

Free Movement of Capital in the EU and the EEA

With emphasis on homogeneity
- Meistararitgerð til Mag. jur. prófs í lögfræði -

Guðrún Inga Guðmundsdóttir

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LIST OF COMMON TITLES AND ABBREVIATIONS

EC Treaty refers the Treaty of the European Community

ECJ means the European Court of Justice

EEA means the European Economic Area

TEU means the Treaty of the European Union, formerly the TEC

TFEU means the Treaty on the Functioning of the European Union

The suffixes EEC and EC refer to the treaty numbering system pre-Lisbon.

The suffix TFEU refers to the treaty numbering system post-Lisbon.

1. Introduction

European Union law, or EU law as it is more commonly abbreviated, is a fascinating field to study. The European Union counts 28 Member States as of 2013 and through the Agreement on the European Economic Area much of its legislation is extended to three members of the European Free Trade Association. The core of the European Union is the Internal Market comprising the Four Freedoms; capital, goods, services and workers. The theme of this essay is the free movement of capital; the freedom slowest to develop but nonetheless, one of the more important ones in that it facilitates the attainment of the other three.

The Internal Market, which has also been known as the Single Market or the Common Market (the terms will be used interchangeably in this thesis), was first realized with the Treaty of the European Economic Community. The European Economic Community (EEC) became the European Community with the Maastricht Treaty and finally the European Union with the Lisbon Treaty. For the purpose of continuity and clarity “European Union” or “EU” will be used in this thesis when referring to the above. Similarly, the numbering of the provisions in the Treaties changed over time; the free movement of capital was first contained in Article 67 EEC, then Article 56 EC, Article 73b EC and finally Article 63 TFEU. Over the years the Internal Market has evolved, expanded to admit more Member States and an agreement has been signed with three Member States of the European Free Trade Association creating the European Economic Area.

The purpose of this thesis is to explore the free movement of capital in depth from two perspectives, that of the European Union and that of the European Economic Area, with emphasis on definition of discrimination and restriction in the field and derogations from the freedom, with an eye towards homogeneity. The thesis begins by exploring the freedom from the EU point of view before comparing the provisions and the case-law of the European Court of Justice to that of the provisions in the European Economic Area and the case-law of the EFTA Court. The aim of this comparison is to ascertain whether the changes of the EU Treaties since the EEA Treaty came into force and subsequent interpretations by the European Court of Justice have impaired the effectiveness of the European Economic Area and its goal of homogeneity.

The first part of this thesis will focus on EU law, in which the development of free movement of capital in the European Union will be explored and the scope of derogations in light of the Treaty changes beyond the EEA Agreement. Chapter 2 will discuss the history of the European Union in brief as well as a short introduction to the freedoms of goods, services

and workers. The Chapter will also describe how the rule of reason developed from the case law of the European Court of Justice. Chapter 3 will describe the development of the free movement of capital and Chapters 4 and 5 will focus on the definition of the free movement of payments and free movements of capital, respectively. As the primary focus is on capital movements, movements of payments will only be dealt with briefly. Chapter 6 will explore how the European Court of Justice has applied the provisions on free movement of capital while Chapter 7 will explore derogations from the freedom.

The EU has seen many treaty amendments in recent years while the basic provisions of the Agreement on the European Economic Area on capital movements have remained unaltered since its signing in 1991. The latter part of this thesis will deal with the freedom from the view of EEA law. Chapter 8 will recount the history of the EEA Agreement and how it came about. It will be interesting to explore if the concept of the free movement of capital for the EU Member States and the EEA EFTA Member States remain the same and what effect divergence can have on EU and EFTA co-operation, as will be done in Chapter 10. In that vein, the principle of homogeneity will be discussed in Chapter 9. As the three EEA EFTA Member States have their own court to adjudicate disputes or give advisory opinions on the Agreement on the European Economic Area, the EFTA Court, it will be interesting to see to what extent the EFTA Court adheres to the ECJ's judgments.

Chapter 11 will discuss the provisions permitting derogations to the free movement of capital in the EEA and compare to the provisions previously discussed in Chapter 7 in the EU context. Furthermore, in light of the economic crisis in Iceland, the Chapter will also explore practical application of the derogations permissible in EU and EEA law, focusing on the capital controls in Iceland and comparing them to the capital controls in Cyprus, and the legitimacy of these restrictions.

Part I: The European Union

2. A Short Introduction to the Internal Market

2.1 General

The impetus for increased co-operation in Europe was undoubtedly to a large extent the experience of the Second World War, with the goal of co-operation being to speed the

recovery of the weakened economy after the war, to prevent further clashes between countries and to ensure protection of human rights.¹

In 1951 six countries signed a treaty setting up the European Coal and Steel Community (the ECSC). The Treaty, negotiated after a proposal by the French foreign minister Robert Schuman, was intended to last for fifty years, or until 2002. The establishment of the ECSC was the first significant step towards European integration as the Treaty called for a supranational authority to be established with institutions able to bind the constituent Member States. While the purpose of the ECSC was to establish a common market in coal and steel it was also seen as the first step towards European integration.² The founding Member States were France, Germany, Italy and the Benelux countries.

During a conference of the foreign ministers of the six Member States in 1955 an agreement was reached to move towards economic integration. Paul Henri Spaak, the Belgian Prime Minister, chaired a committee that published a report in 1956, containing a plan to set up the European Atomic Energy Community (Euratom) and the European Economic Community (EEC).³

The objective of the EEC was to establish a Common Market and progressively approximate the economic policies of Member States, to promote throughout the Community a harmonious development of economic activities, a continuous and balanced expansion, an increased stability, an accelerated raising of the standard of living and closer relations between its Member States.⁴ Customs duties were also to be eliminated between the Member States as well as quantitative restrictions of imports and exports and all other measures having equivalent effect. A common customs tariff and a common commercial policy towards third countries were established and between the Member States the obstacles to free movement of persons, services and capital were abolished.⁵

One of the reasons for establishing the European Economic Community and a common market was to create a stable trading and producing block which would be able to compete with the US as well as the emerging Japanese economy. It was also seen as a defence mechanism against the rising threat of communism in the Cold War era.⁶

The 1960s and 70s were a period of political stagnation in the European Union, the Commission had a difficult time securing Council agreement to proposals which lead to

¹ Stefán Már Stefánsson: *Evrópusambandið og Evrópska Efnahagssvæðið*, p. 29.

² Paul Craig, Gráinne de Búrca: *EU Law*, p. 5.

³ *Ibid.*, p. 6.

⁴ Treaty of Rome, Article 2.

⁵ Treaty of Rome, Article 3.

⁶ Nigel Foster: *Foster on EU Law*, p. 265.

attainment of Treaty objectives being delayed.⁷ For whatever reason, perhaps lack of vision, perhaps due to recession because of the oil crisis in the 1970s⁸, the Member States were reluctant to advance the Common Market project further themselves and momentum was lost. Gradually though, commitment to the project was rediscovered and in 1982 the Heads of States and Governments pledged that the Internal Market would be completed declaring it a matter of high importance.⁹

When Jaques Delors took office as the president of the Commission in 1985, support for the single market project came from commerce and industry as well as the Member States themselves which led to the Commission's *White Paper Completing the Internal Market*.¹⁰ Setting out 300 legislative measures needed to complete the single market and named 1992 as the date by which the measures should be enacted, the White Paper declared that the time for talk had passed and the time for action had come.¹¹

The Treaty of the European Economic Community has been amended several times, one of the earliest such amendment being the Single European Act.¹² The Single European Act brought institutional and legal reforms, facilitating attainment of the 1992 target the White Paper had envisioned. The reforms included Article 95 EC which allowed for harmonization measures and qualified majority voting in the Council to expedite passing of legislation. Additionally, the realization that the single market could not be achieved in isolation led to other policies being set up to support it, including an environmental policy as well as an economic and social cohesion policy.¹³

The Single European Act also introduced substantive changes, such as Article 18 EC which set out the aim of establishing the internal market step by step before December 31, 1992. The article also defined the internal market as an area without internal frontiers ensuring the free movement of goods, persons, services and capital.¹⁴ The Single European Act was therefore the stimulus for the fulfilment of the EU's economic objectives, especially through Article 95 EC. The unanimity requirement in Article 94 EC had been an impediment to the passing of harmonization measures. Article 95 EC therefore became the Commission's instrument for the program for achieving the completion of the internal market.¹⁵

⁷ Paul Craig, Gráinne de Búrca: *EU Law*, p. 10.

⁸ Sven Norberg et al.: *EEA Law*, p. 47.

⁹ *Completing the Internal Market*, p. 4-5.

¹⁰ Nigel Foster: *Foster on EU Law*, p. 269.

¹¹ *Completing the Internal Market*, p. 4-5.

¹² Alina Kaczorowska: *European Union Law*, p. 2.

¹³ Nigel Foster: *Foster on EU Law*, p. 269.

¹⁴ Paul Craig, Gráinne de Búrca: *EU Law*, p. 11.

¹⁵ The definition of the Internal Market can now be found in Article 26(2) TFEU.

In 1991 an Agreement on the European Economic Area between the EU and the European Free Trade Association was drawn up. The Agreement comprehended free-movement provisions akin to the ones in the EC Treaty, similar competition policy and rules and co-operation in range of other policy areas. The Agreement came into force at the beginning of 1994 after some initial obstacles.¹⁶ The ECJ originally considered that the EEA Agreement was incompatible with the EC Treaty¹⁷ but after a separate EFTA Court was established without any connection to the ECJ the ECJ held that the EEA Agreement was compatible with the EC Treaty.¹⁸

The Maastricht Treaty made numerous substantive changes such as new provisions on an economic and monetary union, in Articles 98-124 EC, which laid the foundation for the introduction of the single currency, the euro. The Treaties of Amsterdam, Nice and Lisbon followed. The Lisbon Treaty modified the Treaty on the European Union and the Treaty Establishing the European Community. Henceforth, the European Union, as the European Community was afterwards known, is founded on the Treaty of the European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU), both of which have the same legal value. The European Union replaced and succeeded the European Community.¹⁹

The goal of creating an Internal Market can be found in Article 3(3) of the Treaty of the European Union. The article reads as follows:

The Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It shall promote scientific and technological advance.

With the Treaty of Lisbon the focus seems to have shifted from merely emphasizing the establishment of the internal market, such as in the Single European Act, to guidelines to be observed on how the market should develop.²⁰ The deadline of 1992, which could previously be found in Article 14(1) EC²¹ (which has now become Article 26(1) TFEU) has been dropped, thereby recognizing that establishment of the internal market is a continuing effort, rather than a task that can be completed by a particular date.²²

¹⁶ Paul Craig, Gráinne de Búrca: *EU Law*, p. 16-17.

¹⁷ ECJ Opinion 1/91.

¹⁸ ECJ Opinion 1/92.

¹⁹ Art 1, para. 3 TEU

²⁰ Alina Kaczorowska: *European Union Law*, p. 55.

²¹ Article 14(1) of the EC Treaty read: "The Community shall adopt measures with the aim of progressively establishing the internal market over a period expiring on 31 December 1992, in accordance with the provisions of this Article and of Articles 15, 26, 47(2), 49, 80, 93 and 95 and without prejudice to the other provisions of this Treaty"

²² Paul Craig, Gráinne de Búrca: *EU Law*, p. 588.

There are vast benefits to achieving economic integration. A large internal market enables companies to grow and specialize in their fields. This will then make them more competitive on the world economic stage. The end result is that a dynamic and competitive market is established which benefits both consumers and the producers themselves, as well as the Member States.²³

To achieve integration of a number of separate national markets two strategies are available. Negative integration revolves around removing barriers to trade²⁴ that is prohibiting rules that hinder cross-border trade. The principle of negative integration is seen in the provisions of the four freedoms.²⁵ Positive integration centres on modification of national laws and institutions. This can be done by harmonizing existing national laws or by creating new European laws.²⁶

Harmonization can take different forms. There is firstly total, or maximum, harmonization which means that one rule is enacted for the whole EU precluding the Member States from legislating in the same area. Total or maximum harmonization entails exhaustive regulations in a given field, setting both the floor and the ceiling of regulatory protection²⁷ preventing Member States from raising additional standards that would function to exclude imports.²⁸ Secondly there is optional harmonization which relies on the idea that producers only need to follow a directive when they intend to trade goods across an EU Member State border. Thirdly there is minimum harmonization where minimum standards are established and Member States cannot impose higher domestic standards in case of imported goods.²⁹

2.2 Free Movement of Goods, Workers and Services

Besides the free movement of capital the TFEU stipulates that movements of goods persons and services shall be free within the Internal Market. These three freedoms will now be discussed briefly so as to portray a comprehensive picture of the Internal Market.

The Internal Market provides both for the elimination of duties as concerns goods originating in other Member States and regarding goods originating in third countries that are in free circulation in the Internal Market and on which customs duties have been paid. The

²³ Nigel Foster: *Foster on EU Law*, p. 265.

²⁴ Catherine Barnard: *The Substantive Law of the EU*, p. 10.

²⁵ Paul Craig, Gráinne de Búrca: *EU Law*, p. 582.

²⁶ Nigel Foster: *Foster on EU Law*, p. 270.

²⁷ Paul Craig, Gráinne de Búrca: *EU Law*, p. 600.

²⁸ Nigel Foster: *Foster on EU Law*, p. 273.

²⁹ *Ibid.*, p. 274.

EU fixes duties for goods imported from third countries and a single set of common tariffs is adopted in trade relations with the outside world. However, once a product has been imported into the EU internal market it is in free circulation and further tariffs cannot be imposed.³⁰

Free movement of goods is enshrined in Article 29 TFEU, which states that products “coming from a third country shall be considered to be in free circulation in a Member State if the import formalities have been complied with and any customs duties or charges having equivalent effect which are payable have been levied in that Member State, and if they have not benefited from a total or partial drawback of such duties or charges.” The principle of free movement of goods is concerned with the economic ideals of the EU to create a single trading block within which all factors of production flow freely. It is essential to the creating and running of the customs union and the common market and provides the framework for the rest of the EU.³¹

Central to the idea of a customs union and an internal market is the abolition of customs duties as well as charges having an equivalent effect. The Commission has previously stated that the customs union is a foundation of the EU, essential to the functioning of the single market. To ensure the realization of this fundamental aim ECJ has interpreted Articles 28-30 TFEU strictly³², interpreting the prohibition of customs duties broadly.³³

Member States may be tempted to protect goods originating in their own country in various ways at the cost of goods originating in other Member States. The most obvious way for Member States to achieve this is through customs duties or charges having equivalent effect, dealt with in Articles 28-30 TFEU. The intent of such measures is to render foreign goods more expensive than domestic goods.³⁴

Articles 34-37 TFEU deal with situations wherein a state seeks to preserve advantages for its own goods by imposing quotas or measures which have an equivalent effect on imports, thereby reducing the quantum of imported products.³⁵ Another way for Member States to attempt to protect their own domestic products is through discriminating taxation against imports which is dealt with in Articles 110-113 TFEU. The prohibition of discriminatory taxation is intended to prevent Member States from circumventing the prohibition on customs duties by discriminating against imports by using their internal taxation system.³⁶

³⁰ Nigel Foster: *Foster on EU Law*, p. 275.

³¹ *Ibid.*, p. 265.

³² Paul Craig, Gráinne de Búrca: *EU Law*, p. 611.

³³ Josephine Steiner, Lorna Woods and Christian Twigg-Flesner: *EU Law*, p. 355.

³⁴ Paul Craig, Gráinne de Búrca: *EU Law*, p. 611.

³⁵ *Loc. cit.*

³⁶ Josephine Steiner, Lorna Woods and Christian Twigg-Flesner: *EU Law*, p. 355.

Aid and subsidies are essentially prohibited unless authorized by the Commission. Such aid can create a disadvantage for products from other Member States, distort competition by favouring certain undertakings or the production of certain goods.³⁷ The EU regulates the granting of such aid through Articles 107-109 TFEU.

The main principles governing the free movement of services are set down in Articles 56-62 TFEU. These principles have been developed through case law.³⁸ Whenever a cross-border element is present, the principle of free movement of services requires that restrictions be removed on the provision of services between Member States, for instance when the service provider is not established in the state where the services are supplied or where someone has travelled to receive services in a Member State other than that his Member State of residence. The provisions governing the free movement of services only apply to the extent that provisions concerning goods, persons and capital do not.³⁹

Provisions concerning the free movement of workers can be found in Articles 45-48 TFEU. Free movement of workers entails abolition of any discrimination based on nationality between workers of the Member States concerning employment, remuneration and other conditions of work and employment.⁴⁰ Several legal issues arise in the context of this freedom, including the scope of Article 45 TFEU as regards the interpretation of the term “worker”, what kinds of restrictions states are allowed to rightly impose on workers and their families as well as what rights family members of a worker enjoy under EU law.⁴¹

The case for freedom of movement of workers can be made from an economic perspective and a social perspective. From an economic perspective free movement of workers can be seen as allocation of resources within the EU. While some areas in the union may experience shortage of labour and therefore value it more highly, other areas may be faced with unemployment. The free movement of workers should lead to unemployed workers seeking jobs in Member States where demand for labour is greater than in their home Member State, i.e. the value of labour within the EU is maximized if workers can move to areas where they are most valued. From a social perspective free movement of workers can be linked with the concept of European solidarity with the underlying aim of integration of the peoples of Europe through people moving to other Member States in search of work.⁴²

³⁷ Article 107 TFEU.

³⁸ Paul Craig, Gráinne de Búrca: *EU Law*, p. 765.

³⁹ *Ibid.*, p. 790.

⁴⁰ Article 45(2) TFEU.

⁴¹ Paul Craig, Gráinne de Búrca: *EU Law*, p. 715.

⁴² *Loc. cit.*

Tensions between the economic and social dimensions of the free movement of workers can arise. While the provisions on free movement of persons are found in the economic part of the TFEU and not the social policy section, there have always been claims that the rights were infused with a social character. However, these claims did not find credibility until the rights were developed extensively by statutory supplements and with the generous interpretations given by the ECJ.⁴³ On one hand one can look at EU workers as mobile units of production contributing to the economic prosperity of the EU's Internal Market and on the other hand the as human beings, utilising their right to live in another Member State and enjoy equality of treatment for both themselves and their families. Tensions between realizing the free movement of workers and the Member State's desire to control entry into its country can also occur, especially in relation to entry of non-EU citizens, who may be within the family of the worker who has free movement rights.⁴⁴

2.3 The Rule of Reason

For the purpose of later discussion on the provisions on the free movement of capital it is relevant and necessary to discuss first the methodology the ECJ uses and how it has defined the scope of restriction of the free movement provisions through its judgments.

The Four Freedoms are based on the principle of non-discrimination, requiring that out-of-state goods, persons, services and capital enjoy the same treatment as their equivalents in-state. Non-discrimination has its advantages in that it does not interfere with national regulatory autonomy but it also has its disadvantages, for example it allows barriers to trade to remain; the host Member State can impose its own rules on imported goods or migrants as long as those rules apply equally to domestic goods and persons. Due to this some advocate a broader market access test which provides that rules that prevent or hinder market access are unlawful, regardless of whether they discriminate against imports or migrants or not. The ECJ increasingly favours this approach.⁴⁵

The traditional view is that a national measure which constitutes direct discrimination can only be justified by the grounds stipulated in the TFEU. However, if the measure constitutes indirect discrimination then it may be justified on grounds in the public interest. The ECJ

⁴³ Nigel Foster: *Foster on EU Law*, p. 311.

⁴⁴ Paul Craig, Gráinne de Búrca: *EU Law*, p. 715.

⁴⁵ Catherine Barnard: *The Substantive Law of the EU*, p. 17-19.

developed specific grounds for justifying obstacles to the fundamental freedoms separate from the limitations and exceptions granted according to the TFEU.⁴⁶

Through its case-law on the free movements of goods, namely Article 34 TFEU, the ECJ developed *the rule of reason*. The rule developed during a period when the institutions of the EU were unsuccessful in setting further rules to enforce the EEC Treaty.⁴⁷ Removing discriminatory trade barriers is necessary but it is not a *sufficient* condition for single market integration. Many rules that do not discriminate between goods dependent upon country of origin still create barriers to trade between Member States, as discussed above.⁴⁸

To combat such rules the Commission issued Directive 70/50/EEC on the abolition of measures which had an effect equivalent to quantitative restrictions on imports and were not covered by other provisions adopted in pursuance of the EEC Treaty. In Articles 2 and 3 the Directive listed measures which were to be abolished. Article 2 listed various measures numbered from a to s, including, but not limited to, measures which laid down less favourable prices for imported products than for domestic products (point b), measures which lowered the value of an imported product (point f) and measures which required giving of guarantees or making payments on account for imports (point i).

The first sign of the rule of reason can be seen in ECJ 8/74 *Dassonville*, a case concerning a French wholesaler importing Scotch whisky into Belgium to be sold there. Belgian law, unlike French law, required a certificate of origin for the whisky which Dassonville was not able to procure, having bought it from an importer in France. Dassonville was prosecuted for importing the whisky.⁴⁹ The ECJ said that “all trading rules enacted by Member States which are capable of hindering, *directly or indirectly, actually or potentially*, intra-Community trade are to be considered as measures having an effect equivalent to quantitative restrictions.” (My emphasis)⁵⁰ With this the ECJ introduced the idea that all rules hindering the free movement of goods, not only those discriminating on the basis of nationality, were prohibited.

The Court reinforced this new interpretation in its judgement ECJ 120/78 *Cassis de Dijon*. An importer was denied authorization to import French liqueurs into Germany because its alcohol strength was insufficient and therefore did not have the characteristics required to be marketed in Germany. According to German law fruit liqueurs had to have a minimum alcoholic content of 25%. The German Government maintained that the law was for the

⁴⁶ Mattias Dahlberg: *Direct Taxation in Relation to the Freedom of Establishment and the Free Movement of Capital*, p. 114.

⁴⁷ Stefán Már Stefánsson: *Evrópusambandið og Evrópska Efnahagssvæðið*, p. 24.

⁴⁸ Paul Craig, Gráinne de Búrca: *EU Law*, p. 647.

⁴⁹ ECJ 8/74 *Dassonville*, para. in introduction 1-3.

⁵⁰ *Ibid.*, para. 5.

protection of public health, in that beverages with low alcohol content might more easily induce a tolerance toward alcohol than more highly alcoholic beverages⁵¹, and for the protection of consumers against unfair commercial practices, as lowering the alcohol content secured a competitive advantage to beverages with higher alcohol content as alcohol is the most expensive component of the beverages.⁵² The ECJ pointed out that the public health considerations were not decisive since German consumers could obtain a wide variety of weak or moderately alcoholic products, besides the fact that a large portion of beverages with a high alcohol content sold on the German market was consumed in a diluted form.⁵³ Regarding concerns about unfair commercial practices the ECJ said that it was simply a matter of ensuring that suitable information was conveyed to the purchaser by requiring origin and the alcohol content to be on the packaging of the product.⁵⁴ In practice the purpose of requirements such as those at issue in the judgement was to promote beverages with a high alcohol content by excluding products of other Member States from the national market. There was no valid reason for alcoholic beverages which had been lawfully produced and marketed in one Member State should not be introduced into another Member State. The marketing of such beverages with lower alcohol content than the limit set by national rules could not be subject to a legal prohibition.⁵⁵

Cassis de Dijon is interesting for the sake that instead of adding to a list of previously known restrictions as Directive 70/50/EEC did, the ECJ decided instead to define the scope of restriction. To do this the ECJ relied on the *rule of mutual recognition* (a product produced and marketed lawfully in one Member State should be able to be imported into other Member States) and the *rule of proportionality* (the restrictions were out of proportion to the aim which could be simply reached with adequate information on the packaging of the product). The Court essentially created guidelines for the Member States to follow. *Cassis de Dijon* marked a policy of *negative integration* triggered by the ECJ by interpreting provisions on abolition of non-tariff barriers broadly.⁵⁶

The ECJ later began to use language akin to that used in *Cassis de Dijon* in the field of freedom to provide services. For instance in ECJ C-76/90 *Säger*, the Court stated that Article

⁵¹ ECJ 120/78 *Cassis de Dijon*, para. 10.

⁵² *Ibid.*, para. 12.

⁵³ *Ibid.*, para. 11.

⁵⁴ *Ibid.*, para. 13.

⁵⁵ *Ibid.*, para. 14.

⁵⁶ Paul Craig, Gráinne de Búrca: *EU Law*, p. 10.

59 EEC⁵⁷ required not only elimination of all discrimination against a person providing services on the ground of nationality but also abolition of any restriction, even if it applied without distinction to national providers of services and to those of other Member States, when it was liable to prohibit, or otherwise impede, the activities of a service provider established in another Member State where he lawfully provided similar services.⁵⁸ The *Säger* judgement will be discussed further in Chapter 6.1.2.

Interestingly, in joined cases ECJ C-267/91 and C-268/91 *Keck and Mithouard* the ECJ basically shifted its opinion from its previous *Cassis de Dijon* case-law. *Keck and Mithouard* concerned two individuals who had been prosecuted for reselling products in an unaltered state at a lower price than their actual purchase price, a selling arrangement known as *resale at a loss*, which was contrary to French law.⁵⁹ The ECJ pointed out that quantitative restrictions on imports and all measures having equivalent effect were prohibited between Member States. Any measure which was capable of directly or indirectly, actually or potentially, hindering intra-Union trade constituted a measure having equivalent effect to a quantitative restriction.⁶⁰ National legislation imposing a general prohibition on resale at a loss, however, was not designed to regulate trade in goods between Member States⁶¹, although it might restrict volume of sales and, by extension, the volume of sales of products from other Member States to the extent it deprived traders of a method of sales promotion. The question was then whether such a possibility was sufficient to render the legislation a measure having equivalent effect to a quantitative restriction on imports.⁶² The ECJ found it necessary to clarify the case-law on this matter in light of the increasing tendency of traders to invoke Article 30 EEC to challenge any rules that they find limit their commercial freedom.⁶³

In *Keck and Mithouard* the ECJ said that the *Cassis de Dijon* case-law prohibited obstacles to free movement of goods even when they applied without distinction to all products, unless their application could be justified by an objective of *public interest* taking precedence over the free movement of goods.⁶⁴ The ECJ decided that, in contrast to its prior

⁵⁷ Article 59 EEC: “Within the framework of the provisions set out below, restrictions on freedom to provide services within the Community shall be progressively abolished during the transitional period in respect of nationals of Member States who are established in a State of the Community other than that of the person for whom the services are intended.” A similar provision can now be found in Article 56 TFEU except that in stead of “progressively abolished during the transitional period” it simply states “shall be prohibited”.

⁵⁸ ECJ C-76/90 *Säger*, para. 12.

⁵⁹ ECJ C-267/91 and C-268/91 *Keck and Mithouard*, para. 2.

