REPORT FOR THE HEARING
in Case E-8/04

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 in the case between

EFTA Surveillance Authority

and

The Principality of Liechtenstein

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 21.10.1992 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 in a bank established in its territory.

I Introduction

1. The case at hand concerns a provision in the Liechtenstein Banking Act whereby at least one member of each of the management board and of the executive management in a bank established in Liechtenstein must be domiciled/resident within that country.

2. The application from the EFTA Surveillance Authority is based on one plea in law, namely that the residence requirement, contained in the Liechtenstein Banking Act, is in breach of EEA law provisions on the freedom of establishment.

II Legal background

EEA law

3. 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…*

Thus, the second paragraph of Article 31(1) of the EEA Agreement prescribes the equal treatment of nationals of any EEA State invoking their right to freedom of establishment in another EEA State and those nationals of the EEA State where the establishment is effected.

4. Article 33 EEA provides a derogation from the right to freedom of establishment. It states that the right that this freedom affords shall not prevent the application of national provisions laid down by law, regulation or administrative action, that provide for special treatment of foreign nationals on grounds of public policy, public security or public health.

The contested national legislation

5. Section 25 of the 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.*[1]

III Pre-litigation procedure

6. 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.

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[1] This is an unofficial translation which is provided in both the Application to the EFTA Court by the EFTA Surveillance Authority and in the Defence by the Government of Liechtenstein.

7. By letter of 8 October 2002,[2] 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 EFTA Court's decisions in *Rainford-Towning*[3] and *Pucher*.[4] 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.

8. In its response of 14 January 2003,[5] the Government of Liechtenstein stated that the residence requirement in Section 25 of the Banking Act was essential to the proper business operation of banks based in Liechtenstein. In its view, Section 25 of the Banking Act was the least restrictive means of ensuring accurate business operations that were fundamental to the financial sector and its clients.

9. By letter of 23 January 2003,[6] the EFTA Surveillance Authority informed the Government of Liechtenstein that a residence requirement could be considered to be an obstacle to the right of establishment provided in Article 31 of the EEA Agreement. While such restrictions could be justified on grounds of public interest, as laid down in Article 33 EEA, such justification was conditional on the appropriateness of the measure for attaining the objective pursued and being objectively necessary and proportionate.[7]

10. The EFTA Surveillance Authority further stated that the Government of Liechtenstein had provided no arguments distinguishing the present case from *Pucher*. The EFTA Surveillance Authority concluded that Section 25 of the Banking Act restricted the freedom of establishment provided for by Article 31 EEA. Moreover, the EFTA Surveillance Authority found that Liechtenstein had not provided any valid justification for the restriction.

11. In its reply to the EFTA Surveillance Authority's letter dated 29 April 2003,[8] the Government of Liechtenstein maintained that the findings of the EFTA Court in *Pucher* must be considered carefully.

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2 See Annex 1 to the Application.

3 Case E-3/98 *Herbert Rainford-Towning* [1998] EFTA Court Report 205.

4 Case E-2/01 *Dr. Franz Martin Pucher* [2002] EFTA Court Report 44.

5 Annex 2 to the Application.

6 Annex 3 to the Application.

7 Case E-2/01 *Dr. Franz Martin Pucher*, para 31.

8 See Annex 4 to the Application.

12. The Government of Liechtenstein further recalled that the Council Regulation on the recognition and enforcement of judgments in civil and commercial matters[9] had been qualified as not being EEA relevant and, thus, not included in the EEA *Acquis*. Moreover, in light of the case law of the Court of Justice of the European Communities, it was of the opinion that, on the whole, Section 25 of the Banking Act did not have an appreciable effect on the right of establishment. This was partly because the provision affected only 34 people and partly because, apart from the one member of the management board and one member of the executive management of banks established in its territory, free access was provided to anyone fulfilling the necessary professional requirements.

13. Finally, the Government of Liechtenstein argued that the good functioning and the good reputation of the financial sector, especially the banking sector, were of vital interest to Liechtenstein, and that Section 25 of the Banking Act was indispensable in this regard. The Government further stated that less restrictive measures, such as professional insurance or a security deposit, could not achieve the same results.

14. The EFTA Surveillance Authority sent a letter of formal notice to Liechtenstein on 9 July 2003.[10] In its response of 30 October 2003,[11] the Government of Liechtenstein argued that, while Section 25 of the Banking Act exhibited similarities to the provisions giving rise to the *Rainford-Towning* and *Pucher* cases, there were also important distinctions to be made.

15. Reiterating its opinion that Section 25 of the Banking Act restricts the freedom of establishment provided by Article 31 EEA, the EFTA Surveillance Authority issued a Reasoned Opinion to Liechtenstein on 11 December 2003.[12]

16. On 16 March 2004,[13] 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. Liechtenstein subsequently responded to the Reasoned Opinion on 30 April 2004,[14] stating that the *Liechtensteiner Bankenverband* (Liechtenstein Banking Association) 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.

