



JUDGMENT OF THE COURT

6 January 2010

*(Failure by a Contracting Party to fulfil its obligations – Freedom of establishment –
Residence requirements)*

In Case E-1/09,

EFTA Surveillance Authority, represented by Bjørnar Alterskjær, Deputy Director, and Florence Simonetti, Officer, Department of Legal & Executive Affairs, acting as Agents, Brussels, Belgium,

Applicant,

v

The Principality of Liechtenstein, represented by Dr Andrea Entner-Koch, Director, and Sabine Tömördy, Deputy Director, EEA Coordination Unit, acting as Agents, Vaduz, Liechtenstein,

Defendant,

APPLICATION for a declaration that by requiring the members of the management board and of the executive management of banks established in Liechtenstein to be, by reason of their residence, in a position to actually and unobjectionably perform their functions and duties, the Principality of Liechtenstein has failed to fulfil its obligations under the EEA Agreement, in particular Articles 28 and 31 thereof; and that by requiring lawyers, patent lawyers, auditors and trustees to be, by reason of their residence, in a position to fulfil their tasks, actually and on a regular basis, the Principality of Liechtenstein has failed to fulfil its obligations under the EEA Agreement, in particular Article 31 thereof,

THE COURT,

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

Registrar: Skúli Magnússon,

having regard to the written pleadings of the parties and the written observations of the Commission of the European Communities, represented by Enrico Traversa, Legal Advisor, and Ion Rogalski, member of its Legal Service, acting as Agents,

having regard to the Report for the Hearing,

having heard oral argument of the Applicant, represented by its agents Bjørnar Alterskjær and Florence Simonetti and the Commission of the European Communities, represented by its agents Enrico Traversa and Ion Rogalski, at the hearing on 17 September 2009,

gives the following

Judgment

I The application

- 1 By application lodged at the Court Registry on 3 February 2009, the EFTA Surveillance Authority (hereinafter “ESA”) brought an action under 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 (hereinafter the “SCA”). By that action, the Applicant seeks a declaration from the EFTA Court that the Principality of Liechtenstein has failed to fulfil its obligations under the EEA Agreement, in particular Articles 28 and 31 thereof.

II Facts and pre-litigation procedure

- 2 On 1 July 2005, the Court found the Principality of Liechtenstein to be in breach of Article 31 EEA by maintaining a residence requirement for at least one member of the management board and one member of the executive management of a bank established on Liechtenstein territory (Case E-8/04 *ESA v Liechtenstein* [2005] EFTA Ct. Rep. 46). On 4 July 2006, the Liechtenstein Government submitted a Bill to the *Landtag* (the Liechtenstein Parliament), proposing that this residence requirement be abolished.
- 3 Following a reasoned opinion from ESA, the Liechtenstein Government also submitted to the *Landtag* another four Bills, proposing that similar residence

requirements for lawyers, patent lawyers, auditors and trustees be abolished as well.

- 4 After amendments had been introduced in the course of the legislative process, five Acts were adopted by the *Landtag* on 23 May 2007 and entered into force on 26 July 2007. The amendments entailed reintroducing a form of residence requirement, albeit different from the one previously ruled upon by the Court and from those contained in the earlier Liechtenstein legislation.
- 5 On 5 December 2007, ESA issued two letters of formal notice to the Principality of Liechtenstein in which it took the view that the new requirements relating to residence were contrary to EEA law. One letter was related to bank management, the other to lawyers, patent lawyers, auditors and trustees. The Liechtenstein Government replied by two letters dated 6 and 28 March 2008, respectively, disputing ESA's view.
- 6 In light of the Liechtenstein replies to the letters of formal notice, ESA issued two reasoned opinions on 16 July 2008, requesting that the Principality of Liechtenstein take the necessary measures to comply with the reasoned opinions within three months. The Liechtenstein Government replied to these reasoned opinions by two letters of 5 November 2008, also disputing ESA's view.