⁶⁰ *Ibid.*, para. 11.

⁶¹ *Ibid.*, para. 12.

⁶² *Ibid.*, para. 13.

⁶³ *Ibid.*, para. 14.

⁶⁴ *Ibid.*, para. 15.

case-law, that national provisions restricting or prohibiting certain selling arrangements, which applied to products from other Member States, were not such as to hinder directly or indirectly, actually or potentially trade between Member States within the meaning of the *Dassonville* judgement as long as the provisions applied to all relevant traders operating within the national territory as well as affect the marketing of domestic products and those from other Member States in the same manner, in law and in fact.⁶⁵ Therefore the Court considered that a general prohibition of *resale at a loss* did not fall within the scope of Article 30 EEC.⁶⁶

The Court formulated basic steps of the rule of reason doctrine in ECJ C-55/94 *Gebhard*. The ECJ said that national measures liable to hinder the exercise of fundamental freedoms or make it less attractive must fulfil four conditions. Firstly, they must be applied in a non-discriminatory manner; secondly, be justified by imperative requirements in the general interest; thirdly, be suitable for attaining the objective pursued and fourthly, they must not go beyond what is necessary to attain that objective.⁶⁷

Measures that are liable to hinder access to the market can therefore be justified by reasons of general interest. This can be seen in ECJ C-275/92 *Schindler* which concerned legislation in the United Kingdom prohibiting the holding of certain lotteries, including one which was organized in Germany and individuals intended to advertise in the United Kingdom.⁶⁸ The ECJ held that lottery activities were services⁶⁹ and that the legislation at issue in the case constituted an obstacle to the freedom to provide services.⁷⁰ The ECJ found, however, that considerations of social policy and prevention of fraud justified the legislation in question.⁷¹

The rule of reason doctrine establishes that even rules are non-discriminatory they can be prohibited if they are liable to hinder or impede access to the market unless they can be justified by general interest considerations. The Court has used the same methodology it developed in *Dassonville*, *Cassis de Dijon* and *Keck and Mithouard* in the field of free movement of capital as will be further discussed below.

⁶⁵ ECJ C-267/91 and C-268/91 *Keck and Mithouard*, para. 16.

⁶⁶ *Ibid.*, para. 18.

⁶⁷ ECJ C-55/94 *Gebhard*, para. 37.

⁶⁸ ECJ C-275/92 *Schindler*, para. 1-2.

⁶⁹ *Ibid.*, para. 25.

⁷⁰ *Ibid.*, para. 45.

⁷¹ *Ibid.*, para. 63.

3. The Development of Free Movement of Capital

3.1 Pre-Maastricht

Capital movements were, and are, closely linked to economic stability and monetary policy in the Member States. The original provisions in the EEC Treaty on capital recognized this and were more cautious and less assertively drafted than the provisions for the other freedoms. The result was that liberalization of capital movements took longer than it did for the other freedoms.⁷² While Article 67(1) EEC imposed an obligation to *progressively abolish* restrictions on capital movements during the transitional period it decreed so only to the extent necessary to ensure proper functioning of the common market⁷³, see:

During the transitional period and to the extent necessary to ensure the proper functioning of the common market, Member States shall progressively abolish between themselves all restrictions on the movement of capital belonging to persons resident in Member States and any discrimination based on the nationality or on the place of residence of the parties or on the place where such capital is invested.

Article 67 EEC was therefore less imperatively worded than the provisions of the other freedoms. By comparison, Article 48(1) EEC stated that freedom of movement for workers should be secured within the Community by the end of the transitional period at the latest. Paragraph 2 goes on to detail what such a freedom should entail, namely the abolition of any discrimination based on nationality between workers of the Member States as regards employment, remuneration and other conditions of work and employment. Article 59 EEC stated that restrictions on freedom to provide services should be progressively abolished during the transitional period. Further, free movement of services were defined in Article 60 EEC, unlike the free movement of capital which was not defined in the EEC Treaty. Article 68 EEC stated that as regards to the matters dealt with in chapter 4 of the EEC Treaty the Member States should be *as liberal as possible* in granting such exchange authorisations as were still necessary after the entry into force of the Treaty. It is clear that the wording *as liberal as possible* left the Member States considerable discretion.

The ECJ considered the legal effects of Article 67 EEC in its judgement ECJ 203/80 *Casati*, a case deriving criminal proceedings against an individual for exportation of banknotes.⁷⁴ The ECJ held in *Casati* that the scope of the restriction of free movement of capital depended on an assessment of the requirements of the common market and an

⁷² Catharine Barnard: *The Substantive Law of the EU*, p. 580.

⁷³ Paul Craig, Gráinne de Búrca: *EU Law*, p. 694.

⁷⁴ ECJ 203/80 *Casati*, para. 2. See page 51 for further particulars of the case.

appraisal of both the advantages and risks which liberalization might entail for the latter.⁷⁵ The Court further stated that such an assessment was first and foremost a matter for the Council. The Council had adopted two directives, one in 1960 and another in 1962 to amend the first one, wherein all capital movements were divided into four lists with varying degree of liberalization.⁷⁶ The obligation contained in Article 67 EEC could not be defined in relation to a specific category of such movements in violation from the Council's assessment of the need to liberalize that category in order to ensure the proper functioning of the Internal Market.⁷⁷ Put differently, it was not a forthright rule, directly applicable by a national court, or even the ECJ, but rather a question of policy for the Council, where the role of the Court was limited to monitoring whether the Council had exceeded the limits of its discretion. The Court took the view that it was not necessary to liberalize exportation of banknotes at that time and therefore there was no reason to suppose that the Council had in fact gone beyond its limits.⁷⁸ The ECJ noted that capital movements were closely connected with the economic and monetary policy of the Member States and concluded that complete freedom of movement of capital might undermine the economic policy of one of them or create an imbalance of payments and, as a result, impair the proper functioning of the common market.⁷⁹

The theme of only requiring restrictions to be abolished to the extent necessary to the common market could also be seen in Article 71(1) EEC.

Member States shall endeavour to avoid introducing within the Community any new exchange restrictions on the movement of capital and current payments connected with such movements, and shall endeavour not to make existing rules more restrictive.

The wording of Article 71 was somewhat less strongly worded than the other Treaty Freedoms. As can be seen the article only required Member States to *endeavour to avoid* the introduction of any new exchange restrictions on capital movements within the Union as well as to not make existing rules more restrictive, not imposing on Member States an unconditional obligation capable of being relied on by individuals.⁸⁰ This tepid resolve to free capital movements meant that the field developed slowly and further measures for liberalization came in the form of secondary legislation when necessary. This led to the other freedoms becoming more important as they were more resolutely worded, as evidenced above regarding workers and services, and the ECJ employed dynamic interpretation of their

⁷⁵ ECJ 203/80 *Casati*, para. 10.

⁷⁶ *Ibid.*, para. 11.

⁷⁷ *Ibid.*, para. 12.

⁷⁸ John A. Usher: "The Evolution of the Free Movement of Capital", p. 1535.

⁷⁹ ECJ 203/80 *Casati*, para. 9.

⁸⁰ Treaty of Rome, Article 71(1).

provisions.⁸¹ As Article 67(1) EEC did not abolish restrictions on the movement of capital by the end of the transitional period the Council was left to adopt directives on the basis of Article 69 EEC to affect abolition of restrictions.⁸² Article 69 EEC stated that the Council should issue the necessary directives for progressive implementation of the provisions of Article 67.

3.2 Early Free Movement of Capital Secondary Legislation

The first Council Directive under the original Article 67 EEC was enacted during the first stage of the original transitional period on May 11, 1960. It was amended by Directive 63/21 at the end of 1962. These directives divided capital movements into four lists, with different degrees of liberalization.

According to Article 1(1) of the first Council Directive Member States were required to grant all foreign exchange authorisations required for the conclusion or performance of transactions or for transfers between residents of Member States in respect of the capital movements set out in List A of Annex 1 of the Directive. Capital movements mentioned in List A included direct investment, investments in real estates and personal capital movements such as gifts, dowries and inheritances.

Article 2(1) of the Directive decreed that Member States should grant general permission for the conclusion or performance of transactions and for transfers between residents of Member States in respect of the capital movements which were set out in List B of Annex 1. List B listed operations in securities. According to Article 3(1) of the Directive Member States were to grant all foreign exchange authorisations required for the conclusion or performance of transactions and for transfers between residents of Member States in respect of the capital movements set out in List C of Annex 1. List C included further operations in securities as well as issue and placing of securities of a domestic undertaking on a foreign capital market and a foreign undertaking on a domestic capital market.

Article 4 of the Directive stated that the Monetary Committee should examine the restrictions which were applied to the capital movements set out in lists contained in Annex I of the Directive at least once a year and report to the Commission regarding restrictions which could be abolished. According to list D it applied to capital movements referred to in Article 4 of the Directive. The list included such capital movements as opening and placing funds on

⁸¹ Natalia Bialek, Arkadiusz Bazylko: "Free Movement of Money in the European Union – The Role of European Court of Justice in the Formation of Free Movement of Capital and Payments", p. 58.

⁸² Catharine Barnard: *The Substantive Law of the EU*, p. 580-581.

current or deposit accounts and reparation or use of balances on current or deposit accounts with credit institutions. It also included granting and repayment of short-term loans and credits not related to commercial transactions, personal capital movements, loans, physical import and export of financial assets and finally other capital movements.

According to Article 6 of the Directive Member States should endeavour not to introduce within the Community any new exchange restrictions affecting the capital movements that were liberalised at the date of entry into force of the Directive nor to make existing provisions more restrictive, mirroring Article 71 EEC. It should be noted that the wording of the Article only required the Member States to try their hardest not to introduce any new exchange restrictions, yet it did not completely forbid it. Annex 2 of the Directive contained a nomenclature establishing what capital movements such as direct investments, liquidation of direct investments, operations in securities and investment in real estate entail. The Second Council Directive 63/21/EEC made changes to the First Directive. This framework was amended by Directive 86/566/EEC.

In the 1980s attitude towards international capital transactions shifted. This happened progressively but significantly in favour of deregulation and liberalization. Several factors brought this change about. Firstly, the balance of payment of many countries in Europe improved which enabled them to abandon capital controls. Secondly, governments had also begun to realise that restrictions on external capital movements often just delayed necessary structural adaptations which would just become more costly if they were put off. Thirdly, there was a general tendency to deregulate national financial markets. Fourthly, innovation in technology also contributed with telecommunications and the automation revolution greatly reducing information and transaction costs of the financial sector. Lastly, a large unregulated international financial market had developed to avoid the problem of regulated home financial markets. This unregulated market proved to be more and more efficient in coping with the needs of investors and borrowers.⁸³

In 1985 the *White Paper on the Completion of the Internal Market* was released. In chapter 5 were proposals for reform of the freedom of capital movements. According to the White Paper greater liberalization of capital movements should serve three aims. Firstly that the completion of a large internal market contained a financial angle, that is, the other freedoms must mean that private individuals and firms in the Union must have access to effective financial services. The White Paper went on to state that the effectiveness of the

⁸³ Willem Molle: *The Economics of European Integration*, p. 123.

harmonisation of national measures governing the activities of financial intermediaries and markets would be greatly reduced if the corresponding capital movements were to remain subject to restrictions. Secondly, that monetary stability was an essential precondition for the proper operation and development of the internal market. In that regard actions to achieve greater freedom of capital movements would need to move in parallel with the steps taken to reinforce and develop the European Monetary System as stability of exchange rates and convergence of economic policies would help the gradual removal of barriers to the free movement of capital. The White Paper also mentions that greater financial freedom lead to greater discipline in the conduct of economic policies. Thirdly, the decompartmentalisation of financial markets should boost the economic development of the Union by promoting the optimum allocation of European savings.⁸⁴ In its 1985 White Paper the Commission described capital as a necessary ingredient of the Single Market, and this was confirmed by the definition of the internal market in the Single European Act 1986.⁸⁵

After the publication of the White Paper advocating for greater liberalization in capital movements a new directive was set to amend the framework set forth by the first and second Council Directives discussed above. Directive 88/361/EEC followed a new approach and finally established the basic principle of free movement of capital as a matter of EU law⁸⁶ with effect, for most Member States, from July 1, 1990. Article 1(1) of the Directive stated that without prejudice to the following provisions, Member States should abolish restrictions on movements of capital taking place between persons resident in Member States. According to the joined cases ECJ C-358/93 and C-416/93 *Bordessa and others* Article 1, being both precise and unconditional as well as not requiring a specific implementing measure, had direct effect and could thus confer rights upon individuals which they might rely on before courts of the Member States and which national courts must uphold.⁸⁷

The Directive provided a nomenclature in Annex 1 according to which capital movements were to be classified in order to facilitate the application of the directive. This nomenclature listed capital movements in thirteen different categories. Article 3 stated that Member States could impose protective measures regarding capital movements listed in Annex 2 of the Directive by fulfilling certain conditions and gaining authorization from the Commission. These capital movements were short-term or of exceptional magnitude which imposed severe strains on foreign-exchange markets and lead to serious disturbances in the conduct of a

⁸⁴ *Completing the Internal Market*, p. 32-33.

⁸⁵ Jukka Snell: "Free Movement of Capital: Evolution as a Non-Linear Process", p. 551.

⁸⁶ ECJ C-358/93 and C-416/93 *Bordessa and others*, para. 17.

⁸⁷ *Ibid.*, para. 33.

Member State's monetary and exchange rate policies. However, paragraph 4 stated that such protective measures should not exceed six months. Free movement of capital thus became the only Treaty "freedom" to be achieved in the manner envisaged in the Treaty; that is by the enactment of a programme of legislation. However, it was achieved twenty years after the time limit envisaged in the Treaty.⁸⁸

With Article 73(1) EEC Member States were able to maintain or reintroduce restrictions to capital movements which were liberalized under Community law. The Article stated that if movement of capital lead to disturbance in the functioning of the capital market of any Member State the Commission should, after consulting the Monetary Committee, authorise the state in question to take protective measures, and determine conditions and details of the authorisation. The Council could revoke this authorisation or amend the conditions or details by a qualified majority. In the aforementioned 1985 White Paper the Commission stated that from then on its attitude towards the use of such safeguard clauses would be governed by a threefold criteria. Firstly, that authorization to apply such protective measures should only be for a limited period. Secondly, that such measures should be reviewed on a continuing basis and abolished gradually as the difficulties which originally justified them diminished. Third, an agreement should be reached not to apply the protective clauses to capital movements which were so short term that they were classified as speculative and which were most directly linked to the free movement of goods, services and persons. The Commission did, however, acknowledge that capital movements were freer in the Union when the White Paper was published than they were at the end of the 1970s.⁸⁹

3.3 Post-Maastricht

The Single European Act was the most important revision of the European Union Treaties since their adoption, marking a revival of the momentum towards integration.⁹⁰ This momentum lead to the negotiation and adoption of the Maastricht Treaty, which entered force in November 1993.⁹¹ The Maastricht Treaty completely revised the provisions on free movement of capital, with effect from 1 January 1994. Article 56 EC (now Article 63 TFEU) now provided:

⁸⁸ John A. Usher: "The Evolution of the Free Movement of Capital", p. 1537.

⁸⁹ *Completing the Internal Market*, p. 33.

⁹⁰ Paul Craig, Gráinne de Búrca: *EU Law*, p. 12.

⁹¹ *Ibid.*, p. 13.

Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.

The ECJ took a more prominent role after the Maastricht Treaty came into force. This development was something the Member States sought to reduce later with the Lisbon Treaty.⁹²

A significant distinction between these new provision and the original provisions, as well as the situation reached under Directive 88/361/EEC, is that movements of capital to and from third countries appear to be intended to be treated in the same way as movements between Member States. In retrospect, this can be seen as anticipating the need to restore confidence in the international money markets with regard to the external movement and availability of the single currency. In reality though there are still differences which remain.⁹³ The territorial scope of the current free movement of capital provisions will be further explored in chapter 5.3.

In its judgement ECJ 308/86 *Lambert* the ECJ clarified the distinction between Article 106 EEC and Article 67 EEC. While Article 106 EEC concerned current payments, i.e., the transfers of foreign exchange which constitute the payment within the context of an underlying transaction (of goods, persons, services, or capital), Article 67 EEC covered movements of capital, i.e. financial operations essentially concerned with the investment of funds, rather than remuneration for a service.⁹⁴ The Maastricht Treaty reduced the significance of this distinction by overhauling the provisions on capital and payments profoundly. This was done to go along with the new rules on the single currency. The provisions on capital and payments were brought together in a single chapter and the provisions on capital were amended to emulate the contents of Directive 88/361/EEC.⁹⁵

The provisions adopted in the Maastricht Treaty are still in force today. They enshrine the free movement of capital, but also contain potentially significant exceptions. The wording of Article 63 TFEU is strict in that it prohibits *all restrictions* on the movement of capital between Member States and between Member States and third countries. Article 63 TFEU is unique because it refers both to internal and external EU situations in prohibiting restrictions on movement of capital between Member States and third countries. Articles 64 and 66 TFEU provide the Member States or the Council with means to restrict the free movement of capital

⁹² Jukka Snell: "Free Movement of Capital: Evolution as a Non-Linear Process", p. 548.

⁹³ John A. Usher: "The Evolution of the Free Movement of Capital", p. 1543.

⁹⁴ ECJ 308/86 *Lambert*, para. 10.

⁹⁵ Catharine Barnard: *The Substantive Law of the EU*, p. 581.

to or from third countries and Article 65 TFEU contains a number of derogations which allow the Member States to limit capital movements generally.⁹⁶ Articles 64-66 TFEU will be discussed further in chapters 6 and 7.

The ECJ finally assumed the leadership position that it had in regards to of the other freedoms. As noted earlier, the ECJ found that the provisions of Article 63 TFEU were directly effective. The ECJ adopted a wide understanding of what a restriction amounts to and rather used language that focused on the dissuading or deterring effects of national measures than on their disparate impact.⁹⁷ However, the ECJ met with some resistance from the Member States who inserted Article 65(4) TFEU with the Lisbon Treaty (see further chapter 7 below).⁹⁸

4. Free Movement of Payments

All restrictions on payments between Member States and between Member States and third countries are prohibited.⁹⁹ Free movement of payments is not an independent freedom in nature, but refers to mutual performances concerning free movement of employees, goods and services. Put differently, it consists of transfer of money as a payment for a product or a service.¹⁰⁰

The original EEC article wherein the free movement of payments was stipulated was Article 67 whose second paragraph stated that current payment connected with the movement of capital between Member States should be freed from all restriction at least by the end of the first stage of the transitional period.¹⁰¹

The provision for the free movement of payments is currently in article 63(2) TFEU which states:

Within the framework of the provisions set out in this Chapter, all restrictions on payments between Member States and between Member States and third countries shall be prohibited.

⁹⁶ Jukka Snell: "Free Movement of Capital: Evolution as a Non-Linear Process", p. 551.

⁹⁷ *Ibid.*, p. 552.

⁹⁸ *Ibid.*, p. 554.

⁹⁹ Article 63, paragraph 2.

¹⁰⁰ Natalia Bialek, Arkadiusz Bazylko: "Free Movement of Money in the European Union – The Role of European Court of Justice in the Formation of Free Movement of Capital and Payments", p. 59.

¹⁰¹ Article 8 EEC set out the goal of establishing the Internal Market (then called the Common Market) during a transitional period. Article 8(1) stated: "The common market shall be progressively established during a transitional period of twelve years. This transitional period shall be divided into three stages of four years each; the length of each stage may be altered in accordance with the provisions set out below."

It is clear that the other freedoms, goods, services and persons, would be ineffective if not for the free movement of payments, for instance if an individual making a purchase was not able to pay a seller or a service provider in another Member State. This was recognized in Article 106 EEC as it was originally drafted, a provision which existed until January 1, 1994 as Article 73h EC by virtue of the Maastricht amendments.¹⁰²

Article 106(1) EEC Treaty required Member States to authorise any payments connected with the movement of goods, services or capital, in the currency of the Member State in which the creditor or beneficiary resided, to the extent that the movement of goods, services, capital and persons between Member States had been liberalised pursuant to the Treaty. Furthermore, the paragraph stated that Member States declared their readiness to undertake the liberalisation of payments beyond the extent provided in the preceding sub-paragraph in so far as their economic situation in general and the state of their balance of payments so permitted.

This first paragraph of Article 106 was considered particularly important because it was held to be directly effective at a time when the other Treaty rules on free movement of capital did not give rise to direct effect. This was established in joined cases ECJ 286/82 and 26/83 *Luisi and Carbone*, giving rise to rights enforceable by individuals before their national courts.¹⁰³ Concerning the question of whether, and if so, to what extent, Member States retained the power to subject liberalized transfers and payments to control measure applicable to the transfer of foreign currency, the Court said that freedom of payments which were provided for in Article 106 EEC compelled Member States to authorize the payments referred to in that provision in the currency of the Member State in which the creditor or beneficiary resided.¹⁰⁴

Because the provision required the Member States to authorize means of payment as consideration for trade in goods, persons, services and capital, the ECJ has suggested that it was perhaps the most important provision in the EEC Treaty, as it was then, for the purposes of attaining a internal market. In ECJ 7/78 *R v Thomson*, which concerned rules on import and export of coins, the Court said although Articles 67 to 73 of the EEC Treaty were important, because they concerned the abolition of obstacles to free movement of capital, the provisions contained in Articles 104 to 109, concerned the overall balance of payments and for that reason related to all monetary movements, must be considered essential for the purpose of

¹⁰² John A. Usher: "The Evolution of the Free Movement of Capital", p. 1539.

¹⁰³ *Ibid.*, p. 1540.

¹⁰⁴ ECJ 286/82 and 26/83 *Luisi and Carbone*, para. 27-28.

attaining the free movement of goods, services or capital which is of fundamental importance for the attainment of the Common Market.¹⁰⁵ In this respect the ECJ singled out Article 106, stating that the aim of the provision was to ensure that necessary monetary transfers could be made both for the liberalization of movements of capital and for the free movement of goods, services and persons.¹⁰⁶ In ECJ C-412/97 *ED Srl* the Court further stated that:

Like Article 106 of the EEC Treaty, Article 73b(2) of the EC Treaty is intended to enable a person liable to pay a sum of money in the context of a supply of goods or services to discharge that contractual obligation voluntarily without undue restriction and to enable the creditor freely to receive such a payment.¹⁰⁷

Article 106(2) EEC said that in so far as movement of goods, services, and capital were limited only by restrictions on payments connected therewith, those restrictions should be progressively abolished by applying the provisions of the chapters relating to the abolition of quantitative restrictions, to the liberalisation of services and the free movement of capital.

According to Article 106(3) EEC the Member States undertook not to introduce between themselves any new restrictions on transfers connected with the invisible transactions listed in Annex III to the EEC Treaty. Progressive abolition of the existing restrictions should be effected in accordance with the provisions of Articles 63 - 65 of the EEC Treaty, that is, in so far as such abolition is not governed by the provisions contained in Article 106(1) and (2) or by the chapter concerning the free movement of capital.

Lastly, Article 106(4) stated that the Member States should consult each other on measures to be taken to enable the payments and transfers mentioned in Article 106 EEC to be effected. Such measures should not prejudice the attainment of the objectives set out in Chapter 2 (Balance of Payments), under Title II (Economic Policy) in which Article 106 was found.

In its judgement ECJ 308/86 *Lambert*, the ECJ applied a restrictive approach to Article 106 EEC maintaining that the article was not relevant to the way an exporter received payment but only to ensure that an importer was able to make a payment in the currency of the Member State where the exporter resided.¹⁰⁸ However, one might see the judgement as taking an excessively narrow approach as it can be argued that both aspects are equally important to achieving genuine free movement of goods and services, that is, both that the importer makes a payment and the exporter receives payment. In its joined cases ECJ 286/82 and 26/83 *Luisi and Carbone* the ECJ noted that the original Article 106 EEC applied only to

¹⁰⁵ ECJ 7/78 *R v Thomson*, para. 22.

¹⁰⁶ *Ibid.*, para. 24.

¹⁰⁷ ECJ C-412/97 *ED Srl*, para. 17.

¹⁰⁸ ECJ 308/86 *Lambert*, para. 16.

liberalize current payments made in the currency of the state of the creditor. This helps to explain the Court's decision in *Casati* as that case concerned exportation of currency to pay for services and goods outside of Italy and Article 106 would therefore only have justified payment in lire.¹⁰⁹

Luisi and Carbone concerned Italian legislation relating to transfer of foreign currency. Mrs. Luisi and Mr. Carbone had exported sums of foreign currency from Italy exceeding the maximum amount authorized to export, set in Italian law. For this they each received fines which they contested, Mrs. Luisi claiming she had used the money as a tourist in Germany and France as well as to receive medical treatment in Germany and Mr. Carbone claimed to have used as a tourist in Germany.¹¹⁰ Mrs. Luisi and Mr. Carbone claimed that the Italian law restricting export of foreign currency for tourism violated the free movement of capital and current payments.¹¹¹

In the judgement the ECJ defined the term payments in such a way:

[...] that current payments are transfers of foreign exchange which constitute the consideration within the context of an underlying transaction, whilst movements of capital are financial operations essentially concerned with the investment of the funds in question rather than remuneration for a service.¹¹²

The Court held that physical transfer of bank notes could not be classified as movements of capital where the transfer in question corresponded to an obligation to pay arising from a transaction involving the movement of goods and services.¹¹³ As a consequence the ECJ said that payments in connection with travel or tourism for the purposes of business, education or medical treatment could not be classified as capital movements even when they were affected by means of physical transfer of banknotes.¹¹⁴

The ECJ clarified the line between the requirement of prior declaration and prior authorization in joined cases ECJ C-163/94, C-165/94 and C-250/94 *Sanz de Lera*. The judgement concerned three individuals residing in Spain who were apprehended separately and subjected to criminal proceedings because they had either exported or were about to export sums of money for which they had not sought authorization by the Spanish authorities. According to Spanish law export of any coins, banknotes or cheques payable to bearer in pesetas or foreign currency were subject to a prior declaration when the amount exceeded

¹⁰⁹ John A. Usher: "The Evolution of the Free Movement of Capital", p. 1542.

¹¹⁰ ECJ 286/82 and 26/83 *Luisi and Carbone*, under 'Facts and written procedure.', para. 1

¹¹¹ ECJ 286/82 and 26/83 *Luisi and Carbone*, para. 3.

¹¹² *Ibid.*, para. 21.

¹¹³ *Ibid.*, para. 22.

¹¹⁴ *Ibid.*, para. 23.

