



JUDGMENT OF THE COURT

1 July 2005

(Right of establishment – Residence requirement for one member of management board and one member of executive management in banks)

In Case E-8/04,

EFTA Surveillance Authority, represented by Niels Fenger, Director, and Elisabethann Wright, Senior Officer, Legal and Executive Affairs, acting as Agents, Rue Belliard 35, Brussels, Belgium

Applicant,

v

The Principality of Liechtenstein, represented by Dr. Andrea Entner-Koch, Director of the EEA Coordination Unit, Ministry of Foreign Affairs of Liechtenstein, acting as Agent, Austrasse 79 / Europark, Vaduz, Liechtenstein

Defendant,

APPLICATION to the Court pursuant to the second paragraph of Article 31 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice, seeking an order from the EFTA Court that the Principality of Liechtenstein has failed to respect its obligations, arising from Article 31 of the Agreement on the European Economic Area, by maintaining in force Section 25 of the Banking Act (*Gesetz vom 21 Oktober 1992 über die Banken und Finanzgesellschaften*, hereinafter the “Banking Act”), whereby a residence requirement is imposed on at least one member of the management board and one member of the executive management in a bank established in its territory.

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THE COURT,

composed of: Carl Baudenbacher, President, Per Tresselt (Judge-Rapporteur) and Thorgeir Örlygsson, Judges,

Registrar: Henning Harborg,

having regard to the application and written pleadings of the parties and written observations of the Commission of the European Communities, represented by John Forman and Enrico Traversa, legal advisors, acting as Agents,

having regard to the Report for the Hearing,

having heard oral argument of the EFTA Surveillance Authority, represented by Elisabethann Wright, the Principality of Liechtenstein, represented by Dr. Andrea Entner-Koch and the Commission of the European Communities, represented by Enrico Traversa, acting as Agent,

gives the following

Judgment

I Facts and pre-litigation procedure

- 1 In 2002, the EFTA Surveillance Authority initiated a general review of legislation concerning the financial sector in Liechtenstein. Following correspondence with the Government of Liechtenstein on the matter, a potential problem was identified arising from the residence requirements provided in Section 25 of the Banking Act.
- 2 By letter of 8 October 2002, the EFTA Surveillance Authority asked the Government of Liechtenstein to comment on the potential restrictions arising under Section 25 of the Banking Act, particularly in light of the Court's decisions in Case E-3/98 *Herbert Rainford-Towning* [1998] EFTA Court Report 205, and Case E-2/01 *Dr. Franz Martin Pucher* [2002] EFTA Court Report 44. The EFTA Surveillance Authority acknowledged that restrictions on freedom of establishment might, in principle, be justified. However, it recalled that, if such is the case, the State is obliged to use the least restrictive means available to achieve its purpose. The EFTA Surveillance Authority suggested that a less restrictive solution than Section 25 of the Banking Act would appear to be to repeal the residence requirement and require only an adequate power of attorney.
- 3 On 9 July 2003 the EFTA Surveillance Authority sent a letter of formal notice to Liechtenstein, to which the Government of Liechtenstein replied by letter of 30

October 2003. The EFTA Surveillance Authority then issued a Reasoned Opinion to Liechtenstein on 11 December 2003.

- 4 On 16 March 2004, the Government of Liechtenstein informed the EFTA Surveillance Authority that a working group had been established to scrutinise the necessity of the residence requirement for the financial sector and the consequences of its possible repeal. The Government of Liechtenstein subsequently responded to the Reasoned Opinion on 30 April 2004, stating that the Liechtenstein Banking Association (*Liechtensteiner Bankenverband*) had reaffirmed the need for the residence requirement provided in Section 25 of the Banking Act, finding that the provision was necessary for the good functioning of the financial services sector in Liechtenstein.
- 5 By Decision of 30 June 2004, the EFTA Surveillance Authority decided to refer the matter to the EFTA Court. The application giving rise to this matter was registered at the Court on 9 November 2004.

II Legal background

EEA law

- 6 Article 31 EEA provides for the abolition of all restrictions on establishment between the EEA States. According to the second paragraph of Article 31(1) EEA, the freedom of establishment includes the right to take up and pursue activities as self-employed persons and to set up and manage undertakings under the conditions laid down for its own nationals by the law of the country where such establishment is effected.
- 7 Article 33 EEA provides for a derogation from the right to freedom of establishment, by permitting the application of national provisions laid down by law, regulation or administrative action providing for special treatment for foreign nationals on grounds of public policy, public security or public health.

National law

- 8 Section 25 of the Liechtenstein Banking Act reads as follows:

At least one member of the management board and of the executive management must be resident in Liechtenstein and must be provided with an adequate power of attorney, enabling him to represent the institution in relation to administrative authorities and the courts.

