K&L GATES

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Antitrust and Competition

Landmark judgment of the EU's highest court requires, for the first time, a case-by-case assessment of anti-competitive effects of exclusivity or royalty rebates

On 6 September 2017, the Court of Justice, the European Union ("EU")'s highest court, issued its much awaited decision in a case of abuse of dominance by a US microchip manufacturer using exclusivity or loyalty rebates, i.e. rebates which are conditional upon a purchaser buying all or most of its requirements from a dominant supplier. According to the longstanding case law, such rebates are presumed to be illegal on the basis that they are by their very nature anti-competitive. In this ruling, the Court of Justice departed from its *per se* approach and suggested, for the first time, the need for an assessment of their anti-competitive effects on a case-by-case basis

The case dates back to 2009 when the European Commission ("Commission") adopted a decision imposing a EUR 1.06 billion fine on the company. The Commission found that the microchip manufacturer held a dominant position based on consistent market shares above or around 70% in the relevant period and on the significant barriers to entry and expansion on the market. It concluded that the company abused its dominant position by putting in place a strategy to foreclose a specific competitor. The contested conduct consisted in granting rebates to four computer manufacturers on the condition that they would purchase all or almost all of their specific central processing units ("CPUs") from the company and in making payments to a major retailer on the condition it would sell exclusively computers containing the company's CPUs. In addition, the microchip manufacturer made payments to original equipment manufacturers so that they would delay, cancel or restrict the marketing of certain products which were equipped with CPUs of its competitor. The Commission's decision was upheld by the General Court in 2014.

The Court of Justice found that the General Court erred in the review of the US microchip manufacturer's appeal against the Commission's fine of EUR 1.06 billion since it failed to take duly into account the defendant's economic evidence.

The Court noted that the Commission conducted "*a very detailed*" analysis of the "as efficient competitor" test. This test is premised upon an effects-based analysis of the contested conduct and is used to establish whether competitors who are as efficient as the dominant company could profitably match the dominant company's rebates.

The Court considered that the test played an important role in the Commission's assessment. It then concluded that the General Court was required to examine all arguments presented by the company regarding this test, which it had failed to do.

The General Court will now have to examine, in light of the defendant's arguments, whether the rebates in question are capable of restricting competition.

Dominant companies can take some comfort that exclusivity or loyalty rebates will no longer be condemned as inherently anti-competitive. However, the risk assessment related to such rebates and in particular the risk of substantial fines has not changed dramatically with this judgment. The Court of Justice's ruling should be viewed as a welcome step in the right direction, calling for a more nuanced analysis of exclusivity rebates in the EU on the basis of an effects-based analysis as opposed to per se approaches.

The Commission continues to rely on EU State aid rules to challenge EU tax regimes that grant benefits to companies

On 4 October 2017, the Commission found that Luxembourg had allegedly given illegal tax benefits to a US company operating an e-commerce platform. This decision follows other recent decisions adopted by the Commission which declared illegal certain tax benefits granted to companies since they conferred an undue advantage in violation of EU State aid rules.

EU Member States' tax systems have been under increased scrutiny in the EU under State aid rules. The regime is specific to the EU and prohibits any form of advantage (e.g. financial support, better terms and conditions) conferred on a selective basis to companies by national public authorities. The regime provides for the prior notification of the aid measure to the Commission before its implementation.

In this case, the Commission found that the company had received an illegal advantage because of a tax ruling issued by Luxembourg. This ruling enabled profits to be shifted from an operating to a holding company of the multinational group. The holding company was not subject to tax in Luxembourg under the applicable legislation.

In essence, according to the Commission, the operating company paid an inflated royalty, not reflecting economic reality, to the holding company for the use of intellectual property rights. According to the statement by EU Competition Commissioner Margrethe Vestager ("Competition Commissioner"), "*[it] reduced the operating company's taxable profits to a quarter or what they were in reality*".

The Competition Commissioner also stressed that: "*Tax rulings cannot endorse a royalty between one company to another company in the same group that does not reflect economic reality. Doing so would disadvantage all the stand-alone companies that are not part of a group. They are taxed on their actual profits because they pay market prices for the goods and services they use.*"

Consistent with EU State aid rules, Luxembourg will have to recover from the company approximately EUR 250 million, plus interest, of unpaid tax.