1.000.000 pesetas and to prior administrative authorization when it exceeded 5.000.000 pesetas. In all three cases the amount exceeded the latter.¹¹⁵ The ECJ ruled that the provisions on free movement of capital precluded rules which made export of coins and banknotes conditional on prior authorization but not a prior declaration.¹¹⁶ While the effect of prior authorization would cause the freedom of movement of capital to be subject to the discretion of administrative authorities and might render that freedom non-existent¹¹⁷, prior declaration would enable the national authorities to carry out effective supervision without suspending the concerned operation.¹¹⁸

As discussed above, hindrance on the free movement of capital affects the other freedoms, for instance the payment for goods imported from another Member State. The point was highlighted in the case ECJ 95/81 *Commission v Italy*.¹¹⁹ Italy required importers from other Member States to lodge a security or a bank guarantee for advance payments relating to the importation of goods when payment was made in advance.¹²⁰ The ECJ considered that by setting this requirement into law Italy had failed to fulfil its obligations regarding the free movement of capital under the EEC Treaty.¹²¹

5. What constitutes free movement of capital?

5.1 Definition

While free movement of payments is an important component of the free movement of capital, essentially rendering the other freedoms attainable, the other side of the free movement of capital are capital movements in themselves, without being payments for goods or services.

The ECJ has acknowledged the free movement of capital, for instance in its judgement ECJ 203/80 *Casati* where it stated:

[...] the free movement of capital constitutes, alongside that of persons and services, one of the fundamental freedoms of the Community. Furthermore, freedom to move

¹¹⁵ ECJ C-163/94, C-165/94 and C-250/94 *Sanz de Lera*, para. 2-5.

¹¹⁶ *Ibid.*, para. 30.

¹¹⁷ *Ibid.*, para. 25.

¹¹⁸ *Ibid.*, para. 27.

¹¹⁹ John A. Usher: "The Evolution of the Free Movement of Capital", p. 1542.

¹²⁰ ECJ 95/81 *Commission v Italy*, para. 3.

¹²¹ *Ibid.*, para. 29.

certain types of capital is, in practice, a precondition for the effective exercise of other freedoms guaranteed by the Treaty [...]¹²²

As the Treaty does not define what constitutes movement of capital it is for the ECJ to decide whether a measure constitutes a restriction on the free movement of capital or not.¹²³ The ECJ has held that reference can be made to the nomenclature in Annex I of Directive 88/361/EEC, which may be used for the purposes of defining what constitutes a capital movement, see for instance ECJ C-222/97 *Trummer and Mayer* where the ECJ remarked:

It should be noted in that connection that the EC Treaty does not define the terms ‘movements of capital’ and ‘payments’.¹²⁴ [...] However, inasmuch as Article 73b of the EC Treaty substantially reproduces the contents of Article 1 of Directive 88/361, and even though that directive was adopted on the basis of Articles 69 and 70(1) of the EEC Treaty, which have since been replaced by Article 73b et seq. of the EC Treaty, the nomenclature in respect of movements of capital annexed to Directive 88/361 still has the same indicative value, for the purposes of defining the notion of capital movements, as it did before the entry into force of Article 73b et seq., subject to the qualifications, contained in the introduction to the nomenclature, that the list set out therein is not exhaustive.¹²⁵

The ECJ has relied on the Annex on multiple occasion even after the Directive itself was abolished. A transaction can still constitute a capital movement within the meaning of Article 63(1) TFEU even though it is not listed in the Annex as the list is non-exhaustive. For instance, in ECJ C-35/98 *Verkooijen* the Court held that while the receipt of dividends from a foreign company was not expressly mentioned in the annex it fell within the scope of the Treaty because it was linked to some of the measures in the annex.¹²⁶

Interestingly, unlike the case law on free movement of persons, the ECJ has rarely added the additional requirement that a capital movement be an “economic activity”. The Court seems to assume that movement of capital within Article 63 is in itself economic. In light of this it might be said that free movement of capital has more in common with free movement of goods than free movement of persons.¹²⁷

5.2 Direct effect

As the free movement of capital took a longer time to develop it was not considered to have direct effect at the same time the ECJ was declaring that other freedoms had such effect.

¹²² ECJ 203/80 *Casati*, para. 8.

¹²³ Paul Craig, Gráinne de Búrca: *EU Law*, p. 695.

¹²⁴ ECJ C-222/97 *Trummer and Mayer*, para. 20

¹²⁵ *Ibid.*, para. 21.

¹²⁶ ECJ C-35/98 *Verkooijen*, para. 28.

¹²⁷ Catharine Barnard: *The Substantive Law of the EU*, p. 584.

The doctrine of direct effect was first expressed in a judgement of the Court of Justice, ECJ 26/62 *Van Gend en Loos*. The criteria for direct effect of a treaty article was that it was clear, unconditional, negative, that it contained no reservations on the part of the Member State and that it was not dependent on any national implementing measure.¹²⁸ The original conditions for direct effect have loosened throughout the years since *Van Gend en Loos*. Craig and de Búrca summarized the current condition as “a Treaty Article will be accorded direct effect provided that it is intended to confer rights on individuals and that it is sufficiently clear, precise and unconditional.”¹²⁹

Direct effect of the provisions on the free movement of capital was explored in ECJ 203/80 *Casati* where the ECJ held that Article 67 EEC was not directly effective due to the fact that rules on capital were not sufficiently liberalized.¹³⁰ At the time, as has been noted earlier, there was only an obligation to liberalize capital movements to the extent necessary to ensure the proper functioning of the common market.¹³¹

The ECJ held in joined cases ECJ C-163/94, C-165/94 and C-250/94 *Sanz de Lera* that Article 73b(1) EC (now Article 63(1) TFEU) had direct effect. The judgement concerned criminal proceedings brought against three individuals for having exported banknotes, above an amount set in Spanish law, without prior authorization from Spanish authorities. The ECJ stated that the provisions on free movement of capital laid down a clear and unconditional prohibition for which no implementing measure was required. The provision of Article 73d(1)(b) EC (now Article 65(1)(b) TFEU)¹³² and the fact that Member States had discretion to take all measures necessary to prevent infringement of national law and regulations did not prevent Article 73b(1) EC from having direct effect because the exercise of such discretion was subject to judicial review.¹³³

The ECJ said in ECJ C-101/05 *A*, a case concerning exemption from income tax, that Article 56(1) EC (now Article 63(1) TFEU) laid down a clear and unconditional prohibition for which no implementing measure was needed and which conferred rights on individuals which they could rely on before the courts. The ECJ went on to say in the judgment that the provision was directly effective in respect of the movement of capital between Member States and third countries. According to the ECJ, and referring to paragraph 48 of *Sanz de Lera*, Article 56(1) EC (now Article 63(1) TFEU), in conjunction with Articles 57 EC and 58(1)(b)

¹²⁸ ECJ 26/62 *Van Gend en Loos*, p. 13.

¹²⁹ Paul Craig, Gráinne de Búrca: *EU Law*, p. 188

¹³⁰ ECJ 203/80 *Casati*, para. 9-10.

¹³¹ Article 67(1) of the EEC Treaty.

¹³² ECJ C-163/94, C-165/94 and C-250/94 *Sanz de Lera*, para. 41.

¹³³ *Ibid.*, para. 43.

EC (now Articles 64-65 TFEU) might be relied on before national courts and might render national rules that were inconsistent with it inapplicable¹³⁴, irrespective of the category of capital movement in question.¹³⁵

The ECJ has only established *vertical* direct effect of the provisions concerning free movement of capital, that is, against the state, but not *horizontal* direct effect, that is between individuals. Schepel, however, considers that it may only be a matter of time before the Court establishes horizontal direct effect of the free movement of capital pointing to the consequences of the case-law in the golden share cases (discussed in chapter 6.1.2). Two issues lead him to that conclusion, on one hand the Court has framed Article 63 TFEU as a charter of shareholders rights rather than an obligation for the Member States to meet. On the other hand the ECJ has drawn a distinction between the measures it deems to fall under the freedom of establishments and those it considers restriction on the free movement of capital.¹³⁶

6. Restrictions

6.1 Discrimination and restriction

The original provision on the free movement of capital, Article 67 EEC, made reference to the abolition of all restrictions on the movement of capital and any discrimination based on the nationality or on the place of residence of the parties or on the place where such capital was invested. With the Maastricht amendments the reference to *discrimination* was dropped and the provision only referred to *restrictions*. Despite this the ECJ has used both the discrimination model and the restrictions model, both in regards to decision based on earlier models of the provision as well as decisions based on Article 63(1) TFEU as it appears after the Maastricht amendments, to eliminate measures which interfere with the free movement of capital.¹³⁷

Defining the notion of restriction is one of the most contested developments in the Court's case law with the ECJ's answers varying both in time and among the freedoms.¹³⁸ The broad

¹³⁴ ECJ C-101/05 A, para. 25.

¹³⁵ *Ibid.*, para. 26.

¹³⁶ Harm Schepel: "Constitutionalising the Market, Marketising the Constitution, and to Tell the Difference: On the Horizontal Application of the Free Movement Provisions in EU Law", p. 192.

¹³⁷ Catharine Barnard: *The Substantive Law of the EU*, p. 589.

¹³⁸ Jukka Snell: "Free Movement of Capital: Evolution as a Non-Linear Process", p. 554.

scope given to the concept of restriction can be best seen in the case law on golden shares¹³⁹, which will be discussed below.

6.1.1 Discrimination model

Despite the change in wording discussed above the ECJ still uses the so-called discrimination model. To understand the discrimination model it is perhaps best to take a closer look at Article 67 EEC which prohibited discrimination on the grounds of nationality, the place of residence of the parties and the place where capital was invested, that is direct discrimination. While Article 63(1) TFEU does not reference discrimination, it seems likely that it prohibits both national measures which are directly and indirectly discriminatory following the model of the other three freedoms, as well as prohibiting non-discriminatory measures which (substantially) hinder access to the market. Most of the case law has concerned *direct* discrimination.¹⁴⁰

Direct discrimination is based directly on nationality.¹⁴¹ It is important to distinguish between direct discrimination and indirect discrimination because direct discrimination can only be justified on grounds permitted by the TFEU.¹⁴²

Consider for instance ECJ C-423/98 *Albore* in which the Naples Registrar of Property had refused to register a sale of two immovable properties to German nationals because they had not applied for authorisation prescribed by Italian law concerning property, situated in areas of military importance.¹⁴³ Such authorisation was only needed for non-Italian nationals.¹⁴⁴ The situation clearly constituted a discrimination based on nationality which Article 73b EC (now Article 63 TFEU) prohibited.¹⁴⁵ The orthodox rule is that direct discrimination can only be saved by reference to an express derogation.¹⁴⁶ However, the ECJ held that requirements of public security, on which the contested legislation seemed to be based, could not justify derogations from the free movement of capital unless the principle of proportionality was observed. In other words derogations must be within limits of what is appropriate and

¹³⁹ Jukka Snell: "Free Movement of Capital: Evolution as a Non-Linear Process", p. 555.

¹⁴⁰ Catharine Barnard: *The Substantive Law of the EU*, p. 589-590.

¹⁴¹ Mattias Dahlberg: *Direct Taxation in Relation to the Freedom of Establishment and the Free Movement of Capital*, p. 93.

¹⁴² *Ibid.*, p. 95.

¹⁴³ ECJ C-423/98 *Albore*, para. 2.

¹⁴⁴ *Ibid.*, para. 5.

¹⁴⁵ *Ibid.*, para. 16-17.

¹⁴⁶ Catharine Barnard: *The Substantive Law of the EU*, p. 590.

necessary for achieving the aim in view.¹⁴⁷ The Court found that simply referencing a requirement of defence of the national territory, which did not reach the scope of Article 224 of the EC Treaty, could not justify discrimination on grounds of nationality.¹⁴⁸

In ECJ C-367/98 *Commission v Portugal* the Court held that the prohibition found in Article 63(1) TFEU went beyond the mere elimination of unequal treatment, on grounds of nationality, between operators on the financial markets.¹⁴⁹ Indirect discrimination is not based directly on nationality but has the same effect as if the discriminatory measure had been based on nationality.¹⁵⁰ Distinction such as these can appear neutral, such as limited or unlimited tax advantage, but mainly prejudice non-nationals or foreign investment are just as serious and harmful as direct discrimination.¹⁵¹

Cases concerning *indirect* discrimination have mostly arisen in the field of taxation which have a different impact on non-residents than residents.¹⁵² ECJ C-443/06 *Hollman* for instance concerned an individual residing in Germany who inherited immovable property in Portugal. The property was taxed on the basis of Portugal's law on tax on inheritance and donations on the value of the asset. The individual then sold the property but was not entitled to rely on favourable tax provisions in Portugal concerning her capital gain on the grounds that she was residing in another Member State.¹⁵³ The national legislation effectively made the transfer of capital less attractive for non-residents by deterring them from making investments in immovable property in Portugal as well as carrying out transactions related to those investments, such as selling immovable property. The ECJ maintained that this constituted a restriction on the movement of capital prohibited by Article 56 EC (now Article 63 TFEU).¹⁵⁴

For provisions of national law, such as those at issue *Hollman*, to be considered comparable with the provisions of the Treaty concerning free movement of capital the difference in treatment must concern situations which are not objectively comparable or be justified by overriding reasons in the public interest.¹⁵⁵ The ECJ found that the situation of residents and non-residents were not so different as to justify unequal tax treatment¹⁵⁶ nor could the Court accept that cohesion of the tax system could constitute a justification in the

¹⁴⁷ ECJ C-423/98 *Albore*, para. 18-19.

¹⁴⁸ *Ibid.*, para. 21.

¹⁴⁹ ECJ C-367/98 *Commission v Portugal*, para. 44.

¹⁵⁰ Mattias Dahlberg: *Direct Taxation in Relation to the Freedom of Establishment and the Free Movement of Capital*, p. 93-94.

¹⁵¹ Ben J. M. Terra and Peter J. Wattel: *European Tax Law*, p. 37.

¹⁵² Catharine Barnard: *The Substantive Law of the EU*, p. 590.

¹⁵³ ECJ C-443/06 *Hollman*, para. 10-14.

¹⁵⁴ *Ibid.*, para. 39-40.

¹⁵⁵ *Ibid.*, para. 45.

¹⁵⁶ *Ibid.*, para. 53.

public interest as there was no link between the tax advantage and the offsetting of that advantage by a particular tax levy.¹⁵⁷

6.1.2 Restrictions model

The ECJ has held that rules which are non-discriminatory, that is constitute neither direct nor indirect discrimination, breach Article 63(1) TFEU if they hinder access to the market unless they can be objectively justified.¹⁵⁸ For example, in ECJ C-98/01 *Commission v UK* the British Airports Authority had been privatised and a golden share created.¹⁵⁹ The Court held that while national rules limiting acquisition of shareholdings over a certain level applied without distinction to residents and non-residents, they nevertheless affected the position of a person acquiring a shareholding as such. In doing so the rules were liable to *discourage* investors from other Member States from making such investments and, as a result, accessing the market.¹⁶⁰ The formulation seen in *Commission v UK* comes close to the restrictions model the ECJ used in the other cases concerning golden shares, discussed in further detail below.¹⁶¹

The discrimination model can be difficult to apply to capital movement situations. Equating foreign nationals with foreign currency isn't logical now that the single currency, the Euro, has been adopted in many Member States. Perhaps for this reason, as well as a desire for convergence with the other freedoms, the court has increasingly used the restrictions model¹⁶² using language that indicates that the free movement of capital has a much wider scope than merely discriminatory rules.¹⁶³

In ECJ C-222/97 *Trummer and Meyer* the Court pointed out that rules prohibiting registration of a mortgage in the currency of another Member State could¹⁶⁴ reduce the effectiveness and attractiveness of such a security. Such rules were likely to have the effect of *dissuading* parties from denominating their debt in the currency of another Member State

¹⁵⁷ ECJ C-443/06 *Hollman*, para. 59-60.

¹⁵⁸ Catharine Barnard: *The Substantive Law of the EU*, p. 591.

¹⁵⁹ ECJ C-98/01 *Commission v UK*, para. 8.

¹⁶⁰ *Ibid.*, para. 47.

¹⁶¹ Catharine Barnard: *The Substantive Law of the EU*, p. 591.

¹⁶² *Ibid.*, p. 592.

¹⁶³ Jukka Snell: "Free Movement of Capital: Evolution as a Non-Linear Process", p. 554.

¹⁶⁴ ECJ C-222/97 *Trummer and Mayer*, para. 25.

depriving them of a right which constituted a part of the free movement of capital and payments.¹⁶⁵

The change towards a restrictions-based approach was most clearly signalled by the Golden Share cases where the Court employed the formulation it developed in ECJ C-76/90 *Säger* in the context of services.¹⁶⁶

Säger concerned a specialist in patent renewal services, Dennemeyer, providing services from the United Kingdom.¹⁶⁷ *Säger*, a German citizen, complained of unfair competition and a breach of German law in that Dennemeyer did not have a special licence under German law to perform his services. No such permit was needed in a significant number of Member States.¹⁶⁸ The question referred to the ECJ was essentially whether Article 59¹⁶⁹ of the EEC Treaty (now Article 56 TFEU) opposed national legislation prohibiting a company established in another Member State, from providing to the holders of patents in the national territory a service in respect of those patents, on the ground that the activity was reserved exclusively for persons possessing a particular professional qualification by virtue of that legislation, such as that of patent agent.¹⁷⁰ The ECJ stated:

It should first be pointed out that Article 59 of the Treaty requires not only the elimination of all discrimination against a person providing services on the ground of his nationality but also the abolition of any restrictions, even if it applies without distinction to national providers of services and to those of other Member States, when it is liable to prohibit or otherwise impede the activities of a provider of services established in another Member State where he lawfully provides similar services.¹⁷¹

The trend or tendency to privatise undertakings previously owned and controlled by the state and having them carry on economic activities of public importance, for instance energy supply, has led to safeguards to be adopted in the cases where joint private and public undertakings have been established. These safeguards are sometimes called *golden shares* as they attribute special rights to the government holding the share. Examples of such rights include the right to appoint directors, to veto certain decisions of the company or to restrict acquisition of a controlling interest in the company.¹⁷²

¹⁶⁵ In ECJ C-222/97 *Trummer and Mayer*, para. 26 the ECJ states: “The effect of national rules such as those at issue in the main proceedings is to weaken the link between the debt to be secured, payable in the currency of another Member State, and the mortgage, whose value may, as a result of subsequent currency exchange fluctuations, come to be lower than that of the debt to be secured.”

¹⁶⁶ Catharine Barnard: *The Substantive Law of the EU*, p. 592.

¹⁶⁷ ECJ C-76/90 *Säger*, para. 3.

¹⁶⁸ *Ibid.*, para. 5 and 8.

¹⁶⁹ The provisions on the free movement of services is now contained in Article 56 TFEU, albeit with amendments.

¹⁷⁰ ECJ C-76/90 *Säger*, para. 11.

¹⁷¹ *Ibid.*, para. 12.

¹⁷² Alan Dashwood et al.: *Wyatt and Dashwood's European Union Law*, p. 664-665.

Governments argued in several golden share cases that legislation at issue in the proceedings was not discriminatory as it applied without distinction on grounds of nationality and therefore did not amount to a restriction on the free movement of capital.¹⁷³ The Court has pointed out that Article 73b EC (Article 63 TFEU) lays down a general prohibition on restrictions on the movement of capital between Member States which goes beyond mere elimination of unequal treatment on grounds of nationality. Even though golden share rules might not be considered to constitute unequal treatment they were liable to impede acquisition of shares in undertakings with golden shares and deter investors in other Member States from investing in those undertakings and therefore they were likely to render the free movement of capital illusory.¹⁷⁴ Further, the Court has held that rules which limit acquisition of shareholdings or restrict in some other way the scope for participating effectively in the management of a company or in its control, such as a system of prior approval, constitute a restriction on the free movement of capital.¹⁷⁵

When discussing golden shares it is useful to look to the explanatory notes to Annex I of Directive 88/361/EEC. These explanatory notes define *direct investment* as investments of all kinds by natural persons or commercial, industrial or financial undertakings which serve to establish or maintain lasting and direct links between the persons providing the capital and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity. Therefore, the concept of direct investment must be understood in its widest sense. The explanatory notes further state that in regards to undertakings which have the status of companies limited by shares the nature of direct investment includes an element of participation in that where the block of shares held by a natural person of another undertaking or any other holder, the shareholder is enabled to participate effectively in managing the company or in its control, either pursuant to the provisions of national law.

One instance of an golden share can be found in ECJ C-58/99 *Commission v Italy* which concerned provisions of Italian legislation providing for acceleration of the procedures for the sale of shareholdings held by the State and public bodies in joint stock companies and the decrees concerning the “special powers” laid down in the case of the privatisation of two companies¹⁷⁶ in the energy and petrochemical sectors and the telecommunications sector,

¹⁷³ ECJ C-98/01 *Commission v United Kingdom*, para. 42.

¹⁷⁴ ECJ C-483/99 *Commission v France (Elf-Aquitaine)*, para. 40-41. See also ECJ C-112/05 *Commission v Germany*, para. 19.

¹⁷⁵ ECJ C-98/01 *Commission v United Kingdom*, para. 44.

¹⁷⁶ ECJ C-58/99 *Commission v Italy*, para. 1.

respectively.¹⁷⁷ These special powers provided that the President of the Council of Ministers was to determine by a decree in which companies, controlled directly or indirectly by the State and operating in certain sectors, a provision must be inserted in the statute before the adoption of any measure resulting in the loss of control. Such a provision would have to be inserted by decision taken at an extraordinary general meeting and would confer on the Minister for the Treasury one or more “special powers” which included the power to grant express approvals, a power to appoint a minimum of one or several directors and an auditor as well as the right to veto certain decisions.¹⁷⁸

The Commission argued in *Commission v Italy* that such special powers were liable to hinder or render the exercise of the fundamental freedoms guaranteed by the EC Treaty less attractive and that they must satisfy four conditions: firstly, that they must apply in a non-discriminatory manner; secondly, that they must be justified by overriding considerations in the general interest; thirdly, that they must be appropriate for ensuring that the objective which they pursue is achieved; and lastly, to not go beyond what is necessary in order to achieve that objective. Because there was no evidence in the case that these conditions were met and that the special powers as a result, conferred to the Italian authorities a potential to discriminate which they might use in an arbitrary manner, the Commission held that these special powers were incompatible with Articles 73b EC (now Article 63 TFEU).¹⁷⁹ The reasoning of the ECJ amounted to no more than reciting the Commission’s views and considering that it did not add nor subtract anything from the Commission’s view one can assume the Court was of the same opinion. The conditions listed by the Commission are the same ones set forth in ECJ C-55/94 *Gebhard* mentioned above in Chapter 2.3.

In the following four cases the Commission successfully upheld its view that special shares had amounted to restriction on capital movement except in the case against Belgium where the Court found that the restrictions were justified. The cases also highlight the Court’s assessment of the public interest justifications the Member States put forth as well as the principle of proportionality in regard to those justifications.

In ECJ C-483/99 *Commission v France (Elf-Aquitaine)* French legislation had vested a golden share on the French Republic in Société Nationale Elf-Aquitaine¹⁸⁰, a company operating in the energy sector.¹⁸¹ The legislation stated that any shareholding, direct or

¹⁷⁷ ECJ C-58/99 *Commission v Italy*, para. 5-6.

¹⁷⁸ *Ibid.*, para. 3.

¹⁷⁹ *Ibid.*, para. 13.

¹⁸⁰ ECJ C-483/99 *Commission v France (Elf-Aquitaine)*, para. 1.

¹⁸¹ *Ibid.*, para. 15.

indirect, held by a natural or legal person, acting alone or in conjunction with others, which exceeded the ceiling of one tenth, one fifth or one third of the capital or of voting rights in the company must first be approved by the Minister for Economic Affairs. The legislation also stated that the French Republic had a right to oppose any decision to transfer or to use as security the assets listed in the annex to the legislation.¹⁸² The French government argued that the restrictions that might result from the contested legislation were justified due to public security and overriding requirements of the general interest, namely that availability of petroleum products in the event of a crisis would be guaranteed.¹⁸³ The ECJ pointed out that certain concerns might justify retention by Member States of a degree of influence within undertakings that were initially public and subsequently privatised where those undertakings were active in fields of provision of services in the public interest or strategic services. However, the Court stated that such concerns could not entitle a Member State to plead their own system of property ownership by way of justification for obstacles resulting from privileges attaching to their position as shareholders in a privatised undertaking to the exercise of the freedoms provided for by the Treaty. Further, Article 222 of the EC Treaty (now Article 345 TFEU)¹⁸⁴ did not have the effect of exempting the Member States' systems of property ownership from the fundamental rules of the Treaty.¹⁸⁵ While the objective of safeguarding the supplies of petroleum products in the event of a crisis undeniably fell within the scope of a legitimate public interest, the requirements of public security as a derogation from the fundamental principle of free movement of capital must be interpreted strictly so that their scope could not be determined independently by each Member State without any control by the European Union institutions. Therefore, public security could only be relied on if there was a genuine and sufficiently serious threat to a fundamental interest of society.¹⁸⁶ The Court considered that the conditions for applying the special powers were too generally worded for individuals to estimate the extent of their rights and obligations deriving from Article 73b EC (Article 63 TFEU). The ECJ felt that the golden share left too much discretion to France and therefore constituted a serious interference with the free movement of capital possibly having the effect of excluding it altogether and consequently the system of the French legislation

¹⁸² ECJ C-483/99 *Commission v France (Elf-Aquitaine)*, para. 1.

¹⁸³ *Ibid.*, para. 27-28.

¹⁸⁴ Article 345 TFEU: "This Treaty shall in no way prejudice the rules in Member States governing the system of property ownership."

¹⁸⁵ ECJ C-483/99 *Commission v France (Elf-Aquitaine)*, para. 43-44.

¹⁸⁶ *Ibid.*, para. 47-48.

clearly went beyond what was necessary in order to attain the objective pursued by the French Government.¹⁸⁷

Similarly in ECJ C-98/01 *Commission v United Kingdom* and ECJ C-112/05 *Commission v Germany* the Court found that the UK and Germany had failed to fulfil their obligations pursuant to the Treaty provisions on free movement of capital. In *Commission v United Kingdom* the government held a golden share in a company after it was privatised and the rules of which limited the possibility of acquiring voting shares in a company as well as maintaining the procedure of requiring consent for the disposal of the company's assets, to control of its subsidiaries and to winding-up.¹⁸⁸ The United Kingdom's Government argued that the measures did not restrict access to the market within the meaning of the rule developed in ECJ C-267/91 *Keck and Mithouard* judgement¹⁸⁹, but the Court said that the measures were not compatible to rules concerning selling arrangements, which were the subject of *Keck and Mithouard*.¹⁹⁰ The ECJ held that while the restrictions in *Commission v United Kingdom* on investment operations applied without distinction to both residents and non-residents, they affected the position of a person acquiring a shareholding as such and therefore they were liable to deter investors from other Member States from making such investments. Consequently, they might affect access to the market.¹⁹¹

In *Comission v Germany* the German Government was considered to have failed to fulfil its duties according to the EC Treaty by maintaining in force legislation, the so called VW Law, regarding the privatisation of equity in the Volkswagenwerk limited company. The provisions of the law included stipulating that voting rights of a shareholder, whose shares represented more than one fifth of the share capital, should be limited to the number of votes granted by the par value of share equivalent to one fifth of the share capital as well as that at a general meeting no person might exercise a voting right which corresponded to more than one fifth of the share capital.¹⁹² The German Government maintained that there was no national measure, as the VW Law was based on an agreement entered into between individuals and groups claiming rights in respect of the Volkswagenwerk company at that time.¹⁹³ The Court pointed out that exercise of legislative power by the national authorities authorised according to that end was proof of State power and further pointed out that the provisions of the

¹⁸⁷ ECJ C-483/99 *Commission v France (Elf-Aquitaine)*, para. 50-51.

