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Executive Editor: Scott P. Studebaker, Esq.
Production Editor: Heather J. Martel
Marketing: Jon B. Martel

Brussels Briefing:
A Review of Recent Legal and Business Developments in the EC

By Philip Bentley QC and Jacques Pieters (McDermott Will & Emery/Stanbrook LLP)

Tax Deductibility of Commission Fines for Antitrust Infringements: Dutch Courts Enter the Debate

On June 23, 2009, the Antwerp Court of Appeal ruled that Article 53,6 of the Belgian Income Tax Code allowed fines for antitrust law infringements to be deducted from a company's taxable income. At that time, a similar case was being debated before the Dutch courts, which gave rise to a decision by the European Court of Justice on June 11, 2009 (Case C-429/07) that allowed the European Commission to intervene in the Dutch proceedings as amicus curiae.

Meanwhile, the Amsterdam Court of Appeal has come to a decision in this case. As expected, the Commission did indeed intervene to oppose the tax deductibility of antitrust fines on the grounds that this mitigates the deterrent effect of the fine and therefore undermines the enforcement of competition policy (Amsterdam Court of Appeal, Decision of March 11, 2010, Case 06/00252).

The facts of this case can be summarized as follows: The parent company of the Dutch company involved in the proceedings was fined by the European Commission for taking part in an illicit cartel. The parent company subsequently passed on part of its fine to the Dutch subsidiary, which deducted the amount from its income tax base. The Dutch company argued that a cartel fine does not simply have a punitive element, but is also meant to take away illicitly obtained profits from the perpetrator. As the Dutch Tax Code only forbids the deduction of fines imposed by an EU institution (in this case the Commission), the Dutch subsidiary was of the opinion that the non-punitive part of the levy was deductible. This argument was opposed by the Dutch tax authorities.

The Amsterdam Court of Appeal held that there was no proven distinction between the punitive and non-punitive elements of the Commission's fine and that this distinction had no basis in Dutch tax law. It also affirmed that Dutch tax law excludes explicitly the deduction of EU fines. Furthermore, in the Court's opinion, the fines have a fundamentally punitive and deterrent character and therefore cannot be tax deductible.

It should be noted that the same court, on the same date, came to an almost identical decision with regard to the deductibility of fines imposed by the Dutch Competition Authority (Amsterdam Court of Appeal, decision of 11 March 2010, Case 08/01180).

Commission Adopts New Block Exemption Regulation for Insurance Sector

The European Commission has adopted a new Block Exemption Regulation in the insurance sector after a detailed review of the old regulation.

The new Regulation, which comes into force on April 1, 2010, renews the exemption from the prohibition against restrictive practices contained in Article 101 TFUE for the following practices:

- Agreements in relation to joint compilations, tables and studies
- Common coverage of certain types of risks (i.e., insurance pools) On the other hand, the following practices are no longer exempted:
- Agreements on standard policy conditions
- Agreements on security devices and safety equipment

The Commission plans to address these two types of agreements in its EU Guidelines on Horizontal Cooperation Agreements, which are currently being reviewed.

As far as the two exempted categories are concerned, it is accepted that the exchanging of certain information is important for the insurance sector to allow insurers to assess risks accurately. This can also facilitate market entry and thus benefit consumers. The new regulation clarifies the scope of the information that can be exchanged and creates a new right of access to the results of the information exchange for customers and consumer organizations.

Subject to certain conditions, the new Regulation also exempts pools which either cover new risks or fall below certain market share thresholds, namely 20% for insurance and 25% for reinsurance. For this purpose, a new approach to market share calculation is being introduced: Revenue for market share purposes must now also include revenue from outside the pool, not just inside the pool as under the old Regulation. Moreover, the new Regulation broadens the definition of "new risks" to cover risks whose nature has changed so materially that it is not possible to know in advance the subscription capacity necessary in order to cover them. ❑

Philip Bentley QC is a Partner in the international law firm of McDermott Will & Emery/Stanbrook LLP based in its Brussels office. He is a Member of the Firm's EU regulatory practice and European Competition and Trade Groups. His practice focuses on EU anti-dumping, trade defense and customs, EU competition (including State aid and public procurement), EU regulatory matters, notably GMOs, and EU litigation. (pbentley@mwe.com)
Jacques Pieters is an Associate in the international law firm of McDermott Will & Emery/Stanbrook LLP based in its Brussels office. He is a member of the Firm's corporate department, where his practice focuses primarily on Belgian and international corporate, tax and commercial law. He has significant experience in representing clients in corporate, commercial and tax matters before the Belgian courts, and has also advised on M&A, (tax) restructuring, public and private placement of shareholders' funds, estate planning, internal compliance and business operations. (jpieters@mwe.com)

The Quandary over Quantum:
Does the Commission's New Study on Quantifying Antitrust Damages Shed Any Light on the Issue?

By Andrew J. Bailey (Greenberg Traurig)

In July 2008 the European Commission (the "Commission") launched a tender for research into calculating so-called "quantum," the figure that can be allocated to the financial impact of anti-competitive behavior. The tender was won by an economic consultancy and a group of lawyers who, in December 2009, finished their study for the European Commission aimed at assisting national courts calculate the cost of anti-competitive behavior in private damages actions. The study, simply titled "Quantifying Antitrust Damages," indicates that a typical cartel may lead to a 10-20 percent overcharge in a given market. The study is but one ingredient in the debate on quantum, which will be contributed to substantially by economists, lawyers, academics, policy makers, and governments before the Commission publishes its final guidance to Member State judges. While it provides a comprehensive analysis of the available models and methods of quantification, the study does not reach any determined conclusions apart from the fact that the choice of approach to quantum will depend on the details of each case, and the availability of quality data and information. The fact that the study identifies three different models for calculating quantum also may raise more questions than it answers.

