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The European Commission Decision on Standard Contractual Clauses for the Transfer of Personal Data to Third Countries: an Effective Solution?

Alexander Zinser

I. Introduction

According to the European Data Protection Directive, data transfers to third countries should only take place when the third country in question ensures an adequate level of protection. With regard to the United States, the European Commission adopted the Decision on Safe Harbor whereby "[f]or the purposes of Article 25(2) of Directive 95/46/EC, for all the activities falling within the scope of that Directive, the Safe Harbor Privacy Principles … as set out in Annex I to this Decision, implemented in accordance with the guidance provided by the frequently asked questions … are considered to ensure an adequate level of protection for personal data transferred from the Community to organizations established in the United States." The Safe Harbor Principles issued by the United States Department of Commerce on July 21, 2000 and the accompanying Frequently Asked Question set forth the provisions ensuring the adequate level of data protection. However, an organization must also publicly declare that it complies with the Safe Harbor Principles. It may benefit from the Safe Harbor arrangement as soon as it self-certifies to the United States Department of Commerce.

US companies which have not self-certified for Safe Harbor have a further possibility to ensure an adequate level of protection. According to the Directive, a transfer to a third country, which does not ensure an adequate level of protection, may take place in cases "where the controller adduces adequate safeguards with respect to the protection of the privacy and fundamental rights and freedoms of individuals and as regards the exercise
of the corresponding rights."7 The Directive follows to state "such safeguards may in particular result from appropriate contractual clauses."8 There is provision for the European Commission to stipulate that certain Standard Contractual Clauses offer the necessary safeguards.9 However, it is admitted that individual contracts do not, of course, provide an adequate level of protection for an entire country.10

The idea behind Standard Contractual Clauses is to ensure that data exporters and data importers signing such model contracts can be sure that their transfers will be deemed to have an adequate protection. Any further approvals would not be necessary.11 Basically, the clauses should fulfil the following requirements in order to reach the status of adequacy: a) ensuring a high degree of compliance; b) assisting and helping data subjects; and c) gaining compensation in cases of violations of the clauses. At the European level, special attention should be put on contractual solutions: it is unlikely that the European Commission will adopt findings on the adequacy for more than a few countries.12

II. Historic Development
Contractual clauses as a means to regulate international data transfer have been used before the enactment of the Directive. In 1992, the Council of Europe, the Commission of the European Communities and the International Chamber of Commerce issued jointly a study called the "Model Contract to Ensure Equivalent Protection in the Context of Transborder Data Flows with Explanatory Report." The aims of the model contract were: a) to provide an example for the solution of the problems following the transfer of personal data subjected to various data protection regimes; b) to facilitate the international data transfer; c) to allow the data transfer for the benefit of international commerce; d) to promote the security and certainty of international transactions.

The model contract as set out in the study was the basis for further discussions. Relevant conferences were held in 1993 and 1998. With regard to the content, the model contract is closely linked to the Council of Europe Convention.

Contracts as a way to deal with problems arising from the transfer of personal data from certain European Union Member States have been widely used in France since the late 1980s. The infamous "Fiat case" is illustrative of this: the French data protection authority claimed that the transfer of personal data from France to Italy was problematic, as Italy had not enacted data protection laws. An intercompany agreement could encounter the problem, and, in this case, Fiat had to ask for consent according to the French data protection law before a transfer had taken place.

In Germany, the so-called Düsseldorfer Kreis (Düsseldorfer Circle) issued a checklist on contractual clauses in October 1993: necessary are clauses on the co-operation of the parties; the purpose of the data; the rights of the data subjects; security measures and liability. In the "BahnCard (railway card) case," in 1994, the Deutsche Bahn AG (German Railway AG) and the Citibank Privatkunden AG (Citibank Private Client AG) - a subsidiary of
the Citicorp-group - concluded a contract whereby the transfer of data from Germany to the United States and vice versa was secured.