¹⁸⁸ ECJ C-98/01 *Commission v United Kingdom*, para. 8-10.

¹⁸⁹ *Keck and Mithouard* is discussed in Chapter 2.3 above.

¹⁹⁰ See Chapter 2.3.

¹⁹¹ ECJ C-98/01 *Commission v United Kingdom*, para. 47.

¹⁹² ECJ C-112/05 *Commission v Germany*, para. 5-6.

¹⁹³ *Ibid.*, para. 22.

contested law could no longer be amended solely at the will of the parties to the initial agreement. Therefore, the Court rejected the arguments that the VW Law was not a national measure for the purposes of the free movement of capital.¹⁹⁴

ECJ C-503/99 *Commission v Belgium* concerned a golden share in two companies, one operating in energy and the other in energy transport.¹⁹⁵ The ECJ's reasoning in the judgement is essentially the same as in *Commission v France* up until evaluating if the legislation in question enabling the Member State to pursue its objective and whether or not it went beyond what was necessary for that purpose. In *Commission v Belgium* the ECJ found that the Commission had not shown that less restrictive measures could have been taken to attain the objective pursued. The ECJ considered that the decrees were justified and dismissed the Commission's application concerning Article 73b EC (Article 63 TFEU).¹⁹⁶

Regarding the case law on golden shares some scholars have advocated a discrimination-based approach to prevent possible overextension in the field. They point to past history of overextension in the field of free movement of goods as well as the fact that potential litigants in the field of capital movements are likely to be corporations with means, interest and sufficient resources to bring test cases.¹⁹⁷ In the golden share cases the ECJ has had to deal with national measures whose aim is to retain a degree of public control over privatised undertakings. While the Member States have argued that the rules apply without distinction on ground of nationality and therefore do not restrict capital movements,¹⁹⁸ the ECJ has maintained that the rules are liable to impede and dissuade capital movements and therefore constitute restrictions despite no unequal treatment.¹⁹⁹

6.3 Territorial Scope

The European Union's external policy regarding capital movement has understandably changed over time. While the Treaty of the European Economic Community did not set an objective for capital movements with third countries, merely encouraging Member States to coordinate their capital movements with third countries, the Maastricht Treaty installed a clear principle for the common policy in matters of capital movements with third countries. In principle *external* movements of capital need to be fully free, much like *internal*

¹⁹⁴ ECJ C-112/05 *Commission v Germany*, para. 27-29.

¹⁹⁵ ECJ C-503/99 *Commission v Belgium*, para. 27-28.

¹⁹⁶ *Ibid.*, para. 53.

¹⁹⁷ Jukka Snell: "And Then There Were Two: Products and Citizens in Community Law", p. 66.

¹⁹⁸ ECJ C-463/00 *Commission v Spain*, para. 55 and ECJ C-98/01 *Commission v UK*, para. 42.

¹⁹⁹ ECJ C-463/00 *Commission v Spain*, para. 61 and ECJ C-98/01 *Commission v UK*, para. 47.

movements.²⁰⁰ Article 63(1) TFEU not only applies in respect of movement of capital, between the individual Member States but also states that restrictions on movement between a Member States and third countries shall be prohibited. The free movement of capital has the same meaning in a third State context as in the context of movement within the EU and the concept of restriction is the same as it is in movement between Member States, at least in principle.²⁰¹ In abolishing capital restrictions between Member States and Third Countries, Article 63 TFEU differs from the other freedoms. The EU also promotes adoption of liberal policies by third countries as well in order to obtain symmetry in its external relations.²⁰²

The reasons for extending the territorial scope of this freedom can be many. Snell postulated three reasons for the extension of the territorial scope. Firstly, that the free movement of capital between Member States would undermine capital controls towards third countries, investors would simply enter or exit the EU by the most liberal jurisdiction to access the target state. Secondly, the credibility of the single currency would increase by liberalization. Thirdly, the erga omnes effect arguably contributes to the principle of an open market economy expressed in Article 119 TFEU.²⁰³

Despite the wording of Article 63 TFEU, that movement of capital is free between Member States and third countries, in reality the issue is not quite so clear-cut. According to Article 64(2) TFEU the EU may regulate the movement of capital to or from third countries involving direct investment. According to Article 66 TFEU the EU may adopt safeguard measures with regard to the freedom of capital movement with third countries in exceptional circumstances if movements of capital cause or threaten to cause serious difficulties for the operation of the Economic and Monetary Union. Furthermore, Article 75 TFEU provides recourse when necessary to achieve the objectives regarding the prevention and combating of terrorism and related activities.

²⁰⁰ Willem Molle: *The Economics of European Integration*, p. 124.

²⁰¹ Ben J. M. Terra and Peter J. Wattel: *European Tax Law*, p. 52.

²⁰² Willem Molle: *The Economics of European Integration*, p. 124.

²⁰³ Jukka Snell: "Free Movement of Capital: Evolution as a Non-Linear Process", p. 564. Article 119 TFEU reads: "1 For the purposes set out in Article 3 of the Treaty on European Union, the activities of the Member States and the Union shall include, as provided in the Treaties, the adoption of an economic policy which is based on the close coordination of Member States' economic policies, on the internal market and on the definition of common objectives, and conducted in accordance with the principle of an open market economy with free competition.

2. Concurrently with the foregoing, and as provided in the Treaties and in accordance with the procedures set out therein, these activities shall include a single currency, the euro, and the definition and conduct of a single monetary policy and exchange-rate policy the primary objective of both of which shall be to maintain price stability and, without prejudice to this objective, to support the general economic policies in the Union, in accordance with the principle of an open market economy with free competition.

3. These activities of the Member States and the Union shall entail compliance with the following guiding principles: stable prices, sound public finances and monetary conditions and a sustainable balance of payments."

In ECJ C-452/01 *Ospelt* the ECJ held that measures which entailed a restriction on the free movement of capital might be permissible if they fulfilled certain conditions. The first condition being that the restrictions would be pursued in a non-discriminatory way an objective in the public interest and the second that the restriction was appropriate for ensuring that the aim pursued was achieved by not going beyond what was necessary for that purpose. In cases of prior authorisation, such as in *Ospelt*, the Court maintained that such measures must be based on objective criteria known in advance and would allow all persons affected by a restrictive measure of that type to have a legal remedy available to them.²⁰⁴

In his Opinion in *Ospelt*, Advocate General Geelhoed emphasized the importance of free movement of capital for the functioning of the other freedoms, not only as a condition for the internal market but that it also emphasizes the principle of an open market economy with free competition. Geelhoed wrote that, although this open market economy was not restricted by the physical borders of the territory of the EU, this did not mean that the free movement of capital had the same effect both within and outside of the Union. Within the European Union the Treaty provisions on free movement of capital had direct effect and the freedom was virtually complete while exceptions existed which could be applied to free movement of capital to third countries.²⁰⁵ While Article 63 TFEU did not draw distinction between movements of capital within the Union and to third countries that did not mean that the prohibition on restrictions had the same effect in both situations.²⁰⁶

In his opinion in ECJ C-446/04 *FII Group Litigation* Geelhoed noted that restrictions on free movement of capital to third countries were, in principle, prohibited according to the wording of Article 56(1) EC (now Article 63(1) TFEU). In analysing whether such restrictions were justified, be it on the grounds of Article 58(1) EC (Article 65(1) TFEU) or the discrimination analysis under Article 56 EC (Article 63 TFEU), different considerations might apply in situations concerning movements to third countries than situations of movements within the EU. Geelhoed referred to his opinion in *Ospelt* where he pointed out the difference concerning movement within the EU on one hand and movements of capital to third countries, namely that the European Central Bank sets monetary policy for the Economic and Monetary Union which presupposes complete unity in the movement of money and capital. While capital movements had been liberalised to a large extent worldwide the context was not the same as within the EU. Therefore Member States might be able to prove

²⁰⁴ ECJ C-452/01 *Ospelt*, para. 34.

²⁰⁵ Opinion of Advocate General Geelhoed on ECJ C-452/01 *Ospelt*, para. 33-35.

²⁰⁶ *Ibid.*, para. 40.

that restrictions of capital movements with third countries were justified in circumstances where it would not amount to a valid justification in intra-EU capital movements.²⁰⁷

In ECJ C-101/05 *A* several countries voiced their concerns and argued that the concept of restrictions on the free movement of capital could not be interpreted identically with regard to movements between Member States and third countries to its interpretations as regards relations between Member States. Germany, France and the Netherlands advanced that compliance with the prohibition laid down in Article 56(1) EC (now Article 63(1) TFEU) would lead to unilateral liberalisation by the European Union without securing a similar guarantee on the part of third countries concerned and without harmonisation measure of national provisions for these countries. Germany and the Netherlands held that if free movement of capital were interpreted identically as to relations within the EU and to movement between Member States and third countries that would deprive the EU of being able to negotiate liberalisation with those third countries.²⁰⁸

In *A* the ECJ simply stated that while the objectives of the liberalisation of movement of capital to third countries might be different than establishing the internal market, it was clear that when the principle was extended to movement of capital between third countries and the Member States the Member States themselves decided to enshrine it in Article 73b(1) EC (Article 63(1) TFEU) in the same terms as the principle of movement of capital between the Member States.²⁰⁹

Despite the wording of Article 63 TFEU, however, it is clear in reading the rest of the provisions in Chapter 4 of the TFEU that movements of capital and payments between Member States and third countries are more limited than Article 63 TFEU implies. Besides the express and general derogations found in Article 65 TFEU the free movement of capital and payments to third countries are subject to four further potential restrictions.²¹⁰ The first of these is *historic* as Article 64(1) TFEU exempts restrictions existing on December 31, 1993 on four types of free movement of capital pursuant to EU or national law. These four types of capital movements are direct investment (including in real estate), establishment, the provision of financial services and the admission of securities to trade on capital markets. The second restriction is *potential* as Article 64(2) TFEU enables the Council to adopt measures on the same four types of movement of capital to and from third countries. The third restriction concerns *balance of payments* as Article 66 TFEU allows the Council to take

²⁰⁷ Opinion of Advocate General Geelhoed on ECJ C-446/04 *FII Group Litigation*, para. 121.

²⁰⁸ ECJ C-101/05 *A*, para. 29-30.

²⁰⁹ *Ibid.*, para. 31.

²¹⁰ Catharine Barnard: *The Substantive Law of the EU*, p. 585.

safeguard measures concerning capital movements to and from third countries for periods up to six months if such a measure is strictly necessary.²¹¹ The fourth restriction is *political* in that Article 75 TFEU allows the European Parliament and the Council to define a framework for administrative measures concerning capital or payments, such as freezing of funds, financial assets or economic gains belonging to, or owned or held by, natural or legal persons, groups or non-State entities.²¹²

7. Derogations

Article 65 TFEU contains derogations which enable the Member States to generally limit capital movements and justify discrimination. Article 65(1) TFEU contains two express derogations, one specific and one general. The specific one in Article 65(1)(a) TFEU concerns the Member States' right to tax while Article 65(1)(b) TFEU, which replicates Article 4 of Directive 88/361/EEC, contains the general derogation.²¹³ The provisions in paragraphs 1 to 3 came into the Treaty with the Maastricht Treaty as then Article 73d while paragraph 4 was inserted with the Lisbon Treaty.

The TFEU sends a slightly mixed message with Article 65(1) TFEU in that Article 65(1)(a) permits Member States to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested, while Article 65(1)(b) allows them among other things to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions. The reason for this is that the Member States wanted both free movements of capital, established in Article 63 TFEU, and to retain their national tax autonomy. Following the general move towards more market oriented economic policies and the aim of European Monetary Union they were content to see the capital movements liberalized but did not want their tax policies interfered with.²¹⁴

²¹¹ Steve Peers: "Free Movement of Capital: Learning Lessons or Slipping on Spilt Milk?", p. 335-336.

²¹² Catharine Barnard: *The Substantive Law of the EU*, p. 585-586.

²¹³ *Ibid.*, p. 605-606.

²¹⁴ Jukka Snell: "Free Movement of Capital: Evolution as a Non-Linear Process", p. 551-552.

7.1 Article 65(1)(a) TFEU

The derogation found in Article 65(1)(a) TFEU allows Member States to continue distinguishing between taxpayers according to their place of residence or where their capital is invested. More precisely, the subparagraph states:

The provisions of Article 63 shall be without prejudice to the right of Member States:

(a) to apply the relevant provisions of their tax law which distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested;

The provision must however be interpreted strictly and, as the Court emphasized in ECJ C-315/02 *Lenz*, does not mean that any tax legislation making a distinction between taxpayers on the grounds listed will automatically be considered to be compatible with the Treaty. The Court pointed out that the provision was limited by Article 73d(3) EC (Article 65(3) TFEU) which meant that the national provisions referred to in Article 73d(1) EC (Article 65(1)(a) TFEU) should not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 73b EC (Article 63 TFEU).²¹⁵ This is comparable to the second sentence of Article 36 TFEU concerning goods which states:

Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States.

For a difference in treatment not to be regarded as arbitrary for the purposes of Article 65(3) it must be objectively justified and the ECJ interprets this requirement strictly. For instance in ECJ C-512/03 *Blanckaert* the Court said that while unequal treatment was permitted under Article 58(1)(a) EC (Article 65(1)(a) TFEU) it must be distinguished from arbitrary discrimination, forbidden under Article 58(3) EC (Article 65(3) TFEU). The Court then pointed out that according to case law a national provision could be regarded as compatible with the free movement of capital provisions of the Treaty if the difference in treatment applied to situations which were not objectively comparable or if the national provision was justified by overriding reasons in the general interest.²¹⁶ For the purposes of such disputes, the Court first considers whether the two groups of taxpayers are comparable and if it finds them to be so it then moves onto ascertaining whether the restriction can be justified by an overriding reason in the general interest.²¹⁷

The ECJ will decide whether residents and non-residents are in a comparable position or not, and whether there has been discrimination. For instance in ECJ C-374/04 *Test claimants*

²¹⁵ ECJ C-315/02 *Lenz*, para. 26. See also ECJ C-376/03 *D*, para. 25.

²¹⁶ ECJ C-512/03 *Blanckaert*, para. 42.

²¹⁷ ECJ C-35/98 *Verkooijen*, para. 46.

in class IV of the ACT Group litigation the Court said that in order to determine whether a difference in tax treatment was discriminatory it was necessary to consider whether the companies were in an objectively comparable situation.²¹⁸

Regarding the potential of a national provision being justified where it applies to situations which aren't objectively comparable one can look to ECJ C-376/03 *D*. The ECJ held that, as regards income tax, the situation of a resident was different from that of a non-resident because the major part of his income was normally concentrated in the state of residence. Therefore, the state had all the information needed to assess the taxpayer's overall ability to pay when his personal and family circumstance had been taken into account.²¹⁹ From this the ECJ concluded that the fact that a Member State did not grant certain tax benefits to a non-resident which it granted to residents was usually not discriminatory since the two categories of taxpayers were not in a comparable situation.²²⁰

However, this Court also held in *D* that the situation can be different if the non-resident received no significant income in his Member State of residence but obtained the majority of his taxable income from an activity performed in the state of employment, with the result that the state of residence was not in a position to grant him benefits that resulted from taking into account his personal and family circumstances. When this was the case there was no objective difference between such a non-resident and a resident engaged in comparable employment that justified different treatment with respect to taking account of the taxpayer's personal and family circumstances for taxation purposes.²²¹ Therefore the Court allowed a Member State to grant a benefit to a non-resident subject to the condition that at least 90% of their worldwide income must be subject to tax in that state.²²²

The ECJ has held that a Member State can apply a tax to income regardless of it being taxed in another Member State. As a consequence, double taxation is not contrary to the TFEU provisions on free movement of capital.²²³ See for instance in this respect judgement ECJ C-513/04 *Kerckhaert and Morres* where the ECJ held that Article 73b(1) EC (Article 63(1) TFEU) did not preclude legislation of a Member State which, in the context of income tax, made dividends from shares in companies established in the territory of that State and dividends from shares in companies established in another Member State subject to the same

²¹⁸ ECJ C-374/04 *Test claimants in class IV of the ACT Group litigation*, para. 46.

²¹⁹ ECJ C-376/03 *D*, para. 27.

²²⁰ *Ibid.*, para. 28.

²²¹ *Ibid.*, para. 29.

²²² *Ibid.*, para. 30.

²²³ Paul Craig, Gráinne de Búrca: *EU Law*, p. 695.

uniform rate of taxation, without providing for the possibility of setting off tax levied by a deduction in that other Member State.²²⁴

The ECJ has limited the exceptions in Article 65(1)(a) TFEU. ECJ C-35/98 *Verkooijen* was a judgement concerning tax law in the Netherlands which exempted shareholders from income up to a certain amount on dividends so long as the company paying the dividends was also established in the Netherlands.²²⁵ The Netherlands, and several other Member States which submitted observation, pointed out that even if such a provision constituted a restriction, the Court would have to take into account Treaty rules which had then entered into force, especially the provision of Article 73d(a)(1) EC (Article 65(1)(a) TFEU).²²⁶ The ECJ however pointed out that it had already upheld the rule codified in Article 73d(a)(1) EC in its earlier case law. The Court stated that according to that case law, before the entry into force of Article 73d(a)(1) EC, “national tax provisions of the kind to which that article refers, in so far as they establish certain distinctions based, in particular, on the residence of taxpayers, could be compatible with Community law provided that they applied to situations which were not objectively comparable [...] or could be justified by overriding reasons in the general interest, in particular in relation to the cohesion of the tax system.” Furthermore, Article 73d(a)(1) EC was subject to the provision in Article 73d(3) EC (Article 65(3) TFEU) which stated that national provisions cannot constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital.

The Court, in *Verkooijen*, therefore considered Article 73d(a)(1) EC as merely a codification of its earlier case law in ECJ C-279/93 *Schumacker*, ECJ C-204/90 *Bachmann* and ECJ C-300/90 *Commission v Belgium*.²²⁷ As a result of this the ECJ simply applied its normal test in examining whether the restriction could be objectively justified by any overriding reason in the general interest.²²⁸ In that the Court rejected arguments of the Netherlands et al. that the provision was justified by the need to preserve the cohesion of the Netherlands’ tax system²²⁹, reasoning that no direct link existed between the tax advantage and the offsetting levy²³⁰, as well as pointing out that unfavourable tax treatment could not be justified by existence of other tax advantages.²³¹

²²⁴ ECJ C-513/04 *Kerckhaert and Morres*, para. 24.

²²⁵ ECJ C-35/98 *Verkooijen*, para. 24.

²²⁶ *Ibid.*, para. 37.

²²⁷ *Ibid.*, para. 43-44.

²²⁸ *Ibid.*, para. 46.

²²⁹ *Ibid.*, para. 55-56.

²³⁰ *Ibid.*, para. 58.

²³¹ *Ibid.*, para. 61.

ECJ C-204/90 *Bachmann* concerned a German national working in Belgium and Belgium's refusal to allow him deduction from his total occupational income of contributions paid in Germany pursuant to sickness and invalidity insurance contracts and life assurance contracts which were concluded before he arrived in Belgium. The refusal was based on legislation which provided that only voluntary sickness and invalidity insurance contributions which were paid to a mutual insurance company recognized by Belgium and pension and life insurance contributions paid in Belgium could be deducted from occupational income.²³² Belgium held that the measures were necessary to ensure the cohesion of the tax system.²³³ The ECJ considered that the provisions were contrary to the free movement of workers and the freedom to provide services but that they might be justified by the need to preserve the cohesion of the tax system and that such legislation was not contrary to Article 67(1) EEC (now Article 63(1) TFEU).²³⁴

In ECJ C-279/93 *Schumacker* the ECJ recognized that the situation of residents and non-residents was not generally comparable in relation to direct taxes²³⁵ but that the position was different in cases where the non-resident obtained the major part of his taxable income from an activity performed in the State of employment and no significant income in his Member State of residence. If this were the case the Member State of residence would not be in a position to grant him benefits resulting from taking into account his personal and family circumstances. In such situations there would be no difference between a resident and a non-resident that could justify difference in treatment.²³⁶ The Member States submitted that the discrimination could be justified by reason of cohesion of the tax system as there was a link between taking into account family circumstances and the right to tax worldwide income, which only the Member State of residence could do. Therefore the Member State of employment would not have to take personal and family circumstances into account as that would mean that the individuals circumstances were taken into account twice and that he would enjoy parallel tax benefits in both Member States.²³⁷ The ECJ disagreed, maintaining that as the tax payable in the Member State of residence would be insufficient to enable it to take personal and family circumstances into account and therefore the Member State of employment would have to do so instead.²³⁸

²³² ECJ C-204/90 *Bachmann*, para. 2-3.

²³³ *Ibid.*, para. 17.

²³⁴ *Ibid.*, para. 35.

²³⁵ ECJ C-279/93 *Schumacker*, para. 31.

²³⁶ *Ibid.*, para. 36-37.

²³⁷ *Ibid.*, para. 40.

²³⁸ *Ibid.*, para. 41.

There is however, a difference between *Verkoijen* and *Schumacker* regarding the Court's assessment of compatibility. *Schumacker* concerned the free movement of workers and the Court considered the question of compatibility, at the stage of ascertaining whether there was a breach of Article 45 TFEU. In free movement of capital cases, however, the question is considered at the justification stage, after it has been established that there is a breach of Article 63 TFEU.²³⁹

The ECJ stressed the limited nature of the Article 65 TFEU derogations in²⁴⁰ ECJ C-367/98 *Commission v Portugal*, a case concerning a golden share situation. Portugal maintained that the system it had established was applicable without any discrimination based on the nationality of investors.²⁴¹ The Court did not agree and said that the prohibition of investors from other Member States to purchase more than a certain number of shares in certain Portuguese undertakings gave rise to discrimination incompatible with the provisions of the Treaty relating to free movement of establishment and of capital. This could only be justified on grounds of public policy, public security or public health, none of which were applicable in the case.²⁴² Likewise, rules requiring prior authorisation before purchasing an interest in a Portuguese undertaking above a certain level were also incompatible with the Treaty provisions.²⁴³ The Court maintained that these national provisions created obstacles to the free movement of capital within the EU, even though they were applicable without distinction, as they were liable to impede acquisition of shares in the undertaking concerned and dissuade investors in other Member States from investing in the capital of that undertaking.²⁴⁴ The Court yet again pointed out that the free movement of capital could only be restricted by national rules justified by reasons referred to in Article 73d(1) EC (now Article 65(1)(a) TFEU) or by overriding requirements of the general interest and which are applicable to all persons and undertakings pursuing an activity in the territory of the host Member State. In order for rules to be justified the national legislation must be suitable for securing the objective pursued and not go beyond what is necessary in order to attain it.²⁴⁵

A scheme of prior administrative authorisation, like the one at issue in *Commission v Portugal*, must be proportional, that is the objective could not be attained with less restrictive measures as well as be based on objective, non-discriminatory criteria known in advance to

²³⁹ Catharine Barnard: *The Substantive Law of the EU*, p. 608.

²⁴⁰ *Ibid.*, p. 607.

²⁴¹ C-367/98 *Commission v Portugal*, para. 18.

²⁴² *Ibid.*, para. 24.

²⁴³ *Ibid.*, para. 25.

²⁴⁴ *Ibid.*, para. 26.

²⁴⁵ *Ibid.*, para. 49.

the undertakings concerned and all persons affected by the restrictive measure must have a legal remedy available to them.²⁴⁶ The ECJ then goes on to point out that the financial interest of a Member State cannot constitute adequate justification as it is settled case-law that economic grounds cannot serve as justification for obstacles prohibited by the Treaty that is, unless such justifications fell somehow within the ambit of Article 73d(1) (Article 65(1)(a) TFEU) which relates in particular to tax law. The Court therefore refused to recognize the justification of economic policy objectives the Portuguese government maintained, namely that of choosing a strategic partner, strengthening the competitive structure of the market concerned or modernising and increasing the efficiency of means of production.²⁴⁷

Member States reacted to the jurisprudence concerning Article 65(1)(a) TFEU with some alarm, particularly to the full impact of the application of the internal market law in the field of taxation. There was tension between the idea of a single market and the territorially based national tax systems. According to free market provisions different treatment of residents and non-residents constitutes indirect discrimination on grounds of nationality, that is unless such difference in treatment can be justified. Likewise, countries usually tax residents on the basis of their worldwide income and non-residents on the basis of the income they have earned in the country. As Jukka Snell puts it “residence is a highly suspect distinguishing criterion in Union law, but the generally accepted distinguishing criterion in national and international tax law” seeing as national tax systems usually tax residents based on their worldwide income and non-residents based on their income which they have earned in the state of question. The Member States feared disintegration of their tax bases and made strong interventions, sometimes warning of disastrous revenue losses as a result. Support came from the international tax law community, which criticized the Court’s case law. The Court altered its course of jurisprudence, seemingly in response to the concerns of the Member States, in particular toning down the language of restrictions in the tax context. As a result Member States that had not successfully pleaded their cases before suddenly began to see their arguments taken notice of. Meanwhile the Member States sought to wrestle even more of the initiative into their hands by inserting a new article with the Lisbon Treaty. Article 65(4) TFEU certainly bears a certain resemblance to Article 108(2)(3) TFEU which allows the Member States to appeal to the Council to decide that state aid compatible with the internal market if such a decision is justified by exceptional circumstances.²⁴⁸

²⁴⁶ C-367/98 *Commission v Portugal*, para. 50.

²⁴⁷ *Ibid.*, para. 52.

²⁴⁸ Jukka Snell: “Free Movement of Capital: Evolution as a Non-Linear Process”, p. 552-553.

4. In the absence of measures pursuant to Article 64(3), the Commission or, in the absence of a Commission decision within three months from the request of the Member State concerned, the Council, may adopt a decision stating that restrictive tax measures adopted by a Member State concerning one or more third countries are to be considered compatible with the Treaties in so far as they are justified by one of the objectives of the Union and compatible with the proper functioning of the internal market. The Council shall act unanimously on application by a Member State.