The Study in Context

The Commission published its "White Paper on Damages Actions for Breach of EC Antitrust Rules" in April 2008. The White Paper emphasized the principle that any individual or business suffering harm as a result of a breach of EU antitrust rules (Articles 101 and 102 of the Treaty on the Functioning of the European Union) must be able to claim reparation from the party responsible for the breach. This principle is now established in EU case law so that such victims are entitled to compensation for actual loss and for loss of profit, plus interest. The White Paper declared that one of the obstacles to damages actions was the quantification of damages. The "Quantifying Antitrust Damages" study aims to develop guidance for Member State judges and private parties.

At its core, the study identifies three potential models for analyzing and establishing how a market would look if there had been no anti-competitive conduct (the "but for" world) and, therefore, the quantum of the loss sustained by the claimant.

The study considers a general framework for judges on how to consider claims, not just against cartel members, but also companies abusing a dominant market position. Damages estimation in this area essentially involves two stages. First, the counterfactual scenario must be determined, (i.e., an assessment of what would have happened in a hypothetical scenario where the infringement had not taken place). Following this, the difference between the factual and the counterfactual scenario must be converted into a final damages value (i.e., the annual estimated overcharge by the offending entity must be aggregated to take account of the duration of the offending conduct, and interest must be applied). At its core, the study identifies three potential models for analyzing and establishing how a market would look if there had been no anti-competitive conduct (the "but for" world) and, therefore, the quantum of the loss sustained by the claimant.

The Models Identified by the Study

The Study suggests three approaches to establishing estimated damages. Under the first, courts would look at similar regions or similar products to compare how prices might have developed absent the cartel. This is called the "comparator-based approach," which uses data from sources external to the wrongdoing to estimate the counterfactual -- to make cross-sectional comparisons between different geographic or product markets. The

Andrew J. Bailey (baileya@gtmlaw.com) is an Associate in the Antitrust, Competition and Marketing Practices Group of Greenberg Traurig Maher's London office. He advises clients on all aspects of UK and European Community (EC) competition law, including behavioral competition advice, litigation, and UK/EC merger regulation. Andrew also advises on UK and EC regulatory matters and in relation to public procurement, state aid, and regulated utilities. Andrew's experience spans a range of industries including shipping, telecoms, gas and electricity, financial products, renewable energy, supermarkets, water, oil and gas, construction, and music recording/publishing.

comparator-based approach can also use "time-series" comparisons, which analyze prices before, during, and/or after the violation. It also can combine the two methods above to analyze the change in price for a cartelized market over time, and compare that against the change in price in a non-cartelized market over the same time period.

According to the study, certain cases may be better suited to a second, more finance-focused, analysis. The study identifies a financial-analysis-based approach in which financial information on comparator firms, benchmarks for rates of return, and cost information on defendants and claimants are used to estimate the counterfactual. This technique is better suited to markets in which products are priced from the bottom up, looking at each of the key inputs (e.g. labor, materials, etc.) to establish what the price tag should be.

A third, market-structure-based approach uses a combination of theoretical models, assumptions and empirical estimation, rather than comparisons, to assess the counterfactual. This approach is commonly used by merger analysts, who construct models of the market and simulate the likely effect of a particular transaction.

The study states that depending on the factual scenario and the market in which the anti-competitive conduct has taken place, a combination of all three models could be used in order to establish the likely counterfactual. Courts would use a combination of the models, and potentially pool the results, striking a mean average in order to arrive at the best estimation of loss.

Adding It All Up

The study establishes that for the majority of cartels, overcharges in the range of 10-20% are normal. In the data set analyzed by the study, the median overcharge was 18% of the cartel price. Of interest, the study found that despite the theory that in most cases the cartel overcharge may be expected to be a positive number, there is a small but significant proportion of cartels (7%) where there is no overcharge at all. Whether a particular cartel falls into this category would have to be explored on a case-by-case basis.

The study also recognizes that when trying to reach a figure on quantum damages, the central complication is so-called "passing on" (i.e., the decision that intermediate customers make when paying the higher price to the cartel while knowing they can simply pass this increase down the chain to their customers). The study concludes that there are higher rates of passing on in competitive markets, while in less competitive sectors passing-on can be reduced to around 50 percent.

Are We Left Any The Wiser?

The "Quantifying Antitrust Damages" study certainly provides much food for thought in this complicated area of legal and economic analysis. It proffers a number of non-exclusive models and methods, which could be used in different circumstances, before concluding that no one method will be perfect in any particular scenario. Further, the study seems to recommend, when appropriate, performing the quantum assessment using a combination of models, then simply taking the mean average of the available forecasts as the single value for quantum. This would seem to be an extremely ambitious approach, not to mention complicated and time-consuming.

While this recent study into quantum is non-binding, its conclusions, to the extent that any are reached, would no doubt have been in the forefront of the judiciary's mind. As it is, however, the wait continues for guidance from the Bench on this most important issue.

The quandary with regards to quantum must be reviewed in conjunction with other jurisprudence and guidance on follow-on damages actions. In late December 2009, the Competition Appeal Tribunal (the "CAT"), in the first follow-on damages action to reach trial in the UK, found against Enron, which had brought a claim against English Welsh and Scottish Railway Limited ("EWSR") based on a 2006 decision by the Office of Rail Regulation which determined that EWSR had abused its dominant position (see Article on page [□]). The CAT found that Enron had failed to make out the necessary causal link between EWSR's infringement and Enron's loss. The CAT looked to other, non-economic factors which suggested that even despite the anti-competitive conduct of the defendant, Enron was unlikely to have been awarded the contract that formed the basis of its damages claim. Until this decision, causation had been seen by potential follow-on claimants as a molehill to be easily climbed before attacking the mountain that is quantum.