On the level of the European Union, the European Commission had the power to decide "that certain Standard Contractual Clauses offer sufficient safeguards" as required by Art. 26(2) of the Directive. At the beginning, European officials discouraged organizations from the expectation of having a widespread use of contractual arrangements. In speeches and meetings they had stated that such a use would be very limited. The working party which "shall have advisory status and act independently," had also - among others - contractual clauses on their task list. Mainly, the work was carried out by the working party subgroup on contractual clauses. The working party issued a discussion document on June 26, 1997 stating, "such contractual solutions have inherent problems … they are therefore appropriate only in certain specific, and probably relatively rare, circumstances." Working documents were issued on January 14, 1998; April 22, 1998 and on July 24, 1998. These were more supportive of an important role for contractual arrangements. Opinions were delivered on May 16, 2000 and on January 26, 2001. Meetings were held with the European Commission services and industry representatives. Also, the public was asked for comments. The Securities Industry Association, the United States Department of Treasury and Commerce, the American Chamber of Commerce, the International Chamber of Commerce and the Confederation of British Industries addressed letters showing their concern.

The European Commission submitted draft Decisions on Standard Contractual Clauses on January 19, 2001 and on March 27, 2001. Finally, the European Commission adopted the Decision 2001/497/EC of 15 June 2001 on Standard Contractual Clauses for the transfer of personal data to third countries under Directive 95/46 ("Decision on Standard Contractual Clauses"). Also, the European Commission adopted the Decision 2001/16/EC of 27 December 2001 on Standard Contractual Clauses for the transfer of per-
sonal data to processors established in third countries, under Directive 95/46. However, the latter states less substantive requirements and is not part of this dissertation. Frequently Asked Questions on the Decision on Standard Contractual Clauses ("Frequently Asked Questions on the Standard Contractual Clauses") have also been issued.37

III. Decision on Standard Contractual Clauses

The Annex to the Decision on Standard Contractual Clauses sets out Standard Contractual Clauses for the purpose of Art. 26(2) of Directive 95/46/EC for the transfer of personal data to third countries that do not ensure an adequate level of protection ("Standard Contractual Clauses"). The Standard Contractual Clauses are regarded as offering an adequate level of protection within the meaning of Art. 26(2) of the Directive. However, the Decision on Standard Contractual Clauses does not affect the application of other national measures implementing the Directive.

The data protection authorities may prohibit or suspend the transfer of data to third countries in cases where: [*28*]

- the law applicable to the data importer imposes upon him requirements to derogate from the relevant data protection rules which go beyond the restrictions necessary in a democratic society and where those requirements may have a substantial adverse effect on the guarantees stipulated by the Standard Contractual Clauses;
- the data importer has not respected the contractual clauses;
- it is likely that the Standard Contractual Clauses are not being complied with and the transfer would create an imminent risk of grave harm to the data subjects.

It is anticipated that these safeguard clauses will only be used in rare cases. The national law implementing the Directive will also apply prior to the transfer which means that a transfer to a third country can only be made where the data have been collected and further processed in accordance with the data protection laws of the relevant European Union Member State(s).
Three years after the notification to the Member States, the European Commission shall evaluate the operation of the Decision on Standard Contractual Clauses. In particular, any evidence that a discriminatory application has taken place will be included.42 The Decision on Standard Contractual Clauses applied from September 3, 2001.43

IV. Frequently Asked Questions

As stated above, the European Commission issued Frequently Asked Questions on the Decision on Standard Contractual Clauses. The Frequently Asked Questions on the Standard Contractual Clauses do not form part of the Decision. They have not been approved by the European Commission and are not legally binding. Also, they have not gone through the consultative process with the working party or the management committee. Their aim is to provide additional information to companies and individuals on the Standard Contractual Clauses. The Frequently Asked Questions will be updated if and when the need arises.44 [*29*]

V. General Remarks on the Standard Contractual Clauses

According to the Frequently Asked Questions, the Standard Contractual Clauses are not compulsory for companies and are not the only way of lawfully transferring data to third countries. Companies need to conclude contracts if they would like to transfer data to recipients in countries, which do not have an adequate level of protection. The Directive sets out some derogations from the general principle that data could only be transferred to a country that ensures an adequate level of protection.45 Finally, the national data protection authorities may authorise on a case-by-case basis specific transfers to a non-adequate country.46 At the end of the day, it is up to the transferor to decide on the most convenient and economic way to fulfil the requirements of the Directive.47