In parallel, on the same day, the Commission announced it had decided to refer Ireland to the EU Court as it had failed to recover illegal tax benefits in another case. On 30 August 2016, the Commission found that the tax benefits granted by Ireland to a US technology company constituted State aid, which should have been recovered by 3 January 2017. However, more than a year after the Commission's decision, Ireland had still failed to recover the illegal tax benefits. As a result, the Commission decided to use the procedure expressly provided for in Article 108 of the Treaty on the Functioning of the EU and directly refer the matter to the EU Court to ensure implementation of the recovery decision. If the Member State persists in its non compliance, the Court may impose penalty payments.

These cases are illustrative of the increased scrutiny of Member States' tax practices, such as the tax rulings, i.e. any kind of tax arrangement between a Member State and a company. It is important for companies to be aware of these developments when devising their tax strategies, as even when they are validated by national authorities, they may need to repay significant amounts in case the scheme is considered to be an illegal tax benefit under the EU State aid rules. As stated by the Competition Commissioner, the Commission will continue its work in this direction: "*Both send a clear message that companies must pay their fair share of tax. And our work is by no means done*".

International Trade

Commission to introduce a fast-track ratification procedure for EU trade agreements

In his State of the European Union speech of 13 September 2017, Commission President Jean-Claude Juncker expressed his intention to introduce a fast-track ratification process of trade agreements between the EU and third countries. This decision-making process could eliminate the need for approval by 40 regional and national parliaments of the 28 Member States, preventing attempts by national or regional parliaments to block future trade agreements.

Most chapters in trade deals usually fall under the exclusive competence of the EU and are consequently to be ratified by the European Parliament ("Parliament") and the Council of the EU. At present, some sections of agreements related to investment protection require ratification by the national or, where applicable, regional parliaments of the Member States. President Juncker advocates the splitting of trade agreements into two parts: (i) a bigger one dedicated to trade and falling under the competence of the EU institutions and (ii) a smaller one related to investment and investment protection that needs to be ratified by national parliaments.

The Commission's new approach follows a Court of Justice ruling in May 2017, which said that all parts of the EU's trade deal with Singapore except non-direct foreign investment and investment dispute mechanisms fall under exclusive EU competence. You can read more about it here.

This dualistic model could also prove crucial for a post-Brexit trade deal between the EU and the United Kingdom. The Commission envisages launching negotiations for entering into free trade agreements with Australia and New Zealand. These two deals could be the first where the new legal framework will be used, allowing ratification without the risk of veto by national parliaments.

Transport

Commission proposes new rules on rail passenger rights

At the end of September 2017, the Commission proposed amendments to the current EU legislation related to the protection of rail passenger rights. The current legislative framework set up by Regulation (EC) No 1371/2007, grants passengers the right to financial compensation if their train arrives at destination with a delay of one hour or more. Delayed passengers are also entitled to meals and refreshments (proportionate to the waiting time), and accommodation if they have to stay overnight.

The Commission's proposal updates the existing rules on rail passenger rights in five key areas: (i) *uniform application of EU rules*: under the draft regulation, long distance domestic and cross-border urban, suburban and regional services can no longer be exempted from the application of passenger rights rules; (ii) *transparency and principle of non-discrimination*: passengers should be better informed about their rights; (iii) *protection of passengers with disabilities or reduced mobility*: the Commission's proposal aims to provide persons with disabilities or reduced mobility with better and a more adequate protection; (iv) *enforcement of passenger rights; handling of complaints and sanctions*: the proposal aims to introduce clear deadlines and procedures for complaint handling. Furthermore, the draft regulation will delimit the powers and the competencies of national authorities responsible for the application and enforcement of passenger rights; (v) *exemption in "force majeure" events*: under the current regulatory framework, rail companies have to pay compensation even when faced with such events. The Commission proposes the insertion of a "force majeure" clause to rail companies' general terms and conditions. This clause will exempt rail operators from the obligation to pay compensation in the event of delays caused by natural catastrophes, which they could neither foresee nor prevent.