III Findings of the Court

- 9 This case concerns the compatibility of the requirement under Liechtenstein law that at least one member of the management board and one member of the executive management of a bank established in its territory must reside in that State, with the freedom of establishment under EEA law.
- 10 In assessing that question, the Court must first consider whether the residence requirement at issue constitutes a restriction in the sense of Article 31 EEA, and secondly, if so, whether it is justified on the basis of Article 33 EEA or on considerations of overriding public interest.
- 11 This Court has on two previous occasions been asked to assess the compatibility with the right of establishment, of residence requirements set out in Liechtenstein law (Case E-3/98 *Herbert Rainford-Towning* [1998] EFTA Court Report 205, and Case E-2/01 *Dr. Franz Martin Pucher* [2002] EFTA Court Report 44). At issue in *Rainford-Towning* was the residence requirement for at least one managing director of Liechtenstein companies, contained in the Business Act (*Gewerbegesetz*). In *Pucher* it was the residence requirement for at least one member of the board of directors of Liechtenstein companies, contained in the Persons and Companies Act (*Personen- und Gesellschaftsrecht*). In both cases, the Court found that the residence requirements constituted unjustified restrictions on the right of establishment.
- 12 The assertions by the parties concentrate on those cases. The view of the Applicant is that the findings of the Court in those cases are directly applicable to the case at hand and that consequently, the Court should consider the residence requirement in the Banking Act as an unjustified restriction.
- 13 Conversely, the Defendant asserts that this case must be distinguished from *Rainford-Towning* and *Pucher*. Unlike the national provision at issue in *Pucher*, Section 25 of the Banking Act does not require the exercise of specified professions (lawyer, legal agent, professional trustee or auditor in *Pucher*). Nor does it, as in *Rainford-Towning*, prevent nationals of other EEA States from taking up the positions at issue, since all but one person holding the relevant positions may reside abroad. The scope and aims of the relevant statutory provisions differ as well, in that the residence requirement in the case at hand concerns the banking sector only.

The existence of a restriction - Article 31 EEA

- 14 Article 31(1) EEA provides, in its first sub-paragraph, for the abolition of all restrictions on the freedom of establishment between the EEA States. According to the second sub-paragraph, the freedom of establishment includes the right of nationals of the EEA States to take up and pursue activities as self-employed persons and to set up and manage undertakings in another EEA State under the

same conditions as are laid down by the law of the EEA State of establishment with respect to its own nationals.

- 15 The question is whether the residence requirement contained in Section 25 of the Banking Act constitutes a restriction on the freedom of establishment.
- 16 Clearly, there is no overt discrimination on the basis of nationality in Section 25 of the Banking Act. However, it is settled case law that the rules on equal treatment prohibit not only overt discrimination based on nationality, but also covert forms of discrimination which, by applying other distinguishing criteria, achieve in practice the same result (see, *Pucher*, at paragraph 18; and *Rainford-Towning*, at paragraph 27).
- 17 The residence requirement constitutes such a distinguishing criterion. Both the EFTA Court and the Court of Justice of the European Communities have consistently held that national rules under which a distinction is drawn on the basis of residence are liable to operate mainly to the detriment of nationals of other EEA States, as non-residents are, in the majority of cases, foreigners (see *Pucher*, at paragraph 19; *Rainford-Towning*, at paragraph 29; and, Case C-279/93 *Schumacker* [1995] ECR I-225, at paragraph 28).
- 18 Just like in *Pucher* and *Rainford-Towning*, the effect of the residence requirement at issue is to place nationals of other EEA States at a disadvantage as compared to Liechtenstein nationals seeking to become members of the management board or the executive management of a bank established in Liechtenstein. The Court therefore concludes that the residence requirement contained in Section 25 of the Banking Act constitutes covert discrimination, and consequently, a restriction in the sense of Article 31 EEA.
- 19 The fact that the residence requirement contained in Section 25 of the Banking Act is a minimum requirement, in that it only requires one person in each of those positions to reside in Liechtenstein can not change this conclusion. In *Pucher*, the contested national provision was also a minimum requirement requiring only one board member to reside in Liechtenstein, while the others might reside abroad.
- 20 Nor is the conclusion affected by the fact that Section 25 of the Banking Act does not require the practice of specified professions, as opposed to the situation in *Pucher*, where the resident board member also had to be admitted to practice certain specified professions in Liechtenstein. The finding in *Pucher* that the nationals of other EEA States were placed at a disadvantage compared to Liechtenstein nationals, was based on the residence requirement alone and not linked to the professional requirement.
- 21 Finally, the argument by the Defendant that Section 25 of the Banking Act concerns only 34 persons and, therefore, does not have an appreciable effect on the right of establishment, must be rejected. It is well established that any restriction, even minor, is prohibited (see Case E-1/03 *EFTA Surveillance*

Authority v The Republic of Iceland [2003] EFTA Court Report 143, paragraph 30).