III Legal background

EEA law

- 7 Article 28 EEA reads:
 1. *Freedom of movement for workers shall be secured among EC Member States and EFTA States.*
 2. *Such freedom of movement shall entail the abolition of any discrimination based on nationality between workers of EC Member States and EFTA States as regards employment, remuneration and other conditions of work and employment.*
 3. *It shall entail the right, subject to limitations justified on grounds of public policy, public security or public health:*
 - (a) *to accept offers of employment actually made;*
 - (b) *to move freely within the territory of EC Member States and EFTA States for this purpose;*
 - (c) *to stay in the territory of an EC Member State or an EFTA State for the purpose of employment in accordance with the provisions governing the employment of nationals of that State laid down by law, regulation or administrative action;*

(d) *to remain in the territory of an EC Member State or an EFTA State after having been employed there.*

...

8 Article 31 EEA reads:

1. Within the framework of the provisions of this Agreement, there shall be no restrictions on the freedom of establishment of nationals of an EC Member State or an EFTA State in the territory of any other of these States. This shall also apply to the setting up of agencies, branches or subsidiaries by nationals of any EC Member State or EFTA State established in the territory of any of these States.

Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of Article 34, second paragraph, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of Chapter 4.

...

National law

9 Article 25 of the Liechtenstein Banking Act, as amended by the Act of 23 May 2007, reads:

The members of the management board and of the executive management must, by reason of their residence, be in a position to fulfil their functions and duties, actually and unobjectionably.

10 Article 29(3) of the Banking Ordinance of 22 April 1994 to the Banking Act reads:

The foreseen persons must, considering their further obligations and their residence, be in a position to perform, unobjectionably, their duties in the bank or financial institution.

11 According to amending Acts of 23 May 2007, Article 1(1)(d) of the Lawyers Act, Article 1(2)(d) of the Patent Lawyers Act, Article 1(2)(d) of the Auditors Act and Article 1(2)(d) of the Trustees Act, provide that the authorities may grant a licence to take up and pursue the relevant profession only to an applicant who:

by reason of his residence, is in a position to fulfil his tasks, actually and on a regular basis.

12 A similar clause was introduced by the said Acts of 23 May 2007 in Article 31(2)(c) of the Patent Lawyers Act, Article 32(2)(c) of the Auditors Act and Article 36(2)(c) of the Trustees Act, allowing establishment in Liechtenstein of

nationals of other EEA States wishing to practice such professions on the basis of a licence from their home State only if the applicant provides proof of:

a residence, wherefrom he is able to fulfil his tasks, actually and on a regular basis.

- 13 By Acts of 29 May 2008, Article 1(1)(d) of the Lawyers Act, Article 1(2)(d) of the Patent Lawyers Act and Article 1(2)(d) of the Trustees Act were re-enacted as Articles 1b(1)(d), 1b(2)(d) and 1b(2)(d) of the same Acts, respectively. The provision concerning the licensing of auditors was left unchanged as Article 1(2)(d) of the Auditors Act. Furthermore, Article 31(2) of the Patent Lawyers Act was amended by deleting its subparagraph (c) and inserting a reference to the residence requirement in Article 1b(2)(d) of the same Act. Similar changes were applied to Article 36(2) of the Trustees Act, deleting Article 36(2)(c) and inserting a reference to the residence requirement in Article 1b(2)(d) of the same Act. Thus, the residence requirements referred to in the application were retained as to their substance.
- 14 Reference is made to the Report for the Hearing for a fuller account of the facts, the procedure and the pleas and arguments of the parties, which are mentioned or discussed hereinafter only in so far as is necessary for the reasoning of the Court.