The proposal of the Commission is now to be examined and adopted by the Parliament and the Council of the EU before entering into force.

Telecommunications, media and technology

ePrivacy Proposal passes the first parliamentary hurdle

One of the main pillars of the Digital Single Market Strategy is the overhaul of the data protection framework. The adoption of the General Data Protection Regulation (“GDPR”) was a fundamental action to this end.

In this context, on 10 January 2017 the Commission presented a proposal for a Regulation on Privacy and Electronic Communication (“ePrivacy Proposal”) which would align the existing privacy rules for electronic communications to the GDPR. Moreover, the ePrivacy Proposal interacts with the European Electronic Communications Code - which is still under discussions - and partially relies on definitions provided therein, including that of “electronic communications services”. The Commission aims to implement the ePrivacy Proposal by 25 May 2018, in line with the GDPR.

Within the Parliament, the proposal is going through a fast but intricate process. The file was assigned to the Civil Liberties, Justice and Home Affairs Committee (“LIBE”) and three Committees - Industry (“ITRE”), Legal Affairs (“JURI”) and Internal Market - delivered their opinions at the beginning of October. ITRE and JURI’s opinions recommended serious amendments to the draft report and that, along with the lack of endorsement from the European People’s Party, caused the postponement of the LIBE vote on the Proposal by one week. On 19 October 2017 the report was adopted with a narrow majority and the Committee agreed to enter into interinstitutional negotiations (or “trialogue”).

At first glance it can be stated that, despite facing fierce opposition from the Digital Industry and parties considered more “pro-business”, the controversial key points of the draft report have not been watered down in the voted text:

- An amendment introduced new exceptions to the prohibition of processing, storing and collecting information on and from users' equipment without obtaining users’ consent as defined under the GDPR: (i) when it is technically necessary for web analytics; (ii) when it is necessary for security updates of the terminal equipment; (iii) in the context of employment relationships, when the employer provides and/or is the subscriber of the terminal equipment and it is strictly necessary for the execution of an employee’s task, provided that it will not be further used for monitoring the employee.

  Moreover, and most importantly, the aforementioned amendment adds a new paragraph to Article 8 of the ePrivacy Proposal in order to explicitly forbid the so-called “tracking walls”, cookies that track users’ footsteps across the internet. According to this provision, websites and apps cannot deny users’ access to any service or functionality on the ground that they have not provided the consent for processing, storing and collecting information that is not necessary for the provision of that service or functionality.

- The modified report also introduces the privacy-by-default principle for software. It requires software suppliers to configure their products - including browsers - with the greatest possible privacy protection settings. Therefore, right after the installation, software shall automatically protect privacy and impede tracking, storing and collection of information, without requiring any actions from users.

- In case of breach of the cookie and privacy by default provisions (Articles 8 and 10 of the ePrivacy Proposal), the Parliament’s text enables to impose administrative fines of up to EUR 20 million or, in the case of an undertaking, up to 4% of the total worldwide annual turnover for the preceding financial year, whichever is higher. According to the original proposal from the Commission, such breaches could lead to fines up to EUR 10 million or 2% of the global annual turnover.

As evidence of the tensions behind some of these positions, the Parliament's Plenary discussed and rejected an exceptional proposal to reopen the negotiations on this text and to send it back for discussion in the LIBE Committee.

Economic and financial affairs

Commission sets out steps to complete the Banking Union

On 11 October 2017 the Commission published a Communication on Completing the Banking Union. The Communication takes stock of the achievements so far and outlines the Commission's views on the outstanding elements of the Banking Union.

The Commission calls on the European Parliament and the Council of the European Union ("co-legislators") to deliver the missing elements by the end of the current legislative term in 2019. These include, among others, the package of proposals to further reduce risks and strengthen the resilience of EU banks. As regards the Banking Union's institutional set-up, the Communication calls for the establishment of its third pillar - the European Insurance Deposit Scheme. Amid the lack of political progress since this file was first tabled in 2015, the Commission now proposes a more gradual approach with a limited degree of risk sharing. Importantly, it is noted that the smooth functioning of a common deposit insurance system will also require further steps to harmonize the national options and discretions provided for by the Deposit Guarantee Schemes Directive ("DGSD").