The Enron case is now dead in the water, with the CAT publishing an order of the newly renamed Supreme Court, the highest appellate Court in the UK, on February 9, 2010, refusing Enron permission to appeal the judgment of the Court of Appeal that struck out the overcharge aspect of the its claim against EWSR. If the overcharge appeal had been allowed to proceed, we could have seen, before too long, the first example of how UK courts would approach the issue of quantum. While this recent study into quantum is non-binding, its conclusions, to the extent that any are reached, would no doubt have been in the forefront of the judiciary's mind. As it is, however, the wait continues for guidance from the Bench on this most important issue. ❑

Round-up

By Reuters

EU

Splintered Europe Share Market Seen Ripe For Abuse

The splintering of Europe's share markets into numerous trading platforms in recent years has created a fertile field for market abuse and made it more difficult to detect, a group of London market consultants said. The EU's Markets in Financial Instruments Directive (MiFID) in 2007 opened exchanges to competition from low-cost new rival platforms known as multilateral trading facilities (MTFs), which has fragmented the market. Brian Taylor, a member of the new Alliance of Independent Advisors to Financial Markets, or Avenues, told a media briefing that diminishing fairness and order in the markets could become a macro-economic issue if traders lose confidence.

Taylor is managing director of bta Consulting, which joined forces with Bryok Consulting, Golden Advisors and Capstan Consulting, to form Avenues, and to design a system to comb through trade information to identify possible abuse.

Before MiFID, national exchanges accounted for the large majority of trading. All UK trades had to be reported to London Stock Exchange, which was required to run surveillance for market abuse, for example. Now a stock such as Vodafone trades on 18 different venues including MTFs and dark pools, as well as by dealers over-the-counter, the consultant group said. The new MTFs and trade reporting firms are not obliged to monitor trade data, which is left to regulators, it said. Furthermore regulatory surveillance has remained national, even while MiFID allows cross-border trading.

Steve Leegood, of Bryok, said a single monitoring system was needed so all data could be brought together and monitored.

EU Hedge Fund Rules Stalled, UK Digs in Heels

European Union plans to crack down on hedge funds hung in the balance when talks stalled after Britain dug in its heels to head off new rules that could damage its financial centre. The draft law had been intended to curb pay and borrowing at hedge funds and usher in an era of transparency for a secretive industry that many politicians said exacerbated borrowing difficulties in Greece by betting on its debt.

But EU finance ministers were unable at talks to resolve a dispute between Britain -- which wants lighter regulation of an industry important for London's financial center -- and Germany and France, which want a heavier clampdown. Consideration of the rules was put off for months.

The draft rules would require hedge funds, private equity groups and others to register and disclose trading information to supervisors. London's refusal to sign up to the draft rules casts uncertainty over their future. British elections expected in May could put the Eurosceptic Conservatives in power.

This could further compound difficulties in reaching a deal. Although other European countries could overrule Britain and vote through the legislation, they would be reluctant to do so because of the diplomatic fallout.

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France

France Says New Basel Bank Proposals Too Severe

New regulations that would force banks to raise their capital reserves could choke off lending and stifle economic growth, French Economy Minister Christine Lagarde said.

Lagarde told the business daily Les Echos that France's European Union partners were also concerned that the proposals by the Basel Committee of central bankers and supervisors for an overhaul of the Basel II global bank capital accord were too restrictive. She hoped they could be revised by June in time to be adopted in an EU directive.

Lagarde also said she was worried that the United States was lagging on commitments made at a meeting of the Group of 20 nations last year to force its banks to adopt the Basel II rules by 2011.

She would discuss the issue with her U.S. counterparts later this month and if necessary pursue it when France takes over the G20 chairmanship next year.

Germany

Germany's Merkel Considering Risk Charge on Banks

Germany is working on various possible schemes, including bank charges, to ensure taxpayers do not have to pay for the risks taken by banks in the future, German Chancellor Angela Merkel told the magazine Sonntag Aktuell. Merkel said a possible plan would be a charge based on “ the riskiness of a banks’ business” and the level of its integration in the banking system.

A senior ally of Merkel called last week for banks to pay a charge of 0.1 percent of a bank’s assets to partly cover the costs of funding bailouts. Merkel said the government would make a proposal “by spring.” Finance Minister Wolfgang Schaeuble told Reuters last month he was optimistic an international deal could be reached for banks to share economic crisis costs.

Ireland

Police Arrest Anglo Irish Bank's Former Chairman

Police have arrested Sean FitzPatrick, the former chairman of Anglo Irish Bank, sources said, the first casualty of a fraud investigation seen as vital to Ireland’s efforts to win back investor confidence.

The government has said it wanted to investigate fully the role of nationalized Anglo Irish and other banks in the financial collapse that brought a spectacular period of growth to an abrupt end. It has announced a series of tough new regulatory measures, but until this week no arrests had been made. FitzPatrick said in December 2008 that he had kept shareholders in the dark for years about loans worth 84 million euros ($115 million) that he had received from Anglo Irish Bank, which had to be nationalized in early 2009. The regulator has also been investigating whether Anglo Irish used more than 7 billion euros of short-term deposits from bancassurer Irish Life & Permanent to mask large customer disposals.

Russia

Russia Corruption "May Force Western Firms to Quit"

Extortion by corrupt officials in Russia has gotten so bad that some Western multinationals are considering pulling out altogether, the head of a U.S. anti-bribery group said in an interview. Alexandra Wrage, whose non-profit organization TRACE International advises firms on how to avoid bribery, told Reuters the “rampant endemic” corruption in Russia was much worse than in other big emerging economies.