IV Arguments of the parties

- 15 The Applicant argues that the residence requirements are indirectly discriminatory and constitute restrictions on free movement. According to the Applicant, the effect of the requirements is that nationals of other EEA States, statistically speaking, are put at a disadvantage compared to most Liechtenstein nationals when seeking to become members of the management board or the executive management of a bank established in Liechtenstein; and, equally, when seeking to establish themselves as lawyers, patent lawyers, auditors or trustees in Liechtenstein. In those circumstances, it is irrelevant whether the provisions at issue are to be understood as regulating only the manner in which the activity is carried out or – which is how ESA understands them – also as conditions for the taking up of the activity. Nor can the provisions be understood simply as interpretations of the very notion of establishment. The notion of establishment presupposes neither residence nor satisfactory performance of the activity in question.
- 16 The Applicant contends that the provisions at issue constitute restrictions on the right of establishment, not only in relation to persons who because of their residence are ineligible for the positions or licences in question, but also in relation to banks wishing to establish themselves in Liechtenstein as they are restricted in their choice of management. As the Applicant considers that some members of the executive management of banks may fall to be considered workers within the meaning of Article 28 EEA instead of self-employed persons within the meaning of Article 31 EEA, it argues that the residence requirements

for members of the executive management of banks constitute also restrictions on the free movement of workers.

- 17 Regarding possible justification of the restrictions, the Applicant accepts that consumer protection and the need to safeguard the reputation of financial markets are legitimate aims which may warrant measures to prevent improper management of banks. The Applicant considers also that consumer protection and the attainment of high quality standards are legitimate aims with regard to lawyers, patent lawyers, auditors and trustees. However, the Applicant disputes that the residence requirements at issue are suitable, necessary and proportionate with regard to achieving those aims. The Applicant fails to see any reason to take account of personal residence in relation to the requirement that the members of the management board or the executive management of banks fulfil their function in an unobjectionable manner. With regard to lawyers, patent lawyers, auditors and trustees, the Applicant contends that Liechtenstein has not described the nature of the “artificial” and “abusive” arrangements which the residence requirements are intended to prevent and, as a result, it is not possible to assess the suitability of the requirements. Furthermore, the Applicant disputes that the risk of such behaviour is influenced by the place of residence. In respect of all the sectors concerned, the Applicant contends that modern communication techniques imply that physical presence at all times at a particular workplace is no longer necessary, and that modern means of transportation provide rapid connections from countries at a considerable distance from Liechtenstein in situations where presence at the workplace is necessary.
- 18 The Defendant notes that unlike cross-border supply of services, establishment presupposes the actual pursuit of an economic activity through a fixed establishment in another State for an indefinite period. Thus, establishment is linked to personal residence and the quality of economic performance. Consequently, a professional who, by reason of his personal residence, is unable to fulfil his tasks in a satisfactory manner on the territory of his establishment, in fact, cannot be regarded as established and, consequently, is not entitled to benefit from the freedom of establishment under Article 31 EEA.
- 19 In the event that the Court does not accept this view, the Defendant argues that the residence requirements are not discriminatory, not even indirectly discriminatory, because residence in the area surrounding Liechtenstein will be considered equal to residence in Liechtenstein. Depending on the actual function performed, even residence at a greater distance may be acceptable.
- 20 In this context, the Defendant argues that the right of establishment implies simply the right to take up and pursue activities as a self-employed person under the same conditions as apply to nationals of the country where establishment is effected. The Defendant further argues that the residence requirements do not impede the right to take up a professional activity in Liechtenstein; they regulate only the conditions under which such an activity may be carried out.