Article 65(4) TFEU is notable because it places the Member States, through the Council, in a position to rule on the legality of national measures, something which is normally reserved for the Court, while Article 108(2)(3) TFEU merely replaces a decision of the Commission. In this, Article 65(4) TFEU goes even further than Article 108(2)(3) TFEU. The criterion “justified by one of the objectives of the EU and compatibility with functioning of the internal market” leaves the Council considerable discretion.²⁴⁹ That the Member States chose to include the Article in the Lisbon Treaty demonstrates a distrust of the Court on the part of the Member States when it comes to deciding on tax matters and their willingness to curtail the free movement of capital to and from third countries.²⁵⁰

7.2 Article 65(1)(b) TFEU

The express derogations found in Article 65(1)(b) TFEU contain both the standard public-policy/public-security derogations found elsewhere in the Treaty as well as special provisions concerning taxation which reflect the mandatory requirements on the effectiveness of fiscal supervision.²⁵¹ Article 65(1)(b) is as follows:

1. The provisions of Article 63 shall be without prejudice to the right of Member States:

(a) [...]

(b) to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information, or to take measures which are justified on grounds of public policy or public security.

Article 65(1)(b), which can be divided into two parts, is subject to Article 65(3): the restrictions cannot constitute a means of arbitrary discrimination. The first part of the Article covers the Article up until the reference to public policy and public security. The ECJ will

²⁴⁹ Article 263(4) TFEU reads: “Any natural or legal person may, under the conditions laid down in the first and second paragraphs, institute proceedings against an act addressed to that person or which is of direct and individual concern to them, and against a regulatory act which is of direct concern to them and does not entail implementing measures.”

²⁵⁰ Jukka Snell: “Free Movement of Capital: Evolution as a Non-Linear Process”, p. 553-554.

²⁵¹ Catharine Barnard: *The Substantive Law of the EU*, p. 606.

inquire closely before accepting this defence.²⁵² In ECJ C-451/05 *ELISA* the Court pointed to settled case-law in that a general presumption of tax avoidance or tax evasion cannot justify a fiscal measure which compromises the objectives of the Treaty. The Court said that prevention of tax evasion can only be used as justification if the applicable legislation is aimed at wholly artificial arrangements whose objective is to circumvent tax laws, making any general presumptions of tax evasion impossible.²⁵³

In joined cases ECJ C-358/93 and C-416/93 *Bordessa and others* the Court pointed out that although Article 65(1)(b) TFEU expressly refers to the requisite measures to prevent infringements of national law and regulations and points to taxation and prudential supervision of financial institutions as an example, the list is non-exhaustive and so it follows that other measures can be permitted in so far as they are designed to prevent illegal activities of comparable seriousness. The Court then lists money laundering, drug trafficking and terrorism as examples.²⁵⁴

The second part of Article 65(1)(b) TFEU contains a reference to public policy and public security. The ECJ has drawn on its jurisprudence on other freedoms when interpreting these terms. The Court interprets these exceptions narrowly and that the Member State has the burden of proof.²⁵⁵ The restriction must be justified in terms of pursuing an objective in the public interest referred to in Article 65(1) TFEU or by grounds of overriding public interest.²⁵⁶ The restriction must also be proportionate, if the same result can be achieved by other less restrictive measures, it will not be permitted.²⁵⁷ The national provisions must therefore be appropriate for securing the attainment of the objective pursued and not go beyond what is necessary in order to attain it.²⁵⁸

Article 65 TFEU overlaps other Treaty derogations as well as sharing some similarities with them. Due to this the ECJ has drawn on its case-law concerning the other freedoms when it interprets the derogations in Article 65 TFEU.²⁵⁹ Let us for instance look at two judgements, on one hand ECJ 203/80 *Casati* and on the other hand ECJ C-54/99 *Church of Scientology*. *Casati* concerned an Italian national living in Germany. Mr. Casati had brought with him money to Italy intending to buy equipment for his company. As the factory from which he

²⁵² Paul Craig, Gráinne de Búrca: *EU Law*, p. 697.

²⁵³ ECJ C-451/05 *ELISA*, para. 91.

²⁵⁴ ECJ C-358/93 and C-416/93 *Bordessa and others*, para. 21. Note, the judgement references Article 4 of Directive 88/361 on which Article 65(1)(b) is modelled.

²⁵⁵ Paul Craig, Gráinne de Búrca: *EU Law*, p. 697.

²⁵⁶ ECJ C-174/04 *Commission v Italy*, para. 35.

²⁵⁷ ECJ Joined cases C-515/99, 519/99 to C-524/99 and C-526/99 to C-540/99 *Reisch and others*, para. 33.

²⁵⁸ ECJ C-213/04 *Burtscher*, para. 44.

²⁵⁹ Catharine Barnard: *The Substantive Law of the EU*, p. 606.

intended to do business with was closed for the holidays he had to take the money back with him to Germany but was caught and criminal proceedings were instigated against him in Italy because he had not sought prior authorization for exporting the money from Italy, as was required by law for sums above a certain amount.²⁶⁰ Concerning the criminal proceedings brought against Mr. Casati, the ECJ said that criminal legislation and rules of criminal procedure were in principle matters that the Member States were responsible for. However, EU law set certain limits in the area regarding the control measures it permits the Member States to maintain in connection with the free movement of goods and persons. The Court said of such administrative measures or penalties that they “must not go beyond what is strictly necessary, the control procedures must not be conceived in such a way as to restrict the freedom required by the Treaty and they must not be accompanied by a penalty which is so disproportionate to the gravity of the infringement that it becomes an obstacle to the exercise of that freedom.”²⁶¹

Church of Scientology is an example of the ECJ relying on the free movement of persons case-law²⁶² when interpreting the concepts of public policy and public security of Article 65(1)(b) TFEU. The case concerned a system of requirement for foreign direct investment considered as a threat to public policy, public health or public security, established by France.²⁶³ The ECJ maintained that while the Member States were in principle free to determine the requirements of public policy and public security in the light of their national needs. However, those grounds must be interpreted strictly so as to ensure that the scope of derogations from free movement of capital were not decided unilaterally by each Member State without the EU institutions having any control. Member States can only rely on derogations based on public policy and public security if there is a genuine and sufficiently serious threat to a fundamental interest of society and those derogations may not be applied in such a way to serve purely economic ends. Moreover, persons who are affected by a restrictive measure based on a derogation such as this must have access to legal redress.²⁶⁴ Restrictive measures such as these can only be justified on the grounds of public policy or public security if they are necessary for the protection of the interests which they are intended to guarantee and only to the extent that those objectives cannot be attained by less restrictive

²⁶⁰ ECJ 203/80 *Casati*, para 2.

²⁶¹ *Ibid.*, para 27.

²⁶² Catharine Barnard: *The Substantive Law of the EU*, p. 611.

²⁶³ ECJ C-54/99 *Church of Scientology*, para. 13.

²⁶⁴ *Ibid.*, para. 17.

measures.²⁶⁵ The Court finally concluded that the system France had established for prior authorisation was contrary to the principle of legal certainty as investors were unable to know exactly in what circumstances such prior authorization was required.²⁶⁶

In ECJ C-423/98 *Albore* the Court relied on its case-law concerning the free movement of goods²⁶⁷ to define public security in the context of an Italian rule which required foreigners to have authorization prior to living in certain areas of military importance. The ECJ stated that “public security” included the external security of a Member State.²⁶⁸ The Court held that only a reference to the requirements of defence of the national territory could not justify discrimination on grounds of nationality. The Court went on to say that the position would be different only if the Government could demonstrate that non-discriminatory treatment of the nationals of all the Member States would expose the military interest of the Member State concerned to real, specific and serious risks which could not be countered by less restrictive procedures.²⁶⁹

In ECJ C-503/99 *Commission v Belgium* Belgium held that the objective of the legislation at issue was the safeguarding of energy supplies in the event of a crisis and that it fell within the scope of a legitimate public interest.²⁷⁰ The Court referenced its judgement ECJ C-72/83 *Campus Oil* wherein it had previously agreed that public-security consideration of ensuring a minimum supply of petroleum products at all times might justify an obstacle to the free movement of goods, remarking that the same reasoning applied to the free movement of capital as Article 73d(1)(b) EC (Article 65(1)(b) TFEU) allowed justification on the grounds of public security.²⁷¹ The Court has, however, interpreted derogations of free movement of capital based on public security strictly and such a justification may only be relied on if there is a genuine and sufficiently serious threat to a fundamental interest of society.²⁷² The Court found that the measures were proportionate, and that it was not shown that less restrictive measures could have been taken to attain the objective.²⁷³

The Court’s conclusion in ECJ C-503/99 *Commission v Belgium* in contrast to the its decision in ECJ C-483/99 *Commission v France (Elf-Aquitane)*, discussed in further detail above in chapter 6.1.2. In this case investors were given no indication whatsoever of what

²⁶⁵ ECJ C-54/99 *Church of Scientology*, para. 18.

²⁶⁶ *Ibid.*, para. 21-22.

²⁶⁷ Catharine Barnard: *The Substantive Law of the EU*, p. 611.

²⁶⁸ ECJ C-423/98 *Albore*, para. 18.

²⁶⁹ *Ibid.*, para. 21-22.

²⁷⁰ ECJ C-503/99 *Commission v Belgium*, para. 26.

²⁷¹ *Ibid.*, para. 46.

²⁷² *Ibid.*, para. 45-47.

²⁷³ *Ibid.*, para. 53.

specific, objective circumstances prior authorisation would be granted or refused making the system contrary to the principle of legal certainty. The ECJ remarked that wide discretionary powers seriously interfered with the free movement of capital and might even have the effect of excluding the freedom altogether. The Court considered that the system established by the Member State went beyond what was necessary in order to attain the objective.²⁷⁴

A case where the derogation in Article 65(1)(b) TFEU was successfully relied on is ECJ C-439/97 *Sandoz*. As mentioned above the case concerned a stamp duty imposed on loans contracted by resident borrowers from non-resident lenders. Austria claimed that the purpose of the stamp duty was to ensure that loans to Austrian residents were granted under the same conditions from the point of view of tax, irrespective of whether they were made by lenders residing in Austria or by lenders in other Member States. The Austrian tax authority said that otherwise loans granted by non-resident lenders in Austria or lenders in other Member States might escape duty because the documents pertaining to such loans were drawn up abroad and remained in the custody of the lender. Therefore, the overall purpose of the Austrian provisions at issue was to ensure equality of tax treatment of borrowers.²⁷⁵ The Court pointed out that the legislation in question applied without regard to the nationality of the parties or where the loan was contracted, to all natural and legal persons residing Austria who entered into a contract for a loan. The legislation prevented taxable persons from using the free movement of capital to evade requirements of domestic tax legislation since the effect of the measure was to compel persons to pay the duty. The ECJ therefore concluded that the legislation was essential in order to prevent infringement of national tax law and regulations as Article 73d(1)(b) EC (Article 65(1)(b) TFEU) provided.²⁷⁶ It is interesting to take a look at ECJ C-478/98 *Commission v Belgium* in the context of the result of *Sandoz*. *Commission v Belgium* concerned a prohibition of acquisitions by persons resident in Belgium of securities of a loan issued abroad.²⁷⁷ The Court considered that a “general presumption of tax evasion or tax fraud cannot justify a fiscal measure which compromises the objectives of a directive.” The Court further said that the measure at issue consisted of “an outright prohibition on the exercise of a fundamental freedom” guaranteed by Article 73b EC (Article 63 TFEU).²⁷⁸ By

²⁷⁴ ECJ C-483/99 *Commission v France (Elf-Aquitane)*, para. 50-51.

²⁷⁵ ECJ C-439/97 *Sandoz*, para. 15.

²⁷⁶ *Ibid.*, para. 24.

²⁷⁷ ECJ C-478/98 *Commission v Belgium*, para. 1.

²⁷⁸ *Ibid.*, para. 45.

this Belgium was considered to have failed to fulfil its obligations under Article 73b EC (Article 63 TFEU).²⁷⁹

Part II: the European Economic Area

8. The History of the EEA Agreement

The European Free Trade Association, EFTA, was founded by seven European countries in response to the formation of the European Economic Community (EEC) in 1958. These countries – Austria, Denmark, Norway, Portugal, Sweden, Switzerland and the United Kingdom – began exploring the possibility of a free trade agreement amongst themselves in early 1959. An agreement that was agreed in November 1959 and entered force on May 3, 1960.²⁸⁰

EFTA was intended as an alternative option to the European Union, involving economic co-operation without the political merger that seemed to be pursued within the Union. In accordance with this the goals of EFTA were limited to free trade on the basis of conventional international co-operation.²⁸¹ In 2001 an agreement amending the EFTA Convention was adopted. The Vaduz Convention, as it is sometimes referred to after the place where it was signed, strengthened the coherence in economic relations among the EFTA Member States and provided an improved common platform for developing their relations with trade partners around the world.²⁸²

With the founding of EFTA and the European Union two large trade blocks were established in Western Europe. These trade blocks made free trade agreements in the 1970s, yet these did not mean that all tariffs and restrictions on import were abolished.²⁸³ The EU was the most important trading partner of the EFTA States and vice versa.²⁸⁴ At this time the EFTA States mainly engaged in bilateral negotiations with the EU as EFTA did not involve a

²⁷⁹ ECJ C-478/98 *Commission v Belgium*, para. 48.

²⁸⁰ A Short Introduction to 50 Years of EFTA, p. 1.

²⁸¹ Sigurður Líndal, Skúli Magnússon: *Réttarkerfi Evrópusambandsins og Evrópska efnahagssvæðisins*, p. 115.

²⁸² A Short Introduction to 50 Years of EFTA, p. 1.

²⁸³ Sigurður Líndal, Skúli Magnússon: *Réttarkerfi Evrópusambandsins og Evrópska efnahagssvæðisins*, p. 115.

²⁸⁴ European Economic Area 1994-2009, p. 9.

common trade policy like the EU. The free trade agreements were therefore formally made between individual EFTA States on the one hand and the EU on the other.²⁸⁵

In 1984 negotiations began between EFTA and the Union on further enhancement of economic cooperation, in response to concerns about European competitiveness. From this sprung the idea of a European economic area. The result was the Luxembourg Declaration laying down a programme for development of future European economic cooperation.²⁸⁶ At the start of the 1990s EFTA still had several populous and economically stronger nations as members. At this time it was, however, clear that the European Union was overall stronger economically compared to EFTA.²⁸⁷

Since its founding, several changes in memberships of EFTA have been made. Iceland joined in 1970, Finland joined in 1986, after having been an associate member since 1961, and Liechtenstein joined in 1991. Other Member States left to become full members of the European Union; Denmark and the United Kingdom in 1973, Portugal in 1986 and Sweden, Austria and Finland in 1995.²⁸⁸

In 1989, Jacques Delors, then the President of the EC Commission, proposed a more structured partnership, with common decision-making and administrative institutions with the EFTA States. The EFTA States declared that they were ready to initiate negotiations with the Union leading to “the fullest possible realization of free movement of goods, services, capital and persons, with the aim of creating a dynamic and homogeneous European Economic Space.” Negotiations on the European Economic Area (EEA) began in 1990; the Agreement was concluded in 1992 and entered into force on January 1, 1994. The contracting parties were the EU States, Austria, Finland, Iceland, Norway and Sweden. Switzerland rejected EEA membership in a referendum in 1992 and instead concluded bilateral agreements with the EU. Liechtenstein became a member of the EEA on May 1, 1995.²⁸⁹ Before the EEA Agreement came into force four EFTA States had already applied for membership to the European Union. Austria, Finland and Sweden left EFTA in 1995 to join the EU. The three EFTA States participating in the EEA are therefore Norway, Iceland and Liechtenstein.²⁹⁰ The European Commission’s interest in the EEA Treaty diminished somewhat after Austria, Finland and Sweden left EFTA and its political and economic importance diminished.²⁹¹

²⁸⁵ Sigurður Líndal, Skúli Magnússon: *Réttarkerfi Evrópusambandsins og Evrópska efnahagssvæðisins*, p. 115.

²⁸⁶ A Short Introduction to 50 Years of EFTA, p. 1-2.

²⁸⁷ Sigurður Líndal, Skúli Magnússon: *Réttarkerfi Evrópusambandsins og Evrópska efnahagssvæðisins*, p. 115.

²⁸⁸ A Short Introduction to 50 Years of EFTA, p. 1.

²⁸⁹ *Ibid.*, p. 2.

²⁹⁰ Sigurður Líndal, Skúli Magnússon: *Réttarkerfi Evrópusambandsins og Evrópska efnahagssvæðisins*, p. 117.

²⁹¹ *Ibid.*, p. 118.

The aim of the EEA Agreement is to “promote a continuous and balanced strengthening of trade and economic relations between the Contracting Parties with equal conditions of competition, and the respect of the same rules, with a view to creating a homogeneous European Economic Area.”²⁹² A homogeneous EEA implies that individuals and economic operators should be treated in the same way throughout the EEA, this regardless of whether EU law or EEA rules are applied. Common rules does not ensure homogeneity, however. For homogeneity to be attained the rules must be interpreted and applied in a uniform manner throughout the EEA.²⁹³

The EEA Agreement extends the Internal Market of the EU to the three EEA EFTA States and as a result economic operators in those states can conduct business under the same legal framework as operators in the EU States as well as having the same rights and obligations in areas covered by the Agreement.²⁹⁴ The European Economic Area unites 27 EU Member States and the three EEA EFTA States in the Internal Market governed by the same basic rules aiming to establish that goods, services, capital and persons move freely about the European Economic Area in an open and competitive environment. As previously stated, these concepts are collectively referred to as the *Four Freedoms*.²⁹⁵ Relations between EU Member States continue to be governed by EU law while relations between EU Member States and EEA EFTA States, as well as relations between the EEA EFTA Member States, are governed by the EEA Agreement.²⁹⁶

It is important to note that the EEA EFTA States have not transferred any legislative competence to EEA institutions and that all decisions on the EEA EFTA side of the EEA Agreement are taken unanimously. The EEA Agreement did however establish bodies to match those on the EU side such as the EFTA Court, the EEA Council and the EFTA Surveillance Authority (ESA). Substantive decisions relating to the EEA Agreement and its obligations are a responsibility of the EU and the common bodies, such as the EEA Council and the EEA Joint Committee.²⁹⁷ The EEA Joint Committee is responsible for the management of the EEA Agreement being a forum for exchange of views and decision making by consensus to incorporate EU legislation into the EEA Agreement. The EEA

²⁹² Article 1 EEA.

²⁹³ Sven Norberg et al.: *EEA Law*, p. 177.

²⁹⁴ A Short Introduction to 50 Years of EFTA, p. 2.

²⁹⁵ The European Economic Area (EEA), p. 1.

²⁹⁶ Sven Norberg et al.: *EEA Law*, p. 180.

²⁹⁷ This is EFTA 2014, p. 18

Council is the political force for the development of the EEA Agreement, where the EEA EFTA States are represented by their foreign ministers.²⁹⁸

The main part of the EEA Agreement consists of 129 Articles but additionally there are 22 Annexes and 49 Protocols to the Agreement. Through the Annexes the acquis of the EU applicable to the EEA is adopted by a decision of the EEA Joint Committee. The provisions of the EU acquis taken into the EEA Agreement through the Annexes must be implemented by the EEA EFTA States at national level. The Protocols include provisions in specific areas, for instance that dualist Member States must introduce a statutory provision to incorporate EEA law into their domestic legal order and to the effect that EEA rules will prevail over a conflicting national provision where conflicts between EEA rules and other statutory provisions are possible.²⁹⁹

In order to achieve a homogeneous single market the Agreement provides that new EU legislation relating to the Internal Market shall be incorporated into the EEA Agreement through amendments to the Annexes and Protocols of the Agreement.³⁰⁰ Whenever an EEA-relevant legal act is amended or a new one adopted by the EU, a corresponding amendment should be made to the relevant Annex of the EEA Agreement. Such an amendment should ensure that the text on the EEA sides is as close as possible to the adopted legislation on the EU side. The EEA EFTA States can request for consultation on matters of concern as well as negotiate adaptations to EU legislation when this is called for by special circumstances and agreed on by both sides.³⁰¹

In the following chapters, the principle of homogeneity will be discussed in Chapter 9, before the main provisions on the free movement of capital will be observed in Chapter 10 as well as the provisions providing for derogations therefrom in Chapter 11. These will be compared with their counterparts in the TFEU. Iceland employed capital controls before joining the EEA³⁰², for instance having strict rules on the purchase of currency, obtaining loans and other capital movements³⁰³, in fact most of them were only abolished during 1990-1995³⁰⁴ one reason being the Agreement on the European Economic Area.³⁰⁵ A precondition for the free movement of capital in the EEA Agreement was the reorganization of the

²⁹⁸ This is EFTA 2014, p. 21

²⁹⁹ Protocol 35.

³⁰⁰ Article 102 EEA.

³⁰¹ The European Economic Area (EEA), p. 2.

³⁰² Sigurður Snævarr: *Haglýsing Íslands*, p. 425.

³⁰³ Hugrún Ösp Reynisdóttir: *Saga Viðskiptaráðuneytisins 1939-1994*, p. 172.

³⁰⁴ *Valkostir Íslands í gjaldmiðils- og gengismálum*, p. 291

³⁰⁵ Hugrún Ösp Reynisdóttir: *Saga Viðskiptaráðuneytisins 1939-1994*, p. 172.

Icelandic banking sector.³⁰⁶ Iceland's reprieve from capital controls turned out to be somewhat short lived as in 2008 capital controls were enacted in response to the financial crisis and the collapse of the three largest banks. These currency controls will be explored in Chapter 11, being as they are a major derogation from the EEA Agreement.

9. Homogeneity between EEA law and EU law

The EEA is essentially two joined economic areas intended to have the same rules, conditions of competition for individuals and economic operators and comparable rights and obligations for the EU and EEA contracting parties.³⁰⁷ The aim of the EEA Agreement is to create a homogeneous European Economic Area, set forth in Article 1 EEA as well as being mentioned in the Preamble to the Agreement. The fourth recital of the Preamble makes reference to the goal of establishing a dynamic and homogeneous European Economic Area based on common rules and equal conditions of competition. The fifteenth recital of the Preamble states that the objective of the Contracting Parties is to reach and maintain uniform interpretation and application of the EEA Agreement and the provisions in EU law which are substantially reproduced in the EEA Agreement.

Divergence between EU law and EEA law is compensated by the principle of homogeneity, one of the fundamental principles of the EEA Agreement. The principle of homogeneity entails that the rules that apply within the EEA and within the European Union's internal market be sufficiently uniform. To ensure this the EEA Agreement contains a number of provisions aimed at ensuring homogeneity, such as provisions on legislative and judicial homogeneity.³⁰⁸

Without the principle of homogeneity application and interpretation of common rules could develop along different lines and be applied differently within the EU and within the EEA.³⁰⁹ For the EEA to be homogeneous the two legal systems must develop in parallel and be applied and enforced in a uniform manner. To ensure homogeneity the EEA Agreement establishes a surveillance mechanism to ensure the fulfilment of obligations under the Agreement and a uniform interpretation and application of its provisions ('judicial

³⁰⁶ Hugrún Ösp Reynisdóttir: *Saga Viðskiptaráðuneytisins 1939-1994*, p. 173.

³⁰⁷ M. Elvira Méndez-Pinedo: *EC and EEA Law*, p. 32.

³⁰⁸ Titus van Stiphout: "Achieving Legal Homogeneity in the Field of Free Movement of Capital", p. 429.

³⁰⁹ Sven Norberg et al.: *EEA Law*, p. 183.

homogeneity’).³¹⁰ To this end the EFTA Surveillance Authority and the EFTA Court play an important part in the pursuit of homogeneity.

9.1 Legislative homogeneity

The EEA Agreement owes much of its success to its highly dynamic nature; that is the system of adding new and relevant EU legislation through decisions of the EEA Joint Committee. By doing this the constantly evolving *acquis* of the EU is integrated into the EEA Agreement. The EEA EFTA States have never used their formal right to block this continuous updating of EEA law.³¹¹

In regard to legislative homogeneity between EU and EEA law it is important to note that the dynamic nature of the EEA Agreement does not encompass the main part of the Agreement. Rather, Article 102 EEA stipulates that the Joint Committee may only amend its annexes. Updating the main parts of the Agreement can only be achieved through the process of treaty amendment, involving all 31 parties to the Agreement. The EEA EFTA States reportedly made enquiries in 2001 about the possibility of such an update of the Agreement, but the EU rejected this, citing more pressing tasks, such as the enlargement of the Union and the attempt to renegotiate a new Constitutional Treaty.³¹²

As a result of the EEA Agreement, not having a simplified mechanism to allow the rules in the main part of the EEA Agreement to develop in parallel with the rules of EU primary law, is still largely based on the EC Treaty resulting from the Single European Act. The EU Treaties have in the meantime, as covered in detail throughout this essay, been updated multiple times. This has resulted in claims of an increasing gap between the two systems, which some fear may undermine the goal of the EEA Agreement of creating a homogeneous European Economic Area.³¹³

Some scholars contend that the principle of homogeneity should not be understood in an absolute and dogmatic manner, arguing that it does not require the rules to be completely identical under the EEA Agreement and under the TFEU and that the rules only need to be *sufficiently uniform* in order to allow for the good functioning of the extended internal market,

³¹⁰ M. Elvira Méndez-Pinedo: *EC and EEA Law*, p. 94.

³¹¹ Halvard Haukeland Frederiksen: “Bridging the Widening Gap between the EU Treaties and the Agreement on the European Economic Area”, p. 869.

³¹² Halvard Haukeland Frederiksen: “Bridging the Widening Gap between the EU Treaties and the Agreement on the European Economic Area”, p. 870.

³¹³ Titus van Stiphout: “Achieving Legal Homogeneity in the Field of Free Movement of Capital”, p. 430.

insisting that this view is supported by the wording and structure of the EEA Agreement.³¹⁴ Article 102 EEA for instance stipulates that a decision needs only be taken as closely as possible to the adoption of the corresponding EU legislation. The phrase “as closely as possible” relates to the time at which the EU legislation has to be incorporated as well as the substance of the decision of the EEA Joint Committee in that, ideally, the EU act should be incorporated into the EEA Agreement, with as few adaptations as possible.³¹⁵

In default of a decision of the Joint Committee regarding an amendment of an annex for the incorporation of EU legislation, as prescribed in Article 102(1) EEC, the Contracting Parties to the EEA Agreement are to make all efforts to come to a “mutually acceptable solution”, as stated in Article 102(3) EEA, in case the subject matter falls within the competence of the legislator. Article 102(4) EEA even foresees the possibility of simply taking notice of the equivalence of legislation, as opposed to the incorporation of EU legislation into the EEA Agreement, if an agreement on the amendment on an annex cannot be reached. Thus, should absolute homogeneity not be achieved, the EEA Agreement regulates the situation. Otherwise, the degree of homogeneity that needs to be achieved is determined by what is necessary for the good functioning of the EEA Agreement.³¹⁶ The issue may however not be as simple as that where it concerns actual differences of provisions of the EEA Agreement and the TFEU.

