of the Community to the European Human Rights Convention* (1996) ECR I-1759.

<sup>107</sup> See generally European Commission, *Public Finances in EMU 2010* (cited in note 12).

<sup>108</sup> See *Eurozone crisis 'threatens EU'* (Aljazeera Nov 16, 2010), online at <http://english.aljazeera.net/business/2010/11/20101116101849606475.html> (visited Feb 25, 2011). See also *Budget Crisis Threatens EUR and EMU* (Forex Hub Feb 10, 2010), online at <http://fxngold.com/forex/analysis/823-budget-crisis-threatens-eur-and-emu.html> (visited Feb 25, 2011).

<sup>109</sup> Weiler, 100 *Yale L J* at 2445–46 (cited in note 68).

<sup>110</sup> TFEU, Art 127 § 5.

<sup>111</sup> See the discussion of pricing effects and the bond terms at issue in this Comment, Sections II.A and II.B.

might be enough to justify an EU action requiring collective action clauses and long-term maturities. Yet, as will be explained below, Article 352 is not the strongest available foundation for this position.

### C. Explicit Conferral of Shared Power

TFEU provides for a set of shared competences in Article 4 and supplementary powers in Article 6. The only potentially relevant area of shared power in Article 4 is in matters concerning “economic, social and territorial cohesion.”<sup>112</sup> Article 6 does not include any relevant areas of competence.<sup>113</sup> Ultimately, an informed reading of Article 4 undermines any attempt to justify EU legislation consistent with the EC decision based on explicit conferral of shared power.

A proponent seeking to rely on a shared power would have to argue that legislation in accordance with the EC decision falls within the realm of economic cohesion. Similar to an argument made above, an act establishing a standard for bond issuances is obviously an act promoting some kind of cohesion. And the decision on whether to include certain terms in a bond indenture is arguably an “economic” one, if one understands “economic” to encompass “financial.” Thus, on its face, the argument in favor of including the power to prescribe specific bond terms within the shared power in the area of economic, social, and territorial cohesion seems to be a sensible one.

The proponent, if granted his initial argument, must also demonstrate that the proposed EU bond provisions comport with the principles of subsidiarity and proportionality. In Section II, this Comment explained that the principle of subsidiarity would rarely be used to strike down an EU act, particularly where the act is one to harmonize or standardize within a legitimate area of EU power.<sup>114</sup> The EC proposal would be precisely such an act. And based on the application stipulated by the Commission, the test of comparative efficiency, EU action in this area entails great comparative efficiency relative to national action.<sup>115</sup>

Finally, the principle of proportionality must also be satisfied, which is likely in this instance. The proposed bond requirements actually seem to be a quite prudent means of achieving the stated objectives of the EC decision. Further, based on the deferential analysis of the *Vodafone, Ltd* case discussed in

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<sup>112</sup> TFEU, Art 4, § 2.c.

<sup>113</sup> TFEU, Art 6.

<sup>114</sup> See Section II.C.2 (concluding from analysis of *United Kingdom v Council (Working Time Directive Case)*, Case C-84/94, 1996 ECR I-5755 (1996)).

<sup>115</sup> See *Opinion 2/94*, (1996) ECR I-1759.



the subsection above, on the principle of proportionality,<sup>116</sup> the conclusion that the inclusion of collective action clauses and extension of maturity terms *might* not occur without EU action seems self-evident, in that EU countries have already arrived at debt structures that do not incorporate the desired maturity terms and may decide to preclude collective action clauses in the future.<sup>117</sup>

Unfortunately, the proponent would face fairly strong counterarguments on the issues of conferral and, to a lesser extent, subsidiarity. Foremost, although on a superficial basis the “economic cohesion” power seems to encompass the bond requirements, a full reading of the TFEU undermines that interpretation. Title XVIII of the TFEU sets out specifics relating to the economic, social, and territorial cohesion power, and the introductory article to that title explains the motivation behind the conferral of this power.<sup>118</sup> Specifically, the cohesion power is to be used to “[reduce] disparities between the levels of development of the various regions and the backwardness of the least favoured regions.”<sup>119</sup> Thus, a better interpretation of the Article 4 power would require that legislation pursuant to that power be aimed at the objectives set out in Article 174: correcting for socioeconomic inequalities. The collective action clause and maturity term prescriptions would not satisfy that requirement.