She recommended companies “reconsider doing business in Russia.” Wrage declined to name firms considering leaving, but Swedish furniture retailer IKEA said last year it was halting further expansion in Russia because of “the unpredictable character of administrative procedures in some regions.”

UK

UK's FSA Bulks Up For Tougher Supervision

Britain’s financial regulator is hiring 460 workers this year to help implement new European insurance rules and bolster finance-industry supervision with a more “proactive” approach. In its business plan for 2010/11, the Financial Services Authority (FSA) vowed to become increasingly confrontational as it unveiled plans to increase staff by 14 percent.

The FSA has been adding staff in its quest to improve banking practices and it said still more were needed to help meet EU Solvency II rules designed to ensure insurers have enough capital to cover their risks.

Extortion by corrupt officials in Russia has gotten so bad that some Western multinationals are considering pulling out altogether, the head of a U.S. anti-bribery group said in an interview.

Industry experts said the FSA had “drawn a line in the sand” after its former “light-touch,” or principles-based, approach was blamed for failing to halt a financial crisis that spawned a global recession. Bankers have questioned the regulator’s authority and expertise, but it is boosting its clout with experts ranging from criminal lawyers to London business grandees.

The opposition Conservative Party, tipped in some polls to win an election expected within two months, wants to dismantle the FSA and return banking supervisory powers to the Bank of England. ❑

Antitrust Fining Practice of Cartel Office Under Scrutiny

By Johannes Zöttl and Mirjam Erb (Jones Day)

Are Germany's antitrust fines too high? The German Federal Cartel Office (Bundeskartellamt) (FCO) is well known for its aggressive approach to antitrust violations and for imposing significant fines. In 2009, the FCO imposed cartel fines of about € 270 million in total (2007: € 435 million, 2008: € 314 million). More importantly, the average fine imposed per violation has increased over the past few years. However, a recent decision by the Higher Regional Court (Oberlandesgericht) (OLG) of Düsseldorf suggests that the current level of antitrust fines is outside of the law (VI-2a Kart 2 – 6/08 Owi). The OLG passed its decision in 2009 but published a non-confidential version only at the end of February, 2010.

In 2003, the FCO fined the members of a cartel in the German cement industry € 661 million. Upon appeal, the OLG confirmed that the cement producers had fixed their prices in violation of the law. However, the OLG reduced the fines of the appellants to € 330 million in total. The OLG found that the FCO had erred in how it had read the provision of the German Competition Act (Gesetz gegen Wettbewerbsbeschränkungen) (GWB) that defines the upper limit of fines, Section 81, Para. 4 of GWB.

Based on Sentence 1 of this provision, the FCO may impose fines of up to € 1 million for certain severe infringements of the GWB and/or European competition law, while minor infringements of German competition law are only subject to a lower fining bracket. Severe infringements include, inter alia, cartels, the abuse of a dominant position, and closing a transaction that requires merger control approval without having received such approval.

However, Section 81, Para. 4, Sentence 2 of the GWB provides that:

> *Beyond sentence 1, a higher fine may be imposed on businesses or associations of businesses; the fine must not exceed 10% of the total revenues that such business or association of businesses generated in the financial year preceding the decision of the authority.*

This 10% limit can be interpreted in two ways. The first interpretation is that, for businesses and associations of businesses, the GWB does not limit the amount of a fine except that the fine must not exceed 10% of the infringer's total revenues. The FCO interprets Sentence 2 as a "cap" in this sense. According to its 2006 Guidelines on the Setting of Fines, the FCO first defines a "base amount" of up to 30% of the German revenues that were related to the infringement over the period it continued. This "base amount" is then increased by a factor of up to 100% for reasons of deterrence. Additionally, the FCO takes account of aggravating and mitigating factors. If the resulting figure exceeds 10% of the infringer's total group-wide revenues, the fine cannot be higher (i.e., it is "capped") than a figure equivalent to those 10% of revenues.

If the decision will be upheld, the FCO will have to reconsider how it determines fines in antitrust cases, the likely effect being that fines will generally be lower going forward except for exceptional circumstances.

According to the second interpretation, the first interpretation violates the constitutional requirement of nulla poena sine lege certa. If Sentence 2 were to be understood as a "cap," the law would not contain any objective standard for the amount of a fine as, on that basis, the only limiting factor (i.e., the 10%-rule) would be the revenues of the infringer, a moving target. The OLG found in favor of this interpretation. It decided that the 10% rule of Sentence 2 is not a "cap" but defines the upper limit of the fining bracket. On that basis, antitrust fines have to be determined on a scale from € 0 to 10% of the revenues of the business that has infringed antitrust provisions, taking into account mitigating, aggravating and other factors within the outer boundaries of that range.

With regard to the cement cartel, the issue arose only in relation to one of the five businesses with which the OLG had to deal on appeal. For the other appellants, the fine did not reach the 10% ceiling or that ceiling did not apply (it applies only to businesses, not to individuals). For this business, the OLG reduced the fine from € 142 million to € 70 million. There were, however, several factors that accounted for the OLG's determination in addition to its understanding of Sentence 2 (e.g., that the FCO had taken long to close its investigation, that the series of infringement dated back to 1990s). The OLG did not specify the role played by its novel understanding of Section 81 in this regard.

Johannes Zöttl (jzoettl@jonesday.com), Frankfurt, is a Partner and Mirjam Erb (merb@jonesday.com), Frankfurt, is an Associate in Jones Day's Antitrust & Competition Law practice. They represent companies in antitrust regulation before the German Federal Cartel Office and the European Commission, including merger reviews and antitrust enforcement actions. Johannes Zöttl also is a Vice-Chair of the Unilateral Conduct Committee of the American Bar Association, Antitrust Section.