- 21 The Defendant asserts that even if the residence requirements are considered restrictions on the right of establishment, they are in any event lawful. They all pursue aims which may justify restrictions on free movement. Ensuring the functioning of the banking sector in preventing improper management and artificial arrangements is advanced as the main objective of the relevant provisions of the banking legislation. Safeguarding the reputation of financial markets and protecting consumers are invoked as further objectives. The residence requirements for lawyers, patent lawyers, trustees and auditors are, first and foremost, justified on grounds of consumer protection. Moreover, prevention of artificial and abusive arrangements is also invoked as a particular ground of justification. The Defendant regards the contested provisions as a “requirement of effective establishment”, protecting not only creditors, clients and employees but also contributing to the functioning of the Liechtenstein economy. The Defendant concludes that these provisions prevent individuals and companies from improperly or fraudulently benefiting from the fundamental freedoms established by EEA law.
- 22 The Defendant submits that the contested provisions constitute proportionate means in pursuit of their legitimate objectives. The activities of the professionals concerned cannot be carried out simply by e-mail or telephone communication. Efficient control and supervision require actual involvement in business activities and the knowledge of local circumstances. Especially in the financial market, situations often arise requiring immediate on the spot action by a competent person. Moreover, trust building measures require regular personal communication, not only with clients and employees but also with national authorities. This is especially so for the activities of lawyers, patent lawyers, trustees and auditors which are carried out within the framework of a trust relationship. Residence – defined as the “centre of living” – is an appropriate criterion to assess whether a person is in a position to act properly and whether he exercises a real rather than a merely formal role.
- 23 According to the Defendant, the Applicant would be prepared to accept provisions requiring effective involvement in the business, provided that no residence requirement is attached thereto. In this regard, the Defendant submits that, with respect to the freedom of establishment, a working hours condition imposes a more onerous burden on individuals than a mere requirement for a suitable residence. In addition, it would be almost impossible for the Financial Market Authority to supervise effectively compliance with such a condition.
- 24 The Defendant contends that members of the management of a bank are not workers and that, consequently, Article 28 EEA does not apply in the present case. Unlike workers, who act subject to direction, the members of the management act independently and at their own responsibility.
- 25 The Commission of the European Communities agrees with the Applicant in its assessment that the contested provisions constitute restrictions on the freedom of establishment. Although the current residence requirements are different in formal terms from those previously analysed by the Court, in the sense that the

current provisions do not explicitly refer to Liechtenstein territory, the actual change in substance is insignificant. The Commission submits that as regards the suitability of the residence requirements at issue to attain the objectives pursued and their proportionality in that regard, Liechtenstein appears not to have advanced arguments different to those already considered by the Court in previous cases, or by the ECJ in relevant case-law. Therefore, the Commission considers that the conclusions of the Court and the ECJ with regard to the lack of suitability and proportionality of a residence requirement for the exercise of the freedom of establishment are equally valid in the present case.

- 26 The Commission supports the view taken by the Applicant that Article 28 EEA is applicable in the present case. Depending on the actual circumstances, members of the management board and of the executive management of banks may also be subject to the direction of other persons, e.g. the owners of the company, and, thus, in a relationship of subordination which according to the case-law of the ECJ constitutes an essential characteristic of an employment relationship, except where a manager is at the same time the owner or sole shareholder of the company concerned.

V Findings of the Court

Restriction

- 27 For the purposes of this judgment, the contested provisions are dealt with jointly. On the question of whether the provisions entail restrictions, the Court finds that no significant difference exists between the provisions.
- 28 At the outset, the Court notes that it is not a precondition for establishment within the meaning of Article 31 EEA that self-employed persons have their residence in a place wherefrom they are able to fulfil their tasks actually, unobjectionably or on a regular basis. Establishment means that a person pursues a professional activity on a stable and continuous basis, see for comparison Case C-55/94 *Gebhard* [1995] ECR I-4165, at paragraph 28. Although having one's residence near to the office may facilitate this, it remains possible to maintain a business presence on a stable and continuous basis in a certain place while residing at a considerable distance from that place. Furthermore, it is not a precondition for establishment that business activities are carried out in accordance with relevant rules of professional conduct.
- 29 Whereas the contested provisions are not directly discriminatory on grounds of nationality, the Court finds that the residence requirements contained in those provisions entail indirect discrimination. It cannot be decisive in this respect that there may be more nationals of other EEA States than Liechtenstein nationals who fulfil the residence requirements. The residence requirements are still intrinsically liable to operate to a particular disadvantage for non-Liechtenstein nationals and for banks having or wishing to place non-Liechtenstein nationals in their management (see, in a similar vein, Case E-2/01 *Pucher* [2002] EFTA Ct. Rep. 44, at paragraph 19).