The Communication also calls for the establishment of a backstop to the Single Resolution Fund ("SRF"), which would provide last resort liquidity in cases where shareholders and creditors' resources would not suffice to rescue a failing bank. The Commission insists that the backstop has to become operational as soon as possible and calls for progress to set up a credit line from the European Stability Mechanism ("ESM"). Concrete proposals are to be expected with the forthcoming package on the deepening of the Economic and Monetary Union in December.

Last but not least, a comprehensive package of measures to address the high levels of Non-Performing Loans ("NPLs") was proposed, with the aim to facilitate the development of secondary markets for NPLs, including the creation of Asset Management Companies. Moreover, the Commission is expected to consider the introduction of minimum provisioning for future NPLs, with capital set aside to cover for NPLs' losses. In line with this, the Commission also announced that it will consider a proposal enabling the development of sovereign bond-backed securities to help banks diversify their portfolios and create high-quality collateral for cross border transactions.

Commission proposes overhaul of the EU financial supervisory architecture

On 20 September 2017 the Commission adopted a package of proposals aimed at strengthening the European System of Financial Supervision ("ESFS"). The system includes the European Supervisory Authorities ("ESAs") and the European Systemic Risk Board ("ESRB"). Along with the legislative proposals, the Commission published a Communication on "Reinforcing integrated supervision to strengthen Capital Markets Union and financial integration in a changing environment".

Key elements of the proposals include a stronger coordination of supervision across the EU and a strengthened role of the European Securities and Markets Authority ("ESMA") in the supervision of capital markets. Moreover, the ESAs are expected to integrate sustainable finance elements (environmental, social and governance risks) in their work and to prioritize FinTech issues. Under the proposals, the ESAs would be equipped with new competences, such as to review activities of national competent authorities, set EU-wide supervisory priorities and intervene in cases of supervisory arbitrage. It is proposed for ESMA, in particular, to have direct supervisory power over certain sectors of capital markets across the EU (benchmarks, prospectuses, market abuse etc.) and to receive transaction data directly from market participants. As regards governance, it is proposed that the ESAs have an independent Executive Board with full time members to ensure impartial decision-making. The Commission also wants to amend the existing funding structure, proposing industry contributions to the ESAs' budget.

Taxation

Commission considers options to tax the digital giants

On 21 September 2017 the Commission published a Communication on a Fair and Efficient Tax System in the European Union for the Digital Single Market. The Communication feeds into the ongoing international policy efforts to address taxation challenges brought by the digital economy and the increasing role of intangibles in digital companies' business models. The Commission's aim is to coordinate the European approach in international discussions on reforming international corporate tax rules.

The Communication notes that any future reform will need to address the key questions of where and what to tax. With respect to the general international corporate tax framework, this is likely to include changes to the definition of permanent establishment, as well as transfer pricing and profit attribution rules applicable to digital technologies. The Commission expects a high level of ambition from the Interim Report being prepared by the Organization for Economic Cooperation and Development ("OECD") for G20 meeting in spring 2018.

The Communication makes clear that if international efforts fail, the Commission will push for a solution at the EU level. More details will be known in December, when the EU Member States are expected to agree on an EU-wide approach. Concrete legislative measures might be put forward by the Commission already in early 2018.

To inform its work, on 26 October the Commission launched a public consultation on a number of different options to tax digital giants.

To protect the Member States' tax bases until a lasting solution can be found, the Commission proposes a number of targeted temporary quick fixes.The possibilites include a tax on revenues from digital activities/services; a withholding tax on digital transactions; or a digital transaction tax that would be applied early in the value creation process.

In the long run, the Commission is considering the introduction of new profit atttribution and digital permanent establishment rules, either by modifying the existing proposal for a Common Consolidated Corporate Tax Base ("CCCTB"), or by preparing a standalone Directive. A new coporate tax, based on the consumer destination principle is also mentioned among the options. Another possibility would be to introduce a unitary tax on a share of the company's world profit, which would be attributed to countries on the basis of revenue created in the respective jurisdictions. Lastly, a system with the residence tax base but a destination tax rate is also considered.

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