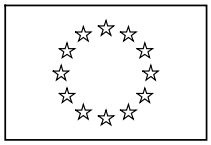

COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL, THE EUROPEAN PARLIAMENT AND THE EUROPEAN CENTRAL BANK

APPLICATION TO FINANCIAL SERVICES OF ARTICLE 3(4) TO (6) OF THE ELECTRONIC COMMERCE DIRECTIVE

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1. INTRODUCTION

The purpose of this communication is to describe the mechanisms introduced in the specific area of financial services by Article 3(4) to (6) of the Electronic Commerce Directive.[1]

In the case of financial services, the communication is justified by the fact that, since the adoption of the Electronic Commerce Directive and, in particular, during the negotiations on the Directive on the distance selling of financial services, a number of Member States have expressed misgivings regarding full application of the "internal market" clause in the area of financial services. They have taken the view that, pending closer convergence in certain areas (such as the rules of conduct for investment services or non-harmonised funds), they should still be able to impose some of their rules on input services provided electronically despite the existence of the Electronic Commerce Directive. A transitional period of this kind, which would have been tantamount to an albeit temporary derogation from the Directive, was rejected by the Commission and by a majority of the Member States.

The Commission had stressed at the time that Article 3(4), (5) and (6) of the Electronic Commerce Directive provides sufficient safeguards for Member States wishing to take measures on a case-by-case basis against a service provider that is prejudicing one of the objectives of general interest specified in Article 3(4)(a)(i) of the Directive or presenting a serious risk of prejudice to such an objective.

This communication sets out to provide assistance to Member States who may wish to avail themselves of these mechanisms. In no way does it constitute an interpretative document. Nor does it systematically cover all the aspects of Article 3(4) to (6) of the Directive, addressing only those aspects where the Commission has noted that there is a need for some explanation and assistance.

This communication does not impose any legal obligation on Member States. It does not prejudge the position that the Commission might decide to take on the same matters if developments, including Court rulings, were to lead it to revise some of the views expressed here.

Together with the Member States, the Commission will also continue to identify the areas in which closer convergence of national rules might be necessary. In this connection, it will examine the harmonisation needs in certain sectors where it transpired that national rules still diverged, creating potential problems for the free movement of services and consumer protection (e.g. in the case of certain non-harmonised investment funds).

The Commission is aware of the fact that not all the rulings referred to in this Communication are related to the area of financial services and that none refer to disputes concerning electronic commerce. Nevertheless, on the basis that the Court of Justice regularly works

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[1] European Parliament and Council Directive 2000/31/EC of 8 June 2000 (OJ L 178, 17.7.2000, p. 1).

according to analogies and strictly speaking has no “sectoral” case law, the Commission is of the opinion that it is both possible and accurate to base the following analysis on existing case law.

However it certainly cannot be ruled out that the Court will develop case law in the specific area of E-Commerce. Such case law could confirm or contradict existing case law. This risk is inherent in the current exercise.

2. ANALYSIS OF ARTICLE 3(4) TO (6)

The Electronic Commerce Directive stipulates that each Member State must ensure that the information society services provided by a service provider established on its territory comply with the national provisions applicable in the Member State in question which fall within the coordinated field.

It also stipulates that Member States may not, for reasons falling within the coordinated field, restrict the freedom to provide information society services from another Member State

- However, it lays down certain derogations.

First, the annex to the Directive contains a number of derogations from the "internal market" clause. These derogations reproduce a number of the provisions laid down in the Directives on insurance,[2] advertising in the case of UCITS[3] and the issue of electronic money by institutions not in possession of a European passport.[4]

Second, there are a number of other general derogations that could be particularly relevant to financial services. They relate to the freedom of the parties to choose the law applicable to their contract, the contractual obligations set out in contracts concluded with consumers, etc.

Lastly, Article 3(4), (5) and (6) of the Directive allows Member States to take measures such as sanctions or injunctions that may restrict the provision of on-line services from other Member States. These measures are subject to strict conditions.