The Standard Contractual Clauses do not prejudice past or future contracts approved by the national data protection authorities. The condition for the approval is that the data exporter has adduced sufficient safeguards to protect the individual's privacy. These
contracts can differ from the Standard Contractual Clauses. However, they need to be notified to the European Commission and to the other European Union Member States.48

VI. Content of the Standard Contractual Clauses

A. Details of the Transfer

Appendix 1 of the model contract sets out the details of the transfer, and, especially the categories of personal data and the purpose for which they are transferred. The data exporter and the data importer have to fill in Appendix 1, which forms part of the whole agreement. Data exporter is defined as the "controller, who transfers the personal data."49 The definition of data importer is as follows: "the data controller who agrees to receive from the data exporter data for further processing in accordance with the terms of these clauses and who is not subject to a third country’s system ensuring adequate protection”50. The following categories are listed in Appendix 1: description of the activities of the data exporter and data importer; information on the data subjects; purpose of the transfer; categories of data; sensitive data (if any); recipients and storage limit.

However, it is admitted that Appendix 1 contains the minimum information that should be stated. It may be necessary to add further requirements in order to make the transfer from a specific country lawful.51

B. Third Party Beneficiary Clause

Data subjects may enforce certain clauses stating the obligations of the data exporter and data importer; the liability, the mediation and jurisdiction and the termination of the agreement. The enforcement action will be brought by the data subject as third party beneficiaries. An association or other bodies may represent the data subject.52

C. Obligations of the Data Exporter

The data exporter has to fulfill the following obligations:
- the processing of the personal data including the transfer itself has to be carried out in accordance with the data protection laws of the European Union Member State in which the data exporter is established;
- the data subjects need to be informed that their data could be transmitted to a third country not providing adequate protection in case that the transfer of special categories of data will take place;
- a copy of the Standard Contractual Clauses must be submitted to the data subjects upon request;
- inquiries from the supervisory authority on the processing of the personal data and any inquiries from data subjects must be responded to in a reasonable time.53

D. Obligations of the Data Importer

The data importer is responsible for fulfilling the following obligations:
- he is not aware of any legislation which prevents him from fulfilling his obligations under the Standard Contractual Clauses, and any change of this legislation which is [*31*] likely to have a substantial adverse effect on the guarantees provided by the Standard Contractual Clauses must be communicated to the data exporter and to the supervisory authority where the data exporter is established, in which case the data exporter may suspend and/or terminate the Standard Contractual Clauses;
- personal data must be processed in accordance with certain mandatory data protection principles as set out in Appendix 2 of the Decision on Standard Contractual Clauses;
- inquiries from the data exporter or the data subjects relating to the processing of the personal data must be dealt with promptly and in co-operation with the competent supervisory authority;
- data processing facilities for an audit must be provided at the request of the data exporter;
- a copy of the Standard Contractual Clauses has to be sent to the data subjects upon request.54

The aforementioned term "legislation" also includes case law, rules or regulations, which may impede on the performance of the agreement. The data importer has the duty to determine if there are any such rules that might have an impact on the fulfillment of his obligations.55

E. Liability

Data subjects who have suffered damage as a result of any violation of the third party beneficiary clause56 are entitled to receive compensation from the data exporter and the data importer for the damage suffered. However, neither party may be liable if they prove that neither of them is responsible for the act. Otherwise, the data exporter and the data importer will be jointly and severally liable for damages. In the event of such a violation, the data subject can take action before a court against either the data exporter or the data importer or both. If one party is held liable for a violation by the other party, the second party will indemnify the first party from any cost, charge, damage, expense or loss incurred by the first party to the extent to which the second party is liable.57