Frederiksen points out that no signs have emerged suggesting that the changes made to EU primary law through the Lisbon Treaty have affected the ECJ’s ability to interpret the free movement provisions in the EEA Agreement in conformity with their corresponding provisions in the TFEU. He concludes that the changes made to EU primary legislation through the Maastricht, Amsterdam, Nice and Lisbon Treaties have not undermined the goal of dynamic homogeneity between the EEA Agreement and underlying EU law. However, Frederiksen also mentions ECJ Case C-540/07 *Commission v. Italy* as the first case where the ECJ concluded that differences in legal context between a provision in the EU Treaties and its corresponding provisions in the EEA Agreement rendered the goal of homogeneity unattainable.³¹⁷

In *Commission v. Italy* the ECJ found that Italy, by maintaining in force a tax regime for dividends distributed to companies established in the other Member States and the EEA

³¹⁴ Titus van Stiphout: “Achieving Legal Homogeneity in the Field of Free Movement of Capital”, p. 437-438. Stiphout refers to the EC Treaty, for the sake of coherence this has been amended to the TFEU.

³¹⁵ *Ibid.*, p. 438.

³¹⁶ *Loc. cit.*

³¹⁷ Halvard Haukeland Frederiksen: “Bridging the Widening Gap between the EU Treaties and the Agreement on the European Economic Area”, p. 874.

Member States less favourable than which applied to dividends distributed to resident companies, had failed to fulfil its obligations under Article 56 EC (now Article 63 TFEU)³¹⁸ but not Article 40 EEA.³¹⁹ The ECJ stated that Article 40 EEA and Annex XII to the EEA Agreement had the same legal scope as that of the substantially identical provisions of Article 56 EC.³²⁰ The ECJ held, however, that the restrictions on Article 40 EEA were justified by reasons of public interest³²¹ as Directive 77/799 establishing a framework of cooperation between competent authorities of the Member States in the field of direct taxation and taxation of insurance premiums did not exist between the EU and the EEA.³²² This case clearly indicates that dynamic interpretation by the Courts may not in itself remedy the failure to update the main part of the EEA Agreement.³²³

Several other judgements followed from the ECJ in all of which the ECJ held that lack of corresponding provisions to those now found in Directive 2011/16/EU meant that national rules which were in breach of EU law, could be justified under the EEA Agreement. It is clear therefore that application of the fundamental free movement rules in the main part of the EEA Agreement, interpreted in conformity with their corresponding provisions in EU law, may differ because of differences in the legal context. Frederiksen states that this appears to be unavoidable due to the fact that the scope of the EEA Agreement is more limited than that of EU law but also points out that as far as Directive 2011/16/EU is concerned the EEA EFTA States can remedy the lack of corresponding EEA rules through a separate agreement with EU States.³²⁴

9.2 Judicial homogeneity

The task of ensuring judicial homogeneity within the EEA falls chiefly to the EFTA Court, though it also involves the ECJ indirectly.³²⁵ The EFTA Court has been in existence for little over twenty years and during that time it has gained a reputation as a promoter of

³¹⁸ ECJ C-540/07 *Commission v. Italy*, para. 64.

³¹⁹ *Ibid.*, para. 75.

³²⁰ *Ibid.*, para. 66.

³²¹ *Ibid.*, para. 68.

³²² *Ibid.*, para. 70.

³²³ Halvard Haukeland Frederiksen: "Bridging the Widening Gap between the EU Treaties and the Agreement on the European Economic Area", p. 874.

³²⁴ *Ibid.*, p. 875.

³²⁵ M. Elvira Méndez-Pinedo: *EC and EEA Law*, p. 33.

homogeneity with the EFTA side of the EEA. The Court's promotion of homogeneity does not only deal with substantive provisions but also procedural issue.³²⁶

The ECJ was initially doubtful that homogeneity between EEA law and underlying EU law was possible, stating that divergence in aims and context of the EEA Agreement as opposed to EU law stood in the way of the objective of homogeneity in interpreting and applying the law in the EEA.³²⁷ However, as Frederiksen points out, the EFTA Court seems to have changed the ECJ's mind to the point where in ECJ C-452/01 *Ospelt* it stated that "it is for the Court [...] to ensure that rules of the EEA Agreement which are identical in substance to those of the Treaty are interpreted uniformly."³²⁸

Article 6 EEA and Articles 105 to 107 EEA concern aspects of judicial homogeneity. Article 6 states that in so far as rules of the EEA Agreement are identical in substance to corresponding rules of the EU treaties they shall, in their implementation and application, be interpreted in conformity with the relevant rulings of the ECJ which were given prior to the date of signature of the EEA Agreement. Article 6 also states that this obligation of confirmative interpretation is without prejudice to further developments of case law. It is also important to point out the second paragraph of Article 3 of the ESA/Court Agreement in this context which provides that the Court has to take due account of later case law. While the EFTA Court is only obliged to take into consideration case-law before the EEA Agreement was signed in reality it also takes note of later case-law in order to maintain homogeneity within the EEA, as the Court stated openly in EFTAC E-10/07 *L'Oreal*.³²⁹ The EFTA Court has therefore *effectively* eliminated the *temporal* limit of Article 6 EEA. The ECJ also follows this approach and continues to interpret EEA in line with its own case-law handed down after the signature of the EEA Treaty. As a result it has, up to this point, never been necessary for

³²⁶ Dóra Guðmundsdóttir: "B. EFTA Court", p. 2019.

³²⁷ ECJ Opinion 1/91, para. 29. See also para. 20-21: "The EEA is to be established on the basis of an international treaty which, essentially, merely creates rights and obligations as between the Contracting Parties and provides for no transfer of sovereign rights to the inter-governmental institutions which it sets up. In contrast, the EEC Treaty, albeit concluded in the form of an international agreement, none the less constitutes the constitutional charter of a Community based on the rule of law. As the Court of Justice has consistently held, the Community treaties established a new legal order for the benefit of which the States have limited their sovereign rights, in ever wider fields, and the subjects of which comprise not only Member States but also their nationals."

³²⁸ Halvard Haukeland Frederiksen: "Bridging the Widening Gap between the EU Treaties and the Agreement on the European Economic Area", p. 869-870.

³²⁹ EFTAC E-10/07 *L'Oreal*, para. 28. The Court states: "The institutional system of the European Economic Area foresees two courts at the international level, the EFTA Court and the ECJ, interpreting the common rules. It is an inherent consequence of such a system that from time to time the two courts may come to different conclusions in their interpretation of the rules. The EFTA States have sought to minimise this risk by establishing, in Article 3(2) SCA, an obligation for the EFTA Court to "pay due account to the principles laid down by the relevant rulings" of the ECJ given after the date of signature of the EEA Agreement. In its interpretation of EEA rules, the Court has consistently taken into account the relevant rulings of the ECJ given after the said date"

the EEA Joint Committee to exercise the powers it has under Article 105 EEA in order to preserve homogeneous interpretation of the Agreement.³³⁰

Articles 105 to 107 EEA belong to a section of the EEA Agreement dedicated to homogeneity. Article 105 states that in order to achieve the objective of uniform interpretation the provision of the EEA Agreement and provisions in EU legislation substantially reproduced in the Agreement, the EEA Joint Committee shall keep development of case law of the ECJ and the EFTA Court under constant review. Should the EEA Joint Committee not succeed in preserving homogeneous interpretation within two months after a difference in the case law of the two courts has been brought before it, the procedures laid down in Article 111 may be applied, procedures which relate to settlement of disputes.³³¹

Article 106 provides that the Joint Committee shall put in place a system for the exchange of information concerning judgements by the EFTA Court, the ECJ, and the Court of First Instance of the European Union and courts of last instance of the EEA EFTA States. Article 107 provides for the possibility of an EEA EFTA State to allow a court or a tribunal to request the ECJ to interpret an EEA rule, provisions on which are laid down in Protocol 34. Common with Articles 6 and 105 to 107 EEA is that they are to foster “as uniform an interpretation as possible” of the rules of the EEA Agreement.³³²

³³⁰ Halvard Haukeland Frederiksen: “Bridging the Widening Gap between the EU Treaties and the Agreement on the European Economic Area”, p. 869-870.

³³¹ Article 111 EEA:

“1. The Community or an EFTA State may bring a matter under dispute which concerns the interpretation or application of this Agreement before the EEA Joint Committee in accordance with the following provisions.

2. The EEA Joint Committee may settle the dispute. It shall be provided with all information which might be of use in making possible an indepth examination of the situation, with a view to finding an acceptable solution. To this end, the EEA Joint Committee shall examine all possibilities to maintain the good functioning of the Agreement.

3. If a dispute concerns the interpretation of provisions of this Agreement, which are identical in substance to corresponding rules of the Treaty establishing the European Economic Community and the Treaty establishing the European Coal and Steel Community and to acts adopted in application of these two Treaties and if the dispute has not been settled within three months after it has been brought before the EEA Joint Committee, the Contracting Parties to the dispute may agree to request the Court of Justice of the European Communities to give a ruling on the interpretation of the relevant rules. If the EEA Joint Committee in such a dispute has not reached an agreement on a solution within six months from the date on which this procedure was initiated or if, by then, the Contracting Parties to the dispute have not decided to ask for a ruling by the Court of Justice of the European Communities, a Contracting Party may, in order to remedy possible imbalances,

- either take a safeguard measure in accordance with Article 112(2) and following the procedure of Article 113;
- or apply Article 102 *mutatis mutandis*.

4. If a dispute concerns the scope or duration of safeguard measures taken in accordance with Article 111(3) or Article 112, or the proportionality of rebalancing measures taken in accordance with Article 114, and if the EEA Joint Committee after three months from the date when the matter has been brought before it has not succeeded to resolve the dispute, any Contracting Party may refer the dispute to arbitration under the procedures laid down in Protocol 33. No question of interpretation of the provisions of this Agreement referred to in paragraph 3 may be dealt with in such procedures. The arbitration award shall be binding on the parties to the dispute.”

³³² Titus van Stiphout: “Achieving Legal Homogeneity in the Field of Free Movement of Capital”, p. 429-430.

It is notable that, except for Article 6, the EEA Agreement only refers to the aim of achieving as uniform an interpretation *as possible*. Further, provisions concerning judicial homogeneity containing explicit references to the independence of the courts or possible developments of future case-law open up the possibility of deviating case law. In Article 105 EEA the Agreement simply provides a mechanism to manage situations such as these, rather than requiring the two pillars of the EEA Agreement to avoid any divergent case-law. The Article aims to preserve homogeneous interpretation of the EEA Agreement but failing that provides for a dispute settlement procedure at the end of which the Contracting Parties are to find an *acceptable* solution. Some scholars contend that this wording does not necessarily mean a solution preserving absolute homogeneity but a solution which enables the maintaining of a good functioning of the EEA Agreement.³³³

Not everyone agrees on the EFTA Court's approach regarding substantive homogeneity. While some maintain that the Court's approach only reflects the institutional arrangements the EEA Agreement established and that the Court has little choice but follow the decisions and principles established by the ECJ, others accept that the EFTA Court has a more proactive role in interpreting the EEA Agreement in pursuit of its good functioning.³³⁴

Identical interpretation of provisions on procedures is referred to as procedural homogeneity. The EFTA Court seems to be prepared to reach far in establishing procedures that serve the good functioning of the EEA Agreement. When dealing with homogeneity in respect to the same effect of EU and EEA law in the legal orders of the Member States, the EFTA Court has had to account for the resistance negotiated into the Agreement of transferring legislative and judicial powers to supra-national institutions established under international law. Because of this the EFTA Court has rejected the fundamental EU law doctrines of direct effect and primacy. Persistent debates about the specificities of the principle of state liability in the EEA/EFTA context reflect similar concerns.³³⁵

The doctrine of state liability is one example of the EFTA Courts efforts to maintain homogeneity in the EEA. In joined cases ECJ 6/90 and 9/90 *Francovich* the ECJ found that in situations where a Member State of the Union had breached EU law it was a principle of Community law that they should be obliged to make good loss and damage which was caused to individuals by the breach.³³⁶ The case concerned a failure by Italy to implement a directive intended to guarantee employees a minimum level of protection in the event of the insolvency

³³³ Titus van Stiphout: "Achieving Legal Homogeneity in the Field of Free Movement of Capital", p. 438-439.

³³⁴ Dóra Guðmundsdóttir: "B. EFTA Court", p. 2019-2020.

³³⁵ *Loc. cit.*

³³⁶ ECJ 6/90 and 9/90 *Francovich*, para. 37.

of their employer.³³⁷ After finding that employees could not enforce their rights based on the directive against the state because it hadn't been implemented³³⁸ the ECJ went on to observe that the full effectiveness of EU law would be impaired if individuals could not obtain a redress when their rights were infringed by a breach of EU law for which a Member State could be held responsible.³³⁹ The ECJ therefore found that the principle of state liability where a State was liable for loss and damage caused to individuals because of breaches of EU law for which the State could be held responsible was inherent in the system of the EEC Treaty.³⁴⁰ The ECJ went on to detail conditions for such state liability; firstly, that the directive in question should grant rights to individuals; secondly, that it should be possible to identify the content of those rights on the basis of provisions of the directive; and lastly, that there existed a causal link between the breach and the damage suffered.³⁴¹

There is no provision in the EEA Agreement concerning state liability; that is liability for damages in cases where Contracting Parties to the EEA Agreement may have violated EEA law. However, in EFTAC E-9/97 *Erla María* the EFTA Court ruled that state liability was part of EEA law.³⁴² The case concerned incorrect implementation of Directive 80/987/EEC by Iceland.³⁴³ The Court found that the homogeneity principle, the objective of establishing rights for individuals and economic operators to equal treatment and equal opportunities were so strongly worded in the EEA Agreement that the EEA EFTA States were obliged to provide compensation to individuals for loss and damage due to incorrect implementation of a directive.³⁴⁴ The EFTA Court then established conditions for state liability which clearly resembled the ones handed down by the ECJ in the *Francovich* case-law.³⁴⁵ While the EFTA Court never expressly mentioned the *Francovich* judgement or subsequent case-law in *Erla María* it is clear that it based its findings partly on those judgements. *Francovich* was handed down before the cut-off date stipulated by Article 6 EEA. However, the EFTA Court did not reference Article 6 EEA in *Erla María* nor did it reference the ECJ's earlier case-law in the field concerning state liability. It is likely that the reason for this is that no provisions were

³³⁷ ECJ 6/90 and 9/90 *Francovich*, para. 3-4.

³³⁸ *Ibid.*, para. 27.

³³⁹ *Ibid.*, para. 33.

³⁴⁰ *Ibid.*, para. 35.

³⁴¹ *Ibid.*, para. 40.

³⁴² M. Elvira Méndez-Pinedo: *EC and EEA Law*, p. 249.

³⁴³ EFTAC E-9/97 *Erla María*, para. 37 and 41.

³⁴⁴ *Ibid.*, para. 60.

³⁴⁵ ECJ C-6/90 and C-9/90 *Francovich* was handed down before the signing of the EEA Agreement and subsequent cases expanded on the doctrine of state liability established in *Francovich*.

identical in substance. The conditions for liability recognized by the EFTA Court reflected the ECJ's case-law faithfully, in particular its post-*Francovich* developments.³⁴⁶

9.3 The Importance of Homogeneity

The emphasis on homogeneity has already been detailed in this chapter but perhaps the impetus for that emphasis is the ECJ 270/80 *Polydor* judgement, a judgement pertaining to the application of bilateral Free Trade Agreements made between the different EFTA States and the EU (then the European Community) in 1972 which contained corresponding or even identically worded provisions to the EEC Treaty.³⁴⁷ The ECJ found however that the fact that the provisions were identically worded did not mean that they should be interpreted in the same way as the EU had different objectives than the Free Trade Agreement.³⁴⁸ The ECJ repeated this observation in its Opinion 1/91. The Opinion concerned the original intention of establishing an EEA Court capable of deciding cases pertaining to the EEA Agreement for both the EU and the EEA EFTA States.³⁴⁹ The ECJ again pointed out that the fact that the provisions in the EEA Agreement and the corresponding EU provisions were identically worded did not mean that they must necessarily be interpreted identically.³⁵⁰

Homogeneity in the EEA is therefore extremely important for the goal the EEA Agreement intends to achieve so that the rules established in the EEA Agreement and the corresponding provisions in the TFEU can be interpreted and applied as similarly as possible. There are differences between the EEA Agreement and the provisions in the TFEU that can be said to be of a linguistic nature. It is doubtful that these differences, pointed out in the following chapters, pose much threat to the goal of homogeneity in the EEA. There are, however, some real differences between the provisions in the EEA Agreement and the provisions in the TFEU about free movement of capital, namely those relating to possible derogations from the freedom. The EFTA Court has gone far to maintain homogeneity within the EEA, but considering its judgement in EFTAC E-1/04 *Fokus Bank* where the Court effectively applied the provisions set forth in Article 65 TFEU without them having a parallel in the EEA Agreement may have gone too far. Considering that the EEA EFTA States did not want to hand over legislative power to the EEA institutions, always implementing any

³⁴⁶ M. Elvira Méndez-Pinedo: *EC and EEA Law*, p. 241-242.

³⁴⁷ Sven Norberg et al.: *EEA Law*, p. 183.

³⁴⁸ ECJ 270/80 *Polydor*, para. 15-16.

³⁴⁹ ECJ Opinion 1/91, para. 6.

³⁵⁰ *Ibid.*, para. 14.

changes to the Annexes in their national legislation, the issue of diverging, or in this case, completely different, provisions in the Treaties should be taken up at the level of the Contracting Parties, not within the case law of the Courts. As will however be pointed out later, the EFTA Court could have reached the same substantial result by a different route which would have been permissible by the EEA Agreement.

10. Free Movement of Capital in the EEA

The provisions in the EEA Agreement on the free movement of capital are essentially the same as the ones found in the EU Treaties before the Maastricht Treaty came into force. The provisions, negotiated in 1990-1992, reflect the corresponding provisions of the EC Treaty as it stood at the time. Later amendments of EU primary law are not reflected in the main part of the EEA Agreement. For the most part the changes that were made with the treaties of Maastricht, Amsterdam, Nice and Lisbon are of a limited nature; at least as far as the core part of the internal market is concerned, that is except for the changes to the provisions governing the free movement of capital.³⁵¹ As previously discussed, the Maastricht Treaty made extensively revised the provisions on free movement of capital and after the Maastricht Treaty came into force the European Court of Justice took a more prominent role relating to the free movement of capital.³⁵²

10.1 Provisions

Within EFTA and the EU the provisions on cooperation in economic- and monetary matters are completely different. Within the EU there is the Economic and Monetary Union with a common currency, the Euro, while in the Article 46 EEA only calls for the Contracting Parties to exchange views and information on a non-binding basis.

The main provision in the EEA Agreement concerning the free movement of capital is Article 40 which states that:

Within the framework of the provisions of this Agreement, there shall be no restrictions between the Contracting Parties on the movement of capital belonging to persons resident in EC Member States or EFTA States and no discrimination based on the nationality or on the place of residence of the parties or on the place where such capital is invested. Annex XII contains the provisions necessary to implement this Article.

³⁵¹ Halvard Haukeland Frederiksen: "Bridging the Widening Gap between the EU Treaties and the Agreement on the European Economic Area", p. 870.

³⁵² Chapter 3.2.

As can be seen Article 40 EEA prohibits discrimination based on nationality, the place or the residence or where capital is invested. Article 4 EEA contains a general non-discrimination clause, stating that discrimination on grounds of nationality shall be prohibited within the scope of application of the EEA Agreement. The EFTA Court has held that because the principle of non-discrimination has been given effect in Article 40 it is not necessary in cases concerning potential breach of the free movement of capital to examine whether a breach of Article 4 has occurred.³⁵³ Furthermore, Article 40 EEA does not only require equal treatment of residents and non-residents as regards substantive rights but also procedural rights insofar as “procedural rights are prerequisite to the protection of substantive rights under the EEA Agreement.” The extent of disadvantages suffered in such situations is irrelevant.³⁵⁴

As earlier discussed in this thesis, the term “capital movement” is not defined in EU primary law. Neither is it defined in the EEA Agreement. Rather, the ECJ defined the term in joined cases ECJ 286/82 and 26/83 *Luisi and Carbone*. The EFTA Court has never relied on the *Luisi and Carbone* to establish a certain operation as capital movements; instead it generally refers to Directive 88/361/EEC concerning the implementation of Article 67 of the EC Treaty.³⁵⁵ The definition of capital movement in *Luisi and Carbone*³⁵⁶ should, however, also be valid in the context of the EEA Agreement, on the basis of Article 6 EEA, which states that provisions in the EEA Agreement which are identical in substance to corresponding rules in the EU treaties shall be interpreted in line with case-law handed down by the ECJ before the EEA Agreement came into force. The definition in the judgement makes sense in the EEA Agreement even though the EFTA Court has not yet referred to it as Directive 88/361/EEC does not contain a definition of the term of capital movement, only a non-exhaustive list of examples of capital movements. A general definition should therefore still be necessary in order to classify operations which are not listed in the Annex.³⁵⁷

As stated in the last part of Article 40, Annex XII contains necessary provisions for implementation of the article. The Annex incorporates Directive 88/361/EEC into the agreement but lists several adaptations. For instance, Iceland may continue to apply restrictions that existed at the date when the Agreement was signed, Article 40 EEA and the provisions of Annex XII notwithstanding, on foreign ownership and/or ownership by non-residents in

³⁵³ EFTAC E-1/00 *Íslandsbanki-FBA hf.*, para. 36.

³⁵⁴ EFTAC E-1/04 *Fokus Bank*, para. 43.

³⁵⁵ Titus van Stiphout: “Achieving Legal Homogeneity in the Field of Free Movement of Capital”, p. 431.

³⁵⁶ Chapter 4.

³⁵⁷ Titus van Stiphout: “Achieving Legal Homogeneity in the Field of Free Movement of Capital”, p. 432.

fisheries and fish processing and Norway may continue to apply restrictions on ownership by non-nationals on fishing vessels that existed at the time of the Agreements signing. The EFTA Court has referred to the nomenclature in Annex I of Directive 88/361/EEC on several occasions, for instance in EFTAC E-1/00 *Íslandsbanki-FBA hf.* the Court said the Annex indicated ‘the scope of capital movements for the purpose of Article 40 EEA and Article 1 of the Directive.’³⁵⁸

Due to the principle of homogeneity discussed above it is important to examine the differences that exist between the TFEU and the EEA Agreement. The differences between the provisions of Article 40 EEA and Article 63 TFEU can be classified in two categories; linguistic and substantial. Examples of the former are the phrases “there shall be no restrictions” in Article 40 EEA but “all restrictions shall be prohibited” in Article 63 TFEU, which are almost identical and carry the same meaning. An example of the latter is for instance that while Article 63 TFEU provides that movement of capital shall be free between Member States and between Member States and third countries, Article 40 EEA only stipulates that free movement of capital shall be between the Contracting Parties.

The principle of free movement of capital in the TFEU benefits both residents and non-residents in the Member States, while the principle in the EEA Agreement benefits only residents of the Member States. The reasons for these differences are essentially that the EEA Agreement, not entailing a common commercial policy, affects third country relations to a much lesser degree than the TFEU. Such a policy, as the TFEU contains, makes it important to create a common regime as regards capital movements to and from third countries or capital movements between the Contracting Parties of capital belonging to persons not residing on the territories of the Contracting Parties.³⁵⁹

It is however important to note that the provisions in the TFEU aren’t quite as unconditional as the wording of Article 63 TFEU might suggest, see for instance the discussion in chapter 6.2. The difference is then that the TFEU sets out with the goal of free movement of capital between Member States as well as Member States and third countries while the EEA Agreement sets out with the premise that free movement of capital only applies between the Contracting Parties to the Agreement.

As discussed in Chapter 6.1 the Article 63 TFEU no longer makes reference to discrimination. Despite this the ECJ has used both the discrimination model and the

³⁵⁸ EFTAC E-1/00 *Íslandsbanki-FBA hf.*, para. 19.

³⁵⁹ Titus van Stiphout: “Achieving Legal Homogeneity in the Field of Free Movement of Capital”, p. 433.

restrictions model as discussed in Chapter 6.1. This difference in wording should therefore not constitute a hindrance to the goal of attaining a homogeneous European Economic Area.

Advocate General Geelhoed, in his Opinion in ECJ C-452/01 *Ospelt*, examined in detail whether Article 40 EEA and Article 63 TFEU should be interpreted in the same way.³⁶⁰ Geelhoed points to Article 6 EEA which provides that provisions of the Agreement which are identical in substance to the provisions of the TFEU must be interpreted in conformity with the case-law of the ECJ as it stood at the time the EEA Agreement was signed. There is, however, no similar provision relating to subsequent case law.³⁶¹ It must be pointed out that while there is no similar provision in the EEA Agreement itself, Article 3(2) of the Surveillance and Court Agreement, which states that in the interpretation and application of the EEA Agreement due account shall be paid to the principles laid down by relevant rulings by the ECJ given after the date of signature of the EEA Agreement and which concern the interpretation of the EEA Agreement. The Surveillance and Court Agreement applies to the EFTA Court and ESA.³⁶² Geelhoed also noted that the ECJ had jurisdiction to interpret the EEA Agreement with regard to the territory of the EU and the EFTA Court with regard to application in the EEA EFTA States. Therefore, the Agreement provides for cooperation between the Courts. Geelhoed considered in that regard that it was for the ECJ to ensure safeguarding of uniformity as regards interpretation of the EEA Agreement but also that interpretation is given in uniformity with interpretation of identical or comparable provisions in the TFEU.³⁶³ Geelhoed next points to ECJ C-162/00 *Pokrzeptowicz-Meyer* which the Commission had referred to in its observations.³⁶⁴ In the judgement the ECJ held that “[a]ccording to settled case-law, a mere similarity in the wording of a provision of one of the Treaties establishing the Communities and of an international agreement between the Community and a non-member country is not sufficient to give to the wording of that agreement the same meaning as it has in the Treaties. [...] According to that case-law, the extension of the interpretation of a provision in the Treaty to a comparably, similarly or even identically worded provision of an agreement concluded by the Community with a non-member country depends on, inter alia, the aim pursued by each provision in its own particular context. A comparison between the objectives and context of the agreement and

³⁶⁰ Opinion of Advocate General Geelhoed in ECJ Case C-452/01 *Ospelt*, para. 57.

³⁶¹ *Ibid.*, para. 66.