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2 Article 30 and Title IV of Directive 92/49/EEC (OJ L 311, 14.11.1997, p. 42), Title IV of Directive 92/96/EEC (OJ L 311, 14.11.1997, p. 43), Articles 7 and 8 of Directive 88/357/EEC (OJ L 172, 4.7.1988, p. 1) and Article 4 of Directive 90/619/EEC (OJ L 330, 29.11.1990, pp. 50-61).

3 Article 44(2) of Directive 85/611/EEC (OJ L 375, 31.12.1985, pp. 3-18).

4 Institutions in respect of which Member States have applied one of the derogations provided for in Article 8(1) of Directive 2000/46/EC (OJ L 275, 27.10.2000, pp. 39-43).

The relevant provisions of the Directive read as follows:

"4. Member States may take measures to derogate from paragraph 2 in respect of a given information society service if the following conditions are fulfilled:

(a) the measures shall be:

(i) necessary for one of the following reasons:

- public policy, in particular the prevention, investigation, detection and prosecution of criminal offences, including the protection of minors and the fight against any incitement to hatred on grounds of race, sex, religion or nationality, and violations of human dignity concerning individual persons,

- the protection of public health,

- public security, including the safeguarding of national security and defence,

- the protection of consumers, including investors;

(ii) taken against a given information society service which prejudices the objectives referred to in point (i) or which presents a serious and grave risk of prejudice to those objectives;

(iii) proportionate to those objectives;

(b) before taking the measures in question and without prejudice to court proceedings, including preliminary proceedings and acts carried out in the framework of a criminal investigation, the Member State has:

- asked the Member State referred to in paragraph 1 to take measures and the latter did not take such measures, or they were inadequate,

- notified the Commission and the Member State referred to in paragraph 1 of its intention to take such measures.

5. Member States may, in the case of urgency, derogate from the conditions stipulated in paragraph 4(b). Where this is the case, the measures shall be notified in the shortest possible time to the Commission and to the Member State referred to in paragraph 1, indicating the reasons for which the Member State considers that there is urgency.

6. Without prejudice to the Member State's possibility of proceeding with the measures in question, the Commission shall examine the compatibility of the notified measures with Community law in the shortest possible time; where it comes to the conclusion that the measure is incompatible with Community law, the Commission shall ask the Member State in question to refrain from taking any proposed measures or urgently to put an end to the measures in question."

2.1. ANALYSIS OF ARTICLE 3(4)

2.1.1. Areas covered by Article 3(4)

Article 3(4) does not cover all the reasons identified by the Court in the context of Articles 49 and 28 of the Treaty as justifying a restriction on the ground of defending the general interest. Except for the grounds stipulated in Article 46 of the Treaty (public policy, public security and public health), it identifies only one of the objectives that could, according to the Court, justify infringements of the free movement of services. This objective is the protection of consumers, including investors.

The exhaustive nature of this list means that some of the objectives recognised by the Court as being in the general interest, such as protecting the good reputation of the financial sector,[5] cannot provide justification for measures taken under Article 34, except in cases where such measures are purportedly designed to protect the consumer.

2.1.2. Concept of "given information society service"

A "given" service is taken to mean here that the Member State of destination may not, under Article 3(4), take general measures in respect of a category of financial services such as investment funds or loans.

To be covered by Article 3(4), the measure must, therefore, be taken on a case-by-case basis against a specific financial service provided by a given operator.

For example, it could be a measure such as a warning or a penalty payment taken by a country of destination against a bank proposing from its place of establishment in another EU country non-harmonised investment services to residents of that country. Such measures could, for instance, be taken on the ground that the bank was not complying with certain rules of conduct designed to protect consumers in the country of destination.

However, a Member State could not, on the basis of Article 3(4), decide that its entire legislation on, say, non-harmonised investment funds was applicable in a general and horizontal fashion to all services accessible to its residents.