It is admitted that joint and several liability means that the data exporter has to pay for damages committed by the data importer. However, the data exporter would only be liable to the extent that the provision violated is covered by the third party beneficiary's rights clause. As a consequence, the data exporter is entitled to recover any cost, charge, damage, expense or loss from the data importer, to the extent that the latter is liable. Apart from that, the indemnification has been eased by some of the provisions of the Standard Contractual Clauses. For example, the data importer is obliged to deal promptly with all inquires from the data subjects or the data exporter.58 From a practical point of view, it could be anticipated that data exporters - in the case of complaints of data subjects for damages caused by the data importers - will do their best to convince their contractual
counterparts to provide any necessary compensations in the first place. Therefore, they could avoid subsequent indemnification. However, the parties are free to agree on additional clauses relating to mutual assistance or indemnification that they consider pertinent.\textsuperscript{59}

F. Mediation and Jurisdiction

In case of a dispute with the data subject, which is not amicably resolved and where the data subject invokes the third party beneficiary provision,\textsuperscript{60} the following decision of the data subject must be accepted: either to enter into third party mediation or to refer the dispute to the courts in the Member State where the data exporter is established. However, the resolution of a specific dispute can also be referred to an arbitration body provided that that party is established in a country, which has ratified the New York Convention on enforcement of arbitration awards. The aforementioned options will not prejudice the data subject’s substantive or procedural rights to seek remedies in accordance with other provisions of national or international law.\textsuperscript{61} [*32*]

Where the parties refer the dispute to an arbitration body, it is necessary to review whether the country of the party involved has ratified the New York Convention on enforcement of arbitration awards with a "commercial reservation" or not. Such a reservation has the effect that only commercial matters can be submitted to arbitration, which is not the nature of the rights of the data subject.\textsuperscript{62}

From a practical point of view, it may be that an action against the data exporter before a European court seems to be thepreferable way for an individual to receive compensation. However, the data subject may also take action against the data importer, especially in cases where the data exporter has disappeared or filed for bankruptcy. The data exporter may be sued before the courts of his own country subject to the rules of private international law.\textsuperscript{63}

G. Further Provisions
A copy of the contract must be deposited with the supervisory authority if it so requests or where deposit is required under national law. The termination of the clauses at any time, in any circumstances and for whatever reasons does not exempt the data exporter and data importer from the obligations under the clauses as regards the processing of the data transferred. The governing law shall be the law of the State where the data exporter is established.

H. Criticism

Basically, the clauses seem to be appropriate. However, some provisions need to be criticized for several reasons. The third party beneficiary clause is necessary in order to grant a right to the data subject whenever his data are subject to a transfer between the data exporter and data importer. Otherwise, the third party may not benefit - among others - from the liability, mediation and jurisdiction clauses. However, it needs to be assessed whether the governing law allows the concept of third party beneficiary clauses. The institute is quite different in the various legal systems. For example, in the United Kingdom, such a third party clause would have the effect that the parties of the relevant contract need to have the consent of any third party involved in order to amend or terminate the contract. In practice, it could be difficult - even impossible - to gain the consent of all third parties involved. The parties could be bound by the contract for an indefinite period. Moreover, the third party beneficiary clause may infringe the legal doctrine of privity of contract, which is inherent in some jurisdictions, for example that of the United Kingdom. According to English law, "a contract cannot (as a general rule) confer rights or impose obligations arising under it on any person except the parties to it." However, the Contracts (Rights of Third Party) Act 1999 laid down some fairly strict conditions. Particularly, the third party covered by the clause must be expressly identified or must be a "member of a class" or "answer a particular description."
The provision setting out the obligations of the data importer should be reconsidered. At the moment, the data importer is obliged - at the request of the data exporter - to submit its processing facilities for audit. However, it would be desirable to have a clause inserted, whereby the data exporter and the data importer are obliged to conduct an external audit in defined time periods. Such a provision could help to ensure compliance with the contractual obligations.

The system of joint and several liability could raise significant problems. The International Chamber of Commerce stated in a letter dated March 13, 2001 and addressed to the Internal Market Directorate General that "joint and several liability is an anomaly in commercial contracts, and parties outside the EU will likely be extremely reluctant to enter into clauses containing it, which will make it difficult for EU-based data exporters to transfer data." The joint and several liability clauses serve the purpose to help the data subject to receive the compensation even if one party filed for bankruptcy. However, from a business point of view, it does not reflect current commercial practices.