Following publication of the OLG decision, the FCO took cover behind the fining practices of other European Union member states and that of the European Commission. However, the fining practices of other member states are, of course, irrelevant in a matter of interpreting national law. And regarding the European Commission, the fining rules are not harmonized in the European Union, as opposed to the actual cartel prohibition that are harmonized. It is, therefore, also irrelevant that the FCO's position on the 10% rule of the GWB is identical to the European Commission's position on the 10% "cap" for antitrust fines in Article 23(2)(a) of Regulation No 1/2003.

The FCO's new President, Andreas Mundt, also pointed out that there can be situations in which the OLG's position results in higher fines. Indeed, the FCO would have to move away from a methodology that is primarily driven by the German revenues that are connected with the infringement and would instead have to take account of 10% of the worldwide revenues that are generated group-wide. However, if the FCO were in fact to assume that the OLG's interpretation of the law would not affect (or would even increase) the general level of antitrust fines in Germany, one is left to wonder why the FCO is fighting the OLG's decision in and outside of the courts (through various press releases). Since the FCO has lodged an appeal to the Federal Civil Court (Bundesgerichtshof) (BGH) against the OLG's decision, a final say on the matter cannot be expected before 2011. If the decision will be upheld, the FCO will have to reconsider how it determines fines in antitrust cases, the likely effect being that fines will generally be lower going forward except for exceptional circumstances. ❏

Specialized Investment Funds in Germany

By Dirk-Reiner Voss (Salans)

Real estate investment trusts (G-REITs) have not yet become common in Germany. Specialised investment funds (SIFs), long established in the real estate market, have been deregulated further, potentially providing an attractive alternative.

Specialized Investment Funds: a Classic Revisited

Background

Compared to G-REITs, SIFs (Spezial-Sondervermögen) have been a constant of the real estate market for some time. They are closed to small investors and open only to corporate and institutional investors not requiring the same level of protection. Consequently, SIFs are subject to softer rules, allowing for more flexibility.

SIFs are not novel in Germany and have come back into the focus of attention. As of December 28, 2007, the Law Amending the German Investment Act (Gesetz zur Änderung des Investmentgesetzes) brought further deregulation. German lawmakers were reacting to a liberalization that had occurred in Luxembourg in the same year.

Investors

Generally, individuals are barred from investing in a SIF. However, the German banking supervision authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin) tends to accept indirect investment by individuals through partnerships, requiring as a minimum for the partnership to have a representative body and a common pool of assets.

Real estate investment trusts have not yet become common in Germany. Specialized investment funds, long established in the real estate market, have been deregulated further, potentially providing an attractive alternative.

Aside from this, there is no restriction on who may hold shares. SIFs are therefore open to both national and international corporate investors. The previous limitation on a maximum number of 30 investors has been waived as of December 28, 2007, which should benefit smaller institutions.

Structure

SIFs share a common trait with other types of investment funds. They merely constitute a separate set of assets and lack legal personality. Therefore, a distinct corporate entity, the investment management company (Kapitalanlagegesellschaft), is needed to acquire and administer assets on the fund's behalf. The German Investment Act provides

Investment Funds, continued on page 10

Dirk-Reiner Voss is a Partner in Salans' Berlin office. He concentrates on real estate, corporate law, and banking and finance. Dirk-Reiner advises German and international clients on all real estate related issues, including advising on the structuring and financing of property transactions as well as on legal questions of the asset management. He further advises German and international banks, mainly with respect to the financing of acquisitions (dvoss@salans.com).

Investment Funds *(from page 9)*

strict rules to ensure the SIF's assets are kept separate from the investment company's assets.

The fund's assets are entrusted to a depository bank for safekeeping. The bank, which also carries out supervisory tasks concerning the legality of fund transactions, must be based in Germany or be a German subsidiary of a bank based in the European Economic Area (EEA).

In practice, as SIFs only have a limited number of professional investors, they are able to closely monitor the investment management company's activities. The management company is assumed to act in consultation with the investors.

Setting Up a SIF

Simplified Authorization

In principle, the contractual terms of an investment fund, which regulate the relationship between the investors and the investment management company, have to be approved by the BaFin. This applies if the investment management company is to be replaced by another, which also requires BaFin approval.

For SIFs that invest in real estate, the authorization procedure has been relaxed. The contractual terms and any change in the investment management company do not have to be approved by the BaFin. Authorization requirements are limited to the approval of the designated depository bank.

Prospectus

SIFs are exempt from the requirement to publish and distribute a selling prospectus.

Minimum Capital and Equity

Investment funds are not subject to minimum capital requirements, as the German Investment Act only targets the investment management company, which is subject to the following:

- The investment management company must have at least € 300,000 (about US$ 422,600) of initial capital.
- If the total assets administered by it exceed € 1.125 billion (about US$ 1.58 billion), it must in addition hold at least 0.02% of the value of the exceeding assets (maximum € 10 million (about US$ 14 million)). Up to 50% of this additional equity can be provided as a financial guarantee issued, in principle, by an EEA-based credit institution or insurance company.
- The company must always hold equity that covers at least 25% of the incurred costs, which is determined based on the profit and loss statement of the previous year's annual accounts.

Consequently, SIFs are not required to hold minimum equity.

Managing a SIF

Investment Policy

While the German Investment Act is relatively strict on the investment policy of investment funds, this is no longer the case for SIFs. The reform affected on December 28, 2007 brought about considerable change. In principle, the only requirement SIFs are subject to is risk spreading.

Aside from this, SIFs can acquire any of the assets listed in section 2(4) of the German Investment Act, provided the investors approve. This broad interpretation is shared by the BaFin. The list of assets includes:

- Securities
- Money market instruments
- Derivatives
- Bank deposits
- Ownership or other rights in rem in real property, including comparable rights under foreign law
- Shares in real estate companies
- Shares in investment funds

As the SIF is not listed on the stock market and not subject to free float and maximum participation requirements, it is more exclusive and less volatile. Without notable developments in the field of G-REITS, the SIF could prove to be more suitable for institutional investors.