2.1.3. Protection of "public policy"

The reasons given in the paragraph of the Directive concerning public policy are intended as examples.

In the area of financial services, it is highly unlikely on the face of it that such services can prejudice public policy, in the Community meaning of the term. This concept must be viewed in the light of the Court of Justice's relevant case law, which states that it must be interpreted in a very restrictive manner.[6]

The Court has, for example, consistently held that economic objectives cannot constitute grounds of public policy within the meaning of Article 46 of the Treaty.[7]

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5 Case C-384/93 *Alpine Investments* [1995] ECR I-1141.

6 Case C-348/96 *Calfa* [1999] ECR I-11.

7 Case 352/85 *Bond van Adverteerders* [1988] ECR 2085.

For the Court, *"recourse by a national authority to the concept of public policy presupposes, in any event, the existence, in addition to the perturbation to the social order which any infringement of the law involves, of a genuine and sufficiently serious threat affecting one of the fundamental interests of society."*[8]

With the exception of services provided illegally in the context of the financing of criminal activities (including terrorism) and money laundering, it is difficult to see which financial services could meet this judicial condition of a "serious threat affecting one of the fundamental interests of society".

2.1.4. Protection of consumers, including investors

The Electronic Commerce Directive defines a consumer as *"any natural person who is acting for purposes which are outside his or her trade, business or profession"*.

It is thus clear from the text that a legal person cannot be regarded as a "consumer" within the meaning of the Directive.

By contrast, investors are not defined. However, it is clear from the wording of Article 3(4) that only "investors" caught by the definition of "consumer" are concerned. Any measure concerning, for example, investors who were legal persons or individuals acting within their profession would not be covered by Article 3(4).[9]

The Court has ruled that both insurance[10] and banking[11] are particularly sensitive sectors from the point of view of consumer protection.

2.1.5. Concept of "serious and grave" risk

The measures must be taken against a given service that effectively prejudices one of the objectives spelt out or presents a serious and grave risk of so doing.

This wording allows the Member State in which the service is provided to take not only punitive but also preventive measures where there is a serious and grave risk to those objectives.

2.1.6. Notification conditions

There are three notification conditions:

– the Member State taking the measures must have asked the Member State in which the provider is established to take measures;

– the latter must not have taken any measures or any measures it did take have been inadequate;

– the Member State taking the measures must have notified the Commission and the Member State in which the provider is established of its intention to take such measures.

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8 Case 30/77 *Bouchereau* [1977] ECR 1999.

9 Joined Cases C-541/99 and C-542/99 *Idealservice* [2001] ECR I-9049.

10 Case 205/84 *Commission* v *Germany* [1986] ECR 3755.

11 Case C-222/95 *Parodi* [1997] ECR I-3899.

These three conditions are perfectly clear.

The first condition requires the Member State in which the provider is established to have been informed and put in a position to resolve the problem at its own level. The second condition is that, in the view of the Member State of destination, it has not done this adequately. The third condition requires prior notification of the Commission in order for it to be able to exercise the powers enjoyed by it under paragraph 6 and of the Member State of origin. The Directive does not specify any precise deadline by which the Member State of the provider must act following the notification received from the Member State in which the service is provided. However, Article 19(3) of the Directive stipulates that Member States must, "*as quickly as possible*", provide the assistance and information requested by other Member States or by the Commission.

It is also clear from Article 3(4)(b) of the Directive that the notification requirement in no way deprives the Member State in question of the right to institute court proceedings, including preliminary proceedings, and to carry out acts in the framework of a criminal investigation.

Lastly, it should be pointed out that the dialogue with the Member State in which the provider is established and notification of the Commission are matters for the State's central administration and not, for example, the courts.

2.1.7. Consequences of a lack of notification

If the Commission and the Member State of origin have not been notified in advance, the Commission could initiate proceedings against the Member State taking the measure for failure to comply with its obligations. In addition, since they are sufficiently precise and unconditional, the provisions of the Directive requiring Member States to give notification could presumably be relied upon before a national court. Accordingly, a bank could bring a matter before a national court on the ground that the measures taken against it in a Member State on the basis of Article 3(4) were not notified in advance.