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9 Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, OJ 2002 L 12, p.1.

10 See Annex 5 to the Application.

11 See Annex 6 to the Application.

12 See Annex 7 to the Application.

13 See Annex 8 to the Application.

14 See Annex 9 to the Application.

17. By Decision of 30 June 2004, the EFTA Surveillance Authority decided to refer the matter to the EFTA Court.[15] The application giving rise to this matter was registered at the Court on 9 November 2004.

IV Forms of order sought by the parties

18. The EFTA Surveillance Authority claims that the Court should:

(i) declare that by maintaining in force the provisions of Section 25 of the Banking Act, whereby a residence requirement is imposed on at least one member of the management board and of the executive management in a bank established on its territory, the Principality of Liechtenstein has failed to respect the freedom of establishment for which Article 31 of the Agreement on the European Economic Area provides; and,

(ii) order the Principality of Liechtenstein to pay the cost of the proceedings.

19. In a communication dated 13 April 2005 the Principality of Liechtenstein sought to supplement its statement of defence by supplying a suggested form of order to the effect that the Court should:

(i) dismiss the application of the EFTA Surveillance Authority; and,

(ii) order the EFTA Surveillance Authority to pay the cost of the proceedings.

20. This communication was transmitted to the Agents of the EFTA Surveillance Authority on 14 April 2005, who refrained from commenting thereon.

V Written procedure

21. Pleadings have been received from the parties:

- the EFTA Surveillance Authority, represented by Niels Fenger, Director, Legal and Executive Affairs, and Elisabethann Wright, Senior Officer, Legal and Executive Affairs, acting as Agents; and,

- 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.

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15 See Annex 10 to the Application.

22. Pursuant to Article 20 of the Statute of the EFTA Court, written observations have been received from:

- the Commission of the European Communities, represented by John Forman and Enrico Traversa, Legal Advisers, acting as Agents.

The EFTA Surveillance Authority

23. In its *application*, the EFTA Surveillance Authority relies essentially on the judgments of the EFTA Court in *Rainford-Towning*[16] and *Pucher,*[17] in support of its view that the residence requirement in the case at hand constitutes an unjustified restriction on the freedom of establishment under EEA law.

Article 31 EEA

24. Although Section 25 of the Banking Act makes no direct reference to nationality requirements, and therefore, does not give rise to direct discrimination on the grounds of nationality, it does, in the view of the EFTA Surveillance Authority, give rise to covert discrimination. The EFTA Surveillance Authority refers in this regard to *Rainford-Towning* and *Clean Car Autoservice,*[18] according to which EEA rules governing equal treatment prohibit not only overt discrimination based on nationality, but also all covert forms of discrimination which, by applying other distinguishing criteria, achieve the same results in practise. It further states that the effect of Section 25 of the Banking Act on nationals and non-nationals of Liechtenstein must be examined in the light of the case law of the EFTA Court and of the Court of Justice of the European Communities.[19]

25. The EFTA Surveillance Authority asserts that by requiring each bank in Liechtenstein to have at least two resident management personnel in order to legitimately function there, the effect of the resident 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 board of a bank established in Liechtenstein.

26. The EFTA Surveillance Authority refers in this regard to *Rainford-Towning* and *Pucher*, where the EFTA Court held that such residence requirements constituted indirect discrimination based on nationality contrary to

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16 Case E-3/98 *Herbert Rainford-Towning* [1998] EFTA Court Report 205.

17 Case E-2/01 *Dr. Franz Martin Pucher* [2002] EFTA Court Report 44.

18 Case E-3/98 *Herbert Rainford-Towning*, para 27; and, Case C-350/96 *Clean Car Autoservice* v *Landeshauptmann von Wien* [1998] ECR I-2521, para 27.

19 Case E-3/98 *Herbert Rainford-Towning*, para 27 and 29; Case E-2/01 *Dr. Franz Martin Pucher*, para 19, and, Case C-279/93 *Finanzamt Köln-Altstadt* v *Schumacker* [1995] ECR I-225, para 28.

Article 31 EEA.[20] As in those cases, this could only be justified if the residence requirement is based on objective considerations independent of the nationality of the person concerned and is proportionate to a legitimate aim pursued by the national law.[21]

27. The EFTA Surveillance Authority claims that the situation in the case at hand is very similar to those in *Rainford-Towning* and *Pucher,* where the EFTA Court concluded that nothing in the information presented to it supported a finding that a residence requirement was suitable and necessary. The Court further concluded that there were less restrictive and more appropriate means to achieve the desired goals.[22] In the view of the EFTA Surveillance Authority, the Government of Liechtenstein has not provided any evidence to support its claim that a distinction must be made between Section 25 of the Banking Act and the legislation at issue in *Rainford-Towning* and *Pucher*.