VII. Mandatory Data Protection Principles

Appendix 2 of the Standard Contractual Clauses sets out mandatory data protection principles, which the data importer agrees to follow. These principles should be read and interpreted in the light of the clauses of the Directive. They are as follows:

- **purpose limitation**: data must be processed only for the specific purpose and must not be kept longer than required to serve the purpose;

- **data quality and proportionality**: data must be correct, adequate, relevant and not excessive in relation to their specific purpose;

- **transparency**: data subjects must be informed on the purpose of the processing and the identity of the data controller in the third country;
- security and confidentiality: security measures must be taken that are appropriate to the risks and any person acting under the authority of the data controller must handle the data in accordance with the instructions of the controller;

- rights of access, rectification, erasure and blocking of data: the data subject must have a right of access to the data which have a relation to him and the right of rectification, erasure and blocking of data which have not been processed in accordance with these mandatory data protection principles;

- restrictions on onward transfer: further transfers of data from the data importer to another controller situated in a third country which does not ensure an adequate level of protection may only take place if the data subject has - in the case of special categories of data73 - given his consent, or - in all other cases - has given the opportunity to object;

- special categories of data: the processing of these data must be protected by appropriate security measures such as strong encryption;

- direct marketing: processing of data for the purposes of direct marketing should only [*34*] take place where the data subject is allowed to "opt-out" from the use of the data for such purposes;

- automated individual decisions: data subjects have the right not to be a subject to a decision, which is based solely on automated processing of data.

Compliance with the mentioned mandatory data protection principles does not mean compliance with the Directive. These principles guarantee an adequate, not an equivalent level of protection.74

VIII. Criticism of the Contractual Solution

In most cases, data protection laws set out the enforceability of the clauses, the control by data protection authorities and the rights granted to data subjects. Contracts that mainly regulate the relationship between the parties, could limit the aforementioned re-
quirements. It is a commendable aim to have data protection laws in place in all countries and, therefore, to have a "level playing field". However, the reality is quite different: the number of countries, which have enacted data protection laws, is still quite low. It is for this reason that, from my point of view, the contractual solution is one measure, which could overcome the lack of equivalent data protection laws.

An argument could be made that Standard Contractual Clauses would limit the freedom of negotiations. However, it is a weak argument. On the one hand, the parties are not bound to use the model contract. They are free to develop their own approach, which would, of course, need the approval of the relevant data protection authority. On the other hand, model contracts could even strengthen the position of the party who proposes them. Especially in international negotiations, the party could refer to the model contract noting that these clauses have been approved by the European Commission and are regarded as fulfilling the requirement of adequacy. [*35*]

Another problem is enforcement: it is quite difficult for data protection authorities to control whether the contract is followed.75 First of all, the data protection authorities must be aware of an international data transfer. With regard to large international organizations, such a transfer can be assumed. Such an assumption is likely not to be correct for small companies undertaking business in the local area or for craftsmen. In connection with the internationalisation, the latter may also transfer data to third countries. So, the data protection authorities need to review any data controller in order to establish whether a data transfer to an inadequate country takes place or not. Apart from that, the data exporter and data importer may have concluded a contract following strictly the Standard Contractual Clauses. In practice, the data protection authorities may face major difficulties to review whether the clauses are respected. Moreover, with regard to the aspect of time, they would need to continuously review compliance with the contract at all times. This would be a task that is impossible to fulfil. However, it would be desirable to have a clause inserted,
whereby the data exporter and data importer are obliged to conduct an external audit in
defined time periods. At the moment, the data importer is obliged - at the request of the
data exporter - to submit its processing facilities for audit.76 A provision, whereby an audit
is compulsory for the data exporter and data importer, could help to ensure compliance
with the contractual obligations.

Data transfers within an international company, or group of companies, may also be
problematic because where data is transferred between a number of subsidiaries, each sub-
sidiary must sign such a contract. Obtaining the signatures of all these subsidiaries is a
process that could be very time-consuming and costly. It is for this reason that a company-
wide code of conduct,77 which would be in line with the contractual solution and which
would fulfil the adequacy requirements, is desirable. Apart from the marketing effect, such
a code of conduct could avoid the time-consuming, and, therefore, expensive process of
obtaining signatures. The European Commission and the European Member States are
[*36*] requested to submit clear guidelines on the content of such a code of conduct, and
also to approve it once the requirements are fulfilled.