2.2. ANALYSIS OF ARTICLE 3(6)

Article 3(6) requires the Commission to examine the compatibility of measures notified under paragraph 4.

It is important to note that this examination does not have suspensory effect in that the Member State of destination may take the proposed measures without awaiting the result of the Commission's examination.

In conducting this examination, the Commission will base itself on the conditions set out in paragraph 4 and on the Court of Justice's case law.

The Court has consistently held that:

"National measures liable to hinder or make less attractive the exercise of a fundamental freedom guaranteed by the Treaty must fulfil four conditions: they must be applied in a non-discriminatory manner; they must be justified by imperative requirements in the general interest; they must be suitable for securing the attainment of the objective which they pursue; and they must not go beyond what is necessary in order to attain it."[12]

On the basis of this case law, the Commission will therefore apply a number of tests in order to ascertain the conformity of a notified measure.

2.2.1. General-interest test

It is essential that the measure taken falls within one of the areas expressly referred to in Article 3(4); we have seen that these are fewer than the objectives recognised as being in the general interest by the Court.

2.2.2. Non-discrimination test

The Court has consistently defined discrimination as:

"the application of different rules to comparable situations or the application of the same rule to different situations"[13].

Account will need to be taken here of the objective circumstances in order to determine whether there is actual discrimination.[14]

Such discriminatory measures are nowadays not very often to be found in national rules governing financial services but there can be no ruling out the possibility that some still exist. For example, if a penalty imposed on a non-established financial service provider were more severe than a penalty imposed in identical circumstances on an established provider, this would be tantamount to discrimination.

In accordance with the Court's case law and subject to its being proportionate, the discriminatory measure could be justified only on the grounds specified in Article 46 of the Treaty (public policy, public safety, public health).[15]

2.2.3. Non-duplication test

The Commission will examine the legal arrangements in the country of origin to determine whether there is duplication between the proposed measures and, say, the protection offered in the country of origin and the checks carried out there. If this were to be the case, it could be concluded that the objective of general interest pursued by the country of destination was already met by the rules in force in the provider's country of establishment. Similarly, the Commission will examine whether the measures taken by the country of establishment are inadequate within the meaning of Article 3(4)(b).

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12 Case C-55/94 *Gebhard* [1995] ECR I-4165.
13 Case C-107/94 *Asscher* [1996] ECR I-3089.
14 Case C-224/00 *Commission* v *Italy* (not yet published).
15 Case C-17/92 *Federación de Distribuidores Cinematográficos* [1993] ECR I-2239.

One illustration of this criterion can be found in the judgment of 9 March 2000, in which the Court ruled as follows:

"By requiring all undertakings to fulfil the same conditions for obtaining prior authorisation or approval, the Belgian legislation makes it impossible for account to be taken of obligations to which the person providing the service is already subject in the Member State in which he is established."[16]

This ruling could be particularly useful in that the Commission has come to realise that some Member States continue to apply prior authorisation procedures in certain areas in particular.

The Court has also ruled that Member States *"must have mutual trust in each other as far as controls carried out on their respective territories are concerned"*[17].

For example, if the country of destination imposes its own rules of conduct on an investment service provided to one of its residents, the Commission will examine whether the rules of conduct in force in the country of origin are not equivalent to those on which the country of destination intends to rely.

2.2.4. Proportionality test

This test has two components. The measures must be suitable for achieving the objective pursued (suitability test) and they must not go beyond what is necessary to obtain that objective (test of substitution by less restrictive measures).

2.2.4.1. Suitability of the measure to the objective pursued

Even if a measure taken by a Member State is described as being in defence of an objective of general interest, it may be open to question whether the measure is really necessary to protect that interest. There may be cases in which, objectively, the measure is not necessary or is not suited to protecting that interest.