Consequently, a real estate SIF is not barred from taking other assets, such as securities or derivatives into its portfolio. However, SIFs that invest in real estate are subject to limitations on granting and raising credit and mortgaging real estate belonging to the fund.

In principle, a SIF can grant credit to a real estate company in which it owns shares provided it occurs under market conditions. However, the credit sum is subject to a double limit of 50% of the value of the real estate detained by the company and 25% of the SIF's assets.

The investment management company can raise a short-term credit on behalf of the fund of up to 30% of the fund's total assets value, and up to 50% of the market value of the SIF's real estate assets.

The real estate assets owned by the SIF can be mortgaged up to 50% of its market value.

Reporting Obligations

The SIF's reporting obligations have been significantly reduced. The obligation to issue semi-annual reports has been removed. SIFs only have to issue an annual report which does not require publication or communication to the BaFin, unless required by BaFin.

Return of Shares

The reform of 2007 has softened the rules on the return of shares. In principle, investment management companies are required to take back shares of an investment fund if the investor wants to return them.

However, according to the new German Investment Act, the contractual terms of a SIF can now provide that shares can only be returned at certain dates, at least once every two years. In addition, the SIF only has a limited number of investors. These factors can greatly mitigate the danger of investor panic leading to a return run, where the SIF's obligation to buy back shares could not be met without selling off real estate.

Competitive Advantages of SIFs

The rules on German SIFs were further liberalized to meet the increased competition of Luxembourg-based investment vehicles, where the Law of February 13, 2007 on Specialized Investment Funds affected a similar deregulation.

Although German lawmakers have not addressed all issues, the SIF appears to have competitive advantages, including that:

- Authorization requirements have been greatly reduced.
- SIFs do not require the set up and the publication of a prospectus.
- SIFs are not subject to minimum capital and equity requirements, while the investment management company is required to have at least € 300,000 (about US$ 422,600) as initial capital.

The SIF's tax regime is comparable to that of G-REITS, as the SIF is equally exempt from corporate income tax and trade tax, while the shareholders are subject to 25% withholding tax (and 5.5% solidarity surcharge on the withholding tax). The withholding tax applies both to dividends and to retained earnings. However, as the SIF is not listed on the stock market and not subject to free float and maximum participation requirements, it is more exclusive and less volatile. Without notable developments in the field of G-REITS, the SIF could prove to be more suitable for institutional investors. ❑

ECJ Ruling on Italian Dividend Withholding Tax:
Analysis and Ramifications

By Mario Martinelli and Alessio Persiani (McDermott Will & Emery LLP)

On November 19, 2009, the European Court of Justice (ECJ) in European Commission v Italy ruled that the Italian practice of withholding tax levied on dividends distributed to companies established in EU Member States constitutes an unjustified restriction on free movement of capital, prohibited by Article 56 of the EC Treaty.

This judgment is consistent with ECJ case law regarding withholding taxes on outbound dividends. In Denkavit International BV v Denkavit France SARL and Amurta v Inspecteur van de Belastingdienst/Amsterdam, the ECJ stated that levying a withholding tax on dividends distributed to EU-resident companies in the absence of a similar taxation of dividends distributed to Italian resident companies constitutes an unjustified restriction on EU free movement of capital.

This latest judgment will not affect EU-resident companies that qualify for the Parent-Subsidiary Directive and enjoy a full exemption from withholding tax on dividends falling under the regime. The restriction concerns EU resident companies that cannot benefit from the Parent-Subsidiary Directive, in particular those owning shareholdings below the qualifying thresholds, i.e., portfolio investments.

The judgment relates to dividend withholding taxes levied in fiscal years prior to the Italian Government's January 1, 2008 adoption of a reduced withholding tax regime compliant with EC Treaty rules. As a consequence, non-resident companies may file a reimbursement claim for withholding tax applied on dividends paid by Italian companies out of profits realized before 2008, provided that the four-year forfeiture term applicable generally to tax reimbursement claims has not expired.

The judgment raises some issues with respect to the more general context of ECJ case law on compatibility of withholding taxes with EC Treaty freedoms. The infringement of such principles by the Italian withholding tax levied on dividends distributed to EU-resident shareholders was quite evident, given the exemption regime granted in the corresponding domestic situation to Italian resident shareholders. However, a question of the compatibility of withholding taxes with EC fundamental freedoms might arise even where the same item of income is taxed under the corresponding domestic regime. More specifically, withholding taxes are always levied on the gross amount of the income, without any deduction for the costs incurred in connection with that income. Where under the corresponding domestic regime the income is taxed on its net amount (as normally happens for corporate income), an infringement of fundamental freedoms might take place.

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To date, the ECJ has analyzed these issues only with regard to income items different from financial income, namely with respect to income deriving from self employment (Arnoud Gerritse v Finanzamt Neukölln-Nord and Konzertproduktionen GmbH v Finanzamt Hamburg-Eimsbüttel). A similar approach, however, could also be adopted for passive income items, such as interest. Particularly relevant could be the cases of those financial entities acting as intermediaries in the "credit chain", lending foreign companies money borrowed from banks. In such cases, interest paid to the bank represents costs incurred in connection with the taxable income, i.e., earned interest. As a consequence, withholding tax levied on interest income without taking into account interest expenses might infringe EC fundamental freedoms, provided that the deduction is normally allowed under a domestic regime. ❑

Mario Martinelli is a Partner based in the Firm's Rome office. He focuses his practice on advising medium and large corporations, both Italian and non-Italian resident, on virtually all aspects of Italian corporate tax law. Mario also has extensive experience in tax litigation and leads the Italian tax litigation team (mmartinelli@mwe.com). Alessio Persiani is an Associate based in the Firm's Rome office. He focuses his practice on advising medium and large companies, both Italian and non-Italian resident, on a wide range of tax matters, covering corporate income tax, VAT, and other indirect and municipal taxes (apersiani@mwe.com). Carlo Maria Paolella, a Partner in the law firm of McDermott Will & Emery Studio Legale Associato based in its Rome office, also contributed to this article (cpaolella@mwe.com).