28. The EFTA Surveillance Authority discards the relevance of the argument by the Government of Liechtenstein that Section 25 of the Banking Act concerns 34 persons only, and therefore has no appreciable effect. The EFTA Surveillance Authority understands the argument as a suggestion that it is possible to apply the principle of *de minimis* in the present case, to the effect that, since only a small number of people are affected by the provision, it does not fall foul of Article 31 EEA. Referring to case law of the Court of Justice of the European Communities on free movement, the EFTA Surveillance Authority maintains that any restriction on free movement, even minor, is prohibited.[23] That case law is relevant for the interpretation of Article 31 EEA, which reflects the provisions of Article 43 EC (formerly Article 52 EC) .[24] In this regard, reference is made to Article 6 EEA and Article 3(2) of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice.

Article 33 EEA

29. The EFTA Surveillance Authority submits that the benefits of the derogation from the freedom of establishment provided by Article 33 EEA cannot be extended to the provisions of Section 25 of the Banking Act.

30. In this regard, the EFTA Surveillance Authority recalls the requirements set out by the EFTA Court in *Pucher*. First of all, the residence requirement must pursue one of the public interest objectives identified in Article 33 EEA;

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20 Case E-3/98 *Herbert Rainford-Towning*, para 30; Case E-2/01, *Dr. Franz Martin Pucher*, para 24.

21 Case E-3/98 *Herbert Rainford-Towning*, para 31.

22 Case E-2/01 *Dr. Franz Martin Pucher*, para 32.

23 Case C-49/89 *Corsica Ferries France* v *Direction générale des douanes française* [1989] ECR I-4441, para 8; and, Case E-1/03 *EFTA Surveillance Authority* v *The Republic of Iceland* [2003] EFTA Court Report 143, para 30.

24 Case E-5/00 *Dr. Josef Mangold* [2000-2001] EFTA Court Report 163, paras 6 and 7.

secondly, the contested requirement must be appropriate for achieving the objective pursued; and thirdly, it must be objectively necessary and proportionate to that objective.[25]

31. The EFTA Surveillance Authority acknowledges that the first requirement is fulfilled in the case at hand. It refers in this regard to the finding of the EFTA Court in *Pucher* that the protection of the functioning and good reputation of the financial services sector in Liechtenstein may be considered a legitimate public policy objective under Article 33 EEA.[26]

32. However, in the view of the EFTA Surveillance Authority, the other requirements are not fulfilled. The EFTA Surveillance Authority is of the view that the residence requirements in the case at hand must be regarded in the same manner as the residence requirements in *Rainford-Towning* and *Pucher,* where the EFTA Court found that they could not be justified.

33. The EFTA Surveillance Authority contends that the Government of Liechtenstein has raised no argument that could justify a different result in the present case. It states that, despite repeated invitations by the EFTA Surveillance Authority, the Government of Liechtenstein has failed to provide any evidence supporting its claim that a residence requirement imposed on a member of each of the management board and the executive board of a bank established in its territory is an appropriate means of protecting the functioning and good reputation of the financial services sector in Liechtenstein. Neither has it demonstrated that there are no less restrictive means of ensuring an equal level of protection. It has merely argued in the abstract that one should be careful in transposing the reasoning of the EFTA Court in *Rainford-Towning* and *Pucher* to the present case, without explaining the motives or factual circumstances that lead the Government of Liechtenstein to this conclusion.

34. In support of its conclusion, the EFTA Surveillance Authority refers to the statement of the EFTA Court that, when derogating from the fundamental principle of freedom of establishment, Article 33 must be strictly interpreted.[27]

35. Finally, The EFTA Surveillance Authority refers to the conclusion of the EFTA Court in *Rainford-Towning*, according to which recourse to the concept of public policy presupposes the existence of a genuine and sufficiently serious threat affecting one of the fundamental interests of society.[28] According to the EFTA Surveillance Authority, nothing in the information provided by the Government of Liechtenstein in the present case has demonstrated the existence of such a threat to a fundamental interest of society.

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25 Case E-2/01 *Dr. Franz Martin Pucher*, para 31. See also, Case 352/85 *Bond van Adverteerders* v *Netherlands* [1988] ECR 2085, paras 33 and 36.

26 Case E-2/01 *Dr. Franz Martin Pucher*, para 32.

27 Case E-2/01 *Dr. Franz Martin Pucher*, para 31.

28 Case E-3/98 *Herbert Rainford-Towning*, para 42.

Recognition and enforcement of judgments

36. According to the EFTA Surveillance Authority, the fact that Liechtenstein has chosen not to accede to treaties governing litigation and execution in foreign jurisdictions, is not an adequate justification for the residence requirement in Section 25 of the Banking Act.

37. In support of its view, the EFTA Surveillance Authority refers to *Pucher*, wherein the EFTA Court recognised that litigation or execution in foreign jurisdictions often involves costs and complications that do not arise in domestic jurisdictions. However, it also recalled that the encouragement of cross-border activity was a fundamental objective of the EEA Agreement. Whenever such activity gives rise to litigation, the enforcement of judgments must often be sought within the jurisdiction of another EEA State.[29] The EFTA Court thus concluded that considerations relating to the national administration of justice in civil matters could not be held to justify the imposition of a residence requirement in derogation of Article 31 EEA.[30]

38. While the EFTA Surveillance Authority does not dispute that it is within the sole competence of Liechtenstein, as a sovereign state, to decide whether or not to accede to treaties governing issues outside the scope of the EEA Agreement, such a decision by Liechtenstein cannot be used to justify provisions of national law that undermine a fundamental right provided by the EEA Agreement.