On the principle of subsidiarity, despite the general presumption favoring EU harmonization measures, there is some reason to doubt that EU action presents significant comparative efficiency. First, collective action clauses (CACs) are already a staple of sovereign bond issuances.<sup>120</sup> Indeed, in 2006, over 60 percent of outstanding sovereign bonds contained CACs, and over 90 percent of new issuances between 2004 and 2007 included the terms.<sup>121</sup> CACs have become standard fare on their own, which arguably renders EU interference to mandate them superfluous. As to maturity terms, the parallel argument does not hold as well. One of the major problems that EU countries

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<sup>116</sup> See *Application of Vodafone*, Case C-58/08, 2010 ECR at ¶ 51.

<sup>117</sup> In fact, the only EU member with an average maturity length over eight years is Britain, and at least thirteen members have an average maturity under six years. For this information, consult the “Debt—Average Debt Maturity” tab of the interactive chart in the online article *Spreading infection* (Economist Feb 9, 2011), online at [http://www.economist.com/blogs/dailychart/2011/01/europes\\_economies](http://www.economist.com/blogs/dailychart/2011/01/europes_economies) (visited Feb 25, 2011).

<sup>118</sup> TFEU, Art 174.

<sup>119</sup> TFEU, Art 174.

<sup>120</sup> See Ahdieh, 6 Chi J Intl L at 241–42 (cited in note 31).

<sup>121</sup> Sonke Haseler, *Collective Action Clauses in International Sovereign Bond Contracts—Whence the Opposition?* \*5 (European Association of Law and Economics, 2009), online at <http://law.haifa.ac.il/eale/site/WorkingPapers/Binder%20WP%20007.pdf> (visited Apr 27, 2011).

are facing is maturity peaking, which indicates overlapping maturities, likely of different lengths. Further, it is unlikely that countries would willingly change to consistent longer-term maturities if they have not already done so. Having already weighed the benefits and drawbacks of short, medium, and long term bonds, those countries arrived at the structure that was deemed best for them. Thus, the analysis on the principle of subsidiarity yields mixed results.

On the whole, a proper reading of Article 4, as informed by Article 174, would likely preclude a conclusion that EU legislation requiring the inclusion of CACs and longer-term maturities could be justified by an explicit conferral of shared power.

#### D. Implied Power

The ruling in *Commission v Council* sets out the basic principle of implied powers as it stands currently: EU legislation, although not explicitly authorized in the Treaties, may nevertheless be valid if it is necessary to make other valid actions effective.<sup>122</sup> An implied power, therefore, must be tied to a valid action. The obvious course for a proponent of the bond requirements is to tie them to the establishment of the ESM, which would be a valid action if events unfold as the EC decision has planned—that is, if the power to create the ESM is incorporated by amendment into the TFEU.<sup>123</sup> Thus, the legal issue will be whether mandating CACs and longer maturity terms is necessary to effecting the ESM.

At this point, the policy implications of these two terms and their relationship to the ESM become absolutely critical. In its published decision, the EC describes the rationale for the two requirements vis-à-vis the ESM. One aspect of the ESM, as proposed, would be to require a member state that appears to be insolvent to negotiate with its private creditors a “comprehensive restructuring plan . . . with a view to restoring debt sustainability.”<sup>124</sup> It is in conjunction with this component of the ESM that the bond terms requirements are proposed as a means “to facilitate this process” and “to avoid refinancing peaks.”<sup>125</sup> Negotiations with private creditors are, undoubtedly, facilitated by CACs: a supermajority is necessarily easier to achieve than unanimity. And refinancing peaks would likely be mitigated in both frequency and severity if maturity terms were extended over longer periods—provided that similarly dated bonds are not issued in bunches.

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<sup>122</sup> See *Commission v Council*, Case C-176/03, 2005 ECR I-7879, ¶ 48 (2005).

<sup>123</sup> See European Council, *Conclusions* at 6–7 (cited in note 24).

<sup>124</sup> *Id.* at 9.

<sup>125</sup> *Id.*

Despite these obvious connections between CACs, maturity terms, and the ESM, the countervailing policy concerns described above in Section II pose a serious problem to arguing that the bond requirements truly serve the interests of debt sustainability.<sup>126</sup> Specifically, longer maturity terms and CACs actually make borrowing more expensive for less credit-worthy issuers, who are exactly the countries whose debt is least sustainable. Which policy concerns should prevail?