UK Courts to Decide If Employees Must Pay Price Fixing Penalties Imposed on Corporation

By Frances Murphy and Matt Evans (Jones Day)

Ongoing private litigation in the English courts will address whether a corporation that, through its employees, violated UK antitrust law may recover from those employees the penalties imposed on the corporation. This litigation involving price fixing of dairy products by Safeway is attracting much interest. If the corporation succeeds in recovering antitrust penalties and costs from the responsible officers and employees, that will change the future dynamic between employees and the corporations that employ them. Engaging in unlawful conduct will put employees at greater individual risk, as they may be held financially accountable for those fines even if their employment has ceased, and the post-conduct interests of the employees and their corporations will diverge.

Background to the Dispute

In 2007, the Office of Fair Trading (OFT), the UK's primary antitrust enforcement agency, charged several large supermarkets and dairy processors with price fixing. The OFT has since settled with many of the parties, but continues to investigate two of the supermarkets (Tesco and Morrisons, which owns Safeway Stores). Safeway has admitted antitrust laws were infringed and could face a penalty of between £10.5 million and £16.5 million.

Safeway initiated private litigation in the High Court against 11 former employees, including some directors, whom Safeway views as having participated in or facilitated the price fixing practices. Safeway seeks to recover from the employees the penalty and Safeway's associated legal costs. The High Court ruled that Safeway's claim would be permitted to proceed to trial, and on March 2, 2010 gave the employees leave to appeal.

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The former employees sought to end the claim before trial by applying for summary judgment or strike out of the claim. The employees argued that:

- The Safeway Stores committed an unlawful act and cannot therefore maintain an action for an indemnity against liability that results from the act. (The principle of ex turpi causa non oritur actio is that one cannot bring a legal action based on one's own wrongful conduct.)
- The claim is fundamentally inconsistent with the UK Competition Act 1998 on which the OFT's investigation is based. The Competition Act is addressed to companies, not individuals.

Corporation's Defense of its Own Wrongful Conduct

In January, the High Court decided that, although Safeway's unlawful acts were sufficiently serious to consider the ex turpi causa defense (the imminent antitrust penalty being akin to a fine), these acts could not necessarily be said to have been committed by the corporation. For the competition law infringements to be attributed to Safeway, its liability had to be "personal or 'primary' or direct" and could not be through vicarious liability or "the general principles of the law of agency." This might require that a former employee have been the "directing mind and will" of the company. The court also stated that Safeway's defense to ex turpi causa – that it was victim of the acts of the former employees – was in itself sufficient to give the corporation a sufficient prospect of success to allow it to proceed to trial.

Fixing Penalties, continued on page 14

Frances Murphy is a Partner in the London office of Jones Day. She has considerable competition law experience representing clients in behavioral and transactional matters across a range of markets. On the behavioral side, her practice focuses on defending leading cartel cases, market sharing and patent settlement arrangements, and alleged abuses of dominant position. As a transactional lawyer, she has considerable experience with mergers and acquisitions, restructurings, joint ventures, and other strategic alliances, as well as with licensing of intellectual property rights. Frances leads the London competition law practice. (fmurphy@jonesday.com) Matt Evans is Of Counsel in the London office of Jones Day. He advises on a wide range of EU and competition law matters, including merger reviews before the European Commission and the UK Office of Fair Trading and Competition Commission. Matt has considerable experience working with clients in the music, betting and gaming, fast moving consumer goods (FMCG), agricultural, and financial services industries. (mevans@jonesday.com)

Fixing Penalties *(from page 13)*

UK Competition Regime

The former employees argued that the provisions of the Competition Act are addressed to companies, not individuals. Accordingly, they argued, the High Court may not apply the Competition Act to individuals indirectly. They argued that if an officer or employee involved in a cartel is to be sanctioned, this must be done by way of the Enterprise Act 2002, which introduced the "cartel offense" expressly to sanction individuals rather than companies. They also argued that this is an area intended for the legislature and that to remove the penalties from the companies would remove the "punishment, deterrence and reversal of unjust enrichment" effects for which they existed.

The High Court was not receptive to these arguments. The High Court decided that well-established common law duties owed by employees to companies were not intended to be affected by the competition law regime in question and that the case would "simply involve the application of existing law to the particular facts of this case."

Next Steps and Comment

The March 2, 2010 ruling allows the former employees to appeal the decision. Their appeal will be heard by the Court of Appeal later this year.

If the Court of Appeal affirms the High Court ruling, the case could proceed to trial. This case provides the first practical example of whether and in what circumstances an employee may be liable for penalties imposed on its employer by the OFT under the Competition Act. A key issue for trial appears to be whether the evidence shows that Safeway did in fact have personal or primary liability for the antitrust infringements and in what circumstances employees can be found to be the directing mind and will of a company.

In its judgment, the High Court noted that it appeared that the real targets of the claim are the former employees' insurance policies, not their individuals' assets. If successful, this could mark a shift towards penalties imposed by the OFT ultimately being paid by insurers or former employees (where the relevant insurance does not provide cover), rather than the infringing companies.