39. The EFTA Surveillance Authority argues that, as in *Pucher*, [31] a residence requirement imposed on a single member of each of the management board and the executive board of a bank established in the territory of Liechtenstein would not ensure the protection of the functioning and good reputation of the financial services sector in Liechtenstein that, in the absence of reliance on the provisions of treaties governing the recognition and enforcement of judgments, Liechtenstein seeks to achieve.

Arguments of general interest

40. According to the EFTA Surveillance Authority, the provisions of Section 25 of the Banking Act cannot be justified as imperative requirements in the general interest in accordance with the test established by the Court of Justice of the European Communities.

41. A residence requirement may be justified with reference to the general interest, provided that the measure is suitable for achieving the objective that it

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29 Case E-2/01 *Dr. Franz Martin Pucher*, para 39.

30 Case E-2/01 *Dr. Franz Martin Pucher*, para 41.

31 Case E-2/01 *Dr. Franz Martin Pucher*, para 40.

pursues and does not go beyond what is necessary in order to attain it.[32] According to the EFTA Surveillance Authority, the argument of the Government of Liechtenstein that it builds heavily on the precautionary effect of a functioning system of responsibility, liability and enforceability in a relatively small society, does not fulfil this test. It further disagrees with the statement by the Government of Liechtenstein that less restrictive measures, such as professional liability insurance or deposit of security, would not be able to achieve the same results as the residence requirement in Section 25 of the Banking Act.

42. In this regard, the EFTA Surveillance Authority asserts that Section 25 of the Banking Act is neither the sole, nor the most proportionate means of achieving the protection of the general interest. It states that nothing in the arguments presented by the Government of Liechtenstein justifies this requirement by reference to the general interest. In the view of the EFTA Surveillance Authority, a residence requirement will not necessarily make a member of the management board and of the executive board of a bank established in Liechtenstein territory more responsible, nor will it increase either their liability, or that of the bank they represent. Moreover, enforceability of responsibility will not be achieved. The EFTA Surveillance Authority adds that the residence requirement in Section 25 of the Banking Act is not applied without discrimination.

43. In its *reply* to the defence of the Government of Liechtenstein, the EFTA Surveillance Authority refrains from addressing the various elements in the Liechtenstein defence in which it is argued that no breach of Article 31 EEA has occurred, but refers to its application in this regard. The EFTA Surveillance Authority merely reiterates its belief that it follows from abundant case law that a restriction on freedom of establishment is prohibited even if such a restriction is of limited scope or minor importance.[33] In the reply, the EFTA Surveillance Authority limits itself to discussing the arguments of the Government of Liechtenstein concerning the possible justification for the restriction.

Protection of the Liechtenstein Financial Services Sector and Administration of Justice

44. The EFTA Surveillance Authority acknowledges the importance of the financial sector to the Liechtenstein economy, and the legitimate wish of the Government of Liechtenstein to preserve the good reputation of that sector. However, in the view of the EFTA Surveillance Authority, the Government of

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[32] Case C-55/94 *Gebhardt* v *Consiglio dell'Ordine degli Avvocati e Procuratori di Milano* [1995] ECR I-4165, para 37; and, Case C-19/92 *Kraus* v *Land Baden-Wuerttemberg* [1993] ECR I-1663, para 32.

[33] See Case C-49/89 *Corsica Ferries France* v *Direction générale des douanes française* [1989] ECR I-4441, para 8; Case E-1/03 *EFTA Surveillance Authority* v *The Republic of Iceland* [2003] EFTA Court Report 143, para 30; Case E-5/00 *Dr. Josef Mangold* [2000-2001] EFTA Court Report 163, paras 6 and 7; and, Case C-9/02 *Hughes de Lasteyrie du Saillant*, judgment of 11 March 2004, not yet reported, para 43.

Liechtenstein has not provided any tangible evidence that Article 25 of the Banking Act is both a suitable and a proportionate method of ensuring this protection. Nor has it demonstrated why the conclusion of the EFTA Court in *Pucher*,[34] that a residence requirement was neither suitable nor necessary in the circumstances, should not be valid in the present context, particularly given that it has provided no arguments additional to those that it submitted in the *Pucher* case.