- 30 Given that finding, it is irrelevant whether the provisions in question are to be understood as governing the conditions under which the relevant activity may be carried out or the conditions for the taking up of that activity.
- 31 Consequently, the residence requirements introduced for lawyers, patent lawyers, auditors and trustees restrict the right of establishment under Article 31 EEA for members of these professions who are nationals of other EEA States.
- 32 The residence requirements for members of the management board and the executive management of banks also restrict the right of establishment for banks from other EEA States wishing to establish themselves in Liechtenstein. The requirements mean that the banks cannot freely choose members of the board and the executive management.
- 33 It is furthermore clear, for the reasons stated at paragraph 29 above, that the residence requirements for members of the management board and the executive management of banks also restrict the right of free movement of EEA nationals wishing to take up such positions. However, the Applicant, whose view is supported by the Commission, and the Defendant disagree on whether membership of the management board and the executive management of Liechtenstein banks falls to be assessed under Article 31 EEA on the right of establishment or, at least in part, under Article 28 EEA on the free movement of workers.
- 34 The Court notes that in Cases E-3/98 *Rainford-Towning* [1998] EFTA Ct. Rep. 205, *Pucher* and E-8/04 *ESA v Liechtenstein*, cited above, all of which concerned Liechtenstein company law or banking law, the positions of managing director, member of the board of directors of a domiciliary company and member of the management board or the executive management of banks were considered to fall under the provisions of the EEA Agreement on the right of establishment. In the present case, the Court has not been furnished with information on the tasks of the members of the management board and the executive management of banks that would allow for a reassessment of that position. In that regard, it must be remembered that it is for the Applicant, in proceedings under Article 31(2) SCA, to prove the alleged restriction on free movement. On that basis, the application must be dismissed insofar as it relates to Article 28 EEA.

Justification

- 35 The decisive issue is whether the restrictions brought about by the Liechtenstein legislation are justified.
- 36 According to Liechtenstein, one of the objectives of the residence requirements is to contribute to the functioning of the Liechtenstein economy. However, it has not been made clear to the Court how, or to what extent, such a contribution might constitute a public interest objective capable of justifying a restriction on free movement. It is recalled that economic aims cannot constitute overriding reasons in the general interest justifying a restriction on a fundamental freedom,

see to that effect Case E-1/04 *Fokus Bank* [2004] EFTA Ct. Rep. 15, at paragraph 33 and, for comparison, Case C-164/99 *Portugaia Construções* [2002] ECR I-787, at paragraph 26. Nor has it been made clear to the Court what is meant by improper or fraudulent use of the fundamental freedoms, or how a residence requirement could prevent such use. As was pointed out at paragraph 28 above, residence does not constitute a precondition for establishment. For the remainder, the objectives invoked by Liechtenstein, such as ensuring the functioning and good reputation of the financial market, are deemed by the Court to constitute legitimate public interest objectives, which, in principle, are capable of justifying restrictive measures such as residence requirements.

- 37 In particular, ensuring that individuals engaged in certain professions and positions hold the necessary professional qualifications and live up to the requisite ethical standards is a legitimate objective. The same goes for the endeavour to ensure that the management of banks is able to react quickly in a crisis, and more generally, that it effectively directs the business. Indeed, Article 11 of Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions requires that there are at least two directors of “good repute” and with “sufficient experience” to “effectively direct the business” of a bank. Article 11 also requires the head office of a bank to be in the same State as the bank has its registered office, and the bank to actually carry out business in that State.
- 38 However, in order to be justified, the residence requirements must not only pursue legitimate objectives. They must also be suitable, necessary and proportionate as means to attain those objectives. Moreover, it falls on the Contracting Party responsible for the restrictions to demonstrate that this is the case, see Case E-1/06 *ESA v Norway* [2007] EFTA Ct. Rep. 8, at paragraph 31. In Case E-8/04 *ESA v Liechtenstein*, Liechtenstein failed to demonstrate the suitability of the residence requirement at issue, see paragraphs 29–30 of that judgment, cited above. This was likewise the conclusion in *Pucher*, see paragraph 32 et seq. of that judgment, cited above.
- 39 In the present case, too, the Court cannot see that the residence requirements at issue are justified as means to attain the relevant public interest objectives.
- 40 Having regard to the aim of ensuring that individuals engaged in certain professions and positions hold the necessary professional qualifications and live up to the requisite ethical standards, the Court notes, first, that the likelihood of living up to the requisite ethical standards is unrelated to residence in a particular area. Thus, a residence requirement does not constitute a suitable means to ensure ethical standards. Furthermore, insofar as the Defendant’s argument relates to professional knowledge concerning the Liechtenstein legal system, it suffices to point out that requirements relating directly to professional experience and training would be more appropriate, and certainly less of a restriction on the freedom of establishment, as a means of ensuring that those concerned hold the necessary professional qualifications.