The Court of Justice has, in a number of judgments, held that a given rule invoked by a Member State with an avowed aim of protecting the consumer was not, in the final analysis, suited to providing this protection.

For example, the Court has taken the view that, since the provision of information is a principal requirement with regard to consumer protection, a Member State that imposes rules which, in the final analysis, restrict the access of consumers to certain items of information cannot rely on consumer protection to justify them.[18]

The Court thus examines closely whether the measure referred to it actually benefits the consumer[19] and whether the Member State taking it does not underestimate the consumer's ability to make a judgment in the matter.[20] It has recourse here to the term "average

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16 Case C-355/98 *Commission* v *Belgium* [2000] ECR I-1221.
17 Case C-11/95 *Commission* v *Belgium* [1996] ECR I-4115.
18 Case C-362/88 *GB-INNO-BM* [1990] ECR I-667.
19 Case C-240/95 *Schmit* [1996] ECR I-3179.
20 Case C-470/93 *Mars* [1995] ECR I-1923.

consumer",[21] taking into account *"the presumed expectations of an average customer who is reasonably well-informed and reasonably observant and circumspect"*.[22]

The Court thus checks in particular whether, under the pretext of consumer protection, some measures do not in fact pursue objectives aimed at protecting the domestic market.

It also examines the nature of the services in question and the corresponding need for protection. For example, in the area of banking services, it has held that:

"…a distinction according to the nature of the banking activity in question and the risk incurred by the person for whom the service is intended. Thus, the conclusion of a contract for a mortgage loan presents the consumer with risks that differ from those associated with the lodging of funds with a credit institution. Furthermore, the need to protect the borrower will vary according to the nature of the mortgage loans, and there may be cases where, precisely because of the nature of the loan granted and the status of the borrower, there is no need to protect the latter by the application of the mandatory rules of his national law." [23]

The Commission could, therefore, be guided by the same considerations when faced with the task of examining the proportionality of a notified measure.

2.2.4.2. Possibility of substitution by less restrictive measures

Existence of less restrictive measures

In determining the proportionality of a given measure, the Commission will ascertain whether the measure does not go beyond what is necessary or whether there are less restrictive ways of achieving the objective of general interest being pursued or measures that are less restrictive in their effect on intra-Community trade.[24]

The Court has, for example, ruled that, instead of preventing the broadcasting and retransmission of broadcasts by a television company, a Member State could achieve the objective of protecting a general interest by taking specific measures solely against the advertiser that is the source of a given advertisement broadcast by that company and that provides its services from another Member State.[25]

In addition, in a recent case concerning the taxes imposed on satellite dishes by Belgian municipalities, the Court had the opportunity to apply the "substitution" principle, ruling that:

"there are methods other than the tax in question in the main proceedings, less restrictive of the freedom to provide services, which could achieve an objective such as the protection of the urban environment, for instance the adoption of requirements concerning the size of the dishes, their position and the way in which they are fixed to the building or its surroundings or the use of communal dishes."[26]

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21 Case C-220/98 *Estée Lauder* [2000] ECR I-117.

22 Case C-210/96 *Gut Springenheide Gmbh* [1998] ECR I-4657.

23 Case C-222/95 *Parodi* [1997] ECR I-3899.

24 Case C-368/95 *Familiapress* [1997] ECR I-3689.

25 Joined Cases C-34/95 *Konsumentombudsmannen (KO)* v *De Agostini (Svenska) Förlag AB* and C-35/95 and C-36/95 *TV-Shop i Sverige AB* [1997] ECR I-3843.

26 Case C-17/00 *De Coster* [2001] ECR I-9445.

Although it concerns an area not directly related to the matters covered by this communication, this last example illustrates particularly well the approach that is taken by the Court, and the Commission could, therefore, be guided by the same considerations when making its assessment under Article 3(6).