45. The EFTA Surveillance Authority disagrees with the Government of Liechtenstein that the residence requirement is indispensable for the administration of justice and that it is needed to minimise the risk of abuse of the Liechtenstein banking sector and to avoid breach of other provisions, e.g. concerning criminal law or tax law. In support of its position, it refers to the statement by the EFTA Court in *Pucher*, that "the residence requirement is neither suitable nor necessary to assist the administration of justice, ensure the execution of civil judgments or enforce administrative and criminal sanctions".[35]

46. The EFTA Surveillance Authority disagrees with the statement by the Government of Liechtenstein that the necessary close cooperation between financial intermediaries can only be guaranteed if the pursuit of responsibility and the enforcement of claims may be carried out within the territory of the State in which the bank is registered. The *Bachmann*[36] judgment, relied on by the Government of Liechtenstein, does not support its position that the need to preserve the effective administration of justice may justify the setting of certain, potentially restrictive, conditions.

47. In paragraph 27 of *Bachmann*, the Court of Justice of the European Communities concluded that "…as Community law stands at present, it is not possible to ensure the cohesion of such a tax system by means of measures which are less restrictive than those at issue in the main proceedings". The part of the *Bachmann* judgment on which Liechtenstein relies, relates solely to the question of fiscal cohesion. The case did not concern the legality of a residence requirement imposed in order that an individual might perform a professional activity.

48. The EFTA Surveillance Authority finds the statements by the Government of Liechtenstein that it is bound by international agreements and standards, unable to support its arguments. The Government of Liechtenstein does not demonstrate that any international agreements or standards require it to provide or maintain a residence requirement such as that found in Article 25 of the Banking Act. Nor does it indicate how these agreements or standards are considered to address the questions raised in the present case. In the view of the

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34 Case E-2/01 *Dr. Franz Martin Pucher*, para 32.

35 Case E-2/01 *Dr. Franz Martin Pucher*, para 37.

36 Case C-204/90 *Hans Martin Bachmann* v *Belgian State* [1992] ECR I-249, para 27.

EFTA Surveillance Authority, the only international agreement relevant to the dispute at hand is the EEA Agreement. National legislation that imposes a residence requirement restricts the fundamental right of establishment of the EEA Agreement.

Assumed benefits of physical presence

49. The EFTA Surveillance Authority questions the argument by the Government of Liechtenstein that the residence requirement is necessary to ensure regular physical presence and sufficient familiarity with local business circumstances, and that it guarantees a certain personal loyalty of the management to the place where the bank is located.

50. Despite the detailed conclusions concerning the importance of residence in Liechtenstein, there is an absence of detail, both in the Banking Act and in the Government's defence, as regards what constitutes "residence". The fundamental question, of what does a residence requirement consist, is not addressed. There is no indication as to whether physical presence is required or whether this simply constitutes a requirement to have an official address in Liechtenstein. In either event, there is no indication as to the means by which the Government of Liechtenstein can conclude that a residence requirement will ensure greater respect of obligations and greater success in business, than other less-restrictive requirements.

51. As regards the benefit of having a permanent residence for ease of communication between the authorities and financial undertakings, the EFTA Surveillance Authority refers to *Pucher*, where the EFTA Court concluded that the physical presence or residence in Liechtenstein of a board member does not guarantee that public authorities are provided with the information they require. Moreover, it is possible for a board member to provide all necessary information without being physically present or resident there.[37]

52. The insistence by Liechtenstein on the validity of a residence requirement further fails, in the view of the EFTA Surveillance Authority, to take cognisance of the fact that, in both *Rainford-Towning*[38] and *Pucher*,[39] the EFTA Court rejected the argument that the residence requirement was necessary to enforce criminal sanctions against either a managing director of an active company or a qualified board member of a domiciliary company. The EFTA Surveillance Authority submits that this finding also applies to management of a bank, and that nothing in the defence of the Government of Liechtenstein contradicts this conclusion.

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37 Case E-2/01 *Dr. Franz Martin Pucher*, para 35.

38 Case E-3/98 *Herbert Rainford-Towning*, para 35.

39 Case E-2/01 *Dr. Franz Martin Pucher*, para 37.

53. The EFTA Surveillance Authority acknowledges that presence may be beneficial in understanding "*local peculiarities*", but states that there is no evidence that the concomitant conclusion must be that a residence requirement is the only, or even the most suitable, manner of acquiring such knowledge.

54. The EFTA Surveillance Authority states that nothing in the Liechtenstein defence supports a presumption that the simple fact of residence will create a close connection between an individual and a place, or that it is necessary to reside in a state in order to respect its legislation. Moreover, the adoption of such an approach places great responsibility on the resident management for the actions of non-resident colleagues.

55. Regarding the fact that the Principality of Liechtenstein is not a member of the Lugano Convention, the EFTA Surveillance Authority states that the Government of Liechtenstein repeats the arguments that it presented, and which were rejected, in *Pucher*.[40]

The Principality of Liechtenstein

56. In its *statement of defence*, the Government of Liechtenstein asserts that Section 25 of the Banking Act does not constitute a restriction on the freedom of establishment, but rather, is justified on public interest grounds.

57. The Government of Liechtenstein starts by explaining the background and purpose of Section 25 of the Banking Act. The Banking Act was adopted on 21 October 1992, after Liechtenstein had signed the EEA Agreement, and the wording of Section 25 takes into account obligations arising from EEA law.