- 41 As regards the objective of ensuring on-site presence by the management of a bank in the case of a crisis, the Court notes that the residence requirements do not entail an obligation for the members of the management never to be significantly further away from the bank's place of business than their own place of residence. Accordingly, in and of themselves, the requirements do not ensure that even one member of the management will always be able to reach the bank's place of business at short notice. Thus, the requirements are unsuited to ensure that banks are able to react quickly to a crisis by having qualified and authorised persons present at short notice. It would be more appropriate, and certainly less of a restriction on free movement, for instance, to require the banks to demonstrate in a credible and verifiable manner that, in the case of a crisis, they have the capacity to muster key personnel at the bank's place of business within a justifiable period of time.
- 42 Finally, with regard to the general objective of ensuring that the management of a bank will effectively direct the business, the Court notes that a manager residing at a considerable distance from the bank's place of business may indeed find it more difficult to effectively perform his duties than a person whose place of residence is nearer to the bank's place of business, see *Rainford-Towning*, cited above, at paragraph 36. However, it is disproportionate to restrict free movement, through the imposition of residence requirements, simply because managers may find it more difficult to fulfil their obligation to effectively direct the business of the bank when residing at a distance. Indeed, irrespective of the personal inconvenience of spending more time travelling or more time away from their own place of residence, it would appear quite possible for the individuals concerned to overcome such difficulties. Thus, the Court questions the necessity of such residence requirements and, in any event, holds that Liechtenstein cannot impose restrictions such as those at hand on the mere assumption that the individuals concerned would otherwise not fulfil their obligation to effectively direct the business of the bank.
- 43 For the reasons set out above, the Court finds the residence requirements at issue not to be justified and holds that Liechtenstein has failed to fulfil its obligations under Article 31 of the EEA Agreement, firstly, by requiring the members of the management board and of the executive management of banks established in Liechtenstein to be, by reason of their residence, in a position to actually and unobjectionably perform their functions and duties, and, secondly, by requiring lawyers, patent lawyers, auditors and trustees to be, by reason of their residence, in a position to fulfil their tasks actually and on a regular basis.

VI Costs

- 44 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. Since the Applicant has requested that the Defendant be ordered to pay the costs and the latter has been unsuccessful, the Defendant must be ordered to pay the costs. The costs incurred by the Commission of the European Communities are not recoverable.

On those grounds,

THE COURT

hereby:

1. **Declares that, by requiring the members of the management board and of the executive management of banks established in Liechtenstein to be, by reason of their residence, in a position to actually and unobjectionably perform their functions and duties, the Principality of Liechtenstein has failed to fulfil its obligations under Article 31 of the EEA Agreement.**
2. **Declares that, by requiring lawyers, patent lawyers, auditors and trustees to be, by reason of their residence, in a position to fulfil their tasks actually and on a regular basis, the Principality of Liechtenstein has failed to fulfil its obligations under Article 31 of the EEA Agreement.**
3. **Dismisses the application insofar as it relates to Article 28 of the EEA Agreement.**
4. **Orders the Principality of Liechtenstein to bear the costs of the proceedings.**

Carl Baudenbacher

Thorgerir Örlygsson

Henrik Bull

Delivered in open court in Luxembourg on 6 January 2010.

Skúli Magnússon
Registrar

Carl Baudenbacher
President