In *Ambry*,[27] the Court held that the requirement on travel agencies to lodge a security with a financial institution situated on the national territory was disproportionate since the requirement that funds must be available for immediate payment *"can normally be met adequately even where the guarantor is established in another Member State"*.

This example, which, while not relating to a problem associated with the on-line provision of financial services, is of particular interest since it concerns investment services and is one of the cases in which the Court has applied the substitution test in a particularly thorough fashion, viz. the *SIM* case, in which the Court ruled:

"While the obligation to have the registered office in Italy facilitates the supervision and control of the operators in the market, such an obligation is not the only means of making sure that they comply with the rules for pursuing the activity of dealer in transferable securities laid down by the Italian legislature and of imposing effective sanctions on dealers who breach those rules."[28]

Situation in the other Member States

As part of this examination, the Commission could look at the legislation in force in the other Member States in order to determine whether less restrictive measures suited to ensuring consumer protection exist.[29]

However, it must be borne in mind that this exercise is limited in scope in so far as the Court has ruled that *"the fact that one Member State imposes less strict rules than another Member State does not mean that the latter's rules are disproportionate and hence incompatible with Community law"*[30]

and that:

"… the mere fact that a Member State has opted for a system of protection which differs from that adopted by another Member State cannot affect the assessment of the need for, and proportionality of, the provisions enacted to that end. Those provisions must be assessed solely by reference to the objectives pursued by the national authorities of the Member State concerned and the level of protection which they are intended to provide."[31]

Accordingly, the situation obtaining in the other Member States is of interest when it comes to identifying and proposing different, less restrictive measures. However, the existence in another Member State of a less restrictive measure does not in itself provide proof of any disproportionality. Although the situation in the other Member States could not be ignored, the arrangements in force in the Member State of destination must be assessed intrinsically in the light of the objectives pursued by that Member State.

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27 Case C-410/96 *Ambry* [1998] ECR I-7875.
28 Case C-94/101 *Commission* v *Italy* [1996] ECR I-2691.
29 Case C-126/91 *Yves Rocher* [1993] ECR I-2361.
30 Case C-384/93 *Alpine Investments, loc. cit.*
31 Case C-124/97 *Läärä* [1999] ECR I-6067.

Specific nature of electronic commerce

Lastly, account could be taken of the fact that the measures are taken against services provided at a distance electronically. The Court has ruled that:

"[…] a restriction is all the less permissible where, as in the main proceedings, and unlike the situation governed by the third paragraph of Article 60 [now Article 50] *of the Treaty, the service is supplied without its being necessary for the person providing it to visit the territory of the Member State where it is provided."*[32]

On the basis of this ruling a measure could theoretically be deemed proportionate as regards its application to providers visiting in person the territory of the country of destination but disproportionate in the case of a service provided at a distance. On the basis of this case law, the Commission might require a Member State to take due account of the way in which the service is provided and, where appropriate, might regard as less permissible any restriction applicable to on-line services.

Considerable care should, of course, be taken when extending this ruling by analogy to electronic commerce. In the situation leading up to the ruling in *Säger* referred to above, the client could not at any time have failed to know that he was dealing with a provider established in another Member State.

2.2.5. Commission decision

In accordance with Article 3(6), if it comes to the conclusion on the basis of the tests that the measure is incompatible with Community law, the Commission will ask the Member State concerned to refrain from taking the proposed measures or urgently to put an end to them.

It should be pointed out that the Commission's examination does not have suspensory effect and does not, therefore, prevent the Member State from taking the proposed measures.

Even if the Commission's examination is not subject to precise deadlines, action should be taken "in the shortest possible time", as provided for in the Directive.

If the Commission decides that the measure is compatible with Community law, the Member State concerned will be able to pursue (or begin, if it has not yet done so as a precaution) implementation of the measures against the Community undertaking in question.

At any event, the position that the Commission might have to defend in a given case is without prejudice to what the Court of Justice might decide.

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[32] Case C-76/90 *Säger* [1991] ECR I-4221.