³⁶² Agreement between the efta states on the establishment of a surveillance authority and a court of justice.

³⁶³ Opinion of Advocate General Geelhoed in ECJ Case C-452/01 *Ospelt*, para. 67.

³⁶⁴ *Ibid.*, para. 68.

those of the Treaty is of considerable importance in that regard.”³⁶⁵ After noting that one of the principle aims of the EEA Agreements is to provide for the fullest possible realisation of the Four Freedoms within the whole EEA, and seeking to extend the Internal Market to the EFTA Countries, Geelhoed maintains that the objectives and context of the EEA Agreement must be compared with those of the TFEU.³⁶⁶ Geelhoed finally explained that, in his view, the provisions of the EEA Agreement that related to the free movement of capital must be interpreted in the same way as the corresponding articles in the TFEU, at least as far as possible. This, he maintains, related both to the content of the freedom and to the grounds on which Member States might restrict these freedoms.³⁶⁷ In ECJ C-452/01 *Ospelt* the ECJ simply states that the rules in the EEA Agreement prohibiting restrictions on the movement of capital and discrimination, so far as concerns relations between the state parties to the EEA Agreement, are identical to the ones in the TFEU as with regard to relations between Member States.³⁶⁸

Article 41 provides for freedom of current payments, stating:

Current payments connected with the movement of goods, persons, services or capital between Contracting Parties within the framework of the provisions of this Agreement shall be free of all restrictions.

To compare the two, while Article 63(2) TFEU provides for prohibition of *all* restriction on payments between Member States and between Member States and third countries, Article 40 EEA, besides only applying to movements between Contracting Parties like Article 40 EEA, only stipulates that current payments shall be free when they are connected with one of the four freedoms.

Article 42(1) EEA contains a provisions stating that when domestic rules, which govern the capital market and credit system, are applied to movements of capital liberalized in accordance with the EEA Agreement, they shall be applied in a non-discriminatory manner. Article 42(2) EEA concerns loans for direct or indirect financing of an EC Member State or an EEA EFTA State or its regional or local authorities. The provision states that such loans “shall not be issued or placed in other EC Member States or EFTA States unless the States concerned have reached agreement thereon.” This provisions mirrors Article 68(3) of the EEC which has now been repealed. The article was probably inserted into the EEA Agreement for reasons of symmetry rather than for its practical relevance and, as it has mainly a bearing on

³⁶⁵ ECJ Case C-162/00 *Pokrzeptowicz-Meyer*, para. 32-33. The case concerned interpretation of provision of an association agreement between Poland, the European Communities and their Member States.

³⁶⁶ Opinion of Advocate General Geelhoed in ECJ Case C-452/01 *Ospelt*, para. 69.

³⁶⁷ *Ibid.*, para. 71.

³⁶⁸ ECJ Case C-452/01 *Ospelt*, para. 28.

the bilateral relations between the Contracting Parties, no adverse effects on the EEA Agreement should be expected.³⁶⁹

The EFTA Court has held that the rules governing the free movement of capital in the EEA Agreement are substantially identical to those found in the TFEU.³⁷⁰ The EFTA Court has drawn guidance from such ECJ cases as ECJ C-452/01 *Ospelt*. In the *Ospelt*, ECJ maintained that Article 40 EEA possessed the same legal scope as Article 56 EC (now Article 63 TFEU) as noted above.³⁷¹ In doing this the EFTA Court has in general followed a restrictions approach when interpreting the free movement provisions.³⁷² In EFTAC E-3/11 *Sigmarsson* the EFTA Court reinforced substantive homogeneity by finding the scope of the fundamental freedoms broadly equivalent in both legal systems which must be interpreted identically.³⁷³

At the same time, the EFTA Court explicitly avoids dealing with issues relating to procedural homogeneity, homogeneous interpretation prescribed by the Agreements, its protocols and side-agreements. The EFTA Court noted in *Sigmarsson* that there were no equivalent provisions in the EU Treaties to the procedures set out in Articles 44 and 45 EEA. This, however, is not entirely correct as Articles 143 and 144 TFEU concern procedures for EU Member States which are not participating in the Euro in instances where they encounter balance of payment difficulties parallel to Article 43(4) and Articles 44 and 45 EEA.³⁷⁴

The EFTA Court has on several occasions given rulings on matters relating to the free movement of capital. The first such case was Case E-1/00 *Íslandsbanki-FBA hf.* which concerned a dispute over the guarantee fee provisions in Icelandic legislation which established a system of state guarantees.³⁷⁵ The legislation provided that guarantee fees, payable to the State Treasury on all loans, were higher for foreign loans than for domestic loans.³⁷⁶ The EFTA Court stated that such a system of higher fees for foreign loans did not necessarily render the foreign loans less attractive as other factors, such as interest rates, might influence borrowers when they considered which the most attractive lending offer was.³⁷⁷ However, this system did render the foreign loans more expensive for the borrower

³⁶⁹ Titus van Stiphout: "Achieving Legal Homogeneity in the Field of Free Movement of Capital", p. 440.

³⁷⁰ EFTAC E-1/04 *Fokus Bank*, para. 23. The EFTA Court reiterates this in EFTAC E-10/04 *Piazza*, para. 33 and 39, and EFTAC E-3/11 *Sigmarsson*, para. 30.

³⁷¹ ECJ Case C-452/01 *Ospelt*, para. 28.

³⁷² Dóra Guðmundsdóttir: "B. EFTA Court", p. 2029.

³⁷³ EFTAC E-3/11 *Sigmarsson*, para. 30.

³⁷⁴ Dóra Guðmundsdóttir: "B. EFTA Court", p. 2030.

³⁷⁵ EFTAC E-1/00 *Íslandsbanki-FBA hf.*, para. 2.

³⁷⁶ *Ibid.*, para. 4.

³⁷⁷ EFTAC E-1/00 *Íslandsbanki-FBA hf.*, para. 24.

than if the lower guarantee fees had been applied to those loans. The Court then goes on to say “National provisions such as those at issue in the main proceedings provide for an inherent difference in the treatment of loans from foreign lenders and loans from domestic lenders. All other terms being equal, that difference will render foreign loans more expensive than domestic ones.”³⁷⁸ The Court held that such difference in treatment between domestic and foreign loans might dissuade borrowers from seeking out lenders established in another EEA State. The Court therefore concluded that the guarantee fees at issue in the case constituted a restriction on the free movement of capital.³⁷⁹ This wording is comparable to the wording the ECJ uses when applying its restrictions model discussed above in Chapter 6.1.2. Further, the Court stated, in response to an argument of the plaintiff, that in order to constitute a breach of Article 40 EEA it was enough to establish that the legislation might dissuade borrowers from seeking loans in other EEA States and therefore it was not necessary to demonstrate an *actual appreciable effect* on the cross-border movement of capital.³⁸⁰

10.2 Territorial scope

As previously mentioned, while the provisions of the free movement of capital in the TFEU concern both free movement between Member States as well as Member States and third countries, the provisions in the EEA Agreement only stipulate that free movement of capital applies between the Contracting Parties.

Interestingly, there seems to have been some misunderstanding regarding the EEA EFTA States status, whether they were Member States or whether they were to be treated as third countries. The issue arose in ECJ C-452/01 *Ospelt*. The case concerned a national of Liechtenstein who owned and resided on land in Austria, some of which she leased to surrounding farmers.³⁸¹ Ms Ospelt wanted to transfer the property to a trust established in Liechtenstein to prevent any division caused through inheritance of the family property. The trust intended to continue leasing plots of land to the same farmers as before.³⁸² Her application to transfer the property was refused on the ground that the conditions for acquisition by foreigners had not been fulfilled.³⁸³ Ms Ospelt and the trust brought an action against that decision and the Austrian court decided to stay proceedings and refer questions to

³⁷⁸ EFTAC E-1/00 *Íslandsbanki-FBA hf.*, para. 25.

³⁷⁹ *Ibid.*, para. 26.

³⁸⁰ EFTAC Case E-1/00 *Íslandsbanki-FBA hf.*, para. 28.

³⁸¹ ECJ Case C-452/01 *Ospelt*, para. 16.

³⁸² *Ibid.*, para. 17.

³⁸³ *Ibid.*, para. 18.

the ECJ for a preliminary ruling.³⁸⁴ In those questions the Austrian court referred to member states of the EEA as third countries.³⁸⁵ The ECJ pointed out that both Austria and Liechtenstein were parties to the EEA Agreement, Article 40 of which provided for no restriction between Contracting Parties on the movement of capital.³⁸⁶ The ECJ held that since the date the EEA Agreement entered into force in respect of Liechtenstein the Member States could no longer invoke Article 73c (now Article 64 TFEU) against Liechtenstein.³⁸⁷

It is however interesting to note that Advocate General Geelhoed, in his opinion in *Ospelt*, noted that the ESA contended that State Parties to the EEA Agreement could not be regarded as third countries within the meaning of Article 64(1) TFEU. While Geelhoed found this view to be incorrect³⁸⁸ he went on to state that he considered the EEA EFTA States to be third-countries maintaining that any State “which is not a Member state of the European Union is a third country” and that the EEA Agreement did not alter this despite the fact that Contracting Parties to the EEA Agreement derived rights from it similar or identical to the rights which citizens of the European Union derived from the TFEU. Geelhoed pointed out that the EEA Agreement is no different from other association agreements the EU has concluded with non-member States nationals of whom can also derive rights from those agreements that they may exercise in the EU Member States.³⁸⁹ Geelhoed concludes that the standstill clause in Article 64(1) TFEU means that the legislation at issue in the case preventing Ms Ospelt from moving her land to the Foundation can be maintained as it existed on December 31, 1993.³⁹⁰

11. Derogations

11.1 Provisions

The EEA Agreement contains provisions on possible restrictions of capital movements that constitute real safeguard and protective measures, which mostly deal with situations when free movement of capital causes difficulties in or for a Contracting Party.³⁹¹

Article 43 EEC lays down such protective measures in four paragraphs:

³⁸⁴ ECJ Case C-452/01 *Ospelt*, para. 20.

³⁸⁵ *Ibid.*, para. 22-23.

³⁸⁶ *Ibid.*, para. 25.

³⁸⁷ *Ibid.*, para. 31.

³⁸⁸ Opinion of Advocate General Geelhoed in ECJ Case C-452/01 *Ospelt*, para. 50.

³⁸⁹ *Ibid.*, para. 51.

³⁹⁰ *Ibid.*, para. 56.

³⁹¹ Titus van Stiphout: “Achieving Legal Homogeneity in the Field of Free Movement of Capital”, p. 433-434.

1. Where differences between the exchange rules of EC Member States and EFTA States could lead persons resident in one of these States to use the freer transfer facilities within the territory of the Contracting Parties which are provided for in Article 40 in order to evade the rules of one of these States concerning the movement of capital to or from third countries, the Contracting Party concerned may take appropriate measures to overcome these difficulties.

2. If movements of capital lead to disturbances in the functioning of the capital market in any EC Member State or EFTA State, the Contracting Party concerned may take protective measures in the field of capital movements.

3. If the competent authorities of a Contracting Party make an alteration in the rate of exchange which seriously distorts conditions of competition, the other Contracting Parties may take, for a strictly limited period, the necessary measures in order to counter the consequences of such alteration.

4. Where an EC Member State or an EFTA State is in difficulties, or is seriously threatened with difficulties, as regards its balance of payments either as a result of an overall disequilibrium in its balance of payments, or as a result of the type of currency at its disposal, and where such difficulties are liable in particular to jeopardize the functioning of this Agreement, the Contracting Party concerned may take protective measures.

The provision in Article 43 EEA is a logical consequence of the fact that capital movements to and from third countries are not liberalised to the same degree in the EEA EFTA States as they are in the EU Member States. The Contracting Parties did not consider that this would threaten the good functioning of the EEA Agreement, as long as each contracting party retained the power to react in case economic operators and individuals started abusing different regimes to evade their national rules on capital movements to and from third countries.³⁹²

The provisions on which Article 43 EEA is based date back to the early days of capital movement regulation. Since then radical changes have come about in the EU after the Euro was introduced in the Maastricht Treaty as well as gradual development of the provisions on the free movement of capital.³⁹³ Article 43 EEA does not contain derogations based on taxation, prevention of infringements and public and security policy unlike Article 65 TFEU which may be employed to justify direct discrimination.

The provisions listing possible exceptions to the principle of free movement of capital in the EEA and the EU look completely different. Article 65 TFEU allows Member States to restrict capital movements by applying their tax law to distinguish between taxpayers who are not in the same situation as regards their place of residence or place or investment, take requisite measures to prevent infringement of national law and regulations or lay down

³⁹² Titus van Stiphout: "Achieving Legal Homogeneity in the Field of Free Movement of Capital", p. 434.

³⁹³ Dóra Guðmundsdóttir: "B. EFTA Court", p. 2030.

procedures for the declaration of capital movements for purposes of administrative or statistical information, or to take measures which are justified on grounds of public policy or public security. The EEA Treaty does not contain corresponding provisions to this, stating instead in Article 42 EEA that Contracting Parties may apply domestic rules governing the capital market and credit system in a non-discriminatory manner. These provisions are very different from those seen in the TFEU; while the EEA Agreement only requires that a domestic measure may be applied in a non-discriminatory manner the TFEU requires that the measure shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital. Therefore it would seem that the TFEU applies a more restrictive test than the EEA Agreement. The former conditions apply to measures concerning capital movements to and from EEA EFTA States as well as to capital movement between an EFTA State and an EU Member State while the latter apply between EU Member States. Therefore, one could conclude that these conditions might conflict with the aim of a homogeneous European Economic Area.³⁹⁴

Article 44 states that the EU and the EFTA States shall apply their internal procedures to implement the provisions of Article 43. Protocol 18 concerns internal measures for the implementation of the Article 43 protective measures and states that the procedures to be followed by the EFTA States are set out in the agreement on a Standing Committee of the EFTA States. Essentially the main rule is that the parties can resort to the protective measures set out in Article 43 EEA but must in doing so follow the procedure set out in these sources, Article 44 EEA and Protocol 18, and Article 45 EEA.³⁹⁵ Article 45 sets down conditions for the measures in Article 43 EEA.³⁹⁶

³⁹⁴ Titus van Stiphout: “Achieving Legal Homogeneity in the Field of Free Movement of Capital”, p. 436-437.

³⁹⁵ Stefán Már Stefánsson: *Evrópusambandið og Evrópska Efnahagssvæðið*, p. 512.

³⁹⁶ Article 45 EEA states: “1. Decisions, opinions and recommendations related to the measures laid down in Article 43 shall be notified to the EEA Joint Committee.

2. All measures shall be the subject of prior consultations and exchange of information within the EEA Joint Committee.

3. In the situation referred to in Article 43(2), the Contracting Party concerned may, however, on the grounds of secrecy and urgency take the measures, where this proves necessary, without prior consultations and exchange of information.

4. In the situation referred to in Article 43(4), where a sudden crisis in the balance of payments occurs and the procedures set out in paragraph 2 cannot be followed, the Contracting Party concerned may, as a precaution, take the necessary protective measures. Such measures must cause the least possible disturbance in the functioning of this Agreement and must not be wider in scope than is strictly necessary to remedy the sudden difficulties which have arisen.

5. When measures are taken in accordance with paragraphs 3 and 4, notice thereof shall be given at the latest by the date of their entry into force, and the exchange of information and consultations as well as the notifications referred to in paragraph 1 shall take place as soon as possible thereafter.”

As mentioned previously in this thesis the Maastricht Treaty set out provisions for a common economic- and monetary policy.³⁹⁷ The EEA Agreement, however, only stipulates that the contracting parties are to exchange views and information concerning the implementation of the EEA Agreement as well as the impact on economic activities and the conduct of economic and monetary policies. The Article 46 EEA then states that the contracting parties may discuss macro-economic situations, policies and prospects. The EEA Agreement provisions are therefore much weaker than the provisions of the TFEU. Article 46 EEA further states that exchange of views on these matters shall take place on a non-binding basis. This should, however, not affect the goal of a homogeneous EEA.

The dynamic interpretation of Article 40 EEA in ECJ C-452/01 *Ospelt* presented the EFTA Court with a challenge in that the EEA Agreement does not contain corresponding provisions to Article 65 TFEU. The ECJ held that Article 40 EEA should be interpreted in conformity with the ‘largely identical’ provisions of Article 56 EC (now Article 63 TFEU) without even mentioning that the rules on capital were amended with the Maastricht Treaty. When the question arose in EFTAC E-1/04 *Fokus Bank*³⁹⁸, the EFTA Court held that Article 40 EEA did not preclude the EEA States from applying provision in their tax law distinguishing between taxpayers who are not in the same situation with regard to their place of residence. The Court, while not referencing Article 58(1) EC (Article 65(1) TFEU) essentially applied the provision similarly in an EEA law context. The EFTA Court then admitted this in its judgment in EFTAC E-10/04 *Piazza*³⁹⁹, where it referred to Article 58 EC and stated that national restrictions on the movement of capital in the EEA could be justified on grounds such as those stipulated therein.⁴⁰⁰ While it would have been paradoxical if the EEA Agreement did not allow the same restrictions on capital movements as EU law, it is undeniable that the EFTA Court applied provisions of EU primary law in these cases that were not in effect when the EEA Agreement was drawn up and negotiated. The EFTA Court applied the provisions in Article 65 TFEU as if they had been incorporated into the EEA Agreement using the homogeneity principle as a legal basis for doing so instead of applying it as a principle of uniform interpretation of identical provisions.⁴⁰¹

³⁹⁷ See Chapter 3 above.

³⁹⁸ Halvard Haukeland Frederiksen: “Bridging the Widening Gap between the EU Treaties and the Agreement on the European Economic Area”, p. 873.

³⁹⁹ *Loc. cit.*

⁴⁰⁰ EFTAC E-10/04 *Piazza*, para. 39.

⁴⁰¹ Halvard Haukeland Frederiksen: “Bridging the Widening Gap between the EU Treaties and the Agreement on the European Economic Area”, p. 873.

11.2 Fokus Bank

Case E-1/04 *Fokus Bank* concerned a dispute about tax assessment of dividends that Fokus Bank had distributed to its shareholders, among whom were two companies from Germany and the United Kingdom. Those two shareholders sold their shares in Fokus Bank to companies resident in Norway immediately before the decision to pay out dividends was taken and then bought the shares back shortly after the payment of the dividends had been completed.⁴⁰² Fokus Bank deducted the withholding tax before paying dividends to shareholders who were resident outside of Norway but for shareholders resident in Norway the tax was not deducted.⁴⁰³ A Tax Assessment Appeals Board found that for tax purposes the foreign shareholders had to be regarded as owners of the shares at the time of the distribution of the dividends and therefore held that Fokus Bank was liable for the tax obligation resulting from the ownership being reclassified.⁴⁰⁴ Fokus Bank then brought an action to claim repayment of withholding tax where the tax was based on information other than that in the register of the Central Securities Depository at the time of distribution of the dividends.⁴⁰⁵ The national court requested an advisory opinion from the EFTA Court, where one of the questions was whether Article 40 of the EEA Agreement precluded legislation where shareholders resident outside of Norway were not granted tax credit on dividends paid by a Norwegian company that was granted to residents of Norway.⁴⁰⁶ The EFTA Court began its opinion by noting that while the tax systems of EEA EFTA states were not covered by the EEA agreement, they must exercise their taxations power in consistency with EEA law.⁴⁰⁷ The EFTA Court said that legislation, such as the legislation at issue, might have adverse effects on the profit of shareholders who were not resident in Norway and therefore could deter them from investing capital in companies having their seat in Norway. Thus, such legislation impeded the freedom of companies and individuals resident in another Member State to invest in Norway as well as potentially impeding Norwegian companies from raising capital outside of Norway. The legislation at issue therefore constituted a restriction within the meaning of Article 40 EEA.⁴⁰⁸ The EFTA Court subsequently examined whether the restrictions could be justified⁴⁰⁹ noting that Article 40 EEA did not preclude EEA States from

⁴⁰² EFTAC E-1/04 *Fokus Bank*, para. 2.

⁴⁰³ *Ibid.*, para. 3.

⁴⁰⁴ *Ibid.*, para. 4.

⁴⁰⁵ *Ibid.*, para. 6.

⁴⁰⁶ *Ibid.*, para. 18.

⁴⁰⁷ *Ibid.*, para. 20.

⁴⁰⁸ EFTAC E-1/04 *Fokus Bank*, para. 26.

⁴⁰⁹ *Ibid.*, para. 27.

applying relevant provisions of their tax law that distinguished between taxpayers which were not in the same situation with regard to their residence. Derogations from the fundamental principle of the free movement of capital, however, must be interpreted strictly according to the EFTA Court and “cannot be interpreted as meaning that any tax legislation making a distinction between taxpayers by reference to their place of residence is automatically compatible with the EEA Agreement.” A difference in treatment can only be considered compatible with Article 40 EEA when situations at issue are not objectively comparable or when such a difference in treatment can be justified by reasons of overriding public interest. However, for in the latter case, for such a difference in treatment to be justified it must not exceed what is necessary in order to attain the objective of the legislation.⁴¹⁰ As can be seen, the Courts reasoning is very similar to that of the in ECJ C-319/02 *Manninen*, in fact the EFTA Court referred to *Manninen* in its reasoning. In EFTAC E-1/04 *Fokus Bank* the EFTA Court found that the difference between resident and non-residents situations was not sufficient to prevent them from being considered to be in comparable situations.⁴¹¹ The Court further stated, in response to an argument of the State party to the Norwegian State, that “permitting derogations from the fundamental principle of free movement of capital laid down in Article 40 EEA on the grounds of safeguarding the cohesion of the international tax system would amount to giving bilateral tax agreements preference over EEA law.”⁴¹²

Fokus Bank concerned a situation similar to that in the *Manninen*. The EFTA Court noted that Article 40 EEA did not preclude the Contracting Parties from applying the relevant provisions of the national tax law that distinguished between taxpayers who were not in a comparable situation with regard to their place of residence. The EFTA Court did not explain how it was able to reach this conclusion in light of the fact that no corresponding provisions exists in the EEA Agreement mirroring Article 58(1) EC (Article 65 TFEU), simply referring to the ECJ’s *Manninen* case.⁴¹³ Therefore the EFTA Court could not rely on Article 6 EEA as reason for its decisions in *Fokus Bank*. Article 6 EEA only states that the EFTA Court must only take note of the ECJ’s case law where provisions of the EEA Agreement are identical in substance to corresponding rules of the EU Treaties. As there is no corresponding rule in the EEA Agreement to Article 65 TFEU Article 6 EEA does not apply nor does Article 3 of the Surveillance and Court Agreement for the same reason.

⁴¹⁰ EFTAC E-1/04 *Fokus Bank*, para. 28.

⁴¹¹ *Ibid.*, para. 29.

⁴¹² *Ibid.*, para. 31.

⁴¹³ Titus van Stiphout: “Achieving Legal Homogeneity in the Field of Free Movement of Capital”, p. 447.

Article 65 TFEU is based on jurisprudence by the ECJ as discussed above in Chapter 7.1, namely the ECJ's judgements in ECJ C-279/93 *Schumacker*, ECJ C-204/90 *Bachmann* and ECJ C-300/90 *Commission v Belgium*, discussed in Chapter 7.1 above. The ECJ has pointed out that this case-law means that national tax provisions which establish a distinction based on the residence of taxpayers can be compatible with EU law on the condition that they apply to situations which are not objectively comparable or if they can be justified by overriding reasons in the general interest.⁴¹⁴ This is the case-law that the EFTA Court should have referred to rather than ECJ C-319/02 *Manninen*, which was passed down after Article 58 EC (now Article 65 TFEU) was inserted into the Treaty and is therefore based on said article.⁴¹⁵ It certainly wouldn't be the first time that the EFTA Court has relied on ECJ jurisprudence to apply rules developed by the ECJ but not inserted into the EEA Agreement, the *Erla María* judgement discussed earlier coming to mind.

But the EFTA Court chose instead to rely on *Manninen*, and without mentioning the article in the judgement, Article 65 TFEU. It did however confirm this line of interpretation in EFTAC E-10/04 *Piazza* and refer directly to Article 58 EC (now Article 65 TFEU).⁴¹⁶

11.3 Capital controls

The global financial crisis of 2008 hit Iceland particularly hard. Having attracted foreign investment through high interest rates and good sovereign ratings, Iceland became highly leveraged with a mismatch between assets and liabilities in foreign currency. In early October 2008 Iceland suffered a major setback as its three biggest banks, comprising 85% of the banking system, collapsed.⁴¹⁷ Within a few months the exchange rate of the Icelandic krona dropped by more than 70% and inflation accelerated, as most of the private debt was either denominated in foreign currency or indexed to inflation. This caused a severe strain on households and corporate balance sheets. The economy plunged into a deep recession.⁴¹⁸

On October 10, 2008 the Central Bank of Iceland, prompted by the pressure from foreign exchange reserves, issued Guidelines for Temporary Modification in Currency Outflows. The Guidelines were issued toward deposit institutions and prioritized foreign currency requests

⁴¹⁴ ECJ C-35/98 *Verkooijen*, para. 43.

⁴¹⁵ ECJ C-319/02 *Manninen* para. 55.

⁴¹⁶ EFTAC E-10/04 *Piazza*, para. 39.

⁴¹⁷ Dóra Guðmundsdóttir: "B. EFTA Court", p. 2021.

⁴¹⁸ Annamaria Viterbo: "Iceland's capital controls and the constraints imposed by the EEA agreement", p. 218.

for importation of goods and services listing examples of priority categories such as foodstuffs, pharmaceuticals, oil products and public expenditure abroad.⁴¹⁹

Subsequently, Iceland sought assistance from the International Monetary Fund (IMF) and as well as its approval of the currency outflow restrictions on grounds of balance of payment. The Central Bank of Iceland believed that a general capital flight would continue to depreciate the krona and therefore, during a period of reconstruction, capital controls would be necessary. The Central Bank established an auction market for the krona. An offshore market with a much lower exchange rate was also developed for trading the krona.⁴²⁰ The Government's program, guided partly by IMF requirements, had three key objectives to respond to the challenges; firstly, to stabilize the exchange rate, secondly, to develop a comprehensive and collaborative strategy for bank restructuring and thirdly, to ensure medium-term fiscal sustainability.⁴²¹

On November 28, 2008 the Icelandic Government notified the Joint Committee of the EEA Agreement of the measures, in accordance with Articles 44 and 45 of the EEA Agreement, stating that the measures were taken to ensure that there would be no cross-border capital flow detrimental to the Icelandic krona which could in turn undermine the economic package introduced by the Government.⁴²²

An Emergency Act of Parliament was enacted to respond to the crisis, Act no 125/2008 on authorization of granting funds from the Treasury due to unusual situation in a Financial Market. The Rules on Foreign Exchange were adopted on November 28, 2008 in accordance with temporary provisions in the Foreign Exchange Act.⁴²³ These rules lifted controls on current account foreign exchange transactions but at the same time imposed more stringent controls on cross-border movement of capital and related foreign exchange transactions.⁴²⁴ The aim of the newly passed legislation was to prevent capital flight and further depreciation of the Icelandic krona, as well as protecting households and businesses with large un-hedged foreign currency exposures.⁴²⁵ Article 6 of Act No 125/2008 granted depositors in insolvency proceedings superior ranking over other creditors and Article 5 of Act No 125/2008 enabled

⁴¹⁹ "Temporary modifications in currency outflow", www.cb.is

⁴²⁰ Dóra Guðmundsdóttir: "B. EFTA Court", p. 2021.