- 22 On this basis, the Court concludes that the residence requirement in Section 25 of the Banking Act constitutes a restriction on the freedom of establishment contrary to Article 31 EEA.

Justification

- 23 The Court must then consider whether the restriction is justified by reasons referred to in Article 33 EEA or by considerations of overriding public interest. In order to be so justified, the national legislation must be suitable for securing the objective which it pursues, and must not exceed what is necessary in order to achieve it, so as to accord with the principle of proportionality. If there are other ways of protecting the relevant public interest, which are less restrictive on the freedoms exercisable under EEA law, the national legislation must be deemed to exceed what is necessary in order to achieve its objective (Case E-1/03 *EFTA Surveillance Authority v Iceland* [2003] EFTA Court Report 143, at paragraph 35; Case E-4/04 *Pedicel v Directorate for Health and Social Affairs*, judgment of 25 February 2005, not yet reported, at paragraph 56; and Case E-10/04 *Paolo Piazza v Paul Schurte AG*, judgment of 1 July 2005, not yet reported, at paragraph 39).
- 24 The public interest grounds invoked by the Defendant in this case concern the protection of the good reputation and functioning of the Liechtenstein financial services sector. These public interests were recognised by the Court in *Pucher* as legitimate objectives capable of justifying restrictions on the freedom of establishment (See, *Pucher*, at paragraph 32; see also, Case C-384/93 *Alpine Investments* [1995] ECR I-1141, at paragraph 44).
- 25 The Defendant relies on several more specific elements related to this general objective. It was maintained that the residence requirement ensures familiarity with local circumstances, and thereby promotes compliance with national legislation; and that the residence requirement facilitates supervision and enforcement of such legislation by the Liechtenstein authorities. Furthermore, it was argued that the residence requirement is indispensable for the administration of justice; and that it may reduce the risk of abuses in the Liechtenstein banking sector, to the effective enforcement of claims by other market players, and, finally, to the confidence of investors and creditors in the Liechtenstein financial market.
- 26 These objectives were also relied on by the Defendant in *Pucher*, where the Court found the residence requirement neither suitable nor necessary to achieve those objectives. Consequently, those objectives could not justify the residence requirement in that case.

- 27 The response of the Court to those arguments in *Pucher*, at paragraphs 32-38, is equally applicable to the present case. Similar observations were made by the Court in *Rainford-Towning*, at paragraphs 34 to 37.
- 28 The fact that the scope of Section 25 of the Banking Act differs from the statutory provision at issue in *Pucher* (contained in the Persons and Companies Act), in that the residence requirement in the case at hand concerns the banking sector only, does not alter the assessment of the justification at issue. The justification adduced in *Pucher*, was, as in the case at hand, the protection of the good reputation and functioning of the Liechtenstein financial services sector. The Government of Liechtenstein has not explained in what way the difference in scope between the Banking Act and the Persons and Companies Act might influence the assessment of the justification at issue.
- 29 In addition, the Court notes that the Defendant has not, in the course of the proceedings before this Court, described the nature of the types of abuse that are sought to be discouraged by a residence requirement, so as to allow an assessment of its suitability. Nor has it substantiated that the risk of such abuse in the banking sector is influenced by the place of residence of the members of its executive board or executive management. As regards the possibility of effective enforcement of claims by other market players, it is not clear from the observations of the Defendant whether it refers to enforcement against the bank or against the individual members of the executive board or management. Nor has it shown that such enforcement is facilitated by the residence requirement. Finally, the Defendant has not sought to demonstrate in what way the confidence of investors and creditors in the Liechtenstein financial market could be affected by the maintenance or repeal of the residence requirement.
- 30 Consequently, the Court cannot accept the argument by the Defendant that the residence requirement contained in Section 25 of the Banking Act is suitable for securing the objectives referred to in paragraph 24 above.
- 31 On this basis, the Court holds that the residence requirement contained in Section 25 of the Liechtenstein Banking Act is not justified.

IV Costs

- 32 Under Article 66(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party's pleadings. The Applicant has asked that the Defendant be ordered to pay the costs. Since the latter has been unsuccessful, it must be ordered to pay the costs.

On those grounds,

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THE COURT

hereby:

- 1. Declares that the Principality of Liechtenstein has failed to respect its obligations, arising from Article 31 of the Agreement on the European Economic Area, by maintaining in force Section 25 of the Banking Act (*Gesetz vom 21 Oktober 1992 über die Banken und Finanzgesellschaften*), whereby a residence requirement is imposed on at least one member of the management board and one member of the executive management of a bank established in its territory.**
- 2. Orders the Principality of Liechtenstein to pay the costs of the proceedings.**

Carl Baudenbacher

Per Tresselt

Thorgeir Örlygsson

Delivered in open court in Luxembourg on 1 July 2005.

Henning Harborg
Registrar

Carl Baudenbacher
President