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While this type of action is new to the UK, it is not without precedent elsewhere. In the United States, for example, there is some precedent for a company to bring a claim against employees whose misconduct caused it to incur antitrust fines and penalties. Such actions, however, are rare and face the same general challenges that Safeway will need to overcome at trial. ❏

Final Amendments to the Listing Rules Following the Listing Regime Review Now Published

By Lauri-Lynn Pursall and Eric Campbell (Mayer Brown LLP)

Introduction

The Listing Rules are being amended on April 6, 2010. These amendments follow the review of the structure of the UK listing regime by the Financial Services Authority (the "FSA"). The purpose of that review, which was initiated in January 2008 and included three separate consultations, has been to ensure that there is greater clarity of the regime's structure and issuers' obligations under it. The FSA is hoping that this will enable investors to make more informed investment decisions and enable issuers to have more flexibility over the route they wish to pursue to raise capital. This article summarizes some of the key changes to the Listing Rules.

Segments and Categories

The Listing Rules are being amended to reflect the FSA's decision to retain the existing two-tier segments of the listing regime but to re-label them as premium and standard listings. The primary listing segment will be re-labeled as premium listing and will denote a listing with the more stringent super-equivalent standards (which exceed the requirements laid down in the EU Prospectus Directive). The secondary listing segment will be re-labeled as standard listing and will denote a listing that meets EU minimum standards. These two segments will be further sub-divided into listing categories according to the characteristics of a security and the type of issuer.

The listing regime review has resulted in some adjustments to the types of securities that are eligible for inclusion in some of the listing categories. For instance:

- a UK company can have a standard listing of its shares. This change (the only one which was introduced on October 6, 2009) is aimed at creating a level playing field for all issuers. Before that date, only overseas companies could have a secondary listing (to be re-labeled standard listing);
- only equity shares will be eligible for the premium listing segment. Currently, equity securities are capable of having a primary listing (to be re-labeled premium listing). Apart from equity shares, equity securities also include securities convertible into equity shares. As a result of this change, securities convertible into equity shares, preference shares and warrants will no longer be able to have a premium listing. As from April 6, 2010, these types of securities will only be able to have a standard listing, although equity shares which had a primary listing before the rule change on April 6, 2010 but which do not confer full voting rights so do not qualify for a premium listing on April 6, 2010 may retain a premium listing until May 31, 2012. Some legacy super-equivalent obligations that apply to securities convertible into equity shares, preference shares and warrants have been removed from the chapters of the Listing Rules that apply to the premium listing segment; and
- a listed investment entity (i.e. closed-ended investment funds and open-ended investment companies) will only be able have a standard listing for a further class of equity shares if it already has and maintains a premium listing of a class of its equity shares. If an investment entity cancels its premium listing it will also have to cancel the listing of any other class of listed equity shares.

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Other Key Changes

Other key changes to the Listing Rules that apply from April 6, 2010 include the following:

- overseas companies with a premium listing will have to "comply or explain" against the UK Combined Code. For an overseas company that has a premium listing on April 5, 2010 this will only apply in respect of financial years beginning after December 31, 2009;

Final Amendments, continued on page 16

Lauri- Lynn Pursall is a Partner based in the firm's London office. She advises on a wide range of corporate matters, particularly emphasizing equity capital markets transactions for both the Official List of the London Stock Exchange and the AIM market. She counsels both issuers and sponsors, as well as brokers and nominated advisors. Her transactional work encompasses corporate finance, public takeovers, mergers & acquisitions, and disposals (including cross-border transactions), and includes related regulatory advice (lpursall@mayerbrown.com). Eric Campbell is a Professional Support Lawyer based in the firm's London office (ecampbell@mayerbrown.com)

Final Amendments *(from page 15)*

- all listed companies with shares or GDRs listed will have to comply with the EU Company Reporting Directive (as implemented in DTR 7.2). Broadly, this will require them, among other things, to provide a corporate governance statement and to describe the main features of their internal control and risk management systems. Overseas companies need only comply with this requirement for financial years beginning after 31 December 2009;
- overseas companies in the premium segment will have to offer pre-emption rights to their existing shareholders when they make an offer for cash unless they have received shareholder approval to disapply pre-emption rights. Overseas companies with a premium listing at the time of the rule changes will not be required to comply with this requirement until April 5, 2011, allowing them time to make any changes to their constitutional documents necessary to effect this requirement at their next AGM;
- securities must be admitted to trading on a regulated market in order to be admitted to the Official List. The rules currently provide that listed equity securities must be admitted to trading on a market for listed securities of a recognized investment exchange (an "RIE"), but do not specify that this market must be a regulated market. The new rules will include a carve out for those securities to which LR4 (Listing Particulars for professional services market and certain other securities) applies. These securities need only be admitted to trading on an RIE market even after the rules change;
- an issuer which is not an issuer with a premium listing of its equity shares must not describe itself or hold itself out as having a premium listing. In addition, such an issuer must not make a representation which suggests that it has a premium listing or complies or is required to comply with the requirements that apply to a premium listing; and
- all listed issuers will need to display the segment and category to which their securities belong when making regulatory announcements.

One interesting issue to watch during 2010 and beyond will be the extent to which UK issuers opt for a standard listing for their equity shares rather than a premium listing or an AIM admission. The FSA is not expecting there to be much take up initially.

Comment

One interesting issue to watch during 2010 and beyond will be the extent to which UK issuers opt for a standard listing for their equity shares rather than a premium listing or an AIM admission. The FSA is not expecting there to be much take up initially. To some extent the appeal of a standard listing to a UK issuer will partly depend on its aspirations as well as investor attitude. Issuers may be concerned that if they opt for a standard listing of their shares, they will not be eligible for inclusion in the UK series of the FTSE indices. The new rules do not contain wholesale changes to the procedure for migrating from one segment to another so we will have to wait to see the number of issuers who would opt to do this in the future. ❏