58. Section 25 of the Banking Act ensures a continuous physical presence as well as sufficient familiarity with the local business circumstances concerning the management of a bank in Liechtenstein. According to the Government of Liechtenstein, the legislator considered a residence requirement imposed on at least one member of the management board and of the executive management of a bank as a proportionate means to achieve the objective of protecting the creditors of a bank as well as investor confidence in the Liechtenstein financial market.[41] The EEA secondary legislation in the banking sector, which aims at achieving similar but not identical objectives, is implemented in the Banking Act. The Government of Liechtenstein asserts that on account of Liechtenstein's special situation, this EEA legislation must be supplemented by a residence requirement in order to provide for the good functioning of the financial sector and sufficient protection for clients and intermediaries involved. This objective is a vital economic interest of Liechtenstein and its population.

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40 Case E-2/01 *Dr. Franz Martin Pucher*, para 39 et seq.

41 See Section 1 of the Banking Act, annexed to the defence.

59. In the view of the Government of Liechtenstein, the case at hand must be distinguished from *Rainford-Towning* and *Pucher*. Section 25 of the Banking Act does not require the exercise of specified professions, and it does not restrict the right of a national of another EEA State to take up an engagement in the management board or executive management of a bank in Liechtenstein. The residence requirement at issue is only a minimum requirement and does not prevent the appointment of other members of the management board and executive management residing outside Liechtenstein. The differences between the scopes and aims of the Trade Act and the Persons and Company Act on the one hand and the Banking Act on the other hand must be taken into account when assessing the EEA conformity of the contested legal provision.

Restriction

60. With regard to the restriction-condition in Article 31 EEA, the Government of Liechtenstein states that the contested residence requirement is formulated in general terms, and does not distinguish between Liechtenstein nationals and nationals of other EEA States. Furthermore, Article 25 of the Banking Act does not prevent the appointment of other members of the management board and executive management from residing outside Liechtenstein. Consequently, in the view of the Government of Liechtenstein, the residence requirement in Article 25 of the Banking Act is not sufficiently obstructive to constitute a restriction on the freedom of establishment.

61. The Government of Liechtenstein also states that since only 34 persons are affected by the residence requirement, it has no appreciable effect on the right of establishment. In *Rainford Towning* and *Pucher*, the number of persons involved was much higher and the question of appreciable effect had to be answered in the affirmative. Since the effect of the contested provision is negligible, the assertion of a lack of appreciable effect is legitimate. Thus, the residence requirement of the Banking Act need not be assessed as to whether or not it is in conformity with the EEA Agreement.

Justification on public-interest grounds

62. In the alternative, if the EFTA Court should follow its prior case law, that national rules drawing a distinction on the basis of residence are liable to operate mainly to the detriment of nationals of other EEA States, and that therefore a residence requirement per se constitutes a restriction on the right of establishment, the Government of Liechtenstein relies upon public-interest grounds in order to justify the residence requirement in Article 25 of the Banking Act.[42]

63. In support of its position, the Government of Liechtenstein refers to the case law of the Court of Justice of the European Communities, according to

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[42] Case 182/83 *Robert Fearon and Co.* v *Irish Land Commission* [1984] ECR 3677.

which an obstacle stemming from an equally applicable rule (whether indirectly discriminatory or not) that does not constitute deliberate discrimination, can be justified based on an open-ended range of public-interests – so called imperative requirements.[43]

64. The public interest grounds invoked by the Government of Liechtenstein concern first, the protection of the Liechtenstein financial services sector and second, the administration of justice.

65. In *Pucher*, the EFTA Court acknowledged that protecting the functioning and good reputation of the financial services sector is a legitimate public policy objective which could justify derogation from the freedom of establishment under Article 33 EEA. The EFTA Court also acknowledged that securing compliance with national legislation, assisting the administration of justice, facilitating the execution of civil judgments, and enforcing administrative law and criminal sanctions are important elements in order to achieve that objective.[44]

66. According to the Government of Liechtenstein, the importance of the financial services sector to Liechtenstein's economy is common ground. Liechtenstein's economy depends mostly on export-oriented industry and on services. The number of people engaged in industry, crafts and construction activities has increased from about 20 per cent in 1930 to 25 per cent in 1950 and to over 53.7 per cent in 2003.

67. When considering the importance of the financial services sector of Liechtenstein, the Government of Liechtenstein states that one must also take into account the specific situation of Liechtenstein. The EFTA Court has expressly and repeatedly taken note of Liechtenstein's specific situation as recognised by the EEA Council in its Declaration on the free movement of persons:[45] "Liechtenstein has a very small inhabitable area of a rural character with an unusually high percentage of non-national residents and employees." The EEA Council also acknowledged "…the vital interest of Liechtenstein to maintain its own national identity".[46]

68. Although the above-mentioned Declaration was made in the context of Liechtenstein's particular problems in the field of free movement of persons, it is of general character and therefore true for Liechtenstein generally. The Government of Liechtenstein's concern in the case at hand is not that much the question of national identity, which could be endangered with the establishment of too many foreigners in Liechtenstein at a time, but the concern for an economy

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43 Case C-55/94 *Gebhard* v *Consiglio dell'Ordine degli Avvocati e Procuratori di Milano* [1995] ECR I-4165.