IX. Conclusion

The European Data Protection Directive sets out that a data transfer out of the Euro-
pean Union is only permitted where the third party ensures an adequate level of protection.
It is acknowledged that the United States does not have an adequate level per se. Therefore,
the United States and the European Union worked out the so-called Safe Harbor solution.
United States companies adhering to the Safe Harbor principles and self-certifying them-
selves are regarded as ensuring an adequate level of protection. Apart from the Safe Harbor
solution, United States companies can use contractual clauses to ensure an adequate level
of protection. The European Commission has issued model clauses that are regarded as
fulfilling the adequacy requirement. However, among others, the third party beneficiary
clause is problematic in some jurisdictions. The provision setting out the obligations of the data importer should be re-considered because the current system of joint and several liability does not accurately reflect current commercial practices.

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2 Art. 25(1) of the Directive.


4 http://www.export.gov/safeharbor

5 http://www.export.gov/safeharbor

6 The certification can also be submitted online. The online certification form is available from http://web.ita.doc.gov/safeharbor/shreg.nsf/safeharbor?openform.

7 Art. 26(2) of the Directive.

8 Id.


13 http://www.coe.int/T/E/Legal_affairs/Legal_co-operation/Data_protection/Documents/Publications/1ModelContract.asp
Poullet, supra note 11, at 172.


Conference organized by the OECD and the Business Advisory Committee to the OECD on Privacy Protection in a Globally Networked Society, Spring 1998.


Art. 26(4) of the Directive.


Art. 29(1) of the Directive.


Swire, supra note 20, at 37.


http://europa.eu.int/comm/internal_market/en/dataprot/modelcontracts/clausesfaq.htm#18

Art. 1 of the Decision on Standard Contractual Clauses.

Refers to Art. 13 of the Directive which sets out that the interests include all such measure that are necessary to safeguard national security; defence; public security; prevention, investigation, detection and prosecution of criminal offences; an important economic or financial interest of the State; the protection of the data subject or of the rights and freedoms of others.

Art. 4 of the Decision on Standard Contractual Clauses.

See Frequently Asked Question on the Standard Contractual Clauses Nr. 8. [*39*]
Art. 5 of the Decision on Standard Contractual Clauses.

Art. 6 of the Decision on Standard Contractual Clauses.


Art. 26 (1) of the Directive.

Art. 26(2) of the Directive,

See Frequently Asked Question on the Standard Contractual Clauses Nr. 1.

See Frequently Asked Question on the Standard Contractual Clauses Nr. 3.

Clause 1(b) of the Standard Contractual Clauses.

Clause 1(c) of the Standard Contractual Clauses.

See Frequently Asked Question on the Standard Contractual Clauses Nr. 11.

Clause 3 of the Standard Contractual Clauses.

Clause 4 of the Standard Contractual Clauses.

Clause 5 of the Standard Contractual Clauses.

See Frequently Asked Question on the Standard Contractual Clauses Nr. 10.

See Part F.II.

Clause 6 of the Standard Contractual Clauses.

See Part F.IV.

See Frequently Asked Question on the Standard Contractual Clauses Nr. 16.

See Part F.II.

Clause 7 of the Standard Contractual Clauses.

Poullet, supra note 11, at 179.


Clause 8 of the Standard Contractual Clauses.

Clause 9 of the Standard Contractual Clauses.

Clause 10 of the Standard Contractual Clauses.

Poullet, supra note 11, at 175.


Section 1, sub-section 3 of the Contracts (Rights of Third Parties) Act 1999; see also Poullet, supra note 11, at 194.

Clause 5(d) at the Standard Contractual Clauses. [*40*]

Clause 5 of the Standard Contractual Clauses.

According to the definition set out in Art. 3(b) of the Decision on Standard Contractual Clauses, "special categories of data" means the data referred to on Art. 8 of the Directive.

See Frequently Asked Question on the Standard Contractual Clauses Nr. 18.


Clause 5(d) at the Standard Contractual Clauses.

See also Art. 27 of the Directive.