In a hypothetical judicial analysis of the matter, the weighing of these policy concerns is probably a close enough matter to merit deference (or review with a “light touch”) to the choices of the EU legislative bodies.<sup>127</sup> Such review of legislative discretion typically entails examination for “manifest error, misuse of power, or clear excess in the bounds of discretion.”<sup>128</sup> The wisdom of prioritizing facilitation of private restructuring and avoidance of refinancing peaks over simply keeping borrowing costs as low as possible is clearly a discretionary policy choice, one that would almost certainly not fall victim to such deferential review. Thus, as laid out in this Comment, an argument from the implied powers doctrine would likely justify the enactment of the CAC and maturity term requirements in connection with the ESM as EU law.

#### IV. CONCLUSION

As with every financial crisis, the 2010 EU sovereign debt crisis has brought to the attention of lawmakers a serious problem—in this case, the need for a mechanism by which to address debt problems of member states. The closely integrated nature of the EU has aggravated the recent crisis through the mechanism of contagion, and if EU leaders desire further, sustainable integration going forward, the debt problem will only loom larger over time. More than ever, the health of the weakest members is determining the health of the Union as a whole.

The EC has determined that its proposal for the ESM is the best answer available for the EU. The primary component, a pool of financial aid for troubled members, is to be enacted by amendment to the Treaties; but the secondary legal aspects—requirements that members include CACs and longer maturity terms in their bond issuances beginning in 2013—pose problems if they are to be enacted simply as EU legislation.

Implicated in this discussion are the foundational principles governing the two layers of sovereignty in the EU—conferral, subsidiarity, and proportionality.

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<sup>126</sup> See Sections II.A, II.B.

<sup>127</sup> Craig and de Burca, *EU Law* at 569–71 (cited in note 4).

<sup>128</sup> *Id.* at 569.

There is no explicit provision of the Treaties that appears to authorize particular bond requirements, whether as an exercise of exclusive or shared power. Further, the determination of bond terms is a fiscal decision, not a monetary or economic one as has been traditionally understood in the EU. Interference into the choice of bond terms, therefore, could be seen as a significant step toward political integration into a European super-state via common fiscal policy, in addition to the current monetary and economic integration.

Complicating this picture are the nuanced, complex economic ramifications of CACs and maturity terms. In some instances, the goal of debt sustainability is served well by modification provisions and longer maturity terms; but in others, the total effect is not so clear. Particularly troubling is the potential additional borrowing costs facing already troubled member states. Longer maturity terms demand higher yields, and CACs, by increasing the odds that bond terms could be altered, also increase the risk that creditors will not be paid in full. Thus, the underlying policy choice entails weighing those higher costs against enhanced flexibility in the event of a crisis and the decreased probability of maturity bunches.

Overall, despite reflecting an economically questionable policy choice, the enactment of the bond term requirements would most likely be viewed by the EU judiciary as just that: a policy choice, deserving of judicial deference. The competence to make that choice would seem to be granted as an implied power, the power to determine what measures are necessary to achieve the objectives of the ESM. Because the Stability Mechanism itself would be explicitly provided for in the Treaties, it would serve as a legitimate hook. Whether that hook comes attached to a line and sinker, and whether Europe's countries are consequently reeled in to a new super-state, could end up being one of the most important story lines of the century.

That end point is a definite possibility if the bond term provisions are enacted as envisioned in this Comment. An actual challenge to the provisions might not be far behind their enactment, especially given the growing sentiment in the populations of core EU nations that they should not be harmed because of the crises facing nations in the EU periphery.<sup>129</sup> Based on the analysis undertaken herein, the fate of such a challenge seems already woven into the law of the implied powers doctrine. From the affirmation of these bond term provisions, a domino effect potentially awaits—term mandates lead to budget constraints lead to taxation requirements and so on—and ultimately, the best way to govern a group of states that has come to exist under substantially identical laws is with a single government. Of course, a line could always be drawn at some point: but if not at bond term mandates, then where? And if a

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<sup>129</sup> See Bastian, *Euro Gets Cold Shoulder at Ballot Box of Outrage* (cited in note 37).

line is to be drawn, who is to draw it? If a key member, such as Germany, were to decide that its autonomy is more valuable than continued participation in the EU project, it could quickly spell the end for the Union. Put simply, the EU could quite possibly find itself at a crossroads with the onset of the ESM where the choice between dissolution and true integration must finally be made.<sup>130</sup>

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<sup>130</sup> Compare Bordo, *The Euro Needs a Fiscal Union: Some Lessons from History* (cited in note 34), with *Eurozone crisis 'threatens EU'* (cited in note 108).