44 See *Pucher*, para 32.

45 OJ 1995 L 86, p. 80.

46 Case E-4/00 *Brändle* [2000-2001] EFTA Court Report 123, para 39; see also Case E-3/97 *Rainford-Towning*, para 40.

that is by nature less diverse than the economies of much larger states, which are normally founded on many pillars, all contributing more or less to the national income and welfare. Liechtenstein relies heavily on the financial services sector as a guarantor of its welfare and, therefore, has an existential interest in protecting this sector, especially from harm and abuse.

69. The Government of Liechtenstein further states that its financial services sector cannot be compared to those of other states, since it is limited to a very narrow set of specialised services. As one of the smallest countries in the world, Liechtenstein cannot rely on the consumption and the export of its own natural resources, but has to compete with all other larger states and, therefore, has always had to offer niche products. It would not be possible to compete in industries dominated by much larger states, since Liechtenstein could never build up such market and political power as to independently and successfully pursue its sovereign interests. Therefore, Liechtenstein has always had to concentrate on niche products, whether in industrial or financial markets.

70. Liechtenstein uses utmost care and diligence in order to protect its successful sectors from abuse and other dangers threatening their existence. In the light of the enormous importance of the financial services sector for Liechtenstein, it is obvious that a bad reputation of this sector would cause a negative image of the country as a whole. The reputation of a state and its standing in the international community is of great importance, especially in the case of a small state which can rely less on its own power and strength.

71. The promotion and maintenance of the good reputation of the financial services sector has always been an objective of Liechtenstein's legislature. The Government of Liechtenstein is obliged by the Constitution[47] to promote the country's welfare. Ensuring the competence and trustworthiness of the financial services sector on the whole has always been and remains a supreme duty of the Government.

72. According to the Government of Liechtenstein, the main objective of the residence requirement is to guarantee the continuous presence of at least one member of the management board and the executive board in Liechtenstein. Such a permanent link to Liechtenstein is indispensable for the administration of justice. In order to minimize the risk of abuse of Liechtenstein's banking sector and in order to avoid the contravention of other legal provisions such as criminal and tax law, the Liechtenstein legislature has adopted the least restrictive measure possible to ensure effective control of the activities in the financial sector, namely the residence requirement of Article 25 of the Banking Act.

73. It is necessary to encourage close cooperation between financial intermediaries, including banks. This can only be guaranteed if institutions can be held responsible, and if claims can be enforced within the territory where the

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47 *Verfassung vom 5. Oktober 1921,* Law Gazette 1921 No 15 (as amended).

bank is registered. The need to preserve an effective administration of justice may justify the setting of certain, and maybe even restrictive, conditions.[48]

74. Furthermore, Liechtenstein, as most other states, is also bound by international agreements and standards, whether of a hard or soft law character, to which it must adhere, not only in order to fulfil its obligations, but also to maintain its reputation as a loyal, trustworthy and equal partner.

Proportionality of the residence requirement

75. The Government of Liechtenstein asserts that the residence requirement in Article 25 of the Banking Act is a suitable and necessary measure to ensure compliance with national legislation in the banking sector, as well as for the effective control of such compliance by the public authorities.

76. With regard to proportionality, the Government of Liechtenstein argues along two lines. First, the residence requirement is appropriate to ensure sound and responsible business operations in the Liechtenstein banking sector, which is a precondition for the functioning and good reputation of the Liechtenstein financial market. Second, it is necessary in order to enforce the liability of the management of a bank, given the substantial assets involved in the banking sector and the fact that the Principality of Liechtenstein is not a party to the Lugano Convention.

77. The smooth operation of the financial market is largely contingent on the confidence it inspires in investors and creditors.[49] Consequently, with a view to protecting confidence in the Liechtenstein financial market, a residence requirement for two members of the management of a bank, which guarantees a certain personal loyalty of the management with the place where the bank is located, cannot be considered to be inappropriate for achieving the objective of securing the integrity of this market.

78. A sufficient physical presence of the management of a company at the location of the company is prerequisite to familiarity with the local peculiarities and the business conduct prevailing in the relevant business sector, which are essential to a company's ability to maintain a sound and successful business. According to the Government of Liechtenstein, it is obvious that the residence requirement in Article 25 of the Banking Act is appropriate to ensure that at least one member of the management board and the executive management is sufficiently present at the place from where the bank is operating.

79. A residence requirement for managers also guarantees a certain personal bond of the management of a company to the place where the company is

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48 Case C-204/90 *Hans Martin Bachmann* v *Belgium State* [1992] ECR I-249, para 27.