⁴²¹ "Notification of Protective Measures Under Article 43 of the EEA Agreement", November 28, 2014.

⁴²² Dóra Guðmundsdóttir: "B. EFTA Court", p. 2022-2023.

⁴²³ Act No 87/1992 on Foreign Exchange.

⁴²⁴ Website of the Central Bank of Iceland: "Foreign exchange". <http://www.cb.is/the-bank/foreign-exchange/> (viewed July 3, 2014).

⁴²⁵ Annamaria Viterbo: "Iceland's capital controls and the constraints imposed by the EEA agreement", p. 222.

the Icelandic Financial Supervisory Authority to transfer assets and liabilities from the collapsed banks to “new” banks.

It is interesting to note that the Central Bank of Iceland, which should be aware of the non-discrimination obligation arising from Article 40 EEA, deliberately introduced a discriminatory clause into the Rules on Foreign Exchange. Article 10 of the Rules provided for different treatment between krona-bonds issued by domestic entities and those issued by foreign financial institutions. The Article stipulated that only the interest paid on krona-bonds issued by a domestic entity were freely transferable, while reparation of interest paid on krona-bonds issued by non-residents were not allowed. Article 40 EEA, as mentioned before, stipulates that no discrimination shall be made on the basis of nationality, residence or place of investment, a measure applying both to direct discrimination and measures which seem neutral but actually cause indirect discrimination. It is therefore clear, nationality and place or residence of the bonds’ issuers being the criteria adopted in Article 10 of the Rules on Foreign Exchange, that the Rules do not heed the non-discrimination aspect of Article 40 EEA.⁴²⁶

In 2009 the EFTA Surveillance Authority received several complaints from creditors of the fallen banks arguing that the Icelandic Government had breached the non-discrimination provisions in Articles 4 and 40 EEA with the aforementioned Act No 125/2008. The creditors argued that by transferring some liabilities, mostly domestic deposits, and some assets from the Icelandic banks to newly established entities and leaving the rest in an insolvent bank, the Icelandic authorities had breached the rule of non-discrimination. The creditors were all general creditors, not depositors, in one or more of the old banks.⁴²⁷ ESA’s decision concerned the measures described above, granted in Articles 5 and 6 of Act No 125/2008. ESA pointed out that the rules did not make distinction based on nationality nor place of residence of the creditor or place of investment. Therefore, they did not constitute direct discrimination on grounds of nationality, place of residence or place of investment.⁴²⁸ Next, ESA considered whether depositors and creditors were in a comparable situation. Pointing out that if depositors lost confidence in the banks it could trigger a bank-run with potentially severe consequences for the stability of the financial system. As such a situation was in fact imminent, considering the situation in Iceland, ESA held that depositors and unsecured creditors were not in a comparable situation with regard to the emergency measures.⁴²⁹ Furthermore, ESA did not consider that the timing of the measures had rendered them

⁴²⁶ Annamaria Viterbo: “Iceland’s capital controls and the constraints imposed by the EEA agreement”, p. 234.

⁴²⁷ EFTA Surveillance Authority Decision No. 501/10/COL, para. 1-7.

⁴²⁸ *Ibid.*, para. 57.

⁴²⁹ EFTA Surveillance Authority Decision No. 501/10/COL, para. 61.

discriminatory.⁴³⁰ ESA considered that there was no reason to examine possible justifications of the measures as it had already come to the conclusion that the measures did not constitute restrictions on the free movement of capital, however, it did so anyway, stating that while the measures had an economic aspect they were an overriding requirement in the general interest and proportionate at that, considering that they were taken in extreme circumstances where a collapse of the whole Icelandic banking system was a real risk.⁴³¹

Case E-3/11 *Sigmarsson* was an advisory opinion on interpretation of Article 43 EEA requested in a case between an individual, Mr. Sigmarsson, an Icelandic national resident in the United Kingdom, and the Central Bank of Iceland.⁴³² Mr. Sigmarsson had purchased Icelandic krona on the offshore market for pounds sterling on November 16, 2009. He applied for an exemption from the Icelandic currency controls to the Central Bank of Iceland, in order to transfer the kronas to Iceland, but was rejected. The conclusion was upheld by the Ministry of Economic Affairs by a ruling.⁴³³ Subsequently, Mr. Sigmarsson sought judicial review of the decision of the Central Bank of Iceland before the District Court of Reykjavík. He maintained that the decision contravened Icelandic law and was incompatible with the provisions on free movement of capital in the EEA Agreement.⁴³⁴ The District Court of Reykjavík decided that an advisory opinion was necessary regarding the latter issue, namely whether the currency controls were incompatible with the EEA Agreement.⁴³⁵ The plaintiff's case before the EFTA Court rested on the arguments that Article 43(2) and (3) of the EEA Agreement were materially comparable to other derogations from the right of free movement of capital protected by Article 40 EEA.⁴³⁶ The EFTA Court went on to dismiss Mr. Sigmarsson's arguments. The Court found that the substantive condition that Article 43 lays down in paragraphs 2 and 4 were satisfied both at the time when the Rules were adopted in October 2009 and when Mr. Sigmarsson was denied an exemption.⁴³⁷ The Court said that Article 43(2) and (4) "call for a complex assessment of various macroeconomic factors" and therefore the EFTA States enjoyed a wide margin of discretion when determining whether the conditions were fulfilled as well as in their choice of measures to be taken.⁴³⁸ The Court went on to discuss the principle of proportionality, namely that for a restriction on the free

⁴³⁰ EFTA Surveillance Authority Decision No. 501/10/COL, para. 71.

⁴³¹ *Ibid.*, para. 87-91.

⁴³² EFTAC E-3/11 *Sigmarsson*, para. 12.

⁴³³ *Ibid.*, para. 13.

⁴³⁴ *Ibid.*, para. 14.

⁴³⁵ *Ibid.*, para. 15.

⁴³⁶ Dóra Guðmundsdóttir: "B. EFTA Court", p. 2023.

⁴³⁷ EFTAC E-3/11 *Sigmarsson*, para. 51.

⁴³⁸ *Ibid.*, para. 50.

movement of capital to be justified the rules enacting that restriction must be suitable for securing the objective pursued and must not exceed what is necessary to achieve it.⁴³⁹ The Court found that none of the information in the case suggested that the measures had not been taken in conformity with the principle of proportionality and pointed out that the krona and the foreign exchange reserves were only stabilised when the rules prohibiting inbound transfer of offshore kronas were enacted. The Court also struck down the argument that the rules rendered paying off debts in Iceland's for individuals such as Mr. Sigmarsson impossible explaining that the rules merely lead to the more favourable exchange rates for Icelandic kronas on the offshore market could not be readily obtained. Finally, the Court explained that Mr. Sigmarsson's argument that as the funds in question were small and that consequently it would be disproportionate not to grant him exception did not hold up because all holders of offshore kronas could argue the likewise and in that case the collective funds would have a major impact.⁴⁴⁰ The Court also held that the measures and the scheme providing for exceptions to the rules did not go against the principle of legal certainty as all inbound transfer of offshore kronas was prohibited except for when an exception was granted.⁴⁴¹

It is regrettable that the EFTA Court's opinion is not completely clear on the issue of whether the exceptions or derogations provided for in Article 43 EEA are substantially comparable to other derogations of Article 40 EEA or not, considering the submissions of the parties.⁴⁴² Derogations can be categorized as general and specific. The ECJ developed its restriction approach and balancing test, Member States may derogate from their obligations on grounds of imperative requirements in the public interest. The derogations listed in Article 65 TFEU are of this type, being considered express derogations. Specific derogations exempt Member States from the obligations of the fundamental freedoms meaning that the free movement provision does not apply which leads to a more extensive derogations than that of a general derogation. It must, however, be kept in mind that the scope of specific derogations must be interpreted restrictively and be limited to what is strictly necessary to safeguard the protected interests in question. The derogations which were at issue in the *Sigmarsson* case belong to the specific derogations. However, some argue that they belong to a third type of derogations, which is protective measures, safeguard measures or escape clauses.⁴⁴³ The

⁴³⁹ EFTAC E-3/11 *Sigmarsson*, para. 52.

⁴⁴⁰ *Ibid.*, para. 53.

⁴⁴¹ *Ibid.* para. 55.

⁴⁴² Dóra Guðmundsdóttir: "B. EFTA Court", p. 2031.

⁴⁴³ *Ibid.*, p. 2031-2032.

EFTA Court could have, but did not, rely on ECJ 203/80 *Casati* in interpreting Article 43(2) EEA. In *Casati* the ECJ said of Article 73 EEC that its purpose was to enable Member States to introduce restrictions subject to certain conditions and in accordance with certain procedures, restrictions it would otherwise have to refrain from imposing under the general rules on the movement of capital.⁴⁴⁴ The formulation stated by the ECJ in *Casati* indicates that the parallel provisions to Article 43 EEA were intended as exceptions to the fundamental freedoms and more extensive than general derogations. Such safeguard measures or escape clauses were restricted to cases of economic difficulties and were envisioned as a possibility of derogations in order to overcome economic difficulties.⁴⁴⁵

A measure which aim at safeguarding vital interest in an economic crisis can involve a serious hindrance, even negation, of the fundamental freedoms and yet be allowed, provided it is to be a temporary measure subject to appropriate authorization or control mechanism. A derogation such as this seems to have more in common with specific derogations rather than general derogations meaning that they are removed from the scope of the free movement provisions and as a result from the balancing test applicable in case of general derogations. This implies that individuals cannot rely on the primary provision to challenge measures which are considered protective measures within the meaning of Article 43 EEA.⁴⁴⁶

In *Sigmarsson* the EFTA Court's approach suggest that it sees Article 43 as a general derogation from Article 40 EEA, based on the EFTA Court referring to its earlier case law relating to justifications of restrictions of the fundamental freedoms and ECJ case law on free movement provisions. Another indication is the Court's comments on the proportionality of the measures rather than focusing on their necessity. Guðmundsdóttir has argued that if the EFTA Court intended to apply the general derogation framework of analysis "it should have left the assessment of proportionality of the measure to the national court, in order to ensure consistency with both its previous case law and the established approach of the ECJ." Guðmundsdóttir further points out that the only point in favour of the EFTA Court seeing the measures at issue as a specific derogation is its lack of scrutiny of recognized public interest objectives as justification for them. The EFTA Court, in acknowledging a wide margin of discretion to the Contracting Parties and not examining the economic policy inherent in the measures, unsettles the general derogation framework of analysis in that the ECJ and EFTA Court have, in previous case-law, scrutinized any justifications advanced by Member States

⁴⁴⁴ ECJ 203/80 *Casati*, para. 14.

⁴⁴⁵ Dóra Guðmundsdóttir: "B. EFTA Court", p. 2032.

⁴⁴⁶ *Ibid.*, p. 2033.

as well as rejecting economic grounds as justification for restrictions of the fundamental freedoms. These factors indicate that the EFTA Court might see the derogations as special derogations or safeguard measures that can be applied in circumstances of economic disturbances.⁴⁴⁷ This assessment must be agreed with.

The Icelandic Capital Controls are still in force today (2014). Considering that this is a major derogation of the EEA Agreement it is not surprising that other Contracting Parties raised concerns on how long this can go on. On February 19, 2014 a member of the European Parliament inquired to the European Commission about the restrictions.

In only 'taking note' of Iceland's capital controls (introduced in 2008) without giving a response and therefore, de facto, approving the controls, is the Commission fulfilling its obligations in the Joint Committee of ensuring the effective operation of the EEA Agreement (Articles 43, 45 and 92 EEA)?

In view of the Commission's obligations to safeguard the free movement of capital throughout the EEA (cf. Article 92 EEA), and in view of the requirement that capital restrictions remain in place only for the shortest period of time (Article 45), does the Commission intend to continue to approve of Iceland's capital controls?

Is the Commission fulfilling its duty to ensure the effective operation of the EEA Agreement and its duty to safeguard and enforce the TFEU (Article 17 TEU), bearing in mind that EU businesses, having invested in Iceland, now find that their investments have effectively been barred for more than five years and that they are unable to invest such capital elsewhere and thereby exercise their rights under the TFEU (Article 63)?

Given that EEA states cannot adopt an à la carte approach to fundamental freedoms, does the Commission believe that Iceland's restrictions satisfy the rules on the free movement of capital?

In light of the fact that Iceland has had capital controls in place for over five years, thereby limiting the free movement of capital between the EU and its fellow EFTA states, is the Commission considering renegotiating the EEA Agreement?⁴⁴⁸

On April 14, 2014 High Representative and Vice-President of the Commission, Catherine Ashton, responded. The High Representative touched on the 2008 financial crisis as the impetus for the capital controls and clarified that the legality of the restrictions had been confirmed by the EFTA Court, referencing its E-3/11 *Sigmarsson* judgement in a footnote. She further stated that the Court had also confirmed that Iceland had respected all the special procedures set forth in Articles 43, 44 and 45 of the EEA Agreement regarding consultation and notification of the EFTA Standing Committee and the EEA Joint Committee. Due to this, the Commission had not objection to the introduction of capital restrictions in Iceland.

⁴⁴⁷ Dóra Guðmundsdóttir: "B. EFTA Court", p. 2033-2034.

⁴⁴⁸ Parliamentary question: Icelandic capital restrictions and the EEA Agreement, February 19, 2014. Reference no. E-001903-14.

Next, the High Representative pointed out that removal of the controls remains a complicated process, confirmed by the conditions-based strategy approved by the Icelandic Government in March 2011. Information available at the time of the response did not make it possible for the High Representative to conclude whether and when the strategy will be successful. The European Commission used its legal competences in the framework of the EEA Joint Committee and invited Icelandic authorities to provide regular updates on the progress achieved that would render an appropriate assessment of the continuous needs of control possible. Further, she stated that the final goal remains the gradual removal of the capital controls, pointing out that they were temporary. The High Commissioner further considered there to be no grounds for considering a renegotiation of the EEA Agreement in light of the fact that the restriction Iceland introduced were done so in respect of the EEA Agreement and that there was an ongoing process to lift them.⁴⁴⁹

In its Notification of March 31, 2011 the Icelandic Government informed the Joint Committee that several days previously it had adopted a revised strategy for the gradual liberalisation of capital controls. The strategy, intended to take place in two phases, had no time limits, its pace of execution depending on evaluation of relevant economic conditions and the outcome of previous steps. In the notification the Icelandic Government further stated that rapidly lifting the capital controls in full would mean unacceptable risk to financial and exchange rate stability. The Government then informed the Joint Committee of plans to extend the capital controls until the end of 2015 in order to put the strategy into effect, though stating that they will be lifted earlier if conditions permit.⁴⁵⁰ Most recently, the Icelandic Ministry of Finance and Economic Affairs hired a number of specialists to aid Icelandic authorities in abolishing the capital controls.⁴⁵¹ It is however interesting to note that but a month earlier the Central Bank of Iceland found that certain types of life insurance contracts, wherein Icelandic nationals invest in life insurance funds abroad through intermediaries in Iceland, were contrary to the currency controls because they included a savings element abroad. According to the Central Bank of Iceland, in order to minimize the disruption to individuals who had made such contracts with foreign insurance undertakings the terms of the contracts would have to be changed so as to ensure that they would be in Icelandic krona and

⁴⁴⁹ Parliamentary questions: Answer given by High Representative/Vice-President Ashton on behalf of the Commission, April 14, 2014. Reference no. E-001903/2014.

⁴⁵⁰ "Notification regarding foreseen prolongation and revision of protective measures notified under Article 43 of the EEA Agreement", March 31, 2011.

⁴⁵¹ "Sérfræðingar ráðnir vegna afnáms gjaldeyrishafta", <http://www.vb.is/frettir/107303/> (viewed July 22, 2014)

that savings would be in Iceland.⁴⁵² Considering that it has been almost six years since the currency controls were put in place and that the contracts do not seem to have had a significant effect on the stability of the Icelandic economy during that time the question of proportionality might be raised regarding these measures and whether it was really necessary to take them at this time.

Consider for instance the capital controls Cyprus was forced to put into place in 2013 to prevent risk due to uncontrollable outflow of deposits which would lead to a collapse of credit institutions in Cyprus and destabilise the financial system of Cyprus. The Commission held that while Member States were allowed to introduce such restrictions on capital movements on grounds of public policy, public security or for overriding reasons of the general public interest such exceptions to the principle of free movement of capital must be interpreted very strictly, be non-discriminatory, suitable, proportionate and be applied for the *shortest possible period* and that free movement of capital should be reinstated as soon as possible.⁴⁵³ Cyprus lifted its capital controls in May 2014.⁴⁵⁴

As regards the principle of proportionality in the Treaties of the European Union, three questions should be posed when applying the principle of proportionality. Firstly, does the measure aim at achieving the objective in question? Secondly, is the measure necessary, that is to say, is there a less far-reaching alternative available? Thirdly, is the public benefit from the measure reasonable in comparison to the damage that the measure causes for individuals?⁴⁵⁵

The capital controls undoubtedly have stabilized the currency and were an important measure in a dire situation but lifting them and removing the discrimination will be mandatory to reintegrate Iceland into the world economy as well as restore investors' faith in the country. The effects of the crisis on Iceland's population may explain the international community's acceptance, or at least tolerance,⁴⁵⁶ of the Icelandic capital controls but the Government must be careful as that cannot be expected to last forever.

⁴⁵² "Reglum um gjaldeyrismál breytt til að milda áhrif stöðvunar óheimils sparnaðar erlendis" <http://sedlabanki.is/utgefid-efni/frettir-og-tilkynningar/>, (viewed July 22, 2014).

⁴⁵³ "Statement by the European Commission on the capital controls imposed by the Republic of Cyprus." (http://europa.eu/rapid/press-release_IP-13-298_en.htm).

⁴⁵⁴ George Psyllides: "Last of domestic cap controls lifted", <http://cyprus-mail.com/tag/capital-controls/>.

⁴⁵⁵ Matthias Dahlberg: *Direct Taxation in Relation to the Freedom of Establishment and the Free Movement of Capital*, p. 30.

⁴⁵⁶ Annamaria Viterbo: "Iceland's capital controls and the constraints imposed by the EEA agreement", p. 236.

12. Conclusions

As I have discussed in this essay, the free movement of capital, despite being an important factor in the other freedoms and the internal market, developed more slowly than the other freedoms, being “the late bloomer” of the bunch. Early provisions on the free movement of capital only required Member States be as liberal as possible with regard to that freedom. To restrictions on free movement of capital further measures were required in the form of secondary legislation to abolish restrictions. With the Commission’s *White Paper on Completion of the Internal Market* in 1985 came greater awareness of the freedom’s importance for the success of the Internal Market. A new directive was adopted, Directive 88/361/EEC, establishing the free movement of capital as EU law. The freedom has developed more steadily and caught up with the other free movement provisions after the Treaty of Maastricht came into force in 1993, emulating the provisions of Directive 88/361/EEC, and the ECJ took a more active role in its development.

The free movement of capital can be split into two parts; the free movement of capital and the free movement of payments. The latter is not an independent freedom but consist of money transfers as payment for goods and services. Article 106 EEC required Member States to authorize payments in relation to movements of goods, services or capital in the currency of the Member State where the benefactor or creditor resided. The provisions was held to have direct effect, at a time when the other provisions concerning the free movement of capital were not considered to have that effect, and was described by the ECJ as perhaps the most important provision in the EEC Treaty being immensely important for the attainment of the Internal Market.

Capital movements are not defined in the TFEU, instead the ECJ has relied on the Annex of Directive 88/361/EEC to define the term, even after the directive was abolished. As the Annex is inexhaustive a transaction can still constitute a capital movement even though it is not listed therein. In ECJ 203/80 *Casati* the ECJ held that provisions on the free movement of capital in the EEC Treaty did not have direct effect as they were not sufficiently liberalized. After the treaty amendments enacted by the Treaty of Maastricht took force the ECJ finally held, in joined cases ECJ C-163/94, C-165/94 and C-250/94 *Sanz de Lera*, that the provisions on the free movement of capital had direct effect.

Changes to the wording of Article 63(1) TFEU, from referring to both abolition of discrimination *and* restriction before the Treaty of Maastricht to simply referring to restriction after the Maastricht Treaty took force, have not deterred the ECJ from applying both the

discrimination and restrictions model. The ECJ has held that both *direct* discrimination, based on nationality, *indirect* discrimination, not based directly on nationality but having the same effect, and restrictions which hinder, impede or make access to the market less attractive breach the free movement of capital. Direct discrimination can only be justified by reference to an express derogation listed in the TFEU while indirect discrimination can be justified by public interest reasons. The ECJ has relied on the rule of reason developed in its case-law concerning goods and services when interpreting the scope of restriction in relation to the free movement of capital. The restrictions approach can be seen clearly in the case-law on golden shares, i.e. cases where government have held shares in private undertakings, often ones that used to be owned by the state, which give them special powers. In its case-law on golden shares the ECJ has deemed that many such scheme restrict the free movement of capital as they deter investors from investing in such undertakings where a scheme of that nature has been set up or restrict participation in the management of such an undertaking. As pointed out in Gebhard restrictions can be saved by public interest justifications but those are subject to conditions, such as complying with the principle of proportionality.

Article 63 TFEU differs from the other freedom provisions in the TFEU as it not only liberalizes free movement of capital between Member States but also between Member states and *third countries*. In principle the free movement of capital has the same scope in the context of capital movements between Members States and third countries as in the intra-Union context but in fact Articles 64 and 66 TFEU provide measures for the EU to regulate such capital movements and adopt safeguard measures. The different context of intra-Union capital movements and extra-Union capital movements also means that the freedom doesn't have the same effect in both situations.

The ECJ considers that Article 65(1)(a) TFEU is a codification of its earlier judgements, ECJ C-204/90 *Bachman* and ECJ C-279/93 *Schumacker*, and therefore did not consider that it had to change its methodology when the provision was first inserted into the EC Treaty with the Maastricht Treaty. Both Article 65(1)(a) and (b) cannot constitute derogations in the tax context, subparagraph (a) allows Member States to distinguish between taxpayers that are not in the same situation and subparagraph (b) allows Member States to take measures to prevent infringements of national law and regulations. Both provisions are limited by Article 65(3) TFEU which stipulates that restrictions cannot constitute arbitrary discrimination. For restrictions not to be considered arbitrary they must apply to situations which are not objectively comparable or be justified by reasons in the public interest. They must also be considered suitable and not go beyond what is necessary to attain the objective. Article

65(1)(b) TFEU contains a reference to public policy and public security and the ECJ has relied on its jurisprudence on other freedoms when interpreting these terms.

The European Free Trade Association was seen as an alternative to the European Union when it was founded. However, these two trade blocks began cooperation through free-trade agreements early on. With the realisation of the EEA the two began an even more extensive cooperation, intending for the internal market to extend to the entire EEA. The EEA Agreement however was concluded before the Maastricht Treaty. Therefore, of this the provisions contained in the the EEA Agreement do not reflect the more recent changes to the free movement of capital rules in the EU, despite the EEA Agreement's dynamic nature and constant updating of annexes and protocols. Additionally, while the provisions of the TFEU are intended to apply to capital movements to and from third countries, even though the freedom may be more limited in the third country context than Article 63 TFEU suggests, the EEA Agreement is only intended to apply to movements *within* the EEA between the Contracting Parties.

The principle of homogeneity can be said to be one of the most important principles of the EEA Agreement. The ECJ pointed out in ECJ 270/80 *Polydor* and Opinion 1/91 that similar or identical provisions were not enough to ensure homogeneity as context could lead to differing interpretation. There is therefore a clear emphasis on homogeneity in the EEA Agreement from recitals in the preamble to provisions which are meant to combat divergence between the EU and the EEA. While minor differences in wording of parallel provisions do not pose a threat to the goal of homogeneity there are real differences, for instance as regards derogations. The fact that the EEA Agreement does not have a parallel provision to Article 65 TFEU is, however, alleviated by the ECJ pre-EEA Agreement case-law. There are however situations where the ECJ has found that the provisions of free movement of capital in EU law on the one hand and EEA law on the other hand cannot be interpreted in exactly the same way due to different legal context of each set of law. An example of this is when the EEA EFTA States have not been required to adopt certain secondary legislation. Such situations could however be remedied with the EEA EFTA States making separate agreements with the EU. The EFTA Court is an important promoter of homogeneity in the EEA and has, for instance, found that the doctrine of *state liability* exists in EEA law, mimicking case-law of the ECJ before the signing of the EEA Agreement.

While the general rule of free movement of capital remains largely the same within the EEA and the EU the same cannot be said for provisions on derogations which differ quite a bit. For instance the EEA Agreement contains no parallel provision to Article 65 TFEU. To

compensate for this legislative gap the EFTA Court has stretched quite far, too far some would say, and even resorted to applying Article 65 TFEU. While the EFTA Court did not reference the provision directly in EFTAC E-1/04 *Fokus Bank* it did refer to ECJ C-319/02 *Manninen* which was based on the Article 65 TFEU. The reasoning of the Court was therefore flawed as it would have made more sense for the Court to refer to *Schumacker* and *Bachman* on which Article 65 TFEU was based but were handed down before the signing of the EEA Agreement. The EFTA Court however went on to reference Article 65 TFEU directly in EFTAC E-10/04 *Piazza*.

In this thesis the Icelandic capital controls were specifically examined. The Icelandic capital controls create an even bigger divergence between that Contracting Party and the rest of the EEA. The restrictions, in force since 2008, have yet to be lifted and while they are *technically* permissible under the EEA Agreement as long as the situation demands it, other Contracting Parties cannot be expected to be tolerant of them forever. Sooner or later the restrictions must be lifted and Iceland will resume its full participation in the EEA regime.

While there are differences between the TFEU and the EEA Agreement those should not prove insurmountable, at least not where it concerns the free movement of capital. It is important, however, that Iceland lift the capital controls in the near future, seeing as it is a major derogation from the EEA Agreement and restriction of the free movement of capital. The free movement of capital is a very important freedom as it facilitates the exercise of the other freedoms but has restricted this freedom for more than half a decade now. Considering that, one must wonder how much longer the capital controls can be kept in force without Iceland being considered to be in contravention of the Agreement.

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