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Auditors' Review of Banks

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In its decision of December 13, 2011, the Constitutional Court of the state of North Rhine-Westphalia ruled that a State Court of Auditors is granted by the constitution a broad scope of powers not only to control the immediate state administration but also entities outside the direct state administration, as far as they exercise financial responsibility for the state. This holds especially with regard to banks organized under public law, if their activities affect the state budget. This is generally the case when the state is liable for the obligations of such an entity, be it by statutory law or by contracts.

It is not unusual that the government transfers some of its tasks to third parties. Frequently, these third parties will be legal entities that belong to the government. This is especially true for legal entities organized under public law, such as the majority of financial institutions in Germany. Transferring tasks to an external entity leads to an effective loss of control and information. This raises the question to what extent parliament and the Court of Auditors are constitutionally entitled to and maybe even obliged to exercise guidance and control over entities that basically remain an indirect part of the administration.

Technically, the case was a dispute between the Court of Auditors as plaintiff and the state government as defendant over the scope of control of the state government. The state government was represented by the Minister of Finance as an agent of the state on the board of the NRW.BANK and the Minister of the Interior as administrative supervisor of the bank as an entity of administrative law. Indirectly it was also disputed whether the bank, like numerous other banks in Germany which are organized more or less as government entities (e.g. the Landesbanken and almost all municipal savings banks), is subject to the control by Courts of Auditors.

The Ruling

The admissibility of the case already posed the first problem: Does the Court of Auditors have standing to sue the state government and its members in constitutional court? The answer had been highly controversial among legal scholars in the past. It had never been treated by a constitutional court and

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cannot simply be derived from the wording of the statutes. That is why the decision had to pave the way for new legal territory. As a result, the court took a clear stand and affirmed at least for the state of North Rhine-Westphalia: The Constitution itself vests rights and powers in the State Court of Auditors. Therefore, it has standing in the Constitutional Court of the state to argue these rights and powers.

On the merits of the case, the court emphasized that the control exercised by the Court of Auditors plays a crucial role for enabling the parliament to competently discharge its budgetary responsibilities. It comprises not only the immediate budgetary process of the state, but also includes a comprehensive control of measures by other entities which have a direct or indirect effect on state finances. The court argues that any fiscal responsibility without a corresponding right of control for the Court of Auditors is not admissible from a constitutional point of view.

Such a fiscal responsibility can be the result of all business transactions of the NRW.BANK. It arises from an almost complete direct liability of the state for any deficit of the bank and an explicit guarantee given by the Minister of Finance on behalf of the state for obligations of the bank. This has to be judged in light of the volume of its balance sheet, which exceeds by far the state budget's volume. This fiscal responsibility has to be considered alongside the loss of control on the side of the parliament, because important decisions that might substantially affect the state budget are made by the bodies of the NRW.BANK. Even though the Minister of Finance is a member of the decision-making bodies of the NRW.BANK, he refused to submit to the control of the Court of Auditors, as did the Minister of the Interior. Incidentally, he also refused to disclose details to the state legislature when it asked for them.

On the basis of its essentially constitutional reasoning, the court bluntly rejected the argument of the government that the scope of control might be limited by rules contained in the NRW.BANK Act and the general Code on State Budgets (Landeshaushaltsordnung). It reminded of the basic legal fact that the constitution is the superior law of the land. Furthermore, the argument that the demanded control of the members of the state government would result in an indirect control of the bank itself, which would allegedly be unacceptable, was also set aside. Finally, in view of the ongoing crisis of the banking system the court's stance on other means of control which are applied on the bank is especially interesting and worthwhile to consider the broader application. It rejected plainly the argument of the government that the activities of the bank are sufficiently controlled by accountants and the general banking supervision by the Bundesbank and the (federal) financial services authority (BaFin).

The court acknowledged the limited scope of that control and stressed again the constitutional requirements and the potential threat for the state's finances resulting from the guarantees. In view of the

recent banking history, this imminent danger is not only theoretical – despite the control by accountants and by the supervisory authorities. Further evaluation and interpretation of the NRW.BANK Act, the State Budget Code and the (federal) Act on Budget Principles were therefore superfluous. According to the decision, the scope of the information and supervision rights vested in the Court of Auditors is generally unlimited and is determined only by the Court of Auditors itself and not by the controlled entities.

Outlook

The court's explanation for the far flung scope of control is the (potential) impact of the activities of the NRW.BANK on the state budget. This results, in the first place, in a comprehensive control of the NRW.BANK itself, but might also be extended to other bodies with budgetary responsibilities in the broad interpretation the court uses the term. Due to its constitutional foundation it cannot be limited by statutory law.

The decision also carries on the case law of the Federal Administrative Court (“Bundesverwaltungsgericht”) concerning separate institutions of indirect public administration, which often refuse to be examined by a Court of Auditors. They argue in a similar way as the state government in North-Rhine-Westphalia, but the federal court, in its recent jurisdiction, generally has ruled in favor of the courts of auditors.

To what extent the findings of the court have to be applied to other financial institutions, especially those with limited or implicit state guarantees only, is an open question. Following the line of the court's reasoning, a wide scope of control might be indispensable, depending, however, on the probability and the scope of the danger for state finances. A close scrutiny might give room for some limitations to the scope of control by legislative acts. A minimum standard of control by the Court of Auditors will have to remain in any case, because all state actions have to serve a public purpose and because the assets endowed in the institution by the state might be endangered. Judging from the developments of the last years, this decision can be interpreted as evidence for potential constitutional supervision and control duties in the case of implicit guarantees for financial institutions; an important question for the responsibilities that governments took on for the banking sector in the past. This ruling may, for instance, have serious implications for the capital guarantees extended by EU Member States to the newly established institutions on the European level, as for instance the European Stability Mechanism (ESM).