49 See Case C-384/93 *Alpine Investments BV* v *Minister van Financien* [1995] ECR I-1141, para 42.

located, and thus strengthens the loyalty and responsibility with a view to complying with national legislation. In case of irregularities, communication between the authorities and the persons representing a company is much easier and faster if these persons are residing in the same jurisdiction as the company is located. Consequently, the residence requirement for at least two members of the management of a bank ensures successful and responsible business operations in the Liechtenstein financial market.

80. With regard to the compliance with national legislation and the effective control of such compliance, the residence requirement is also an appropriate measure to facilitate the execution of civil judgments and for the effective enforcement of administrative law and criminal sanctions. In particular, it ensures the supervision of the authorities with a view to combating money laundering and organised crime. A residence requirement for managers has a certain precautionary effect by raising the awareness of these persons of their liability for business conduct.

81. The Government of Liechtenstein further states that when it comes to the question of necessity of the residence requirement, special account has to be taken of the fact that Liechtenstein is not a party to the Lugano Convention of 16 September 1988 on jurisdiction and the enforcement of judgments in civil and commercial matters,[50] and that therefore, litigation or execution in foreign jurisdictions may involve particular complications for the Liechtenstein authorities. As the EFTA Court held in *Pucher*, accession to the Lugano Conventions would constitute one remedy. When interpreting provisions of the EEA Agreement, the EFTA Court should take into account that it was the common understanding of the Contracting Parties to the EEA Agreement that the conclusion of the EEA Agreement shall not restrict the treaty-making power of the Contracting Parties, and especially not precipitate an accession to other international treaties; see paragraph 16 of the preamble to the EEA Agreement. The proportionality of the residence requirement in Article 25 of the Banking Act must be assessed against this background.

82. As regards the enforcement of administrative and criminal sanctions, the EFTA Court took the view in *Pucher* that there are less restrictive means of attaining that objective, such as the serving of notices of fines at the registered office of the company combined with the requirement that the company or a member of the management provide a guarantee beforehand. In this regard, the Government of Liechtenstein points out that the possibility of serving notices of fines at the registered office of the company does not ensure the enforcement of criminal sanctions against a member of the management. Furthermore, considering the enormous amount of assets owned by banks, potential damages claims hugely exceed what could be covered by a guarantee provided beforehand. In any case, it is questionable whether a residence requirement such

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50 OJ 1988 L 319, p. 9.

as the one at issue is in fact more restrictive to the freedom of establishment than a requirement to provide such a guarantee that covers all possible risks.

The Commission of the European Communities

83. The Commission of the European Communities supports the position of the EFTA Surveillance Authority that the residence requirement in the case at hand constitutes an unjustified restriction under Article 31 EEA. In support of its position, the Commission of the European Communities refers to the results and the reasoning of the EFTA Court in *Rainford-Towning* and *Pucher*.

84. The Commission of the European Communities further points out that *Rainford-Towning* and *Pucher* are entirely consistent with the case law of the Court of Justice of the European Communities, according to which the "obligation to have a residence in the host Member State" has been held to be incompatible with both Article 43 and Article 49 EC. The Court of Justice of the European Communities has said that such a residence requirement constitutes a restriction, in particular to the freedom of establishment, in several heterogeneous sectors of economic activity governed by national law. Thus, this wide interpretation of Article 43 EC has been held to apply to directors and managers of security undertakings,[51] to dentists,[52] and to lawyers.[53] The Commission of the European Communities also notes that, in all its judgments on residence requirements, the Court of Justice of the European Communities has systematically rejected the justifications put forward by Member States, which were based mainly on Article 46 EC and, in particular, on public security reasons. In the view of the Commission of the European Communities, it may be inferred from this strict and consistent case law of the Court of Justice of the European Communities that the illegality of an obligation of residence, imposed upon directors or managers of undertakings, or upon members of regulated professions, now constitutes a general principle for the interpretation of all the provisions of the EC Treaty governing the fundamental freedoms.[54]

85. In the view of the Commission of the European Communities, no further argument has been advanced by the Liechtenstein authorities which would affect what has already been decided, both by the EFTA Court as regards the unacceptability of the various residence requirements in Liechtenstein business legislation, and by the Court of Justice of the European Communities as regards the unacceptability of residence requirements more generally, in order that the

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51 Cases C-114/97 *Commission* v *Spain* [1998] ECR I-6717, para 44-48; and, C-355/98 *Commission* v *Belgium* [2000] ECR I-1221, paras 31-34.

52 Case C-162/99 *Commission* v *Italy* [2001] I-0541, paras 16-28.

53 Case C-145/99 *Commission* v *Italy* [2002] I-2235, para 27.

54 Case C-131/01 *Commission* v *Italy* [2003] I-1659, paras 42-43, concerning the freedom to provide services.

residence requirement, in the form it takes in the case at hand in the banking sector, could be considered legitimate.

Per Tresselt
Judge-Rapporteur